EDITOR'S NOTE

Welcome to the second, idea-packed issue of *The Milken Institute Review*, the Milken Institute's quarterly (at least for the time being) magazine. Our goal is to inform the debate on economic policy issues, both current and future. While no one is likely to mistake MIR for *People* or *Vanity Fair*, we are going to make the hard stuff readable – and maybe even fun.

David Hale, the peripatetic chief economist at Zurich Financial Services in Chicago, stayed in one place long enough to report on the good news from Japan. Well, "good news" is putting it too strongly. Hale envisions an extended period of political infighting as Japan scrambles to halt its economy's frightening deflationary spiral. "Outsiders should not regard such conflict as unhealthy or dangerous," he says. "It is the inevitable consequence of the most far-reaching shift in Japanese economic values since 1940 – if not since the Meiji restoration."

Demographers, goes the joke, are people who wanted to become accountants when they grew up, but didn't have enough personality. **Bill Frey**, a senior fellow at the Milken Institute, may not be the ultimate party animal, but his "charticle" in this issue does prove that demographers have interesting things to say about who Americans are – and who they are becoming.

Jeffrey Sachs, the director of Harvard's Institute for International Development, was once called "the most important economist in the world" by The New York Times Magazine. I should know: I wrote the article. These days Alan Greenspan, Wim Duisenberg, Larry Summers or Eisuke Sakakibara might quibble with the choice. Still, there's no doubt that when Sachs talks, policy wonks listen.

Sachs argues (as much in anger as in sorrow) that the International Monetary Fund has let down the developing world in general, and Brazil in particular. "The principal error," he says "was to defend the exchange rate at all costs, living with high interest rates for one-and-one-half years and running down foreign exchange reserves to dangerous levels."

Cliff Winston, a senior fellow at the Brookings Institution, is best known for his analyses of airline deregulation. Like most mainstream economists, Winston assumed that free markets would serve consumers better than Soviet-style planning of routes and fares. But unlike others, he quantified what proved to be awesome gains. Yes, riding the airlines today is too much like riding on Greyhound in 1955. But more frequent service for business travelers and deep discounts for everybody else vastly outweigh the loss of comfort.

This time around, Winston tackles a more problematic issue for economists: urban transportation. While most would acknowledge that getting from here to there is a mess these days, relatively few have been prepared to write off America's half-century-old commitment to heavily regulated and subsidized transit. But Winston is ready to break with the past. "As long as government delivers the service and pays the bills," he writes, "urban transportation is destined to remain inefficient – and inequitable."

Marcus Noland is a specialist on Asia at the Institute for International Economics. His interests extend well beyond the usual suspects – a breadth that serves him well in this unusual contribution to MIR. Some day, some way, Noland predicts, the authoritarian, wretchedly poor North Korea will be reunified with democratic, relatively prosperous South Korea. And while no one is in a position to say how the paranoid Stalinists now running the north will play the political end-game, Germany's experience with reunification offers insights on how the two economies might be integrated. "Korea has an opportunity to learn from Germany's mistakes," he writes. "The political rights afforded to the residents of North Korea will likely prove the key determinant of economic outcomes, affecting the assignment of property rights and the extent of cross-border migration."

You may have heard of the demographic transition: the benign, seemingly inevitable decline in fertility rates, as average living standards rise. **Brad Edmondson**, the former editor of *American Demographics* (the first jazzy magazine ever on the subject), offers a chilling analysis of China's "health transition." What kills people in rich countries, it seems, is different than what kills people in poor ones – but they end up just as dead. "In the middle of the 21st century," he writes, "when today's new smokers are tomorrow's victims of lung cancer and heart disease, China can expect some three million tobacco-related deaths a year."

Those who haven't repressed all they never wanted to know about Monica, Bill and Ken may remember **Bruce Ackerman** from his testimony in the House impeachment hearings. Ackerman, a constitutional scholar at the Yale Law School, argued that the impeachment vote was effectively invalid because a new Congress was seated before the Senate got a chance to vote on the President's removal.

But Ackerman is no one-trick pony. His new book excerpted here, which is co-authored by **Anne Alstott**, (a Yale Law School colleague and former United States Treasury official), offers a bold solution to the problems of equity and social mobility in America's winner-take-all economy. "The stakeholder society is no utopia," they write. "But it does provide an alternative to our current moral drift. Perhaps we will never fully realize the American Dream of equal opportunity. But without that dream, this country will become a very ugly place."

As you might guess, **Michael Milken**, chairman of The Milken Institute, has a few ideas to share on subjects ranging from capital markets to health care. What you wouldn't be able to predict, though, is what Milken would say to an assemblage of Nobel Prize winners in economics (and vice-versa). Your curiosity is about to be slaked. We've digested his fascinating 90-minute roundtable discussion with **Gary Becker, Merton Miller, Douglass North** and **Myron Scholes** at the Milken Institute's March 1999 Global Conference into a 20-minute read.

Not enough to keep you busy? Check out the book reviews and current research abstracts, solve our acrostic puzzle or share **Mark Alan Stamaty**'s sly take on Social Security in MIR's cartoon original, Ekinomix.

– *Peter Passell* (ppassell@milken-inst.org)

P.S. Don't forget to write. Everybody likes a good letter to the editor.

L E T T E R S

WHERE CREDIT IS DUE

You observe (Michael Milken, "From the Chairman," First Quarter 1999) that balance sheets don't account for economic value. Why would they? They were designed for collateral lenders worrying about getting their money out in liquidation scenarios. But established firms rarely liquidate, so what's the sense in valuing their debt against that unlikely outcome?

It seems to me your contribution was to convince people to apply the same reasoning to new, growing firms, as in:

Firms are organic and carving them up destroys value. So it'll rarely happen, Mr. Creditor, get over it. There's no more gold standard. Instead of giving you stuff to hold against your early-stage risk, you'll get a firmer payout promise, the liquidity that comes with it and maybe an upside kicker – warrants, etc.

As firms mature, no one would dream of valuing their debt against liquidation value rather than cash flow. Maybe the ultimate example is the non-interest-bearing government debt in your pocket. What's a dollar worth, other than its pro-rata share of America's earning power?

How about writing about how your ideas would apply to emerging market restructuring? I'm no expert, but it seems that the international agency approaches have been focusing on protecting current creditors by requiring steps to pump up currency value, rather than on building the long-term value of the economies – which, after all, aren't going away.

– *Mitch Berns*
Washington, D.C.

OH YE OF LITTLE FAITH

In "Euroland: The Morning After" (First Quarter 1999), Lawrence Lindsey warns the United States to expect no good from the euro. He argues that the inherent flaws of the construction are such that the euro is likely to be a weak currency, and that its weakness will disrupt trans-Atlantic trade and cooperation.

Lindsey's skepticism is misguided and his view of trans-Atlantic cooperation too narrow. The creation of a monetary union by 11 continental European nations covering 250 million people is a major historical event. Only once or twice before – and never on this scale – have nations been united in monetary union other than by the force of arms.

Lindsey seems to agree with American economists like Martin Feldstein, who have argued that monetary union is such a bad idea economically for Europe that the only justification is political. In Lindsey's words, "Europe has not factored the economic ramifications into the political equation."

But the builders of the European Monetary Union (E.M.U.) did not only want to strengthen their political union, and "contain Germany." They also wanted to enhance the economic well-being of their citizens.

Paradoxically, Americans, who ought to understand this better than anyone else, often do not appreciate the push that a common currency can provide for economic integration. Monetary union will undoubtedly make capital more mobile within Europe. Cross-border investment will no longer be deterred by the complexities of accounting in different currencies and by the risk of divergent