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*in*FOCUS

QUARTERLY

Money Makes the World Go 'Round

Marian L. Tupy on Our Pessimistic Outlook | **Adam Reuter** on Israel's Economic Development | **Daniel Ikenson** on North America's New Trade Agreement | **Anders Åslund** on Russian Economic Stagnation | **Steve H. Hanke** on Venezuela's Hyperinflation | **Casey Pifer** on Aid and Open Markets in Africa | **Aaron Friedberg** on the Challenging China | **Dan Mitchell** on Chile's Privatized Retirement Program | **Jeffrey Dorfman** on the Nordic Economic Model | **Shoshana Bryen** reviews *I Love Capitalism*

Featuring an Interview with **Peter G. Morici**

LETTER FROM THE PUBLISHER

When I was a child, my mother told me to eat my vegetables because children were starving in India. Or was it China? Either way, I couldn't figure out how eating my broccoli helped, but I understood that there were children literally dying in other places for lack of food. And I wasn't.

The introduction of capitalism and markets to China, India and elsewhere has proven to be the biggest lever in the history of mankind for prying people out of the morass of poverty and into a safer, healthier, better educated, and more self-fulfilling way of life. Certainly not everyone has everything, but a lot more people have something today than during my childhood.

This issue of *in*FOCUS is a cheer for capitalist economics.

Start with our interview with Professor Emeritus Peter Morici to understand where capitalism is taking us, our friends, and some of our competitors.

Essayist Marian Tupy points out, "Things are getting better – so why are we so gloomy?" Chile's successful privatization of Social Security is addressed by Dan Mitchell, and Israel's dizzying climb from socialist stagnation to high-tech prosperity is the purview of Adam Reuter. If you think the Nordic countries have something on us, Jeffrey Dorfman reminds us – and Democrat candidates for office – that they are not socialist. Property rights are the key to prosperity in Africa, writes Casey Pfifer. Dan Ikenson explains why free trade with Canada and Mexico are in America's interest.

Some countries are gloomy – with cause. Venezuela, Russia, and China are stuck and likely to remain so, according to Steve Hanke, Anders Åslund and Aaron Friedberg.

Ken Langone positively sings his ode to markets and risk-taking capitalists in *I Love Capitalism*, reviewed by Shoshana Bryen.

If you appreciate what you've read, I encourage you to make a contribution to the Jewish Policy Center. As always, you can use our secure site: http://www.jewishpolicycenter.org/donate.

Sincerely,

Matthew Brooks,
Publisher

***in*FOCUS**
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Things Are Getting Better – So Why Are We So Gloomy?

by MARIAN L. TUPY

At the end of last year, I documented the constant stream of technological, scientific and medical breakthroughs that are improving the lives of billions of ordinary people. Given all this good news, the real question is why people are so unbelievably pessimistic.

Judging by a 2016 poll of close to 20,000 people in some of the world's richest countries, you could barely overstate the extent of the gloominess. In response to the question "All things considered, do you think the world is getting better or worse, or neither getting better nor worse?" just 10 percent in Sweden, six percent in the United States, four percent in Germany and three percent in France thought things were getting better. Why? Because, it turns out, we are pessimists by nature.

Over the last 200 years or so, the world has experienced previously unimaginable improvements in standards of living. The process of rapid economic growth started in Europe and America, but today some of the world's fastest growing countries can be found in Asia and Africa – lifting billions of people from absolute poverty. Historical evidence, therefore, makes a potent case for optimism. Yet, pessimism is everywhere. As the British author Matt Ridley noted in *The Rational Optimist:*

> *The bookshops are groaning under ziggurats of pessimism. The airwaves are crammed with doom. In my own adult lifetime, I have listened to the implacable predictions of growing poverty, coming famines, expanding deserts, imminent plagues, impending water wars, inevitable oil exhaustion, mineral shortages, falling sperm counts, thinning ozone, acidifying rain, nuclear winters, mad-cow epidemics, Y2K computer bugs, killer bees, sex-change fish, global warming, ocean acidification and even asteroid impacts that would presently bring this happy interlude to a terrible end. I cannot recall a time when one or other of these scares was not solemnly espoused by sober, distinguished and serious elites and hysterically echoed by the media. I cannot recall a time when I was not being urged by somebody that the world could only survive if it abandoned the foolish goal of economic growth. The fashionable reason for pessimism changed, but the pessimism was constant. In the 1960s the population explosion and global famine were top of the charts, in the 1970s the exhaustion of resources, in the 1980s acid rain, in the 1990s pandemics, in the 2000s global warming. One by one these scares came and (all but the last) went.*

Ridley raises a more specific point than general pessimism: Why are we as a species so willing to believe in doomsday scenarios that virtually never materialise?

The chairman of the X Prize Foundation, Peter H. Diamandis, offers one plausible explanation. Human beings are constantly bombarded with information. Because our brains have a limited computing power, they have to separate what is important, such as a lion running toward us, from what is mundane, such as a bed of flowers. Because survival is more important than all other considerations, most information enters our brains through the amygdala – a part of the brain that is "responsible for primal emotions like rage, hate and fear." Information relating to those primal emotions gets our attention first because the amygdala "is always looking for something to fear." Our species, in other words, has evolved to prioritise bad news.

The negativity bias is deeply ingrained in our brains. The best that we can do is to realise that we are suffering from it.

The Harvard University psychologist Steven Pinker has noted that the nature of cognition and nature of news interact in ways that make us think that the world is worse than it really is. News, after all, is about things that happen. Things that did not happen go unreported. As Pinker points out, we "never see a reporter saying to the camera, 'Here we are, live from a country where a war has not broken out.'" Newspapers and other

media, in other words, tend to focus on the negative. As the old journalistic adage goes, "If it bleeds, it leads."

To make matters worse, the arrival of social media makes bad news immediate and more intimate. Until relatively recently, most people knew very little about the countless wars, plagues, famines and natural catastrophes happening in distant parts of the world. Contrast that with the 2011 Japanese tsunami disaster, which people throughout the world watched unfold in real time on their smart phones.

The human brain also tends to overestimate danger due to what psychologists call "the availability heuristic" or a process of estimating the probability of an event based on the ease with which relevant instances come to mind. Unfortunately, human memory recalls events for reasons other than their rate of recurrence. When an event turns up because it is traumatic, the human brain will overestimate how likely it is to reoccur.

Consider our fear of terror. According to John Mueller, a political scientist from Ohio State University, "In the years since 9/11, Islamist terrorists have managed to kill about seven people a year within the United States. All those deaths are tragic of course, but some comparisons are warranted: lightning kills about 46 people a year, accident-causing deer another 150, and drownings in bathtubs around 300." Yet, Americans continue to fear terror much more than drowning in a bathtub.

Moreover, as Pinker also points out, the psychological effects of bad things tend to outweigh those of the good ones. Ask yourself, how much happier can you imagine yourself feeling? And again, how much more miserable can you imagine yourself to feel? The answer to the latter question is: infinitely. Psychological literature shows that people fear losses more than they look forward to gains; dwell on setbacks more than relishing successes; resent criticism more than being encouraged by praise. Bad, in other words, is stronger than good.

Finally, good and bad things tend to happen on different timelines. Bad things, such as plane crashes, can happen quickly. Good things, such as the strides humanity has made in the fight against HIV/AIDS, tend to happen incrementally and over a long period of time. As Kevin Kelly from *Wired* has put it, "Ever since the Enlightenment and the invention of Science, we've managed to create a tiny bit more than we've destroyed each year. But that few percent positive difference is compounded over decades in to what we might call civilization … [Progress] is a self-cloaking action seen only in retrospect."

In other words, humanity suffers from a negativity bias or "vigilance for bad things around us." Consequently, there is a market for purveyors of bad news, be they doomsayers who claim that overpopulation will cause mass starvation, or scaremongers who claim that we are running out of natural resources.

Politicians, too, have realized that banging on about "crises" increases their power and can get them re-elected. It may also lead to prestigious prizes and lucrative speaking engagements. Thus politicians on both Left and Right play on our fears – whether it is a worry that crime is caused by playing violent computer games or that health maladies supposedly are caused by the consumption of genetically modified foods.

The negativity bias is deeply ingrained in our brains. It cannot be wished away. The best that we can do is to realise that we are suffering from it.

MARIAN L. TUPY, *Ph.D., is senior policy analyst at the Cato Institute's Center for Global Liberty and Prosperity.*

Israel: From Kibbutz to a High Tech Nation

by ADAM REUTER

Israel's kibbutz movement was certainly important – and more than that, prominent – but, contrary to conventional wisdom, it was never a central force in the Israeli economy.

The 1980s in Israel

The roots of economic change in the kibbutz movement can be traced to the mid-1980s. Israel had a major problem. There was dangerous deterioration in all economic parameters, and it reached the second most difficult economic crisis in its history. (The first came with the establishment of the State.)

The seriousness of the situation could be understood from the rate of inflation, which reached 445 percent in 1984. The difficult situation of the economy further exacerbated a crisis that erupted in 1983 with the collapse of Israeli bank shares. The government undertook to cover a large part of the expected losses. To this end, it transferred to itself the ownership of most of the commercial banks and became the guarantor of a large part of the public's investments in their shares.

The unsurprising result was an increase in the government's internal debt. Israel's government already was involved in every aspect of the economy. Public expenditure reached a peak of 76 percent of GDP, and most of the large companies were owned by the government as well.

The high inflation resulted in a very large deficit in the state budget and the balance of payments accounts. Debts rose to such a level that there was a fear of national bankruptcy. In June 1985, the politicians decided that the direction must be changed dramatically. That is how the "Economic Stabilization Program" was born and the government began a process of self-reduction. Thirty-four years later, Israel's government involvement in the economy is one of the lowest in the Organization for Economic Cooperation and Development (34 democracies with market economies).

Economic Stabilization

Behind the stabilization plan was a national unity government that took office in July 1985– representing parties from the left to the right – and managed to deal with various pressure groups. The main points of the plan were a deep cut in the state budget, a wage freeze, a freeze on prices of goods, cuts in subsidies and fixing the dollar exchange rate.

In addition, Israel received generous aid from the United States, some of whose senior economists were sent to Israel by the Reagan administration to accompany and help formulate the plan, as well as pressure the heads of government to take the painful steps to ensure that such a crisis did not recur.

The program took advantage of one the main characteristics displayed by Israel since its inception—the ability to act in situations of no choice. The results of the plan were primarily containing inflation, improving the government's budget deficit and the debt-to-GDP ratio. The program was exceptionally successful and became a model for other countries.

Privatization and Immigration

At the same time, as part of the plan, and in order to generate additional revenues for the State, a very broad privatization of government companies took place. The process was intensified following a global wave of privatization led at the time by Great Britain and other countries.

However, efforts to revive economic growth failed. Israel remained in an economic depression, exacerbated by the lack of continuity and reluctance to further reduce public expenditures, and by a significant increase in interest rates to ensure that inflation did not return. Renewed growth came only in 1989 when the Israeli economy grew by some 20 percent in a short time, following the massive wave of immigration from the Soviet Union.

Renewed growth came only in 1989 when the Israeli economy grew by some 20 percent in a short time, following the massive wave of immigration from the Soviet Union.

The program was a turning point in Israel's economic system, which gradually shifted from a clearly social-democratic policy to a policy characterized by a more liberal and capitalist focus.

There were casualties. In particular, the Histadrut was hurt. It was Israel's largest and most powerful labor union, which at the time included most public

Members of the Kibbutz Ein Harod dance the Hora in 1936. (Photo: Israel Goverment Press Office)

sector workers. Cancellation of various government subsidies granted to it exposed the Histadrut factories' inability to compete in a free market and its failed management, the product of years of regulated economic certainty. Histadrut factories were forced to take loans and went into a whirl of debt. A cut in Histadrut's power and a dramatic cut in the defense budget were probably the most important structural changes in the long term.

Another important sector that was hurt was that of the kibbutzim.

The Kibbutz Movement Changes

Kibbutzim (originally collective agricultural and industrial settlements), whose members helped so much in the establishment and defense of the country, were always a small fraction of Israeli economy and population, never exceeding a few percent. Nevertheless, their influence had always been significant.

The movement began long before the establishment of the State and the aura surrounding the builders of the kibbutzim was justified. Many of them sacrificed greatly for the people and the homeland. However, in many ways a kibbutz functioned as an economic mechanism along the lines proposed by many communes: "From each according to his or her abilities and to each according to his needs." Such a mechanism works when all members participate as self-sacrificing idealists, but collapses when participants seize openings to function as exploiters or parasites or grow frustrated at the denial of individual opportunity and reward.

The increasing importance of professional knowledge and technology in economic development, and the fact that in Israeli society the status of the individual became more important than the collective, both in social and legislative terms, caused a loss of public prestige for the kibbutz idea. As a result, the status and political power of the kibbutz movement weakened. The change of political power in 1977 with the election of Israel's first right-of-center government strengthened this trend. Nevertheless, few kibbutzim made a real effort to adapt themselves to the changing reality.

> The increasing importance of professional knowledge and technology in economic development ... caused a loss of public prestige for the kibbutz idea.

Over the years, many kibbutzim had accumulated large debts and found it difficult to pay them. Political control by the socialist Labor movement (HaAvoda), which had roots reaching to the establishment of the State, had given them assurance that the government would be the guarantor of those debts and would take care, in one way or another, of their repayment. Considering this understanding, many mutual guarantees were signed, in which each kibbutz was the guarantor of debts of all others. This gave the financial system the feeling that it would be possible to overcome any future crisis for the kibbutzim.

Yet many kibbutzim became insolvent and in 1989 and 1996, the Israeli government, the banks and the kibbutz movements signed two debt arrangements designed to solve the crisis. This became a major catalyst for the process of change that many kibbutzim have undergone since the 1990s.

At first these arrangements created a rigid economic system and led to a long period of stagnation in the members' personal standard of living. But the debt arrangements, accompanied by control and supervision by the banks, eventually led to economic reforms that enabled kibbutzim to improve their business performance. Many of the kibbutzim that held industrial plants under the exclusive management of kibbutz members now recruited private capitalists as partners and hired professional managers. Decision-making began to shift to representative and technocratic bodies with the personal involvement of kibbutz members greatly reduced. Some members were asked to go to work outside the kibbutz and some were given the opportunity to develop business initiatives.

	1985	2018	Change %
Number of residents (in millions)	4.4	8.95	103%
The tax burden	45%	30%	-33%
GDP (in $ billions)	35	358	923%
GDP per capita (in $ thousands)	8	40	400%
Foreign Currency Reserves (in $ billions)	4	115	2775%
Government debt as percent of GDP	155%	59%	-62%
Defense expenditure as percent of GDP	17%	5%	-71%
US aid as a percentage of GDP	7%	1%	-86%
Total exports (in $ billions)	10	110	1000%
Energy from independent sources	4%	73%	1725%
Water from desalinated sources	3%	52%	1633%
Employment of Women	36%	60%	67%
Number of students (in thousands)	70	316	351%

Table 1. Israel has since made an almost unbelievable leap, evident from the above statistics. Moreover, many of these parameters are currently among the best in the OECD.

Immigration from the former Soviet Union

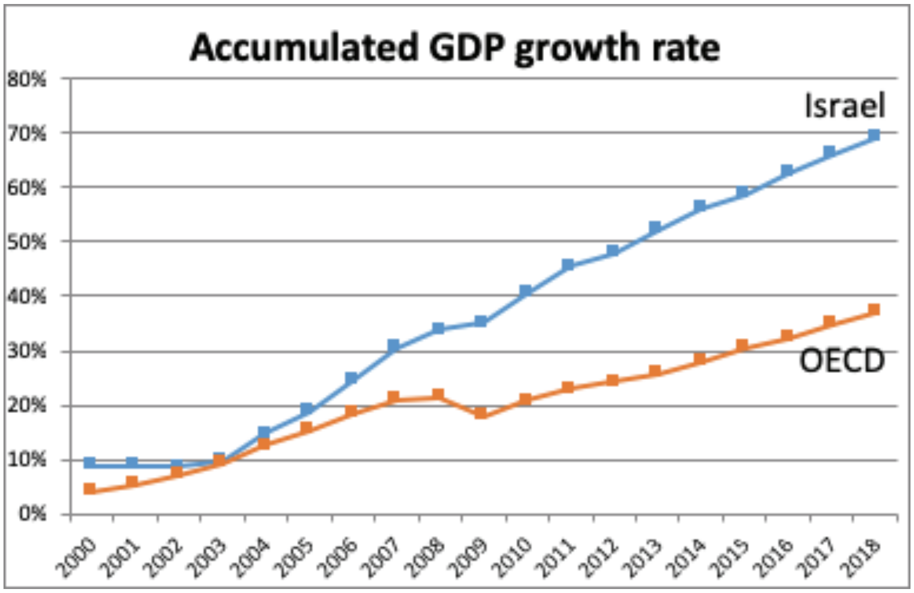
Economic studies have found that highly educated immigrants are a net positive for many countries, helping them to high rates of growth. This has happened in the United States, Canada, Australia, and in Israel as well.

A huge wave of *olim* (immigrants) began coming from Russia and Ukraine with the breakup of the Soviet Union in 1989. This changed the face of the country, and in some ways was like the arrival of the cavalry rescuing a besieged Wild West outpost. This phenomenon was quick to make the general public forget the troubles of the kibbutzim.

The vast majority of immigrants quickly integrated into the work force, and within a few years, participation in the labor force by recent immigrants was higher than that of veteran residents. New civilian engineers staffed large parts of Israel's construction industry. Many other new immigrants with scientific or technological backgrounds greatly helped develop the high-tech industry.

Encouraging Private Investment

Another measure that greatly helped was the government's Yozma program. Implemented in 1993-1998, it was designed to encourage the growth of the high-tech industry with money invested from venture capital funds. The government directly invested $100 million in 10 venture capital funds. Then the funds could choose to turn the government into a partner or return to the government the amount it invested plus interest. The government initially held 40 percent of each fund, but allowed the private partners to buy its share on favorable terms after five years. Although the investment was not large, it was an encouraging signal, which gave a significant boost to Israel's venture capital industry and created a climate that encouraged investments in Israeli high-tech.



Graph 1. The cumulative growth rates of the Israeli economy; almost double that of the OECD countries, since the beginning of the century:

Within seven years, the population grew by about 25 percent from 4.4 to 5.5 million, with 80 percent of this growth due to the arrival of olim. In the modern era, no other country absorbed such a large percentage of immigrants in such a short period of time. In this, too, economic aid from the United States greatly supported this success.

Yet the relative suddenness of this wave and its widespread scope soon led to a severe shortage of housing and a drastic rise in house prices. That, in turn, led to social protest that subsided only slowly.

Four advantages and three revolutions

Since the beginning of the 21st century, Israel's economy has been very different from what came before, based more than any other country on high-tech.

The high-tech industry grew out of the universities and military research laboratories that helped create an excellent human and technological infrastructure that served as a springboard. Success stemmed from a unique combination of the maturation of educational and technological products, civil applications of the defense industry, and government assistance in raising venture capital—which later became private—along with immigration from the former Soviet Union that brought in a large pool of talented engineers. Global shifts from hardware to software opened chances for thousands of Israeli companies to break out and show a significant comparative advantage in the global technology market.

It should be noted that Israel always placed emphasis on scientific research and human development, in part as a response to its lack of natural resources and in response to the long-standing Arab League economic boycott.

Israel is the world leader in research and development as a percentage of GDP, also ranking first in the world in the number of start-up companies (about 7,500), fifth in the world in patents per capita, and ranked third in the world by the number of engineers per capita. More than 300 major international companies operate R&D centers in Israel. These includ Facebook, Microsoft, IBM, Intel, Google, Apple, Cisco, Motorola, Philips, Applied Materials, Johnson & Johnson, Siemens, Citibank, HP and EMC. More than 90 Israeli companies are listed on the NASDAQ stock exchange, most of them high-tech.

Graph 1 shows the cumulative growth rates of the Israeli economy; almost double that of the OECD countries, since the beginning of the century:

It's not all high-tech. In our book, *Israel - Island of Success*, published by Amazon in 2018, Noga Kainan and I found, after a long-term study, four great advantages and three revolutions in the making.

- Technological and Scientific Advantages that are quite clear.
- Entrepreneurial Advantage—the second largest number of entrepreneurs in the world relative to the size of population.
- Global Advantage—ties in other countries, understanding of many cultures and languages, and the connection among Jews around the world—all of these are very helpful for Israeli exports.
- Demographic Advantage—the youngest population in the OECD, which is most important for continued economic growth and high consumer demand, the third-most educated population in the world, and waves of highly educated immigrants.

We also have marked three revolutions of great importance:

- Gas Revolution – the discovery of huge natural gas reservoirs will transform Israel from an importer to an energy exporter and generate high revenues.
- Water Revolution—Israel operates some of the largest desalination plants in the world and almost all urban water consumption comes from these facilities. Israel's also the world champion in the return of treated wastewater; this helps prevent the phenomenon of desertification.
- Transportation Infrastructure Revolution derived from massive investments.

From its modern start in the socialist labor movement of the 19th century, Israel has the assets and the infrastructure to continue to grow faster than other OECD countries well into the 21st century.

ADAM REUTER *is chairman of Financial Immunities and co-author of* Israel - Island of Success.

USMCA: A Marginal NAFTA Upgrade at a High Cost

by DANIEL IKENSON

On the campaign trail, Donald Trump vowed to strengthen enforcement of existing trade rules and negotiate better trade deals than his predecessors had. With his national security tariffs on steel and aluminum, his safeguard tariffs on washing machines and solar components, his broad trade war with China, and the looming specter of new barriers for automobile imports, President Trump has delivered—for better or worse—on the first promise. On the second, he has little to show.

On Sept. 30, 2018, American, Mexican, and Canadian negotiators reached a deal to replace the North American Free Trade Agreement (NAFTA), which President Trump had described as "the worst trade deal ever negotiated." Two months later, Trump and his Mexican and Canadian counterparts signed the "United States-Mexico-Canada Agreement" (USMCA), which modernizes—and revises in ways both good and bad—the 25-year old NAFTA. But before the USMCA can enter into force, it must be approved by the legislatures of all three countries. This will be a heavy lift.

Whether the U.S. Congress passes the implementing legislation, which will be introduced by the administration after an assessment of the deal is published by the U.S. International Trade Commission on or around April 19, remained an open question at press time. But considering the controversial substance of the agreement, the vitriolic nature of America's partisan politics, and the fact that the presidential primary election season is rapidly approaching, prospects for passage before the November 2020 elections are no better than 50-50, and fading.

Why did the president choose to renegotiate NAFTA? How does the USMCA compare to the original NAFTA? How does it compare to other important benchmarks? Why are its prospects for congressional approval so uncertain? And what will happen if it doesn't pass?

> ... USMCA [has] the distinction of being the first U.S. trade agreement that doesn't include any significant new U.S. market-opening provisions. That's a notable missed opportunity.

Have We been Losing at Trade?

American presidents of both major parties from Franklin D. Roosevelt through Ronald Reagan to Barack Obama considered trade a mutually beneficial endeavor, essential to global economic growth and prosperity, and integral to promoting peace among nations. President Donald Trump doesn't share this perspective. He sees trade as a zero-sum competition between Team America and foreign teams—a win-lose proposition—where exports are America's points, imports are the foreign teams' points, and the trade account is the scoreboard. To Trump, perennial U.S. trade deficits mean that the United States has been losing at trade for decades, and it has been losing because it has negotiated bad trade deals.

It is in that context that the president deemed NAFTA a failure and set out to revise its provisions to tilt the playing field in favor of U.S. producers. But that is an ahistorical view. After NAFTA came into effect in 1994, nearly all tariffs among the three countries were eliminated, many non-tariff barriers were reduced, and trade and investment flourished.

Between 1993 (the last year before NAFTA went into force) and 2016, total U.S. trade in goods and services with Canada and Mexico increased more than 125 percent in real terms, reaching over $1 trillion in 2016. During the same period, foreign direct investment in the United States from Canada and Mexico increased from $41.6 billion to $285.6 billion.

NAFTA certainly enabled more cross-border final goods trade, but it also facilitated the development of a globally competitive North American production platform, most consequentially in the auto sector. Today, 40 cents of every dollar of goods imported from Mexico and 25 cents of every dollar of goods imported from Canada can be attributed to U.S. inputs of labor and material—U.S. value added.

Much has been made over the years since Ross Perot's 1992 description of a "giant sucking sound" of jobs and investment being drawn south of the border from the United States. But like the trade and investment data, the employment figures don't support that claim

Mexican President Enrique Peña Nieto, U.S. President Donald Trump and Canadian President Justin Trudeau sign the U.S.-Mexico-Canada trade agreement during a ceremony in Buenos Aires, on the sidelines of the G-20 Leaders' Summit on November 30, 2018. (Photo: U.S. Department of State)

either. U.S. manufacturing employment peaked in the United States in 1979 at 19.43 million workers. Between 1979 and 1993 (the last year before NAFTA took effect), manufacturing employment shrunk by 2.66 million jobs. In the next 14-year period (between 1993 and 2007), when NAFTA was in effect, employment in the manufacturing sector decreased by 2.89 million—effectively, no significant change in the trajectory. And over the first six years of NAFTA, the U.S. economy added 540,000 manufacturing jobs. This is not to suggest that NAFTA should be credited with creating those jobs, but that those who blame NAFTA for manufacturing job decline need to account for these countervailing facts.

Changing the Rules

As a "Perot-ist" on NAFTA, President Trump aimed to change the so-called "rules of origin" in a way that would strongly encourage manufacturers to invest more, produce more, and create more jobs in the United States. A trade agreement's rules of origin establish the minimum level of regional value a product must contain to qualify for the agreement's preferential terms.

For both autos and apparel, those thresholds were increased in the USMCA. There is even a requirement that a minimum of 40 percent of the value of auto production be produced by workers earning at least $16 per hour. These production restrictions likely will hurt more than they help. The reduced capacity for automakers in North America to make use of the most efficient supply chains, using inputs from within and outside of North America as requirements and economic conditions would dictate, is likely to make regional producers less competitive relative to producers in countries where there are fewer restrictions on sourcing. The more rigid rules of origin translate into higher regional production costs, which will encourage automakers, apparel producers, and other manufacturers to forego the costs of complying with these rules in favor of using non-qualifying inputs or producing outside the region altogether, and paying the non-preferential tariff rates upon entry into the United States. That would mean less investment and more divestment from the region, which is what happens when origin rules are too onerous.

Although the USMCA does not raise tariffs over the rates effective under NAFTA, it does have the distinction of being the first U.S. trade agreement that doesn't include any significant new U.S. market-opening provisions. That's a notable missed opportunity. In 2017, U.S. consumers spent $4.1 trillion on goods with imports totaling $2.3 trillion (57 percent). In contrast, U.S. consumers spent $9.2 trillion on services, only $550 billion (six percent) of which were imported. What this wide disparity in import penetration—six percent for services versus 57 percent for goods—suggests is that the United States maintains significant barriers to trade in services.

The USMCA does nothing to reduce barriers to services trade. Instead, it reaffirms bans on foreign competition in maritime shipping, commercial air services, and trucking services. Transportation costs comprise a significant share of the prices Americans pay for goods purchased on Amazon and at brick and mortar establishments. Meanwhile, commercial air travel is a significant cost of doing business for companies across all industries, and it accounts for an important share of consumer spending. The absence of foreign competition across our transportation services industries—as well as in our education, health care, professional services industries—suggests that the USMCA could have been much more liberalizing.

Opening the Market

The U.S. market is generally open to foreign investment already, but investment restrictions persist in certain industries, including financial services, commercial air services, communications, and mining. The USMCA provides no significant new access to foreign investors in the United States.

Likewise, the USMCA does close to nothing to open any wider U.S. government procurement spending to bids from Canadian and Mexican companies. That's a huge missed opportunity because under the various "Buy

American" provisions, foreign firms and foreign products are limited in competing for the estimated $1.7 trillion of annual U.S. federal and state government procurement spending. This, of course, drives up the cost of every government project and ensures that taxpayers get the smallest bang for their buck. In light of the president's interest in advancing a major infrastructure bill—maybe in the neighborhood of $1 trillion—this is a problem that should concern us all.

Despite backsliding in some areas and missed opportunities in others, the

The agreement establishes needed new rules in the realm of digital trade, including prohibitions of data transmission taxes and data localization requirements.

USMCA isn't all bad. Most goods trade will continue to be tariff-free (the NAFTA status quo) under the new agreement, and barriers to certain agricultural products will be reduced, as well. The agreement establishes needed new rules in the realm of digital trade, including prohibitions of data transmission taxes and data localization requirements.

The USMCA is a marginal improvement over NAFTA—better in some areas, worse in others, about the same in most. Relative to the existing NAFTA, there are pros and cons. Though there is greater liberalization in goods trade, it is marginally to imperceptibly so. Taking into consideration the negative changes, especially to the rules of origin, it's not obvious that USMCA is much of an upgrade from NAFTA. But it's possible—even probable—that some of the less directly liberalizing, technical and procedural provisions, such as those governing "Digital Trade," "Customs and Trade Facilitation," "State-Owned Enterprises" and others, utilized in ways not completely apparent now, could lead to lower trade costs down the road.

The only real certainty is that the USMCA is better than a U.S. withdrawal from NAFTA without a replacement agreement. But that couldn't happen, right?

Congress's Battle

The Democratic takeover of the House of Representatives raises doubts about the feasibility of passing the USMCA implementing legislation. The irony in all of this is that U.S. Trade Representative Robert Lighthizer was explicit about his intention to make the agreement one that would have bipartisan appeal. He went out of his way to incorporate provisions Democrats have long sought in trade agreements, including more rigorous labor and environmental provisions, and other measures presumed to dissuade outsourcing. But Democrats have some substantive concerns over the question of whether those beefed-up labor and environmental provisions will be enforced. They may insist on having the agreement reopened to include more rigorous language in this regard or they may seek concessions from Trump in other policy areas.

House Speaker Nancy Pelosi could also exercise her prerogative to take the agreement off the fast track (as she did with the U.S.-Colombia FTA in 2007), if she asserts that the administration deviated from its statutory obligations under the Trade Promotion Authority legislation. That would essentially foreclose consideration of the deal until she's no longer speaker or until negotiations with Canada and Mexico are re-opened.

But substantive opposition to the USMCA's provisions from the House majority party is only one part of the problem. Another is that Democrats have used NAFTA as a wedge issue for 25 years and are unlikely to know how to position themselves on the trade question if they join Republicans in support of the USMCA. Even though a majority of voters who affiliate with the Democratic Party support trade and free trade agreements, Democratic leadership in Washington is wary of ceding its capacity to showcase the party's opposition to trade agreements when wooing voters in the Rust Belt.

Meanwhile, Democrats may not want to give Trump something that could amount to a political victory. Aversion to that outcome will only increase as pressure builds for House investigations and possibly impeachment proceedings, and as the calendar closes in on 2020.

In the final analysis, if USMCA doesn't pass and the existing NAFTA remains in force, the downside won't be all that substantial because the new deal is only slightly better than the existing one. However, NAFTA remaining in force is an uncertainty, as Trump has been threatening to issue the USMCA implementing legislation and the NAFTA withdrawal notification on the same day to compel Congress to act quickly.

It's not clear why Trump thinks that his provoking a crisis would compel Democrats to act on the USMCA. It's more likely that Trump would bear the brunt of the blame for the dissolution of the integrated North American economy.

The USMCA is far from the ideal free trade agreement, but an agreement pursued with trade deficit reduction and supply chain repatriation as its main objectives was never going to be an exemplar of trade liberalization. For the sake of restoring some predictability to the North American business environment, it would be wise of policymakers to find a way to implement the agreement as quickly as possible.

DANIEL IKENSON *is director of the Cato Institute's Herbert A. Stiefel Center for Trade Policy Studies.*

Russian Stagnation: Kleptocracy and Sanctions

by ANDERS ÅSLUND

Official Russia boasts about economic progress, although the Russian economy has been nearly stagnant for the last decade as the Kremlin focuses on solid macroeconomic stability. But people do not eat macroeconomic stability. Far more important is the real income of the population, which has fallen for five years without signs of improvement. How long will the Russian people accept their government's underperformance?

President Vladimir Putin gives three big public performances each year – his State of Russia address, a call-in program for the Russian people in the spring, and a big international press conference in December. His latest press conference took place on December 20, 2018. As he has for years, Putin emphasized the stability and sustainability of the Russian economy. Inflation was just 4.3 percent in 2018. Unemployment has fallen below 5 percent for the first time in modern Russia. Foreign trade offers steady and large surpluses, adding to the impressive international currency reserves of $469 billion at the end of 2018. Also, the government budget is in surplus and Russia's public debt is impressively low at 12 percent of GDP.

Honestly, Putin did mention the growth rate, which was only 1.7 percent during the first 10 months, but he presented it as progress. Allegedly, the growth rate surged to 2.0 percent for the year as a whole. Since 2009, Russia has had an average annual growth rate of 0.9 percent with three years of contraction. In the medium term, virtually all forecasters predict a growth of 1.5-2 percent a year. Former Finance Minister Alexei Kudrin talks realistically about a more likely growth rate of one percent a year.

> Russia's fundamental problem is that the country has no real property rights… This is by design. Weak property rights enable the rulers to take what they want through corporate raiding…

Rosstat's Numbers

The situation for the Russian population looks far worse. According to the most recent official statistics, Russians' real disposable incomes have fallen by a total of 11 percent during the last five years. While that appears shocking, the numbers were far worse a year ago, when the real incomes had fallen by 17 percent during the four preceding years.

This revision is noteworthy. In 2018, the Russian Federal Service of State Statistics (Rosstat) claimed that construction had increased by a measly 0.5 percent after 11 months, but for the year as a whole, the Economic Ministry claimed implausibly that it had grown by 5.3 percent, which explains the higher than expected growth rate. For years, the Russian government had been dissatisfied with the statistics from Rosstat, which has a good international reputation. The government called for a change in methodology. When Rosstat refused, in 2017 the government reduced its independence, placing it directly under the Economic Ministry. When that did not help, in December 2018 the government replaced the long-time head of Rosstat, the respected professional Alexander Surinov, with a department head from the ministry. Little surprise that statistics from previous years reflecting output, consumption, and real income have quickly improved.

A growth rate of 1.5 percent might not appear bad in the context slow-growing European countries, but the Western European economies have a GDP (gross domestic product) per capita that is four times higher than Russia's measured in current U.S. dollars. After a growth spurt of an average of seven percent a year from 1999-2008, Russia has gotten stuck in a middle-income trap with an average growth of merely half a percent per year – and it seems unable to get out of it. Russia used to be far wealthier than China in per capita terms, but now China has caught up. Russia is also diverging economically from the West.

There are basically four reasons for Russia's low growth rate: crony capitalism, war, oil prices, and demography.

Crony Capitalism and Capital Outflow

Russia's fundamental problem is that the country has no real property rights

Vladimir Putin at the "Russia is a Country of Opportunities" conference in March 2018. (Photo: Press Service of the Russian President)

because the Kremlin maintains political control over its judicial system. In a fine recent book, *Property Rights in Post-Soviet Russia: Violence, Corruption, and the Demand for Law*, Jordan Gans-Morse documents how property rights have been weakened since the Yukos confiscation in 2003-6. Any entrepreneur in Russia risks a year or so in pretrial detention if he offends the government.

This is not by accident but by design. Weak property rights enable the rulers to take what they want through corporate raiding with the assistance of lawless law enforcement agencies. Therefore, Russia has steady and large private capital outflows that reached $68 billion in 2018, or four percent of the $1.6 trillion economy. Foreigners see what is going on. If the locals dare not invest in Russia, foreign investors will stay away as well. Foreign direct investment was a negligible $2 billion in 2018, while four percent of GDP would be normal. This means that Russian investment is eight percent of GDP less than it would be if Russia had normal property rights.

War and Sanctions

Add to this the cost of war and Western economic sanctions. Russia started its rearmament program in 2008, when its military expenditures as assessed by the Stockholm International Peace Research Institute (SIPRI) amounted to 3.3 percent of GDP. By 2016, it had increased to 5.5 percent of GDP, which implies that Russia's rearmament cost society an additional 2.2 percent of GDP every year. The official Russian state subsidy to Crimea is $2 billion a year. If we presume that the subsidy to the occupied Donbas region of Ukraine, with a larger population, is equally large, this would be a cost of $4 billion a year or 0.3 percent of GDP.

Among the sanctions that the United States and European Union imposed on Russia in response to the Russian military incursion in Ukraine beginning in 2014, the most economically important are the financial sanctions that started in July of that year. The International Monetary Fund (IMF) has assessed their cost at 1-1.5 percent of Russia's GDP each year. Putin downplays the cost of the Western sanctions, claiming that they are ineffective, but at the same time he complains about them and wants them abolished.

Russia has nearly been cut off from international financing. As a consequence, Russia's foreign debt has shrunk from $730 billion at the beginning of 2014 to $454 billion at the start of 2019. Unlike the Rosstat statistics, the Central Bank statistics are provided in such detail and so frequently that they appear quite reliable. That is, Russia paid back $276 billion that it otherwise could have deployed for investment in the national economy during years of very low international interest rates. Under normal circumstances Russia would have increased its foreign indebtedness as most other countries did.

> Putin and his cronies have engineered capital outflows in the order of $15-25 billion since they got their machinery of looting going around 2006.

Adding the negative costs of war and financial sanctions to the Russian economy, we find that they reduce Russia's economy by about 3.5-4 percent of GDP each year, which is a large number. Thus, the Russian economy is unlikely to grow significantly again until the Kremlin decides to cut its military expenditures and to leave eastern Ukraine so the West lifts its sanctions.

Oil and Gas Exports

Great fluctuations in the global oil price strain the Russian economy, but the Central Bank has successfully neutralized their impact on the current account and the government budget by letting the exchange rate float with the oil price. Still, the international assets available to Russia vary greatly because in good years oil and gas comprise two-thirds of Russia's exports and Russia has no alternative exports of note. Russia's total exports of goods and services fell from $527 billion in 2012 when the oil price was high to $282 billion in 2016, while recovering to $509 billion in 2018 as the oil price rose.

Demographics

During the good years – the early 2000s – Russia benefited from an annual increase in its labor force of one percent a year. Now, on the contrary, Russia is expecting a decline in its labor force of one percent a year until 2030, which explains two percentage points of the lower growth in recent years. Moscow could expand its work force through a more liberal immigration policy, attracting more workers from poorer former Soviet republics, but it has failed to do so. Central Asian immigrants are not popular in Russia. While emigration is not large in numbers, many wealthy Russians and members of the entrepreneurial elite emigrate.

So, what is Putin going to do about this? The answer is nothing.

Managing the Problem

During Dmitri Medvedev's presidency, 2008-12, he made some humble attempts at reform, but however small they were, Putin reversed them all when he returned to the presidency in May 2012. At that time, Putin issued 11 substantial and rather detailed policy decrees but, as was widely expected, hardly anything was accomplished. This was not a time of opening up but of increased repression. In May 2018, when starting his new term, Putin issued one single policy decree, which was so vague with a minimum of numbers that it hardly meant anything. In a rather Soviet fashion, it set 12 national projects on which public expenditures were supposed to be concentrated without clarifying what should be done or why it would be helpful.

Putin appears sincere in one single reform area, the World Bank's Ease of Doing Business index. Russia had risen from ranking number 120 in 2011 to number 31 in 2018. This illustrates that Putin – like most other authoritarian rulers in the former Soviet Union – aspires to be more effectively obeyed, while caring little about economic growth. By contrast, Putin has shown no interest in reducing corruption, because Russia is a captive state. Corruption benefits him and his cronies and he rules through a kleptocracy. In the Corruption Perception Index of Transparency International, Russia ranked number 138 in 2018.

The Irony of Kleptocracy

It might appear curious that the Kremlin has not done anything to impede the massive and steady currency outflow, but the obvious explanation is that it is Putin and his cronies who benefit. The irony is that having formed an authoritarian kleptocracy, not only their enemies, but also the rulers, cannot secure their property rights in Russia. If they were to lose power, their sensible expectation is that all their loot would be confiscated by the new regime.

> Russians' real disposable incomes have fallen by a total of 11 percent during the last five years.

My assessment is that Putin and his cronies have engineered capital outflows in the order of $15-25 billion since they got their machinery of looting going around 2006. These funds are extracted primarily from Gazprom but also from other state companies and state agencies. Meanwhile, the market capitalization of

Gazprom has slumped from a peak of $369 billion in May 2008 to currently $55 billion. In spite of having lost more than $300 billion, Gazprom's CEO Alexei Miller, a Putin loyalist, stays in place, indicating that this is what Putin desires.

Putin appears oblivious to the need for reforms to speed up economic growth. In his annual press conference, he avoided the word "reform," while "Soviet" was stated 15 times. In a very Soviet way, Putin believes in the concentration of state resources in two critical sectors. The one reform that Putin has pursued is pension reform, which means the gradual increase in the retirement age by five years to save public funds. Furthermore, Putin has increased the value-added tax from 18 to 20 percent.

Putin appears oblivious to the need for reforms to speed up economic growth.

Together, these two measures will increase public revenues by about 1.5 percent of GDP, but this is from the people and not for the people. Usually Putin leaves unpopular measures to the hapless prime minister Medvedev, but untypically he took ownership of the pension reform by making a special television address in August to explain it to the Russian people. While most economists approve of the pension reform, Putin is effectively demanding popular sacrifices for his aggressive foreign policy and kleptocracy.

So far, relatively mild repression has kept the population at bay. The leading opposition activist Alexei Navalny has skillfully produced well-documented and entertaining videos about the corruption of Russia's top officials. His video about the corruption of Prime Minister Medvedev to the tune of $1.2 billion was seen by more than 28 million people on YouTube. Navalny has organized mass protests against corruption in up to 100 cities with slogans such as "Putin is a Thief." Hundreds of protesters are regularly detained, but the protests have not had any further effects as yet.

The regime continues to organize highly restrictive elections. In the fall, four of the Kremlin's candidates lost to nominal candidates amidst low turnout. Putin's popularity has fallen to a new low. The Kremlin-supported polling organization, the Foundation for Popular Opinion, records that the share of Russians who say that they would vote for Putin if there were prompt elections has fallen from 74 percent in 2015 to 46 percent in January 2019. Only 33 percent of the population expressed full confidence in him. As many as 60 percent stated that they did not have confidence in Medvedev and only 27 percent expressed confidence.

While Russia's economic situation appears predictably stable and stagnant, the question is rather how long the Russian population will tolerate a regime that performs so poorly.

ANDERS ÅSLUND, *Ph.D., is a senior fellow at the Atlantic Council and author of the forthcoming book* Russia's Crony Capitalism: The Path from Market Economy to Kleptocracy.

Venezuela's Hyperinflation, 29 Months and Counting

by STEVE H. HANKE

At present, Venezuela is the only country in the world that is suffering from the ravages of hyperinflation. Alas, the word "hyperinflation" is thrown around carelessly and misused frequently in the financial press. Indeed, the debasement of language in the popular press has gone to such lengths that the word "hyperinflation" has almost lost its meaning.

So, just what is the definition of this oft-misused word? The convention adopted in the scientific literature is to classify an inflation as a hyperinflation if the monthly inflation rate exceeds 50 percent. This definition was adopted after Phillip Cagan published his seminal analysis of hyperinflation, which appeared in a book, edited by Milton Friedman, *Studies in the Quantity Theory of Money* (1956).

Since I use high-frequency (daily) data to measure inflation in countries where inflation is elevated, I have been able to refine Cagan's 50 percent per month hyperinflation hurdle. With improved measurement techniques, I now define a hyperinflation as an inflation in which the inflation rate exceeds 50 percent per month for at least thirty consecutive days.

Calculating Inflation - PPP

Just what is Venezuela's inflation rate? Today, the annual inflation rate is 125,862 percent annually. How do I measure elevated inflation? The most important price in an economy is the exchange rate between the local currency – in this case, the bolivar – and the world's reserve currency, the U.S. dollar. As long as there is an active black market (read: free market) for currency and the black market data are available, changes in the black market exchange rate can be reliably transformed into accurate measurements of countrywide inflation rates. The economic principle of purchasing power parity (PPP) allows for this transformation. The application of PPP to measure elevated inflation rates is both simple and very accurate.

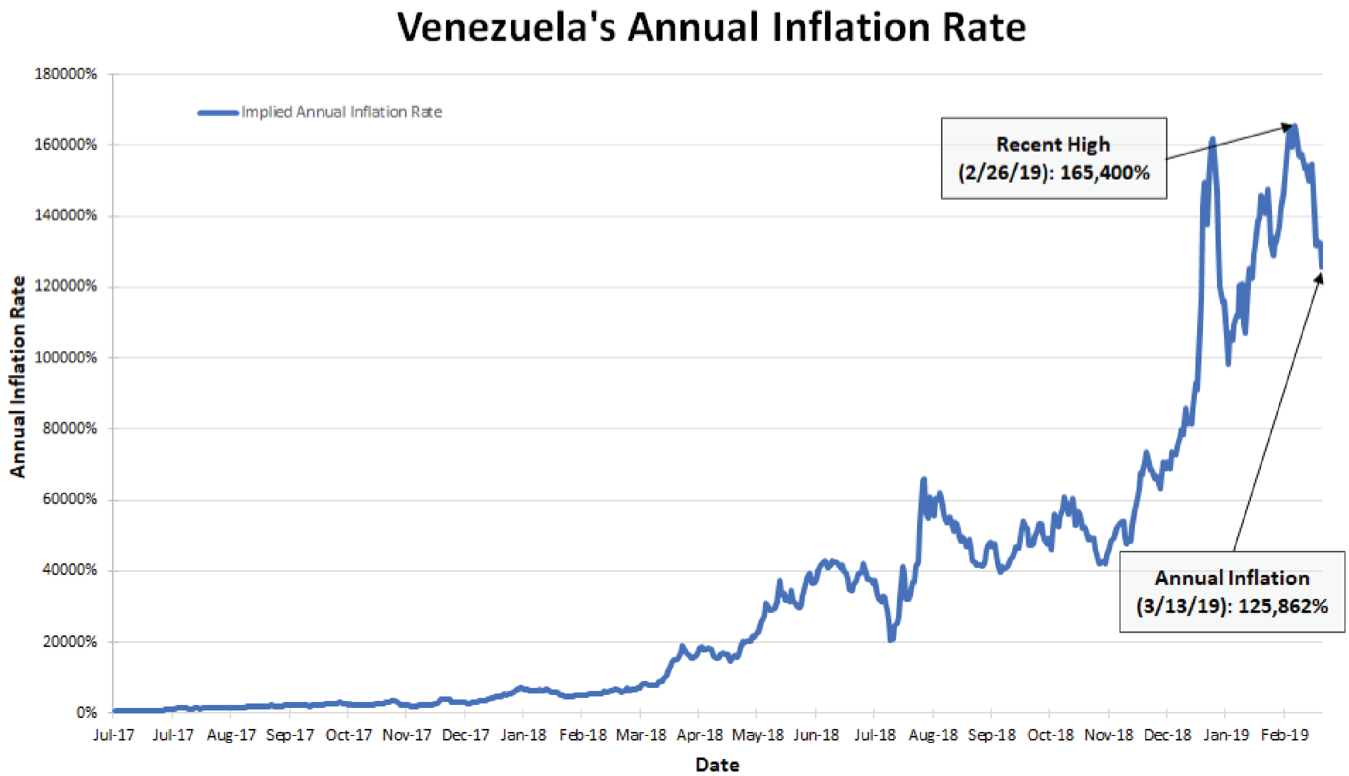
Using evidence from Germany's 1920-23 hyperinflation, my long-time friend, distinguished economist, and former Governor of the Bank of Israel Jacob Frenkel confirmed the accuracy of PPP during hyperinflations. In the July 1976 issue of the *Scandinavian Journal of Economics*, Frenkel plotted the Deutschmark/U.S. dollar exchange rate against both the German wholesale price index and the consumer price index. The correlations between Germany's exchange rate and the two price indices were very close to unity throughout the episode of hyperinflation, indicating that changes in the inflation rate mirrored changes in the exchange rate.

Beyond the theory of PPP, the intuition of why PPP represents the 'gold standard' for measuring inflation during episodes of hyperinflation is clear. During those episodes, virtually all goods and services are either priced in a stable foreign currency (the U.S. dollar) or a local currency (the bolivar). In Venezuela, bolivar prices are determined by referring to the dollar prices of goods, and then converting them to local bolivar prices after observing the black market exchange rate. When the price level is increasing rapidly and erratically on a day-by-day, hour-by-hour, or even minute-by-minute basis, exchange rate quotations are the only source of information on how fast inflation is actually proceeding. That is why PPP holds and why I can use high-frequency data to calculate Venezuela's inflation rate.

Duration Matters

Just how severe is Venezuela's hyperinflation? Well, that depends on the metrics used to measure severity. If one looks at the rate of inflation itself, Venezuela's hyperinflation is a bit above average. Of the world's 58 episodes of hyperinflation that Nick Krus and I documented in the *Routledge Handbook of Major Events in Economic History* (2013), Venezuela ranks as the 23rd most severe hyperinflation.

...Venezuela ranks as the 23rd most severe hyperinflation.



Sources: U.S Bureau of Labor Statistics, AirTM
Calculations by Prof. Steve H. Hanke, The Johns Hopkins University.
Note A: These inflation rates are implied by the movements in the black-market VES/USD exchange rate.

But, if one measures severity by the duration of a hyperinflation, Venezuela's episode, which started in November of 2016 and has yet to end, is rather severe. It has lasted for 29 months and counting.

So much for the definition and accurate measurement of Venezuela's hyperinflation. What about forecasts for the course and duration of Venezuela's episode? Well, even though you can measure a hyperinflation with great accuracy, you can't reliably forecast what heights a hyperinflation will reach, or when those heights will be reached.

Surprisingly, that impossibility hasn't stopped the International Monetary Fund (IMF) from throwing economic science to the winds. Yes, the IMF has regularly been reporting what are, in fact, absurd inflation forecasts for Venezuela.

The table on page 19 contains five forecasts made by the IMF at different dates for Venezuela's 2018 year-end inflation rate. The last IMF forecast was made in October, shortly before the end of the year.

Even a superficial examination of the table suggests that the IMF forecasts are problematic at best. Just look at the dramatic changes in the inflation forecasts—all made over a short period of time and for the same end date. The IMF's absurdity comes into full view, however, when we compare the final year-end forecast value of 2,500,000 percent to the real measured year-end value of 80,000 percent annually. The IMF's final forecast was not even in the same ball park as the measured value. Interestingly enough, the most inaccurate forecast made by the IMF was the one published in October 2018, just a few months before year's end. As the IMF moved closer to the end date, the divergence between the forecast and the real measured rate widened.

As it turns out, one can accurately measure hyperinflations, but one can't forecast their course or duration. The IMF has clearly failed to learn these lessons.

In any case, it's clear that Venezuela's big problem is hyperinflation. The first order of business for any new government in Venezuela will be to slay the hyperinflation dragon. This can be done within 24 hours with the introduction of a currency board.

A Currency Board

A currency board issues notes and coins convertible on demand into a foreign anchor currency at a fixed rate of exchange. As reserves, it holds low-risk, interest-bearing bonds denominated in the anchor currency. The reserve levels (both floors and ceilings) are set by law and are equal to 100 percent, or slightly more, of its monetary liabilities. So, the domestic currency issued via a currency board is nothing more than a clone of its anchor currency. A currency board generates profits (seigniorage) from the difference between the interest it earns on its reserve assets and the expense of maintaining its liabilities.

By design, a currency board, unlike a central bank, has no discretionary monetary powers and can't engage in the fiduciary issue of money. It has

Venezuelan citizens in Houston protest against the regime of President Nicolás Maduro. (Photo: Shutterstock/E_Rojas)

an exchange rate policy (the exchange rate is fixed) but no monetary policy. A currency board's operations are passive and automatic. The sole function of a currency board is to exchange the domestic currency it issues for an anchor currency at a fixed rate. Consequently, the quantity of domestic currency in circulation is determined solely by market forces, namely the demand for domestic currency.

A currency board can't issue credit. Accordingly, a currency board imposes a hard budget constraint and discipline on the government. This is an underappreciated feature of currency boards. Unlike central banks, a currency board can't be used as a means to finance government budgets.

Currency boards have existed in about 70 countries, and none have failed. The first one was installed in the British Indian Ocean colony of Mauritius in 1849. By the 1930s, currency boards were widespread among the British colonies in Africa, Asia, the Caribbean, and the Pacific Islands. They have also existed in a number of independent countries and city-states, such as Danzig and Singapore. One of the more interesting currency boards was installed in North Russia on November 11, 1918, during the civil war. Its architect was none other than John Maynard Keynes, who was a British Treasury official at the time.

Countries that have employed currency boards have delivered lower inflation rates, smaller fiscal deficits, lower debt levels relative to the gross domestic product, fewer banking crises, and higher real growth rates than comparable countries that have employed central banks.

> Countries that have employed currency boards have delivered lower inflation rates, smaller fiscal deficits, lower debt levels relative to the gross domestic product...

To smash inflation and establish stability, a currency board for Venezuela would do the trick. Indeed, that's why I proposed a currency board to Venezuela's President Rafael Caldera when I was his adviser from 1995-96. The details of what I proposed then, and now, are contained in a book I co-authored with Kurt Schuler, *Juntas Monetarias para países en desarrollo: Dinero, inflación y estabilidad económica,* which was published in a second edition in 2015 by CEDICE in Caracas.

I know that currency boards work from, among other things, a great deal of personal experience in stopping hyperinflations—stopping them with the introduction of currency boards. One such case was in Bulgaria, when I served as President Petar Stoyanov's adviser from 1997-2002.

Bulgaria

After Bulgaria took the exit from Communism in 1990, Bulgarians encountered some potholes. The economy

The IMF's 2018 Year-End Inflation Forecasts for Venezuela

Date of Forecast	IMF Inflation Forecast[1]
October, 2018	2,500,000%/year
July, 2018[2]	1,000,000%/year
April, 2018	12,874.6%/year
October, 2017	2,529.6%/year
April, 2017	2,529.6%/year

[1] These are the International Monetary Fund's year-end inflation forecasts for 2018 found in the biannual World Economic Outlook reports for 2017 and 2018.
[2] On July 23, 2018, in the IMF Blog, "Outlook for the Americas: A Tougher Recovery," Alejandro Director of the Western Hemisphere Department of the IMF, revised Venezuela's forecast.
Prepared by Prof. Steve H. Hanke, The Johns Hopkins University

plunged, there were debt defaults, and that Balkan paradise experienced an episode of hyperinflation. This episode peaked at an astounding 242 percent per month in February 1997. Yes, that's per month.

With the expectation that a currency board would be the best system to crush Bulgaria's hyperinflation, I wrote a book with Kurt Schuler that was translated into Bulgarian. In late 1996, it reached the top of the best-seller list in Sofia. In January 1997, I became President Stoyanov's adviser. My primary tasks were to draft a currency board law for Bulgaria, and to explain to Bulgarian politicians and the public how such a system would halt the episode of hyperinflation.

Things moved rapidly. There's nothing like a crisis to move the ball down the field. The currency board was installed on July 1, 1997, and inflation and interest rates plunged immediately. I can recall the genuine pleasure (perhaps relief, too) that President Stoyanov displayed when he congratulated me on the outstanding results produced during the first few weeks of the currency board. It was then that he confessed his hope that the currency board would kill inflation, but that he had reservations, and he was amazed when it worked even more rapidly than I had predicted. Much later, President Stoyanov confided that, without the stability created by the currency board system, Bulgaria would have had much more difficulty entering the North Atlantic Treaty Organization (NATO) in 2004 and the European Union in 2007.

Today, Venezuela should do exactly what Bulgaria did in 1997. A currency board would make the bolivar sound—a clone of the U.S. dollar, the world's most important currency. With that, inflation would be smashed within 24 hours and stability would be established. And, while stability might not be everything, everything is nothing without stability.

The political forces behind the introduction of a currency board would be seen as credible in the eyes of Venezuelans. By amassing a huge stock of political capital for slaying the hyperinflation dragon, the politicians who introduce the currency board would be able to then begin to clean up Venezuela's other messes. But, if the politicians fail to kill inflation first, there will be no successful reforms. That's why a currency board is a vital first step for Venezuela.

STEVE H. HANKE, *Ph.D., is a Professor of Applied Economics at the Johns Hopkins University and is a Senior Fellow and Director of the Troubled Currencies Project at the Cato Institute.*

Democracy has a Way of Sorting Out Problems

An *in*FOCUS interview with Professor Emeritus PETER MORICI

Professor Emeritus Peter G. Morici is an expert on economic policy and international economics. Prior to his tenure at the University of Maryland, he served as director of the Office of Economics at the U.S. International Trade Commission. He is published widely in leading public policy and business journals including the *Harvard Business Review* and *Foreign Policy*, and has lectured at Columbia University, the Harvard Business School and Oxford University, among others. He is also a frequent guest on television and radio. inFOCUS Editor Shoshana Bryen spoke with him recently.

***in*FOCUS: What is your fear for the American economy as you look out into the future?**

Prof. Morici: My fear is that we become isolated. That we fail to reach some sort of consensus with the Chinese about how the relationship should be conducted that is beneficial to both societies. That the Chinese continue to operate as they do and basically get to use the technology that we pay for and develop and it they steal from us through various forms of technology theft. It's very difficult for American companies, or Western companies generally, to compete on that basis and that's one of the reasons the Chinese are making the strides they are in cellphones, and they're ahead of us on 5G. They have their market to themselves and they can penetrate our markets. They can steal technology and so forth. All of these things make it impossible for Western companies to compete fairly and it makes Western companies increasing dependent on the Chinese.

***i*F: Would trade blocks help us better compete?**

Prof. Morici: The United States, if Congress chooses to ratify the U.S.-Mexico-Canada Agreement, essentially begins that process, because the agreement dissolves for a participant if they sign a free trade agreement with a non-market economy - you can read in that, essentially, China. It isn't clear to me that the Europeans would be willing to make a trade deal with us that had those provisions.

I might say it's a bit of Obama redux. Because one of the reasons for the Trans-Pacific Partnership was to counterbalance Chinese influence in Asia and it would have served to better isolate China. It would have created the calculus or the incentive for more trade between the United States and other Pacific Rim nations as opposed to with China.

Part of the problem is that the major European economies, in particular the Germans, make a lot of money in China and they want to be very careful. Another problem is that China has a lot of influence in some of the former Eastern bloc countries that are part of the European Union.

Dealing with Europe

Prof. Morici: And, even if there were no China, the Europeans could put conditions on trade agreements that are very difficult for another major economy – like the United States – to comply with. They like to be in a position where their standard-setting bodies are setting standards for the world as opposed to, "Well, we'll accept products that met your standards if you accept products that meet our standards." It's really hard to negotiate with the Europeans on the basis of mutual recognition.

> We can't buy ourselves out of this overnight, we also have a budget issue, and the deficit. I think we're at the right spot for slowly getting healthy.

Another problem is that the Europeans have become technological laggards, with perhaps the exception of the British. They like to engage in industrial policies that penalize American technology companies so that they – not we – succeed. I don't know how to deal with that inside a trade agreement because that's largely in the area of things like anti-trust. They have written some peculiar anti-trust practices over there which are not that amenable to negotiation.

***i*F: President Trump seems to think that tariffs on their goods is a way to rebalance our trade with Europe. Whatever**

they do to us, we do to them. Is that reasonable?

Prof. Morici: I don't think so. Europeans have higher tariffs than we do, but they don't have terribly high tariffs. One of the things I find humorous about Brexit is that if the British have to start paying tariffs on the products they send to Europe, they're not going to be very high. Yes, in some cases they are. They have a higher tariff on cars than we do. But overall, Europeans tariffs, E-tariffs are not terribly high.

The Europeans have a lot of pride on this issue and they're fairly resilient. If we impose high tariffs on them, they'll impose high tariffs on us. This is very different than China. We can rattle China with tariffs. I don't think we can rattle the Europeans that way.

Also, the Europeans are always telling us we should negotiate with the Chinese. I don't buy that. We've tried negotiating with the Chinese and using the WTO and so forth and the tariffs have proven useful with regard to China. But with regard to the Europeans, they have strong, diversified economies where I don't think it would work very well.

Professor Peter Morici.

iF: Is our best bet with the Europeans a series of bilateral agreements?

Prof. Morici: Our best bet with Europe is to try to accomplish a bilateral agreement and to demonstrate, by effectively dealing with the Chinese, how it can be done. They do have problems with the Chinese similar to ours.

Belt and Road

iF: China's Belt and Road program appears to be a way for China to get into a lot of countries, create debt, and then suck up their assets. Is that a reasonable description?

Prof. Morici: It has had that effect in places, but it's more a way for the Chinese to develop considerable influence in emerging economies. Economies that aren't as advanced as Germany or France. And it's enabled by the U.S. trade deficit because China would not be able to pursue Belt and Road if it didn't have lots of dollars to work with – which the trade deficit provides. We not only become indebted to the Chinese, but we have given them the funds they need for soft power.

Brexit

iF: Brexit yes or Brexit no?

Prof. Morici: Brexit yes.

My feeling is the agreements that Prime Minister (Teresa) May has brought back to Parliament for ratification really turn Britain into a European colony. They dictate the terms of the divorce and essentially bind, written one way or another, Britain to European rules.

They have an issue of how to deal with the Irish border because of the Good Friday Agreement that ended the terrorist problem in Northern Ireland. But British sovereignty is being held hostage to that. May has failed to come up with Plan B. If the Europeans won't be reasonable, we will see what a "hard" Brexit looks like. My feeling it's possible for the UK to leave the European Union and to deal reasonably with the Ireland problem, but she hasn't formulated a program to do that.

Sanctions and Trade Policy

iF: Can economic sanctions on countries advance our foreign policy goals? Do sanctions on Iran or Venezuela have a sig-

nificant impact and can we get what we want from them?

Prof. Morici: They do if our allies participate and participate fully, but it depends on the regime. Sanctions have been applied so many times on the North Koreans that the Koreans have become resilient. They've learned how to live with sanctions and they are very resourceful. So, sanctions in case of the Trump sanctions with regard to North Korea's nuclear arms are going to take a long time to work and to wear them down.

Also, if you're dealing with a dictator who, if he relinquishes power, has an uncertain future even regarding his personal survival, all the sanctions in the world aren't going to change his mind. Because after all, he could end up in a jail cell at best and executed at worse. In the case, for example, of Venezuela, I don't know how well those are going to work unless the military defects.

In the case of Iran, I think they could have worked, but the deal Hillary Clinton proposed and that Barack Obama ultimately agreed to was fatally flawed and Donald Trump is correct.

I don't think sanctions on Iran are going to work now. The Europeans aren't participating because they don't agree with the American policy of abrogating the agreement on nuclear development in Iran. Without them it's problematic.

Now there's really another question here: If the United States repeatedly resorts to economic sanctions, do they lose their impact?

***i*F: That's a great question.**

Prof. Morici: In some measure they do. A good deal of American leverage is based on the fact the world increasingly uses the dollar as the currency for trade – even transactions between countries that have nothing to do with the United States. So, the U.S. economy is denominated in trade in dollars and the U.S. banking system provides the global plumbing to enable that trade. It is possible to build an alternative system of plumbing based on the dollar outside the jurisdiction of the United States – because there are so many dollars already abroad that they can literally provide the reserves for banks that participate in the dollar system beyond the reach of the Federal Reserve. The Europeans are trying to lay that type of plumbing system to trade with Iran; so far, they're having difficulty. But if we use sanctions too many times then the number and scope of countries interested in an alternative system gets larger, and eventually they'll find a way around it. Instruments of soft power have limited durability and sanctions are an instrument of soft power.

> It is possible to build an alternative set of plumbing based on the dollar outside the jurisdiction of the United States – because there are so many dollars already abroad...

The American Economy: Decent

***i*F: Turning to the U.S., things are looking pretty good. Employment is up, unemployment is down, wages are rising. On the other hand, the stock market is up and down, the Federal Reserve appears tentative. First of all, what's your general assessment of the health of the American economy?**

Prof. Morici: The overall health of the American economy is decent; it could be better. Part of the problem is unresolved issues with regard to China and the problem the trade deficit poses to the U.S. economy. Part of the problem is unresolved issues about immigration. We need a better immigration program because U.S. birth rates are falling.

Millennials and Generation Z are marrying later and having fewer children to the point where, without immigration, we could have a decline in population at some point. That is not a world that we want to live in.

Part of the problem is the stresses that have been imposed on young folks by dysfunctions in our education system. Tuition has been rising at twice the rate of health insurance since 1999. Twice the base of the rate of inflation. In turn, people borrow a great deal of money to go to school and lots of times, American universities haven't given them much value. If you're going to tell people to borrow money to go to school then school becomes an investment. And, for many young people, school has proven to be a poor investment. In turn, that's a drag on the economy.

They're going to be paying student debt forever and many are in jobs that don't require a college degree. And many don't earn the kind of money necessary to retire large student debt, they just don't.

There are a lot of dysfunctions in the educational system. It is increasingly being run for the people that run it and not for the students and not for the faculty.

> There are a lot of dysfunctions in the educational system. It's increasingly being run for the people that run it and not for the students and not for the faculty.

The National Debt Clock in Times Square, New York City, in 2017. (Photo: iStock/400tmax)

That's having a lot of negative consequences for the economy broadly.

***i*F: Continue the thought. What does this mean for programs like Social Security and Medicare?**

Prof. Morici: If we have stagnant population, if we don't come to a consensus on immigration, it becomes more difficult to finance them. If you look at what's going on in Japan, people are working longer and the government is providing assistance to them to do it – to overcome the physical problems that people have as they age. We'll likely have to do that no matter what, but we are going to be compelled to do it more quickly and more drastically if we don't resolve our demographic issues.

A society in which young people are too pessimistic to have children is a society that's got a virus.

***i*F: That could be the title of this article. Another thing we talk a lot about is the deficit and the debt.**

Debt and Deficits

Prof. Morici: The national debt has been going up by the pace of the deficits, and the deficits are close to a trillion dollars per year. The debt is financed by Treasury securities, but there is a limited capacity for the world to absorb them. It has increased in recent years because the world uses the dollar more as a means of transaction and U.S. bonds are as good as U.S. dollars for backing up the world's banking systems. Banks around the world, not just American banks, issue dollar denominated deposits and they use the U.S. Treasury securities for reserves. It's the same thing with countries' central banks.

There is an appetite for Treasury securities, and so we've gotten away with having bigger deficits, but it's not infinite. The dollar is so important. The future of the Chinese yuan, for example, is uncertain because of the nature of the Chinese government is uncertain. Property is insecure there. If you have dollars, you can buy property in New York and feel that the property is secure. If you have British pounds, you can buy property in London and feel that it's secure. The only other large economy is the European economy and the future of the Euro is uncertain because if the Italians were to decide to leave the Euro Zone (and it would serve their interest to do so) and perhaps leave the European Union in the wake of Brexit – a hard break – that would be the end of the Euro. Euro-land doesn't really exist; it doesn't issue bonds.

So, my feeling is that the dollar is the only alternative right now, but just like the plumbing system with regard to U.S. sanctions, the world will find a way around the Federal Reserve printing currency if it needs to.

***i*F: Printing currency as in?**

Prof. Morici: Issuing dollars. If the world decides if it no longer wants to hold a very large number of Treasuries, it will find something else to hold. It's only paper.

***i*F: What would be an effective American strategy to reduce the deficit and therefore the debt?**

Prof. Morici: To grow more. And that would be accomplished by cleaning up entitlements, having more adults participate in the labor force, improving the education system, and improving the healthcare system. The education system and the healthcare system absorb huge amounts of American wealth and they don't run very well. The U.S. healthcare system is extraordinarily expensive and it's hard to say it's as good as, for example, the German system.

Deregulation and Growth

***i*F: Are President Trump's deregulation policies a step in the right direction?**

Prof. Morici: Generally, deregulation is good. The Obama folks went too far in the other direction. This is a sort of course correction. We need regulations so that there are rules of the road for competition. But it doesn't work if people are so pinned down by filling out forms that they can't get anything done – and it's gotten to that point for a lot of smaller banks, for example, it just became too cumbersome to make mortgages. Unfortunately, there's a certain deafness in Washington to the legitimate prize of the private sector and that is an unfortunate situation in America.

***i*F: Deafness to what?**

Prof. Morici: Deafness to needs of businesses; to being able to do business. If you have a regulatory objective, the idea is to accomplish it with the least burden. It seems in Washington that the bureaucracy's objective is to accomplish the business objective with the greatest amount of paper.

Healthcare Reform

***i*F: I want to wrap up with two questions. If you had to choose a single thing that would spark the kind of growth you're looking for, what would be the most effective thing that Washington could do?**

Prof. Morici: Genuine healthcare reform, because healthcare costs so much money. That's the biggest problem.

***i*F: What would it look like – are we talking about single payer healthcare?**

Prof. Morici: It depends on what Americans want. When they say every civilized country in the world has socialized medicine, that's likely true. There are all different kinds of government-run programs. In Germany, they have private insurers that look like the Blue Cross Blue Shield system we used to have. Non-profit insurers as we used to have.

And the Germans largely have Obamacare – everyone has to buy health insurance unless they can post a very large bond of some kind. They show that they are very, very wealthy and that they can pay for their own medical care if they have to. So, Warren Buffet wouldn't have to buy.

The rest of us would have to buy. But the German system only costs about two-thirds as much as ours does, because they have meaningful price regulations and they seem to have a lot less bureaucracy.

Frankly, healthcare is the kind of service in which it is very difficult to have competitive markets. If competition were capable of solving the problem, as the Republicans say, then California being the 6th or 7th largest economy in the world, should be quite large enough to have much lower healthcare prices, but it doesn't.

So interstate competition and tort reform, the usual palliatives of the right, is hardly going to be enough. If Americans are not willing to regulate the price of drugs for example, then drug companies are going to continue to take advantage of the fact that the federal government buys more than half of the drugs and they will charge the government whatever they want.

***i*F: One last thought for us please. Overall, are you optimistic, pessimistic or somewhere in the middle?**

Prof. Morici: Overall, I'm optimistic about America because of our technology and the fact that democracy has a way of sorting out problems in the long run.

> I'm optimistic about America because of our technology and the fact that democracy has a way of sorting out problems in the long run.

***i*F: On that positive note, and on behalf of the members of The Jewish Policy Center, Professor Peter Morici, thank you for a very enlightening conversation.**

In Africa, Effective Aid is Local Aid

by CASEY PIFER

Bring up the topic of Africa to most Americans and their minds will race through images of slums, hungry children, undrinkable water, and war. For some, it's comforting to know that the United States government invests huge sums of cash and capital in the continent, even if the goals aren't always clear. Many Americans even contribute to those efforts privately via charity or participation in "one-for-one" purchases which, like TOMS shoes, provide a matching donation of your product to someone in need.

We care. And doing something is better than doing nothing, right?

We all know the parable which suggests that we should teach a man to fish rather than simply give him a fish. But in the United States, where extreme poverty and lack of access to adequate nutrition, medical care, and clean water feels a world away, giving a man a fish often seems the best way to help.

But is giving a man a fish really the best we can do?

Aid as a Problem?

Africa is flooded with billions of dollars in humanitarian aid from the United States alone each year—so it makes sense to assess the outcomes of that astronomical sum to see if our best is doing any good. Is Africa better off as a result of this influx of cash, programs, and assistance? Are its economies becoming more mature and its people less dependent on aid?

In recent years, more and more scholars have tackled the question of whether our development aid efforts are succeeding or failing. Just last year, Dr. Dan Honig launched the Project Performance Database (PPD), "the world's largest database of development projects." The database contains outcomes assessments of more than 14,000 aid projects from around the world. Disappointingly, based on aid agencies' self-assessment, this database showed that nearly 40 percent of those projects failed. Only a small percentage of projects achieved their expected results.

More troubling than this is the increasing concern that our humanitarian aid efforts are not only failing, but they are actually harming local economies by disrupting existing incentives and ignoring local context. Atlas Network President Matt Warner provides a vivid example of this in his recent article for The Foundation for Economic Education, "Can Local Solutions Succeed Where Foreign Aid Has Failed?"

> *In Ruhiira, Uganda, an international aid project once offered villagers $300,000 to grow maize instead of matoke, a banana-like starch. Maize, the aid experts reasoned, was better to farm because it is nutritious, drought-resistant, and produces high yields. The experts were right. At harvest time, the villagers found themselves with a bumper crop of 3,840 tons of maize.*
>
> *What happened next, though, cut short any celebration. No one could figure out what to do with all the excess maize. Transport costs to distant markets were too high to be profitable, and the village lacked the kind of storage facilities needed to preserve the corn for future use.*
>
> *So, it rotted. As one widow and mother of nine explained, "Maize is everywhere! Under the beds, in the living rooms, in the kitchens—everywhere! And the rats are everywhere, too." What began as a hopeful, well-funded effort by foreign experts with good intentions ended in disappointment and even resentment on the part of those it was meant to help.*

Stories like this are all too common in the world of economic development. And while free market advocates are quick to criticize government aid efforts, the problem is not limited to government projects. The trouble comes when outsiders fail to consider they might not have all the information and, that without local knowledge, their efforts could harm rather than help people in impoverished communities – and that reality applies to both private and government aid efforts. Warner calls this problem "the outsider's dilemma"; the problem that arises when outsiders are not equipped with the local knowledge and insights necessary to help people lift themselves out of poverty. Warner reasons that the outsider's dilemma is the main reason traditional

...outsiders fail to consider they might not have all the information and, that without that local knowledge, their efforts could harm rather than help people...

aid projects are so often met with failure and, as was the case in Ruhiira, actually do harm.

TOMS Shoes

In a famous example of well-meaning private initiative gone awry, TOMS shoes and its "One for One" effort has been deeply criticized as not only focusing on the wrong issue (as the *Harvard Review* put it, "Is donating shoes an effective way of aiding impoverished communities when an estimated 800 million people worldwide lack access to basic nutrition?"), but also for creating aid dependency with handouts that ultimately disenfranchise local shoe cobblers and vendors. TOMS commissioned a study on the "One for One" model. The results, published in the *World Bank Economic Review*, confirmed two major concerns: There were "insignificant impacts on overall health, foot health, and self-esteem" and "the overall impact of the shoe donation program appears to be negligible" in that the TOMS shoes simply replaced the shoes people had previously gotten elsewhere.

So, what are we to do? A world away from the real consequences on the ground, people in rich countries continue to flock to the traditional aid model because doing something has to be better than doing nothing at all.

But economies, cultures, and communities are infinitely complex, and what works for one country might not work for another. At Atlas Network, we believe there is a better way to help—a way that is grounded in locally-grown solutions that call for local knowledge, local leadership, and local empowerment.

Our team often quotes Lant Pritchett, a Harvard University development expert who asserted that "There are no poor people. There are people living in poor places."

And what makes those places poor?

Economic Rights and Institutions

Increasingly, research has shown that poverty stems from a lack of economic rights and the institutions that support those rights. And that's where Atlas Network and our associated partners in more than 90 countries are playing an important role.

Atlas Network serves as the center of gravity for a worldwide effort to create freedom and opportunity by helping local organizations develop and implement local solutions that are helping people improve their lives. Most of these organizations are think tanks that use research and data to establish the need for public policy reform, and then work with local stakeholders—including legislators, businesspeople, and others who care about change—who become advocates for progress.

Today, there are nearly 500 Atlas Network partners who operate independently with support from a diverse base of voluntary supporters, meet a minimum budget requirement, have a professional online presence, and are working toward a shared vision of a free, prosperous, and peaceful world where limited governments defend rule of law, private property and free markets. We are capacity builders, and our unique model, known as "Coach, Compete, Celebrate!" helps our partners create a stronger, more effective foundation for lasting change.

This network of extraordinary organizations led by intellectual entrepreneurs is growing each day, and nowhere is that growth more energized than in Africa. That's encouraging because, with extreme limits on economic freedom in Africa, there is a lot of work to be done there.

Most of Africa's countries perform poorly in the Economic Freedom of the World report, which annually measures the economic freedom environment of each country and ranks them in relation to one another. The 2018 report ranks 162 countries around the world, including 40 countries in Sub-Saharan Africa. The ranking shows that 80 percent of Sub-Saharan African countries place in the bottom half for economic freedom; 58 percent of them are in the bottom quartile and categorized as "least free."

The Economic Freedom of the World report is widely used to analyze the impact of economic freedom on economic growth and poverty, and, according to its authors, "virtually without exception, these studies have found that countries with institutions and policies more consistent with economic freedom have higher investment rates, more rapid economic growth, higher income levels, and a more rapid reduction in poverty rates." Africa's poor performance in this ranking and others relating to economic rights, like the World Bank's Doing Business Report, begin to give us a picture of why so many countries in Africa are, in the words of Lant Pritchett, "poor places."

While the average American may frown in consternation during a discussion about Africa's struggles, we are hopeful that the future is bright because our partners in Africa are creating meaningful and lasting change to secure economic rights and freedoms.

> Property rights have long been recognized as an essential key to economic development, as well-defined and secure property rights allow individuals to trade and maximize the use of their resources.

Rights and Freedom

It's happening in Burundi.

A few years ago, a young intellectual entrepreneur named Aimable Manirakiza asked if we could share books about the principles of liberty. Armed with material, he has done tremendous work with thousands of students in Burundi, Rwanda, and the Democratic Republic of Congo, hosting events and teaching students about the virtues of a free society.

Last year, Manirakiza officially launched Center for Development Enterprises Great Lakes (CDE), raising $8,000 from local and international donors—which is, incidentally, 26 times the GDP per capita of Burundi. With Manirakiza at the helm, donors can rest assured that their funds are making a difference. CDE Great Lakes recently played a major role in reducing the mandatory fee for registering a business in Burundi from $78 to $22. In a country where average yearly income barely reaches $300, a $78 registration fee meant that many poor entrepreneurs couldn't scrape together enough capital even to get started. But as a result of CDE Great Lakes' work, that barrier to entry has been reduced by 72 percent.

Sometimes reform is decades in the making. Property rights have long been recognized as an essential key to economic development, as well-defined and secure property rights allow individuals to trade and maximize the use of their resources.

Property Rights

The Economic Freedom of the World, 2018 report points out that especially in Sub-Saharan Africa, "weakness in the rule of law and property rights is particularly pronounced." An example of this was highlighted in 2015, when the Free Market Foundation in South Africa tackled a huge local problem: between five and seven million black families living in apartheid-era housing had no official titles to their homes, effectively making them squatters even if their families had lived for generations on that land. For people with few resources, there is no incentive to invest in improvement if the land you live on doesn't belong to you. Free Market Foundation's Khaya Lam project addressed this problem by helping hundreds of black South Africans access fully tradable titles to their property. Through their efforts, tenants living in poverty have been able to unlock nearly $4.5 million in dead capital and create new opportunities for trade and sale.

Our partner in Côte d'Ivoire, Audace Institute Afrique (AIA) also prioritized secure property rights in a country where only four percent of rural land was legally registered. Historically, the lack of defined property made rural villages vulnerable to disputes because it was nearly impossible to establish who owned property and thus who had the right to sell it. AIA launched a project to formalize land ownership with the Ivorian government, relying on local knowledge and village customs. Using GPS and other digital technologies to set boundaries, AIA now publishes the results digitally and physically and creates secure contracts that can be used in land transactions. Its work has been replicated in villages across the country, and new national legislation requires similar procedures for unregistered land.

Historically, the lack of defined property made rural villages vulnerable to disputes because it was nearly impossible to establish who owned property and thus who had the right to sell it.

Is it Legal to Fish?

All three of these examples, and especially the Ivorian case, demonstrate the necessity of local knowledge in creating lasting change that can position communities and countries in Africa for economic growth. Atlas Network stands alongside these local experts as a cheerleader and supporter, all the while recognizing that our position as an outsider prevents us from calling the shots that lead to reform. Our goals are to increase our partner capabilities' and help inspire and support their ambitions for greater impact while staying deferential to their vision of what makes the most sense on the ground.

The "Coach, Compete, Celebrate!" model that Atlas Network has pioneered has proven to be an excellent way to inspire, engage, and elevate our partners' achievements. The power of network effects is well documented, and we've seen it at work with our partner think tanks. We coach our think tank partners with world-class training that helps them set clear, achievable goals, learn how to be effective change agents, and discover how their efforts can improve the quality of life for people in their communities and countries. Our partners compete with one another for grants and awards, challenging each other to improve and achieve extraordinary outcomes. And as their projects result in policy reforms that make a difference for people around the world, we celebrate their efforts by featuring their successes in events, promotional materials, and case studies that allow organizations to learn from one another.

By interacting with peers and learning how others are creating substantive, lasting change, our partners discover the many ways they can up their game. And armed with new skills and energized by the efforts of their global peers, Atlas Network's partners are driving economic prosperity across Africa and the rest of the developing world.

So, the next time you're tempted to give a man a fish or teach him to fish … remember to ask whether it's even legal for him to fish there in the first place. And if not, take heart. Someone is doing something that is actually making a difference. There is probably an Atlas Network partner out there working hard to liberate him.

CASEY PIFER *is Director of Institute Relations for Atlas Network, a non-profit organization connecting a global network of more than 450 free-market organizations in over 90 countries.*

How to Get the China Challenge Right

by AARON FRIEDBERG

American and other Western observers often cast the China challenge in primarily material terms, as an inevitable byproduct of the country's growing wealth and power. The basic premise here is that rising states naturally seek to expand the sphere of their influence, and dominant powers, seeking to defend their privileges, naturally oppose them.

While not flatly wrong, this view is incomplete and, insofar as it understates the severity and complexity of the problem, misleading too. China's rise represents a test for the United States and other democratic countries, not solely or even primarily because of its growing power, but because of the uses to which that power is being put. These, in turn, reflect its repressive, authoritarian domestic political system. The internal dynamics of the Chinese Communist Party (CCP) regime and its prevailing ideology shape how its leaders perceive threats, define goals, and select policies to attain them. And it is these perceptions, policies, and objectives that put Beijing fundamentally at odds with Washington, raise the stakes of their expanding rivalry, and diminish the likelihood of a lasting, stable entente between them.

American Expectations

For the better part of three decades, the ultimate aim of American policy has been to bring about a change in the character of the Chinese regime. From the end of the Cold War onward, with a brief interlude in the early 1990s following the 1989 Tiananmen Square massacre, U.S. policy in both Democratic and Republican administrations sought to engage China across all fronts: diplomatically, through deepening scientific, cultural, and educational ties, and above all through trade and investment. Successive administrations believed that engagement would encourage China to become a satisfied power or a "responsible stakeholder" in the existing international system, accelerating the process of market reform and promoting forces that would lead eventually to political as well as economic liberalization. It was assumed that trade would fuel growth, growth would lead to the emergence of a middle class, and, as had happened elsewhere in both Asia and Europe, the middle class would act as the standard bearer for democracy.

Chinese Intentions

From the start, China's Communist Party rulers had very different ideas. The CCP leadership recognized early that engaging with the outside world would pose risks to its continued rule. As Deng Xiaoping famously warned: Opening the windows would let in flies as well as fresh air. Deng believed that economic reform was essential to China's return to great power status. But he was also keenly aware that subversive ideas and outside influences could encourage dissent and produce unwanted pressures for political change.

In the wake of Tiananmen, those atop the CCP who might have been willing to contemplate eventual liberalization were purged. Deng and his remaining colleagues then launched a three-pronged program to counteract and contain the potentially destabilizing political effects of continued economic reform. By allowing the Chinese people to enjoy more of the fruits of their labors, the regime hoped to win their loyalty, or at least their acquiescence. In addition, Beijing began greatly to expand its investments in the tools of surveillance and repression, including multiple domestic security forces. Finally, the CCP began to implement an intensive, nationwide program of ideological indoctrination, or "patriotic education." The aim of this program was to bolster popular support by promulgating a substitute for Marxism-Leninism-Maoism in the form of a distinctive variant of nationalism which, rather than emphasizing the great achievements of Chinese civilization, stressed instead the "century of humiliation" and the vital and as yet unfinished role of the Communist Party in restoring national dignity.

All of these elements have remained in place to this day, although their relative weights have shifted over time. As economic growth has slowed, China's leaders have cracked down even harder while stepping up their use of nationalist appeals. These tendencies first became evident during the second half of Hu Jintao's reign, following the global financial crisis of 2008 and the 2011 "Arab Spring." But they have been especially visible since Xi Jinping assumed leadership of the party-state six years ago.

The Expansion of Repression

The expanded resources available to the CCP regime have given it a widening array of options for crushing dissent. In addition to strengthening its "Great Firewall" to block unwanted Internet content, the government is moving toward implementing a nationwide "social credit" system that will use facial recognition

Members of a Chinese military honor guard march during a ceremony om 2017. (Photo: United States Air Force)

software and big data analytics to monitor the activities, track the movements, and assess the political reliability of virtually every man, woman, and child in China.

Some means of repression are more old-fashioned. There is growing evidence of an extensive network of "detention facilities," or concentration camps, that may hold as many as one million members of China's Uighur Muslim minority—nearly 10 percent of the total Uighur population—whom the regime fears may be susceptible to Islamist radicalism. Prisoners are reportedly subjected to intense psychological pressure intended to "re-educate" them; many have not been heard from since being detained. CCP policy appears to constitute a violation of human rights on a truly massive scale; but to date, Western governments, including those which profess to care most about human rights, have been wary about commenting on it publicly, presumably because they fear damaging valuable economic relationships with China.

Thirty years ago, there may have been a case for downplaying the CCP regime's mistreatment of its own people in the belief that continued engagement would catalyze faster political reform. It has become increasingly apparent, however, that what Xi Jinping and his colleagues have in mind is not a transitional phase of authoritarian rule to be followed by eventual liberalization, but an efficient, technologically empowered, and permanent one-party dictatorship: an illiberal version of "the end of history."

What is happening inside China should shock the conscience of democratic citizens and their governments, and give pause to those who continue to believe in the transformative effects of engagement. But the harmful consequences of these developments extend well beyond China's borders. The surveillance technologies and social control techniques being perfected by Beijing have already begun to spread, as Chinese companies expand telecommunication networks around the world and provide support to like-minded regimes. China's increasing wealth and the growing importance of its market have also enhanced the regime's ability to exert leverage over foreigners, including both governments and private actors, who dare criticize its human rights policies or otherwise incur its wrath.

Even as they seek to silence foreign critics, China's leaders also have intensified their use of impassioned patriotism, including by courting confrontations with other countries in an attempt to rally domestic support. Beijing's increasingly forceful prosecution of long-standing disputes with its maritime neighbors is one example of this trend; its stiffening stance toward the United States, even before the advent of President Donald Trump, is another.

The CCP regime may not want war, but it needs enemies and an atmosphere of crisis to justify its tightening grip on political power.

Economic Development and Theft

Developments in the economic sphere parallel and reflect those in the political domain. From the early 1990s onward a widespread expectation in the West was that economic and political reform would go hand in hand, and that a greater Chinese reliance on markets would encourage, and indeed require, a steady reduction in the power of the party-state. But this is not what has happened. Beyond a certain point, the CCP has proven unwilling to relinquish its grip.

Resistance to thorough-going market reforms is also a result of the incentives embedded in the structure of China's opaque, hierarchical political system, in which party members and their families benefit from privileged access to power. Increasingly, too, the CCP leadership's determination to continue on the path of "socialism with Chinese characteristics" also reflects the conviction that these policies are working.

The pace of economic reform began to slow shortly after China's accession to the World Trade Organization in 2001 and, in certain respects, it has shifted into reverse under Xi Jinping. Despite its WTO commitments, Beijing is continuing to use a mix of subsidies, tariffs, non-tariff barriers, and other measures to protect domestically-based companies and to promote them in global markets. Its latest trade and industrial programs are designed to catapult it from perennial follower to a position of leadership across an array of cutting-edge technologies.

Because they continue to lag behind in many of these sectors, Chinese firms, at the direction and with the assistance of the party-state, have for some time been using a variety of techniques for acquiring the necessary technology from the advanced industrial countries. In addition to buying up foreign companies and compelling foreign firms to transfer core technologies in return for access to the Chinese market, Chinese actors have used cyber intrusions and other more traditional methods of industrial espionage to steal intellectual property in massive quantities

The problems with all of this are threefold. Some of the methods just described represent severe distortions or outright violations of existing rules and international understandings. China has been gaming the system to its own advantage and the disadvantage of its trading partners.

Aside from the means it uses, Beijing's stated goals, as recorded in official planning documents like "Made in China 2025," contribute to this sense of concern. The regime has declared its intention not only to promote the fortunes of Chinese firms in a general way, but to help them achieve a dominant position—including specified market shares—in a variety of high-tech sectors, first in its heavily protected domestic market and then overseas. If successful, these efforts would jeopardize the prosperity and future growth prospects of many other advanced industrial countries, including the United States.

Finally, because virtually all of the technologies involved have both commercial and military applications, Beijing's policies could help it achieve a meaningful edge in the development of future weapons systems, reducing or perhaps eliminating a longstanding source of strategic advantage for the United States. Indeed, given its worldview, this is likely an even more important objective for the CCP regime than simply promoting national economic welfare.

Changing Asia's Status Quo

China's rulers have long been dissatisfied with the status quo in East Asia, especially in the maritime domain off their eastern coasts. Among their objectives are taking control of Taiwan, which the CCP regards not only as a rebellious province but also a dangerous example of a successful Chinese democracy, and asserting dominance over virtually all of the waters, surface features, and resources in the South China Sea, as well as portions of the East China Sea.

Beijing also seeks an end to America's regional alliances and the removal of U.S. military bases from Japan and South Korea. It regards these as temporary artifacts of historical accident, the byproduct of "unequal treaties" that followed the end of World War II and are now sustained by what the Chinese describe as an outdated "Cold War mentality." The CCP leadership believes that Washington has long sought to encircle it from without with democratic allies, while subverting its rule from within with liberal propaganda. Weakening and ultimately breaking up America's alliances is therefore seen as essential to regime survival and to regaining China's rightful place as the preponderant power in East Asia.

What has changed in recent years are not the CCP's goals, but rather the means available to achieve them, as well as Beijing's willingness to exercise its growing power in order to do so. Since the mid-1990s, China's rapid economic growth has enabled it to fund a wide-ranging and sustained modernization of its armed forces. Among other things, the regime has invested heavily in so-called anti-access/area denial capabilities—precision conventional-strike systems capable of hitting fixed and mobile targets throughout the Western Pacific, including U.S. bases and aircraft carriers. Beijing has also begun to improve its intercontinental-range nuclear strike forces in ways that could eventually call into question the credibility of America's extended nuclear guarantee to its allies. At the other end of the spectrum, China has developed and put to use "gray zone" capabilities—coast guard, paramilitary, and maritime construction forces that it has used to build and now to fortify a set of artificial islands in the South China Sea.

The purpose of China's military buildup is not primarily to fight and win a war with the United States but rather, if possible, to "win without fighting."

China's economic growth has also given its leaders an expanding array of non-military tools with which to achieve their objectives. The increasing size and centrality of the Chinese market and its rapidly expanding role as a provider of aid and investment is helping Beijing draw others toward it. In addition to attracting clients with the promise of profits, the regime now has the ability to use economic instruments to threaten—and if necessary to punish—those who would defy it.

> China's rise represents a test… not solely or even primarily because of its growing power, but because of the uses to which that power is being put.

Pushing the U.S. Out

The ultimate objective of CCP strategy appears to be the creation of a new regional order in eastern Eurasia, formed from a group of countries joined by trade, transportation, and communication infrastructure with Beijing at the center. With America's alliances dismantled or drained of significance, the United States would be pushed to the margins, if not out of the region altogether.

Regional hegemony would also give China a secure base from which it could more easily project power into areas closer to the United States, including the Western Hemisphere. Since the start of the 20th century a central objective of American grand strategy has been to forestall just such a threat by preventing a hostile power or coalition from dominating either end of the Eurasian landmass.

The ambitions of China's CCP regime are no longer limited to its immediate neighborhood but extend to the global stage.

Chinese strategists have never accepted the Western vision of a liberal order, a world made up of states that share a commitment to certain principles, including representative government, the rule of law, and protection of individual rights. What they say they seek instead is a "community of common destiny," a live-and-let-live world united only by the shared pursuit of material prosperity, in which every state can govern as it sees fit, free from outside criticism or interference.

Rather than trying to overturn the existing structure of global institutions, Beijing thus seeks for the moment to exploit those parts that can be turned to its advantage (like the World Trade Organization and the U.N. Security Council), ignoring those that challenge its interests (like the International Tribunal for the Law of the Sea), and subverting or weakening others (like the U.N. Commission on Human Rights) that might threaten its legitimacy.

The CCP regime has also begun to develop some new institutions that bypass those favored by the West, including mechanisms that enable cross-border financial transactions beyond the reach of U.S. surveillance or sanctions, and development banks that offer capital without Western-style conditions for good governance or transparency. Finally, Beijing is attempting to win acceptance for new norms (like the notion of "Internet sovereignty" as opposed to the ideal of "Internet freedom" favored by many in the West) designed to reinforce its own efforts to block what it regards as subversive and dangerous ideas.

On Offense in the War of Ideas

China's rulers no longer see themselves as operating entirely on the defensive in the ongoing clash of ideas with the West. They now feel emboldened not only to attack the inequities and inefficiencies of liberal democracy, but to advance their own distinctive mix of market-driven economics and authoritarian politics as, in Xi Jinping's words, a "new option for other countries."

> China's increasing wealth and the growing importance of its market have also enhanced the regime's ability to exert leverage over foreigners...

Whatever the philosophical appeal of the Chinese model, the outflow of Chinese money, most notably under the auspices of Xi's signature Belt and Road Initiative, is influencing the policies and shaping the institutions of countries in many parts of the developing world. Beijing's largesse tends to strengthen the hand of the authoritarian rulers with whom it generally prefers to do business, but it is also fueling corruption and weakening democratic practices in places where liberal norms have yet to take firm root.

Despite China's loudly proclaimed commitment to "non-interference," in the past five years the CCP has stepped up its use of political warfare or so-called United Front influence operations. These involve a combination of techniques, including bribery and cooptation, that are intended to shape the perceptions and attitudes of foreign business, academic, media, and political elites in ways that reduce criticism of the CCP regime or opposition to its policies.

Unlike Moscow, Beijing is not trying to destabilize the advanced industrial democracies, but it does seek to exploit their openness for its own ever more clear strategic ends. Just as American policymakers set out to "make the world safe for democracy" at the start of the 20th century, so Chinese leaders are using every means at their disposal to make it safe for authoritarianism, or at least for continued CCP rule, at the start of the 21st.

In keeping with the president's own predilections, the Trump Administration has chosen for the most part to eschew the language of values and beliefs, casting China not so much as an ideological rival but rather as America's main opponent in a "new era of great power competition." This is both inadequate and unwise. What is at stake in the emerging contest between Washington and Beijing is not just the delineation of spheres of influence, or some marginal readjustment in the balance of power, but the future prosperity and security of free societies in Asia and around the world.

For all their talk of "win-win solutions," China's current rulers regard the escalating rivalry with the United States as a zero-sum game from which only one power can emerge triumphant.

Last and perhaps most important: Downplaying the differences between liberal democracies and authoritarian regimes risks overlooking the vulnerability and potential frailty of CCP-ruled China while underestimating the dynamism and resilience of the United States and its allies. Sun Tzu's ancient aphorism is still apt: To achieve strategic success it is necessary to know the enemy, but also to know yourself.

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The Case for Chile's Private Social Security System

by DAN MITCHELL

The United States and other western nations became rich during the 1800s thanks to a combination of rule of law and very small government.

Sadly, very few nations – most notably East Asian tiger economies – have become rich in the modern era. Yes, some other countries have grown, but they are not on a path to converge with rich nations.

Chile, however, may be an exception to that unfortunate pattern. It has enjoyed amazing levels of growth since a shift to free-market policies starting about 40 years ago. It is now the richest country in Latin America and if its "improbable success" continues, it will soon be comfortably part of what used to be called the First World.

The flagship reform in Chile was the creation of a funded retirement system based on personal accounts. Basically, universal IRAs.

The Chilean Model Lives

Writing for the *Weekly Standard*, Fred Barnes shared what he learned about the nation's private retirement system.

> *The rags-to-riches Chile story lives on as a model of what a poor country can achieve if it spurns socialism and adopts free markets and democracy. Peru is now copying Chile. More may follow. …Chile was once a Third World country headed downhill economically after Salvador Allende was elected president in 1970…bent on creating a Marxist state. 1973, the military led by General Augusto Pinochet staged a coup. …When he took over, Chile had one of the highest rates of poverty in South America. It was a basket case. Now it has the continent's strongest economy. Without Pinochet's having heeded the advice of economist Milton Friedman, imposed capitalism, and hired a team of free market economists, many trained at the University of Chicago, the rise to First World status wouldn't have happened. One of the economists was José Piñera, brother of the new president and Harvard-educated. He created a stable, fully-funded pension program that has become a monument to the success of private markets. …Piñera released a study in January that found "72 percent of the capital accumulated in the personal retirement account of the average Chilean worker, after 36 years in the private pension system, comes from the return on the investments done with their contributions." That's a long way of saying the plan is a dazzling success.*

Chile's system isn't perfect, but it's far better, by several orders of magnitude, than the debt-ridden, pay-as-you-go models...

Though there are opponents, mostly those inspired by the communist regime in Cuba and a pope who thinks we should worship the state.

> *But obstacles remain. …Even with Fidel Castro gone, Cuba exports communism as aggressively as it once did sugar. …socialists have an ally in Pope Francis, who spent three days in Chile in mid-January. …there's a disconnect between how people here feel about capitalism—as a concept anyway—and the economic success they are experiencing. Pinochet is partly to blame, I suspect. He's a hard man to credit, given his bloody takeover.*

Barnes' final point is also important.

> *I've had many people tell me that personal accounts are bad because they were implemented during Pinochet's reign. But that's a silly argument, sort of like deciding to be against free trade because the dictatorial Chinese government opened up to the global economy.*

As far as I'm concerned, tyrannical leaders are awful and should be condemned, but if they happen to grant citizens a slice of economic liberty, that's a silver lining to an otherwise dark cloud.

Back to our main topic, Monica Showalter, in a column for the *American Thinker*, explained what makes Chile's system a role model for the United States.

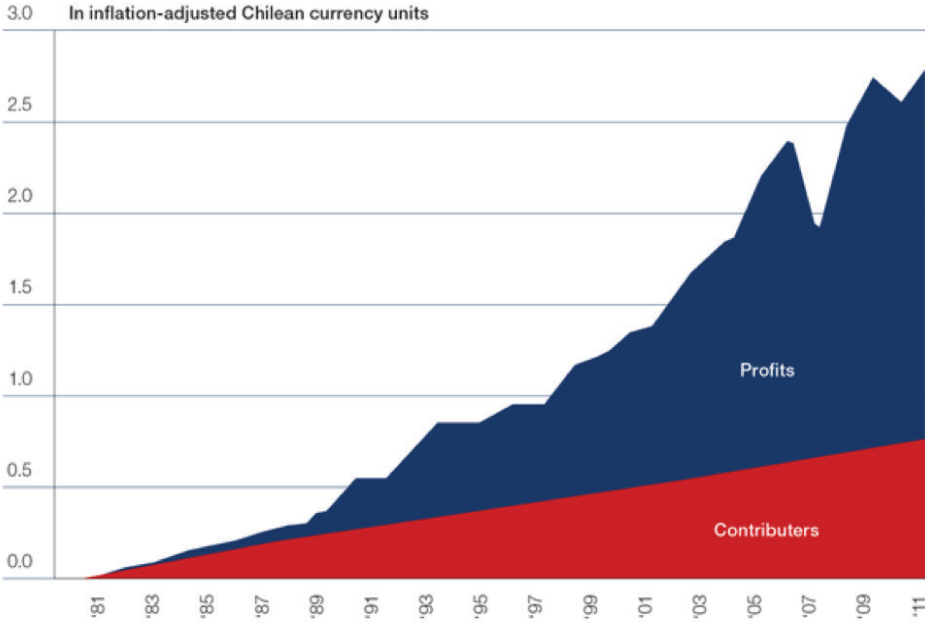


Figure 1. In Chile 73 percent of retirement savings come from the profits on investments. Just 23 percent come from contribution. (Source: Chilean Association of Pension Fund Administrators.

> *…the Chilean Model…shows some spectacular new results for ordinary citizens… the Chilean Model is working, big time. Basically, you skip Social Security taxes for starters, which leaves you a lot more money to play around with. You then put 10 percent of your income into a government-certified private pension account (and you have many choices among them) … This is mass-scale wealth creation, and it benefits workers most of all. … Chile has no pension crisis as most of the rest of the developed world does – no worries about a "trust fund" and no Social Security "cuts" to speak of. This is why. Thirty nations have adopted the same plan… the left hates this stuff. It keeps workers out of the clutches of unions and un-dependent on government handouts. Of course leftists want it gone. They tried hard in Chile to turn workers against this pension idea.*

And figure 1 is from her article showing how investment returns have played a big role in helping ordinary Chileans build nest eggs for their old age.

Let's look at some additional research. In a monograph published by the U.K.-based Institute of Economic Affairs, Kristian Niemietz takes an in-depth look at Chiles's approach.

> *Taken together, the value of the assets accumulated by Chilean pension funds is equivalent to about two thirds of the country's GDP. This places Chile in the same league as countries which have had private pensions for over a century, and miles ahead of countries with traditional Bismarckian systems…The poverty rate among the elderly is lower than that of the population as a whole – 3.9 percent vs. 10.3 percent, or 8.4 percent vs. 14.4 percent, depending on the poverty measure used…*
> *Chile's 1981 pension reform has given rise to a number of positive economic spillover effects: the prefunded system has been an active ingredient in the accelerated economic development that the country has been experiencing since the mid-1980s. …It has increased employment, especially in the formal sector… It has boosted the development and sophistication of Chile's capital markets, and thus raised Total Factor Productivity… Despite the current backlash against it, Chile's pension system is a success story. The system has achieved consistently high rates of return. It offers excellent value for money and solid pensions for those who contribute regularly. … The official retirement age is not as important in Chile as it is in countries with state-run systems. By and large, in that system, people retire when they have accumulated enough savings, not when politicians think they should retire.*

Kristian also mentioned figure 2 in the text. By this important metric, Chile is firmly ensconced in the upper tier of developed countries.

The Perils of Not Saving

Now let's address some of the critics. Under the previous leftist government, there were protests against the country's famous private social security system and attempts to undermine the model. Indeed, I wrote about that battle back in 2014. And I also noted that even some academics agreed that it would be foolish to undermine a successful approach.

Let's see what's happened since then. *The Economist* reported about the complaints about a year ago.

> *…tens of thousands of Chileans in Santiago…protest against the country's privatized pension system. Organizers—a mix of unions, pensioners' associations and consumer-advocacy groups—say that… Pensions are too small…benefits have not measured up to people's unrealistic expectations. The scheme's founders told workers that if they contributed continuously throughout their careers they would receive a generous 70% of their final salaries upon retirement. …But most workers contributed far less. Women took time off to raise children (and retire earlier than men). Many Chileans spent time in informal jobs or unemployed. On average, they contribute for only 40% of their prime working years. …The system has generated*

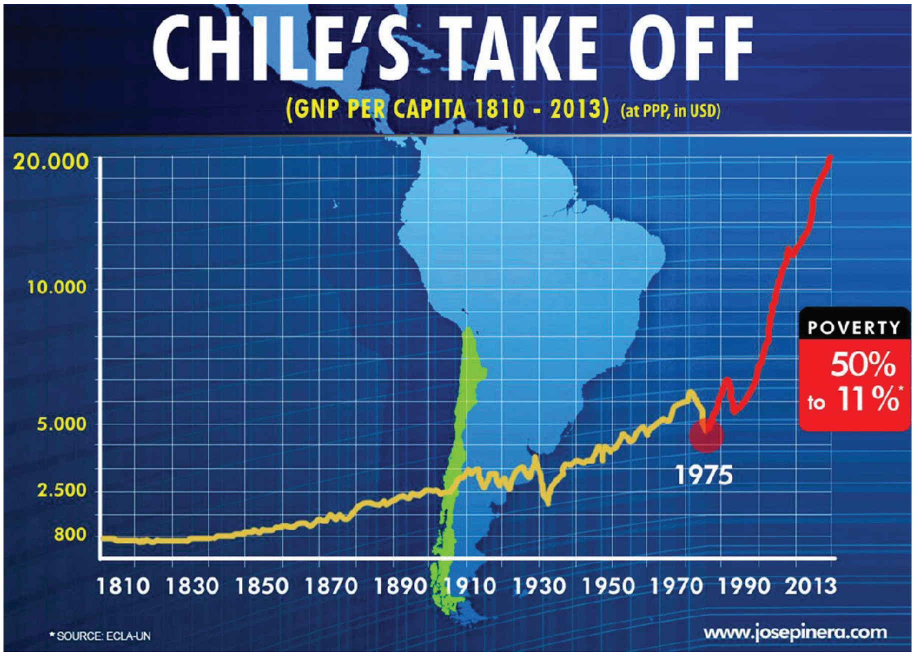


Figure 2.

high returns for pensioners, averaging 8.6 percent a year between 1981 and 2013. But…high fees have bitten a huge chunk out of those returns, reducing them to 3-5.4 percent.

Though the article also noted all the benefits of personal accounts:

Rather than saddle the government with an unaffordable pay-as-you-go system, in which today's taxpayers support today's pensioners even as the population ages, Chile created one in which workers save for their own retirement by paying 10 percent of their earnings into individual accounts. These are managed by private administrators (AFPs). …the system worked. Contributions to the AFPs flowed into capital markets, which boosted growth. Annual GDP growth from 1981 to 2001 was 0.5 percentage points higher than it would have been without the investment, according to one study. This helped lift millions of people out of poverty.

The last couple of sentences of the above passage are worth highlighting. As I've noted, even small differences in economic growth – if they are sustained for a long period – make a huge difference in terms of national prosperity. And 0.5 percent more growth every year is actually a big boost when looking at the impact of just one policy.

The Attack on the System

Last but not least, here's Ian Vasquez's response to the attacks on the Chilean system.

Critics in Chile assert that the average pension provided by the private pension fund companies is around $340 per month, which is not better than the public pension system. But as the Chile-based Liberty and Development institute (LyD) has shown that is like comparing apples to oranges. To calculate the private system's figures, all those affiliated with it are taken into account, even if they have only contributed to their accounts once in their lifetime. The corresponding figure for the public pension system, however, only takes into account the pensions of those who have contributed for a minimum of 10 to 15 years, something that leaves out half of the people affiliated with that system. In addition, pensions under the private system are obtained through contributions that amount to 10 percent of wages, while in the public system the contribution is 20 percent.

Correcting for those distortions shows that the value of the pensions the AFPs provide is three times higher than that of the public system. … it's true that many Chileans do not contribute regularly to their retirement accounts because too many work outside the formal sector and getting work is still too precarious for many, that is a problem that affects any pension system, whether public or private, and can only be solved with labor reforms. …Chile's private pension system can certainly be improved, but the reality is that it has been extremely successful. …old-age pensions no longer represent a burden on the treasury. Pension savings have reached $168 billion, about 70 percent of GDP, which has stimulated high growth and domestic investment, and has put Chile on the verge of becoming a developed country—a remarkable achievement.

Amen. Chile's system isn't perfect, but it's far better, by several orders of magnitude, than the debt-ridden, pay-as-you-go models that are wreaking havoc with the public finances of other countries.

And Chile is prospering in a way unimaginable in other Latin nations.

P.S. Chile also has nationwide school choice.

P.P.S. Bill Clinton supported good Social Security reform and was prepared to work with congressional Republicans (and some Democrats) on good legislation for personal accounts, but that effort was sidetracked by the partisan impeachment fight. A genuine tragedy.

DAN MITCHELL *is co-founder of the Center for Freedom and Prosperity and chairman of the board.*

Sorry, Bernie Bros, Nordic Countries Aren't Socialist

by JEFFREY DORFMAN

As the American left embraces a platform that continues to look more and more like a socialist's dream, it is common for those on the right to counter with the example of Venezuela as the nightmare of socialism in reality. A common response from the left is that socialism (or democratic socialism) works just fine in Sweden, Norway, and Denmark. It is certainly true that Sweden, Norway, Finland, and Denmark are notable economic successes. What is false is that these countries are particularly socialist.

The Myth of Nordic Socialism

The myth of Nordic socialism is partially created by a confusion between socialism, meaning government exerting control or ownership of businesses, and the welfare state in the form of government-provided social safety net programs. However, the left's embrace of socialism is not merely a case of redefining a word. Simply look at the long-running affinity of leftists with socialist dictators in Cuba, Nicaragua, and Venezuela for proof many on the left long for real socialism.

To the extent that the left wants to point to an example of successful socialism, not just generous welfare states, the Nordic countries are actually a poor case to cite. Regardless of the perception, in reality the Nordic countries practice mostly free market economics paired with high taxes exchanged for generous government entitlement programs.

First, it is worth noting that the Nordic counties were economic successes before they built their welfare states. Those productive economies, generating good incomes for their workers, allowed the governments to raise the tax revenue needed to pay for the social benefits. It was not the government benefits that created wealth, but wealth that allowed the luxury of such generous government programs.

Second, as evidence of the lack of government interference in business affairs, there is the fact that none of these countries have minimum wage laws. Unions are reasonably powerful in many industries and negotiate contracts, but the government does nothing to ensure any particular outcome from those negotiations. Workers are paid what they are worth, not based on government's perception of what is fair.

A third example of Nordic commitment to free markets can be found in Sweden which has complete school choice. The government provides families with vouchers for each child. These vouchers can be used to attend regular public schools, government-run charter schools, or private, for-profit schools. Clearly, the use of government funds to pay for private, for-profit schools is the opposite of socialism.

> ...it is worth noting that the Nordic counties were economic successes before they built their welfare states...

Economic Freedom Reigns

We can also confirm these isolated facts by looking at a comprehensive measure of capitalism relative to socialism. The Fraser Institute, a Vancouver-based, pro-free market think tank, compiles a worldwide ranking of countries called the Economic Freedom Index. Its website explains that its ranking "is an effort to identify how closely the institutions and policies of a country correspond with a limited government ideal, where the government protects property rights and arranges for the provision of a limited set of 'public goods' such as national defense and access to money of sound value, but little beyond these core functions." Clearly, a socialist country should perform poorly in any ranking based on these principles.

What we find, however, is the Nordic countries rank quite high on this index of economic freedom. In fact, while Hong Kong and Singapore top the list

Flags of Nordic Countries.

and the United States ranks 12th, we can find the Nordic countries in quite respectable rankings. Denmark ranks 15, Finland 17, Norway 25, and Sweden 27. In terms of numerical scores, Sweden is only 5 percent lower than the U.S. For further comparison, South Korea and Japan, both considered fairly pro-free market, rank 32 and 39, respectively.

> Perhaps a better name for what the Nordic countries practice would be compassionate capitalism.

Socialism can take the form of government controlling or interfering with free markets, nationalizing industries, and subsidizing favored ones (green energy, anyone?). The Nordic countries don't actually do much of those things. Yes, they offer government-paid healthcare, in some cases tuition-free university educations, and rather generous social safety nets, all financed with high taxes. However, it is possible to do these things without interfering in the private sector more than required. It is allowing businesses to be productive that produces the high corporate and personal incomes that support the tax collections making the government benefits feasible. The Nordic countries are smart enough not to kill the goose that lays the golden egg.

If the left insists on naming a system of generous government benefits combined with a free market democratic socialism, I cannot stop them. That seems unnecessarily confusing since the government is actually running no industries other than education (and meddling somewhat in healthcare). It certainly isn't socialism. In fact, the only reason most such countries can afford those benefits is that their market economies are so productive they can cover the expense of the government's generosity. Perhaps a better name for what the Nordic countries practice would be compassionate capitalism.

JEFFREY DORFMAN, *Ph.D. is a professor of economics at The University of Georgia and author of* Ending the Era of the Free Lunch.

"A Love Song to Capitalism"

review by SHOSHANA BRYEN

Economics was dubbed "the dismal science" by historian Thomas Carlyle not, as some think, regarding Thomas Malthus's bleak view of a future balance of population and resources. It was, rather, Carlyle's belief that slavery was a more moral institution than the free market for slaves and people of color. He was calling John Stuart Mill's capitalist, free market theories "dismal."

There are other names for Carlyle's theories. Don't take it out on economics.

I Love Capitalism by Ken Langone is the happiest book going about economics, economies, or people making money, and people spending it. Capitalism, contrary to the rising flock of young "socialists" who refuse to look at the socialist hell-hole that is our sad neighbor Venezuela, is the best way ever devised to let people rise, live well, spend money, and give it away in large chunks.

From the story of his poor early life to his very wealthy 9th decade, Langone sings what he calls a "love song" to capitalism. Founder and chairman of Invemed Associates LLC, and perhaps best known as an early partner in Home Depot, Langone tells the quintessential boot strap story of an outsider, poor and Italian in the 1950's WASP culture of Wall Street.

His maternal grandfather was illiterate in both Italian and English, working the sand pits of Long Island. His one luxury was Saturday afternoon spent with Texaco's Metropolitan Opera on radio. [As it was for my own non-English-speaking, Jewish grandfather from Riga. I'm betting his grandfather sang along, too.] His father was a plumber and his mother a cafeteria worker – neither graduated from high school. Their legacy to Langone was love and hustle. Work every day. Work at anything. Work at everything. Work some more. Take two jobs if two are available. No job is beneath you, no job too dirty. Just work. And when you're finished, work some more.

And get an education.

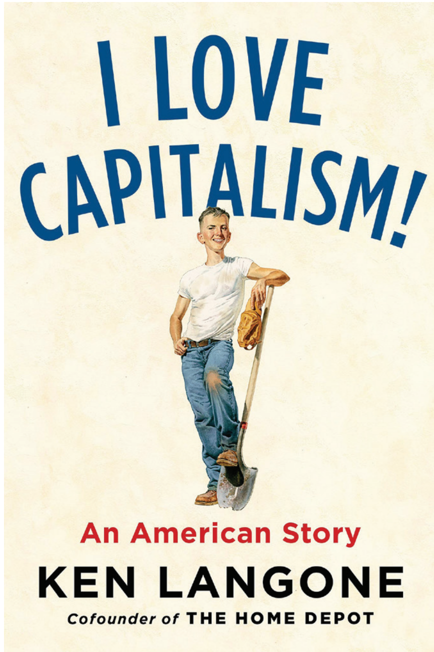
After an "iffy" high school career, he managed to get into Bucknell University in Pennsylvania, where various students, friends and professors alternately opened doors for him, got him into trouble, and got him out again. Bravado and a night school MBA took him through his early positions on Wall Street, where the culture was dominated by hereditary bankers and brokers. Blunt honesty took him farther. And really good decision-making took him farther still.

To Wall Street and Beyond

The middle of the book is a travelogue of companies, IPOs, leveraged buyouts, corporate finance, mergers, and selling stocks and bonds. You don't have to understand the mechanisms to enjoy the story – "You're going to probably pay 6 percent and it's going to be for a ten-year term. I can probably get the bondholder to take no repayments for the first two years, and then eight equal payments for the last eight years, fully amortized." What is important is that Langone never made a deal without understanding the company or product or the person at the center of it. Refractories, pajamas, oil, plungers? He knew about them. People? He understood them. Ross Perot, Bernie Marcus, Arthur Blank, Frank Borman, Ed Braniff? They knew him and trusted him.

Instinct kept him away from Bernie Madoff.

Langone, like all good capitalists, worked for himself and his family – a wife he clearly adores and his children. "I knew exactly what I had to do. I had three kids to feed and educate and provide a home for, and all I knew was I had



I Love Capitalism
By Ken Langone

Portfolio
2018

Ken Langone, 82, in his New York office 22 floors above Park Avenue. (Photo: Yana Paskova/The Washington Post)

to go out and kill every day to eat. So, I wasn't producing for [my bosses]. I was producing for my family."

That's the setup.

The payoff is watching a craftsman at work, gently sculpting deals, moving the parts to get where he wanted to be and with whom. And then, there is the super-payoff.

Langone's long relationship with Ross Perot almost didn't get started. Having been told that he had half an hour – to the minute – for the meeting, and Perot having spoken for most of that, Langone told Perot he had no time to make his presentation, so he would just say goodbye and leave. Perot kept the meeting going for 13 hours. Perot ultimately bought into the Langone way of doing business, and Langone produced an IPO that *Fortune* magazine called "the greatest personal coup in the history of American finance."

You don't need to know how an IPO works to get the point.

He was also willing to walk away. Hot on the heels of the Perot EDS deal, a situation arose in which people holding the stock were about to make a lot of money. Someone in Langone's firm wanted to use the information to buy up the stock ahead of the situation – "front running" Langone called it; "insider trading" most of us would say. Langone immediately told the senior members of his firm that he was leaving because he wouldn't work in a firm in which that was tolerated. The senior partners fixed it and Langone was shortly elected president of the firm.

Into companies, out of companies, and the fascinating story of what didn't work at Handy Dan, and did work for its successor, Home Depot.

The Super Payoff

Aside from feeding his family – which could have been done on a lot less money than he ultimately made – what moved Ken Langone? This is the super payoff and the heart and soul of *I Love Capitalism*.

Langone made it to give it away.

Today, when capitalism and wealthy people are under increasingly intense political attack, it is worthwhile to consider the charitable giving of the wealthy.

Can the government build a hospital? Of course it can. With all of government's bureaucratic excesses, inefficiencies, and meandering funding streams, a hospital could probably, eventually, arise where it was supposed to be – or at least where congressmen and city councilmen wanted it. But the story of Langone and NYU Medical Center is the story of what happens when business, money, and the charitably inclined come together.

NYU Medical School had merged with Mt. Sinai Hospital and both were in shambles. Langone was offered the chairmanship of the medical school. As he did with his business ventures, he investigated the problems, met the people, made decisions about how to improve the institution, and jumped in. Then he put $100 MILLION into it – anonymously. Then he went to friends and solicited gifts of $35 million, $150 million, $100 million, and $50 million and more. His second gift of $100 million was public in hopes of encouraging others.

THAT, a government cannot do.

Capitalism is not a charitable institution, but capitalism provides the means for charitable people to help the rest of us. Langone figures that "everything I own – the plane, the houses, the cars – and even including all the yearly maintenance, the som comes to about one-third of the total amount of money that we've given away." His charities include the Animal Medical Center, the Boys' Club of NY, Bucknell University, Harlem Children's Zone, and St. Patrick's Cathedral. His wealth allowed him to serve on boards including Ronald McDonald House NY, the Center for Strategic and International Studies (CSIS), the Horatio Alger Society Foundation and more.

All that from the grandson of Italian immigrants who came to America with nothing but the will to work.

Capitalism, then, is the mechanism by which people can start with very little, work very hard, and end up better off. Not necessarily millionaires, and "better off" isn't only about money, but, according to Langone, how ever many rungs you climb on the ladder, you are obliged to share your success. People across the book rise and Langone enjoys watching and helping.

…"better off" isn't only about money, but, according to Langone, how ever many rungs you climb on the ladder, you are obliged to share your success.

"I Can't Forgive"

It isn't all sweetness, though. Sometimes you have to fire people – not nice, but necessary. Sometimes, you run afoul of the authorities whether or not you did what they said you did. One of the most interesting sections is about how Eliot Spitzer, the ambitious and conniving attorney general of New York, went after Langone and one of his partners.

Spitzer took the issue of compensation for the president then-CEO of the New York Stock Exchange, David Grasso – who had worked his way up from unionized clerk to the top of the heap. His compensation was determined by a formula devised by a committee of which Langone later became chairman. In the hot and heavy late 1990s, the formula resulted in a lot of money for Grasso. A lot. But by 2003, when things were slowing, the amount rankled some people – including Spitzer and N.Y. state Comptroller Alan Hevesi. Under pressure, Grasso resigned. And then Spitzer filed a law suit against him

Capitalism, then, is the mechanism by which people can start with very little, work very hard, and end up better off.

and Langone, calling Langone a "serial overpayer," although Langone had nothing to do with the formula or the result.

It was a bitter and nasty fight. Langone wrote:

> *The only thing that disappointed me about that episode in my life was the number of my friends who called me saying, "Why don't you settle with this guy?" I wasn't offended, but I was hurt that they didn't understand how I'm put together. My stand had nothing to do with loyalty to Grasso. It had everything to do with feeling I'd done the right thing. And I would do it again. Anyone who really knew me knew that I'd sooner jump off the Brooklyn Bridge than settle with that weasel.*

He won, and couldn't help gloating just a little when Spitzer's own sex scandal destroyed his reputation. "I can't find it in my heart to forgive…And maybe it makes me a worse person not to be able to forgive that schmuck. If that's what I have to live with, I'll live with it."

The Philosophical Langone

The last chapter is more philosophical than nuts and bolts.

- There are no "self-made men." Everyone has family, friends, employers, employees, teachers, and students who help to form the adult we grow up to be. Langone is grateful to his.
- Capitalism is better than socialism. His distaste for socialism is explicit and should be read by presidential wannabes and millennial college students.
- People are different, have different skills and needs, different likes and ambitions. Capitalism, which allows for maximum personal input into lives and business, is best able to account for all of those differences and reward them in the marketplace. No, it isn't perfect. Yes, some people have less. Some people will have more and some of those won't share. Langone regards it as an article of faith – he is a religious man – that those having more have to have a conscience.
- "You want my philosophy in a nutshell? I want everybody to do well. The world is a lot more fun if we're all rich instead of just some of us."

Sometimes Langone's language is, shall we say, "salty," and sometimes he characterizes people – Jews, Italians and others – in words that will make really stiff readers cringe although it is, really, done with love. Never mind. This is a great book. The personalities, the philosophy, the peek into Wall Street, the suspense as Langone works a deal.

Nothing dismal here.

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A Final Thought ...

Iran's War in Yemen

What the U.S. Senate calls the "Saudi war in Yemen," is actually Iran's war for control of the Red Sea.

Iran has no border on the Red Sea, so a base in the heel of the Saudi boot, i.e., in Yemen, would put it in a perfect position to encircle Saudi Arabia by water, and to also undermine Egypt, Jordan and Israel. It would allow access to overland routes through Somalia, Eritrea and Sudan — and directly into Egypt — for the purpose of arming rebels along the coast and the militias Egypt has been fighting in the Sinai Desert

The Red Sea is the only Israeli outlet to the Gulf of Aden and then the Arabian Sea, the route of Israel's burgeoning trade with India and China. It is Jordan's only sea outlet, and the Eilat-Aqaba Free Trade Zone is a major source of trade revenue for America's ally, King Abdullah II. For Egypt, it is the route to and from the Suez Canal.

Therefore, Iran has been stoking the Houthi insurrection in Yemen, providing, among other things, long-range missiles that have been fired into Riyadh.

Furthermore, and directly impacting the United States, Camp Lemonnier sits directly opposite Yemen off Djibouti. It is home to the U.S. Combined Joint Task Force Horn of Africa and USAFRICOM. It is the only permanent U.S. military base in Africa.

What are we doing there? The countries north of the Mediterranean Sea are European, all of which except Bosnia are NATO members. Facing them, along the North African coast, are Sunni Muslim countries, all of which except Libya are partners in NATO's Mediterranean Dialogue. The arrangement helps keep the Mediterranean stable and free for shipping.

One way to make North Africa less stable is to make the row of countries underneath it less stable. Chad, Mali, Somalia, Eritrea, Sudan and Niger all are targets of instability seekers, including Iran. The United States helps those governments more effectively control their own territory and borders, reducing the likelihood of transnational jihad.

They are, to be sure, as much targets of Sunni jihad as they are of Iran, but Iran seeks instability, chaos, anti-Americanism, anti-Israelism, anti-Westernism and anti-Christianity in the region. Sunni jihadists seek them as well, so Iran is willing to pay.

In Iraq and Syria, ISIS did the destabilizing and Iran reaped the benefit. If Iran wins in the Red Sea, most American goals for the Middle East and Africa will be compromised.

– Shoshana Bryen
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