Biology and Finance

Reviewed by Tim Stonesifer

THE ASCENT OF MONEY: A Financial History of the World
By Niall Ferguson
432 pages; Penguin Press, 2008

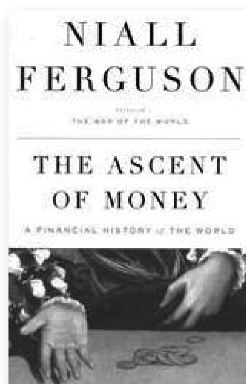
Today's financial upheaval and its slow recovery seem to beg for a timely book on all things finance. Enter Niall Ferguson's *The Ascent of Money*, the subtitle of which modestly proclaims it to be "a financial history of the world." That, it turns out, might be a bit overstated.

Ascent serves as a useful guide through today's thickets of stocks, bonds, and options, but as a financial history the 358-page book is necessarily incomplete. Yet it is illuminating and instructive, including both a rich recounting of centuries of financial advances and a peek behind the curtain at a steady undercurrent of market setbacks caused in part by the deceptive practices of central planners full of monetary hubris and possessing a penchant for derailing progress.

The vexing aspect of *Ascent* is that Ferguson waits until the book's end to present his most interesting, original idea, that financial markets are similar to evolutionary biology systems. The reader is regrettably left to wonder how differently 350 pages of text would have read through this unique lens.

EVOLUTION OF FINANCE Ferguson adapts his "finance as biology" idea from Joseph Schumpeter's concept of the "creative destruction" that takes place in free markets. Ferguson concludes that today's financial system has resulted chiefly from "institutional mutation and natural selection." He likens the progression of our financial landscape, with its high attrition of small funds and emergent dominant species of financial institutions, to the same "survival of the fittest" ethos.

Akin to biological evolutionary systems, the financial world features "genes" that allow information to be passed down over generations, a form of spontaneous mutation via financial innovation, and speciation by which new types of financial institutions arise. According to the author, the list of similarities goes on and on.



The key difference, Ferguson notes (though fails to stress adequately), is the unnatural element of "intelligent design" introduced into the financial system via government regulators. These "poachers turned gamekeepers" can introduce negative, exogenous shocks into an otherwise stable system through design that usually proves not so intelligent, and that "can make previously good traits suddenly disadvantageous." Further, in an effort to avoid the necessary dying-off of financial "species," these same bureaucrats, by keeping terminal institutions alive, often exacerbate crises. In short, an otherwise organic and self-maintaining system can be insidiously undermined by the introduction of the poisonous "too big to fail." Or, in the evolutionary terms Ferguson uses, "the possibility of extinction cannot and should not be removed by excessively precautionary rules."

The idea of finance as self-perpetuating and mostly self-correcting is an important one, and vital to the understanding of how the ascent of money has continued nearly uninterrupted for centuries. Indeed, throughout the book — and intermingled with rare and random facts on early currencies and obscure financiers — Ferguson alludes to the damage caused by central bankers in league with rogue companies and individuals, all using the political system to exact financial gain. The eras and locations he describes are quite disparate, yet the common thread of central meddling is the same.

In Germany's Weimar Republic, Ferguson explains how government was able to confiscate a portion of citizens' wealth through debauching the currency; citizens' liberties were no impediment to regime interests. And he provides further examples — think Argentina, Zimbabwe, even Britain and the United States in the late 1970s — that illustrate that war is not necessary for such implicit robbery to occur.

"Inflation is a monetary problem, as Milton Friedman said. But hyperinflation is always and everywhere a *political* phenomenon," explains Ferguson.

The ascent of money, it seems, has been dogged at every step of history by politicians with varied, specific interests, but all holding the same unwavering ignorance of the freedom that markets need in order to work well. The resulting chronology of finance shows a "saw-tooth" quality of gains and losses, with innovators constantly under fire from overprotective and unscrupulous bureaucrats.

While he does not frame it in this manner, what Ferguson deftly demonstrates is that everywhere money and finance have succeeded in history, that success has been not because of stores of gold or government edicts. Rather, "money is a matter of belief, even faith.... Money is not metal. It is trust inscribed." Nearly every system that has failed has had at its heart inept monetary authorities content to give to the unscrupulous few the very rope necessary to hang entire systems.

In one representative passage, Ferguson draws eerie comparisons between the Great Depression and the Scottish gambler-turned-financier John Law's absolutist financial policies in 18th century France. Law — whom Ferguson calls "the man who invented the stock market bubble" — envisioned for France a national system combining the attributes of a monopoly trading company with a note-issuing public bank. He enticed the leaders of a struggling French economy into granting him ever-increasing

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centralized control of their system. In 1716, France created under Law's direction the Banque General, soon mandating the bank's notes be used for tax payments.

"This was an absolutist theory of finance, based on the assertion that 'in credit as in military and legislative authorities, supreme power must reside in only one person,'" Ferguson writes, referencing the historian Thomas E. Kaiser.

But by 1720, Law's reliance on manipulation of public confidence — as well as his strong personal interest in monetary expansion — predictably led to an inflation he was increasingly unable to manage. Despite price floors, centralized mandates, and real-time adjustments, Law was unable to prevent either a massive flight by French citizens back to specie or a monumental crash of share values. Of course the final flight in 1720 was Law's, who left France broke and disgraced, his "Controller General of Finances" title hollow and more than a little ironic.

Two centuries later, a young U.S. Federal Reserve tried to run an even larger economy, but proved tragically deaf to the lessons of history as it reduced credit in the face of bank failures and sought to control a dynamic system by central planning. With more than $1 billion in gold reserves above the amount needed to cover legal requirements, the Fed in 1931 nonetheless raised the discount rate, exacerbating an already desperate situation for many banks. Only in 1932 did the Fed accelerate open market operations — too late to prevent even more bank failures, as it turned out. Such inflexible policy, which necessarily accompanies centralized systems, must inevitably worsen the natural cycles of dynamic financial markets.

"As in 1719, it was the action of the monetary authorities that determined the magnitude of the bubble and of the consequences when it burst," concludes Ferguson.

NO PLACE LIKE HOMES After a brisk 250-plus pages of financial history, ranging from Mesopotamian-clay-tablet credit to the bundled "securitization" of mortgages that helped bring about the U.S. savings and loan crisis (aided by a moral hazard–inducing government), Ferguson's final chapter reaches the rub. In it, he explores his personal chimera, "Chimerica." More explicitly, he chronicles the uneasy meeting of East and West that is today's relationship between the world's most populated country and its wealthiest one: China and the United States.

In 2007, the United States needed to borrow $4 billion every working day to keep up with massive and ever-increasing government expenditures. Such rapaciousness necessarily required many people somewhere to save money that could in turn be lent to Uncle Sam. Enter China, which, after years of financial turbulence, today represents a country full of unusually cautious, high savers. And enter one national government ready and willing to buy billions of dollars worth of bonds to help ensure exported manufactures remain as cheap as possible for foreigners.

It is this shaky symbiosis, Ferguson argues, with its requisite huge flow of capital from East to West, that accounts for several decades of seeming financial anomalies, including hard drives full of new and complex derivatives, an explosion of convoluted hedge fund activity, and a real estate market so bloated with cheap credit that it led to the housing bubble and subprime mortgage crisis. Chimerica has also given rise to sovereign wealth funds that manage billions in assets for countries running trade surpluses, the value of which could grow to over $27 trillion in the next 15 years.

Ferguson is correct in his analysis of credit flows as playing a major part in shaping the American economy in recent years. Since the book's release, Chimerica has been adopted into standard vernacular for financial discussions and has been much explored. Further, his logical if vague claims of the eventual breakdown of this uneasy relationship seem quite plausible, particularly in the troubled and tense political climate that necessarily surrounds the current economic downturn.

But Ferguson seems, for the sake of completeness, too determined to cover all bases with one metaphor. No doubt our problems have not really all arrived via airmail from China.

Closer to home (read: Washington, DC) the U.S. housing bubble was helped along by the Clinton and Bush administrations, both all too eager to extend artificially cheap housing and proselytize citizens to the unequaled value of homeownership. And no one would now argue Fannie Mae and Freddie Mac did not nurture Americans' unrealistic housing expectations. Indeed, as Ferguson's history ably demonstrates, if you look closely, nearly every great financial meltdown has been helped along by government — often crucially.

> If you look closely, you find that nearly every great financial meltdown has been helped along by government.

What economists, government officials, and concerned citizens alike are left to ponder is where the financial system during the housing bubble went wrong, and what the best way to avoid a future debacle is. Sadly, today's suggested answers too often center on increased regulation and the stifling of market forces. The popular argument is that deregulated financial markets and the failure of the Fed to act in a timely manner led to a housing market that quickly spiraled out of control. A better Fed response is necessary and tighter controls are needed, these people say.

But what such arguments miss — indeed the thread that runs through Ferguson's book — is that even the best economists and the smartest financial planners at the Fed and elsewhere cannot detect and respond to such bubbles in real time. The information needed is simply too great. As well, even if such massive fact distillations were possible, political pressures toward ever-increasing growth likely would trump any proposed caution over an unrealized (and necessarily ethereal) bubble.

Similarly, the tighter regulatory controls so many seek miss the point that much of what took place in the run-up to the housing collapse was based not on destructive deregulation, but on misplaced, previous regulation. For instance, the much maligned Gramm-Leach-Bliley Act in 1999 did little to loose a wave of exploitative bankers on an unsuspecting public, but it did more subtly place investment banks under the same long-standing — and government-made — rules of commercial banks (Basel I and II's kindly treat-

ment of mortgages and mortgage-backed securities), which led to an over-evaluation of the relative safety of mortgage investment. Such misapplication of necessarily static rules was a result of previous regulation, and is the inevitable endgame any time planners paint with such a wide brush. And with the moral hazard inherent now in knowing, regardless of rules, that, in a time of crisis, government will step in with taxpayer-funded bailout money, who can rationally argue that further regulation is not simply creating a set of rules to be ignored?

As *Ascent* (finally) goes on to enumerate in its afterword, financial systems are much like evolutionary systems in both their astounding complexity and their unknowable intricacy. There are breakdowns and advances, mutations and extinctions. Much like the amoebas and antelope we find in nature, free and flourishing systems of finance can produce anything from a 10-year-old's savings account to complex, securitized derivatives. Yet in both systems the surest path to irreparable harm — in fact the only path — is through exogenous shocks. And a disheartening number of those shocks have been sparked or amplified by government meddling.

Like any system that relies on fallible and biased human beings to make decisions, financial markets will struggle at times. But by harnessing the creativity of millions — and with basic and solid rules from which all can work — markets can raise citizens from poverty to extraordinary wealth. Ferguson would likely agree that money's ascent is truly limited only by human imagination and ingenuity. And that unencumbered vision, as we have seen through centuries of ever-evolving, decentralized markets, stretches from here all the way over the rainbow. R

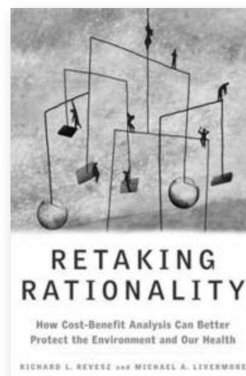
Kinder, Gentler Cost-Benefit Analysis

Reviewed by Jonathan H. Adler

RETAKING RATIONALITY: How Cost-Benefit Analysis Can Better Protect the Environment and Our Health
By Richard L. Revesz and Michael A. Livermore
254 pages; Oxford University Press, 2008

Environmental activists and progressive academics have long campaigned against the use of cost-benefit analysis in regulatory policy. Georgetown law professor Lisa Heinzerling, for instance, maintains that cost-benefit analysis inevitably undervalues health and environmental protections, and leads to under-regulation. In Heinzerling's view, "cost-benefit analysis is at odds with fundamental premises of environmentalism."

President Obama's election seemed to present an opportunity to exorcise cost-benefit analysis from environmental policy. Heinzerling herself became associate administrator for the Office of Policy, Economics, and Innovation at the Environmental Protection Agency — just one of many progressive academics hired by the new administration. Yet it is too soon to write cost-benefit's obituary; not all the progressive academics within the Obama administration share Heinzerling's antipathy. One in particular, Cass Sunstein, has been an outspoken cost-benefit proponent. Nominated as the new administrator of the Office of Information and Regulatory Affairs (OIRA), Sunstein would become, in effect, the administration's regulatory czar and would be well-positioned to keep cost-benefit around. At his confirmation hearing, he proclaimed his fealty to a progressive regulatory agenda, but also maintained cost-benefit analysis — properly applied — can play a useful role. In effect, he promised to mend it, not end it.



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ACTIVIST ANALYSIS If Sunstein aims to implement a kinder, gentler approach to cost-benefit analysis, *Retaking Rationality* by New York University's Richard Revesz and Michael Livermore could well serve as his how-to guide. The book outlines a regulation-friendly vision of cost-benefit analysis and centralized regulatory review. With it, Revesz and Livermore hope progressives will learn to stop worrying and love cost-benefit.

Retaking Rationality expressly "challenges the liberal camp to rethink" its reflexive hostility to cost-benefit analysis. The authors concede that it, "as currently practiced, is indeed biased against regulation," yet argue that "those biases are not inherent to the methodology" and can be overcome. Like many of cost-benefit analysis's progressive critics, Revesz and Livermore believe "we regulate less, and less stringently, than we should." Yet for them, cost-benefit analysis is part of the solution. Relieved of its anti-regulatory biases, they believe, it will become a powerful pro-regulatory tool.

Their general defense of cost-benefit analysis is basic and straightforward. When the government makes far-reaching regulatory decisions that affect large numbers of people, it "has a responsibility to use the most powerful tools at its disposal to make the best decisions it can." Insofar as one goal of regulatory policy is to maximize the net benefits of regulation, cost-benefit analysis can help ensure that current and proposed regulations are, in fact, net beneficial. As they explain, the point of cost-benefit analysis "is to identify wealth-maximizing regulations, namely, those approximating the situation that would arise absent market failures; that people are willing to pay to have in place; and that deliver benefits that are valued more highly by people than their costs."

While they advocate reliance upon cost-benefit analysis, Revesz and Livermore do not believe it can answer every question. It "can be useful without being the alpha and omega of policy analysis." It is just one valuable input, and should not be relied upon to the exclusion of others. We may "need a formal and systematic way of

measuring the impacts of proposed regulations and comparing them across a common economic scale," but we need not delude ourselves that it is capable of quantifying all relevant effects, rendering regulatory policy a purely mathematical exercise. Distributional and other normative concerns must still come into play, they caution. Regulatory efforts should be focused on those areas in which government intervention can do the most good, but a utilitarian cost-benefit calculus should not be the sole criterion for action.

Revesz and Livermore reject the notion that cost-benefit analysis is inherently biased against government regulation. Insofar as it limits regulatory stringency today, it is only because, in the hands of Republican administrations and anti-regulatory analysts, cost-benefit analysis has been weighted down with anti-regulatory premises. This need not be the case. The "biases toward or against regulation that are built into the methodology of cost-benefit analysis play out over and over again in the administrative process, significantly shaping our regulatory regimes." If cost-benefit analysis, as currently implemented, contains anti-regulatory biases, this can be remedied by adopting appropriate biases in the other direction.

Cost-benefit analysis's history readily confirms this aspect of Revesz and Livermore's thesis. Before those on the Right thought to apply cost-benefit principles to regulation, environmentalists and taxpayer advocates used it as a tool to combat wasteful and ecologically harmful public works projects. An early analysis helped make the case against damming the Grand Canyon. In more recent years, as Revesz and Livermore note, progressive and libertarian groups have used it to attack excessive regulatory measures adopted in the name of homeland security. George W. Bush's first OIRA administrator, John Graham, also used it to prod regulatory agencies into adopting more stringent regulations where analyses indicated benefits greatly exceeded costs.

DISCOUNTING Revesz and Livermore purport to identify "eight fallacies of cost-benefit analysis" that have become "entrenched" in regulatory policy due to the anti-regulatory bias of most cost-benefit practitioners. Those fallacies are:

- "All unintended consequences [of regulation] are bad."
- "Wealth equals health."
- "Older people are less valuable."
- "People cannot adapt."
- "People always want to put off bad things."
- "We are worth more than our children."
- "People value only what they use."
- "Industry cannot adapt."

Correcting those fallacies, and implementing an improved cost-benefit methodology, can make cost-benefit analysis a more useful — and more regulation-friendly — policy tool. The collected fallacies, Revesz and Livermore claim, "amount to a virtual Berlin Wall blocking good regulations."

> There is nothing "unsustainable" about discounting future values so as to account for the uncertainty of future circumstances.

Yet some of the fallacies are caricatures of cost-benefit analysis, scarcely reflecting the position of its advocates and practitioners. Others are not clearly fallacies at all. After initially suggesting it is a "fallacy" that "people want to put off bad things" — which is the basis for discounting future costs and benefits — Revesz and Livermore end up accepting the claim. As they later acknowledge, "the available empirical evidence generally supports the conclusion that people have some time preferences for health and safety risks." Thus, they accept that "discounting may be appropriate to reflect people's preference for benefits now rather than in the future," even if the method and rate of discounting may need to be adjusted in some cases to address particular types of effects. They are concerned that current approaches to discounting may undervalue some potential health benefits, such as avoiding long-latency diseases, and suggest a need to alter discount rates to account for "dread" or the involuntary nature of some harmful environmental exposures. Yet if some exposures are truly voluntary, one might wonder why the federal government is regulating them at all, a question Revesz and Livermore do not really address.

While accepting individual discounting, if done properly, the authors object to discounting on a generational scale. In their view, generational discounting implies "we are worth more than our children," and that deciding how much to spend today to avert health or environmental consequences that will be borne by future generations is fundamentally a "moral" question. Yet all regulatory decisions that burden some individuals to the benefit of others implicate serious moral concerns. Cost-benefit analysis requires regulatory analysts to attempt interpersonal utility comparisons, a Sisyphusian task that inevitably raises distributional and other normative concerns.

If anything, the generational problems are less difficult, particularly insofar it is easier to conceive how present generations could compensate those of the future through wealth creation and technological advance. Revesz and Livermore believe "the concept of sustainable development" is preferable to intergenerational discounting, yet there is nothing "unsustainable" about discounting future values so as to account for the uncertainty of future circumstances.

DISTRIBUTION Revesz and Livermore claim to "debunk" the "health-wealth myth" that increasing people's wealth (in part by rationalizing regulation) will lead to better health — a goal of regulation. Yet after much discussion, the authors merely claim it is a "debatable" proposition. In the face of numerous studies documenting a correlation between wealth and health in a variety of contexts, they note a single study suggesting, quite plausibly, that health also influences wealth and that education levels may have a greater health effect than income. Yet this hardly disproves the wealth-health connection. It seems their real complaint is that some regulatory analysts ignore the potential for health protections to increase economic productivity, making us wealthier and healthier at the same time. This is a fair complaint, but it does not discredit the presumption that wealthier is healthier.

Revesz and Livermore rightly note that distributional effects from regulatory costs are important. The costs of government regulation rarely fall equally across the board and there is no assurance regulatory costs will fall on those for whom the burden is rightly theirs. Insofar as there is a wealth-health connection, they believe "it would primarily affect people on the lower end of the income scale." True enough. Yet those on lower socio-economic levels are also most likely to be affected by many regulations that reduce employment and increase prices for consumers. Revesz and Livermore suggest that a more appropriate and "economically efficient" response would be to "minimize the impact of regulation on the poor," yet they offer no examples of how this might be done. Compensation for such regulatory costs will often need to come from somewhere else.

The authors object to the assumption, hardly universal in regulatory analysis, that mortality benefits of regulation should be measured in terms of life-years instead of lives saved. This assumption, they argue, leads to "the fallacy that older people are less valuable than younger people." Perhaps in some contexts, but there is little debate that there is a difference between a regulatory intervention that delays mortality by a matter of days or weeks and one that increases life expectancies by decades or more. Their solution is nonetheless sensible enough: "using the average value of a statistical life" so as not to discount the value of the elderly.

Environmental regulations often implicate deeply held beliefs about the way the world should be and the normative obligations that people owe to future generations and other species, if not the planet itself. People place great value on achieving desired states of affairs and preserving those things that are of greatest subjective benefit to them, even if such values are not reflected in the marketplace. And yet if such values are not accounted for by cost-benefit analysis, "we will see less protection" of environmental resources than we might otherwise have. As they explain, "it is incorrect to believe that people can value only what they use, and that, therefore, regulatory benefits for important preservation programs will be seriously understated if existence value is not counted." Yet it does not follow that cost-benefit analysis should seek to incorporate such values in monetary terms, particularly if it is intended to provide a reliable metric for evaluating government choices.

If regulatory analysts must account for the marginal effect of regulatory activity on the utility of all those with a potential preference on the policy outcome, the analysis will never end. I prefer to see species habitat protected. Someone else may prefer not to see timber workers unemployed. If we must include the former, why not the latter? If we account for an environmentalist's preference for cleaner air, over and above any health effects, should we not also account for my Ohio neighbors' preference for a vibrant domestic steel industry? Where does it stop?

> It is not enough to know that a given expenditure may generate net social benefits

ESTIMATION Revesz and Livermore repeat the oft-made claim that cost-benefit analysis, at least as practiced by the federal government, has a tendency to over-estimate regulatory costs. In their view, there is every reason to believe industry and anti-regulatory advocates overstate regulatory costs, but little reason to believe agencies and pro-regulatory interests exaggerate the likely benefits of regulation. They reject the caricature of an "overzealous regulator" — they believe regulatory review is "needlessly skewed against regulation." Yet they readily concede "the empirical literature … is not sufficiently developed to generate clear conclusions about the extent of systematic bias" in regulatory cost estimates. Nonetheless they assert "strong theoretical reasons to believe cost overestimation is prevalent."

A 2005 report by the Office of Management and Budget found "a greater tendency for costs to be overestimated than underestimated" among the rules analyzed. Yet as Revesz and Livermore concede in a footnote, the same study found that the benefits of regulation, including estimated lives saved, tended to be overestimated as well. The study also found cost underestimates were significantly more prevalent than benefits underestimation, and that the benefit-cost ratio was more often overstated than the reverse — and these are the regulations that survived OIRA's review, not just the regulatory proposals put forward by individual regulatory agencies.

Revesz and Livermore acknowledge that regulation can be "equivalent to uncounted — and unaccountable — governmental spending," yet fail to grasp the full implications of this observation. It is certainly important for policymakers to "know how much money they are spending, and what results they are buying," but that is hardly sufficient. Nor is it enough to know that a given expenditure may generate net social benefits. In the fiscal context, we are well aware that the government cannot (and should not) pay for each and every thing that would provide net social benefits. Yet once our attention turns to regulation, and the costs are born by private firms instead of government coffers, an over-reliance on cost-benefit analysis would suggest a favorable cost-benefit ratio is sufficient to act. In the fiscal realm, this approach would produce insolvency right quick. In the regulatory context, it yields excessive regulatory costs, net benefits notwithstanding.

CONCLUSION The authors seek to do more than rehabilitate cost-benefit analysis for progressives. They also want to reform centralized regulatory reform within the Executive Branch so as to reduce the hurdles that inhibit effective regulation. Existing regulatory review is premised "on the false belief that agencies have a systematic tendency to overregulate," and thus serves to prevent the adoption of desirable regulatory measures. It is "naïve" in their view to expect White House regulatory review to be systematically better at balancing costs and benefits than individual agencies. Yet, as with cost-benefit analysis itself, Revesz and Livermore wish to mend centralized regulatory review, not end it. Centralized review can ensure greater transparency and consistency across regulatory programs without creating new roadblocks to regulation. In the right hands, it can encourage more regulation just as surely as block it.

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In closing, Revesz and Livermore claim their reforms would yield "an administrative state that is more efficient and fair, and delivers more environmental, health, and safety protection for less cost." Who could be against that? They argue that "the most appropriate and natural role for cost-benefit analysis is to help find the regulatory sweet spot, the optimal point that is between not enough and too much." Yet at other places, it is unclear whether their aim is more "neutral" regulatory analysis or simply more regulation. While they often stress the importance of "neutral" analysis, they also presume such analysis will produce particular results, and trumpet this claim to their presumably progressive audience.

They are correct to highlight the need to consider the distributional implications of regulatory decisions. But they ignore the broader ethical questions about when government intervention in private economic decisions is appropriate. Cost-benefit analysis can inform regulatory policy, but it is insufficient to determine when regulation is itself desirable. It is a powerful tool that can enhance the understanding of a regulation's likely effects, but it is also prone to misuse. It can provide a veneer of technical precision to regulatory judgments and augment the political case for action.

As the authors show, pro-regulatory interests could have much to gain by deploying a regulation-friendly cost-benefit analysis. Yet this will not make it any more "neutral," nor will it ensure that better regulatory policies result. R

Go Quietly, Old People

Reviewed by David R. Henderson

TAMING THE BELOVED BEAST: How Medical Technology Costs Are Destroying Our Health Care System
By Daniel Callahan
267 pages; Princeton University Press, 2009

For many years, Daniel Callahan, cofounder of the Hastings Center, has been writing about medical ethics and bioethics. Throughout most of his writing, one central premise appears again and again, sometimes articulated and sometimes implicit. His premise is that ethical issues in health care and biology are never to be settled simply by appeals to individual rights, but must always consider what he sees as the interests of society. His thinking about health care also carries a recurring theme: that we, especially Americans, are too focused on extending our lives and that we need to accept old age and inevitable death with grace. His latest book, *Taming the Beloved Beast*, is based in part on this premise and amplifies his recurring theme. By giving up on extending the life of the elderly, he argues, we could substantially reduce the use of high-cost medical technology and thus save money.

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For someone who has had decades to think about his ideas, Callahan, somewhat surprisingly, does not ultimately appear very thoughtful. His coercive proposals fail to take into account a much bigger picture than the one that his own particular worldview displays. Specifically, in reaching his major conclusion — that people beyond about age 80 should just accept death — he seems unaware of how elastic the concept of "old age" has been across the centuries. But this does not stop him from advocating that the government step in and make it difficult for people beyond a certain age to get life-saving health care, even if they are willing to pay for it or for non-subsidized insurance to cover it.

VALUING LIFE One technique that many proponents of government intervention in health care have advocated is the use of "willingness to pay" measures to decide whether a particular procedure is worthwhile. Harvard University health economist David Cutler, for example, has computed that the value of an extra year of life is $100,000. I saw a glimmer of hope when Callahan criticized this approach by writing, "Calculations of that kind rest on a chain of shaky assumptions and ignore the variation among people in valuing the kind and quality of their lives." He is right, but his criticism is relevant only to those who believe that it is important to let people make their own judgments about when and how much to spend on increasing the length or quality of their lives. Otherwise, why would he mention the "variation among people"?

My hope was dashed, though. Callahan's criticism is really the pot calling the kettle black. Much of his life's work and much of this book are his case for giving government a big say about what gets spent and on whom, and on not letting people act according to their own values.

At about page 146 of a 233-page book (not including footnotes and index), Callahan finally gets around to stating his key ethical assumption, writing:

> I start with the assumption, earlier uncontroversial but now more contentious, that we are biologically finite creatures, born to live but eventually to die, and whose lives as a whole should be valued more for what is done with them than for how long they last.

Even if you accept this criterion, the fact remains that, all other things equal, you can do more with your life if you live longer. More important, isn't the person himself the ultimate judge of the value of his life? Imagine that someone crosses the threshold at which Callahan claims life is not very valuable — he puts this at about age 80 — and wants to do things that Callahan considers not very valuable. To do so, this person must keep living and maintain a modicum of health. Imagine that to keep his health, he can spend his own money on high-tech health care. Shouldn't he be allowed to do so? Callahan seems to say no. He writes:

> The fact that it would be a delight to add to my long life

> a short visit to Nepal, to learn French, or to go to the wedding of my granddaughter, does not mean that, if I cannot work them into the years I have left, I will not have a rich and full life even if, at 79, I die tomorrow.

Well, bully for him, as the British would say. He has had a good life. But does this man who seems relaxed about his own life and content with his many accomplishments not recognize the simple fact of diversity? "I'm happy with what I've achieved," he seems to say, "and so you should be too." But, then, what happened to the author who, earlier in the book, denounced value-of-life measures because they "ignore the variation among people in valuing the kind and quality of their lives." Take the person who has achieved as much as Callahan (if that could be measured) but wants more; or the person who has not achieved as much and wants time to do more; or, finally, the person who, by Callahan's standards, has not achieved much, has not much desire to achieve more, but still wants to continue living in order to experience life's simple pleasures.

Certainly, Callahan seems to be aware that many elderly people want to live longer. Indeed, if he were not aware of it, if he thought that everyone was like him, there would be no need to write this book. Everyone would already be convinced that the elderly should go quietly. But rather than writing a book that tries to persuade them to go quietly, he writes a book to persuade government policymakers to cut down on their health care, by force if necessary.

THE STICK Elsewhere in the book, Callahan shows that he is quite aware of people who think very differently about life from the way he does. He writes:

> We know from current American experience that, if a life-saving or life-extending drug is beyond private or Medicare insurance coverage, desperate families will mortgage all they have to obtain it.

I would have liked to have seen a citation for this assertion. If it is true, it is powerful evidence that people value their lives very differently from the way Callahan says they should. But he would substitute his values for theirs and, if necessary (and, he admits, it would be necessary if he wants to get his way), by using a "stick."

Does Callahan explicitly advocate coercive measures to prevent the elderly from getting health care? He never uses the terms "coercion" or "force," but it is clear that force is what he has in mind. He writes:

> Alternatively, because of their cost, a very high co-payment could be required, at a level to make even the desperate think twice (e.g., 50% of the costs). But that requirement would be a cruel form of consumer-directed health care, the kind designed to give people choices but also to make them think seriously, and even desperately, about making them, and all the more so if the choice is life or death or sustained misery. The only feasible alternative left is simply not to make the technology available or, if it is already available, not to allow it to be chosen unless the particular case passes the "sufficient evidence" test proposed by Dr. Eddy and his colleagues.

How would he not "make the technology available" or "not allow it to be chosen" without having the government use force? He could not. If a doctor or hospital wanted to provide health care to an elderly person who was willing to pay for it, then the only way to make it not available or to prevent the patient from choosing it would be to have some kind of legal sanction with the penalty of a fine or a prison sentence for those who disobeyed. Of course, Callahan does not specify the penalty — that kind of specification would happen only if a bill were written to implement his policy views.

Callahan seems to have sympathy for those having to make "desperate" tradeoffs to obtain health care, but he fails to address a crucial question: Who would feel more desperate, the one who must decide whether to pay a potentially large portion of his wealth for a technological means to extend his life, or one who, no matter how much he is willing to pay, is told that he cannot have it and must, therefore, die?

The quote above is the closest Callahan comes to advocating that health care be denied even to those who are willing to pay for it. Elsewhere, though, he comes almost as close. He presents three policy options, only one of which would allow people to pay for high-tech care. The first option is to outlaw the private purchase of health care as, he notes, is done in Canada. But the result of that policy, he concedes, "has not been a happy one": long waiting lists for many forms of care, and affluent Canadians (he might have noted even some Canadians of modest means) coming to "the United States to buy care." His second option is to allow people to buy insurance that covers high-tech care, but to increase co-payments and deductibles for expensive forms of care. He does not say whether he would require these co-payments and deductibles to be high by law — presumably he would. He argues that with this option, which is the closest he comes to allowing freedom in the purchase of health care, "there will be no feasible way of stopping the affluent from buying whatever they want." He seems to regard this as a problem. That leads to Callahan's third option, which he seems to favor. He would have the health care system emphasize "health promotion and disease prevention" (he calls this "the carrot") and have "fewer expensive technologies with tougher eligibility standards for their use" (he calls this "the stick"). The problem here, he writes, is that we "will continue to find clever technological ways to keep people alive when they finally get sick." Oh, the horror! Solving this "problem" without rationing, he writes, "can best be done by not having the technology readily available in the first place." How would he enforce this? A few pages later he advocates forbidding certain "marginal" benefits, which he admits could be life-saving, to be covered — not only by Medicare, but also by private insurance. Again, to prevent private insurance from covering these benefits would require coercion.

Interestingly, one of the people who would need to be coerced is Daniel Callahan. Early in the book, he tells quite humorously about the 10 diagnostic scans and tests he had at his last physical, the total cost (he means "price") of which was $5,500. One short excerpt:

> Did my heart murmur, detected by a stethoscope followed by an echocardiogram, turn out to mean anything? No. Did my high and rising PSA score, followed by a cautionary biopsy, show any serious problem? No, just an enlarged prostate gland — "but let us check the PSA level again in 3 months." Did some

> irregular noises in my carotid artery, also detected by stethoscope and followed up by a sonogram, mean anything? No.

So, in spite of decades of his own learning and observation, which led him to conclude that far too much is invested in medical technology for the elderly, and despite his statement that "I have an obligation at our moment in history, and at my stage of life (age 79), to make use of as little expensive technology as possible," he did not follow through. Bioethicist, heal thyself.

OPPOSING VIEWS Callahan usually plays it straight, stating accurately the views of those he disagrees with. But on the costs of creating a successful new drug, he badly misleads the reader. Callahan writes that "there has been dispute about how much its research actually costs (the drug companies say $800 million to bring a new drug to market.)" In a heavily footnoted book, Callahan gives no footnote for the source of this $800-million estimate. Had he done so, he would have had to admit that the source is not a drug company but, rather, an article in a peer-reviewed academic journal. The article was written by Joseph DiMasi, Ronald Hansen, and Henry Grabowski, all recognized experts in the literature on the cost of new drugs. Moreover, the journal that published the article, "The Price of Innovation: New Estimates of Drug Development Costs," is the *Journal of Health Economics*, one of the most prestigious journals in health economics. Interesting, also, is that the data are in 2000 dollars, and so the inflation-adjusted data would show a cost per new drug of close to $1 billion now. Has there been "dispute" about that number? Probably; what derived number is not disputed? Yet by treating this important issue the way he does, Callahan will leave many readers muttering, "There go those drug companies again, always exaggerating."

The main reason Callahan takes so long to get to his own proposals is that he spends much of the book criticizing other proposals. One of his main criticisms is of the idea that competition in health care will work to bring down costs the way it has worked in other industries. He calls competition "the fix that will fail." He points to competition in cosmetic surgery, laser eye surgery, and generic drugs as examples that advocates of competition have offered. He grants that competition from generics does work well but argues that competition in cosmetic surgery and laser eye surgery "do not work well." Why? Because, he argues, "they are intensively advertised, not ordinarily covered by health insurance, and for most patients (more properly called consumers in these cases), they are not 'medically necessary' procedures in even the loosest definition of that term." But intensive advertising is part of the essence of real-world competition, as opposed to the anemic and boring (and mislabeled) "perfect competition" that economics textbook authors use to torture undergrads. (See "In Defense of Monopoly," p. 16.) And the main reason competition does work so well in these two areas is precisely that they are not covered by health insurance, and so consumers — yes, he used that word correctly — are paying with their own money.

> The main reason competition works so well for cosmetic surgery and laser eye surgery is because they are not covered by insurance.

The tragedy is that here is a place where Callahan could have found allies in his fight to reduce costs. These allies are the John Goodmans, Regina Herzlingers, David Gratzers, David Hendersons, and other health policy analysts who see the power that consumers, paying their own money, can bring to the medical marketplace. Go back to the $5,500 that Callahan spent for his last physical. Would he have been this cavalier about accepting each test that the doctor offered had he been spending his own money?

By now, you might be thinking that there is nothing I like about this book. That is not quite true. Every so often, Callahan scores points against the irrationality of our health insurance system, although even these are mixed with misfires. He writes:

> A finite direction would (in my view), for instance, eliminate coverage for contraceptives, male or female (because a risk of pregnancy from intercourse is not a disease, illness, or injury); for assisted reproduction for women over the age of 35 (because a decline in fertility beyond that age is not a disease or illness either); for erectile dysfunction for men over the age of 65 (a normal pattern, not a disease); repeat joint or other surgery for men and women who, after the age of 65, want to continue an athletic recreational life (joint problems increase with age and are not necessarily a disease); a denial of screening of people for low probability diseases unless there is a clear family history of risk; denial of mental health coverage for all but the most severe cases, not as a response to an unhappy life, a troubled romance, or difficulties raising one's children.

On some of these coverages, Callahan is right for the wrong reason. He seems to make it a moral issue: some things "should be" covered and others "should not be." But really, what is wrong with insurers covering these things if people are willing to pay for them with non–tax advantaged dollars? I predict that some of these coverages would go away if the government did not give preferential treatment, under the U.S. tax code, to employer-provided health insurance and if governments did not require coverages such as mental health. But because Callahan seems unwilling to take yes for an answer, he never draws on his allies in the health economics literature whose analyses would buttress some of his point.

RIPE OLD AGE What if Callahan had been writing this same book 200 years ago? He probably would have regarded age 60 or, at most, 70 as a suitable age at which life should end. Perhaps he would have advocated cutting off medical care, or making it very difficult for the elderly — those age 60 or older — to get health care, saying that they had lived a good life and that they should not expect more.

Interestingly, we do not need to speculate because Callahan admits the point by bringing up George Washington. "Washington's death after a full life," he tells us, "did not deprive our nation of an irreplaceable leader." Whether one agrees with

that or not—I would prefer Washington to any of our current leaders — here is the point: Washington died at age 69. So, if Callahan can accept that 69 was a ripe old age in the 18th century, why isn't it a ripe old age in the 21st century? Why has he raised the bar to 79 or 80? The answer seems obvious: it is because life expectancy has risen and that is, in part, due to medical progress. But if medical progress continues, couldn't 90 become our concept of old age within a decade or two?

Most of us are humble enough to let older people decide for themselves how they want to live. If Callahan had made a case against a socialized insurance system, Medicare, that taxes working people to subsidize their longevity, he would have had more allies, including this reviewer. But cutting off the elderly from medical care, even when they are willing to pay for it? Count me out. R

Unfair Harvard

Reviewed by Richard L. Gordon

ACTING IN TIME ON ENERGY POLICY
Edited by Kelly Sims Gallagher
188 pages; Brookings Institution Press, 2009

When two great centers of economic thinking unite, they should produce a definitive, well-reasoned statement on an important issue. However, *Acting in Time on Energy Policy*, a Brookings Institution publication of the proceedings of a Harvard University conference, is just another example of the exploding literature of energy hysteria. Brookings is guilty only of agreeing to serve as publisher; people at Harvard set up the conference, and they are the ones who chose to include only one economically competent contributor. This is not what we want from such respected institutions. No need exists for them to reinforce the flood of economically illiterate discussions that are coming from institutions with far less status in economics. The outcome is due to ignoring, or in one key case misusing, the available expertise.

The book consists of several papers written or co-written by Harvard professors in disciplines ranging from international relations to conflict resolution. One contributor is John Holdren, then a professor of environmental policy and now President Obama's science and technology adviser. Given the expertise available in the close vicinity of the conference, the organizers could have readily secured a far better panel that would have produced a far better result. Indeed, changing the assignment of the one competent contributor to the book — global energy policy professor William Hogan, who authored the chapter on electricity markets —would have greatly improved the result. Hogan was relegated to the mundane task of discussing the relation of energy initiatives to electric power. A visit to his website leads to an excellent 2008 paper that debunks the hysteria about oil security — a worthy paper that is far superior to the book's chapter on the subject, written by Henry Lee.

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UNREALITY The book's editor, Kelly Sims Gallagher, authors the introductory chapter, which is divided about equally between unsubstantiated generalizations about the urgency of energy action and admiring summaries of the subsequent chapters. Gallagher also authors the first chapter, on climate change. She begins with a routine discussion of the assumed dangers of global warming that includes an incoherent discussion of why delay may make adjustment more expensive. Unfortunately, Gallagher seems unaware of the principles of investment economics, which are central to appraising global-warming policy. The key question is whether near-term wealth gains from a carbon-intensive economy justify combating global warming later, when humanity is wealthier and can more easily shoulder the cost. There are important arguments on both sides of that question, but she does not discuss any of them.

Elsewhere in the chapter, Gallagher overcomplicates the single goal of getting carbon prices right, making an inept distinction between setting goals and setting price. The remainder of the chapter discusses actions on control. When she turns to China, she confuses her argument by noting, apparently with approval, that China has turned to energy mandates to deal with greenhouse gases, but then she concedes that fuller Chinese participation in global carbon-control initiatives is needed. (See "No Time for Cap and Trade," p. 3.) Her suggestion that the Obama administration should "begin direct talks with the Chinese government about how to collaborate to reduce the threat of global climate disruption" is an all too typical example of the muddled thinking that mars interventionist policy discussions. The unreality of her proposals on feasibility and efficacy grounds should have been evident.

As with all the chapters, Gallagher's bibliography is frustrating for those familiar with the literature. Key observers are ignored; the best she can do is mention only in a footnote a journalistic piece by William Nordhaus, perhaps the leading economic analyst of the global warming issue.

OIL Harvard lecturer Henry Lee's paper on energy security is the critical essay in the book. It is the only extensive effort to deal fully with oil issues. Lee starts with a bloated tabulation of the conventional arguments for why we should fear oil imports: disruption of supplies, the short-term macroeconomic instability produced by price swings from disruptions and other events, environmental impacts, the access to oil by poor countries, and the flow of oil money to countries that use it to oppose U.S. policy.

His exposition then turns to debunking some of those arguments, with sections on reducing imports, funding our enemies, and high prices. This mixes treatment of one possible response with direct treatment of two issues. Lee is left with four purportedly legitimate problems:

macroeconomic effects, long-term instability in the oil market, effects on foreign policy, and environmental impacts.

His effort has manifold defects. Lee's initial "poor country" access point is embarrassingly feeble, which he tacitly acknowledges by never developing the argument. His solid general discussion of reducing imports through increased domestic production correctly points out that a unified worldwide market prevails in oil; isolation is impossible. The United States cannot shut itself off, nor can an oil producer shut off the United States. Implicit in this is that poor countries are deprived only because they are poor; in short, lack of strong markets, not market failure, is the problem. The cure then is ending poverty, and Lee has inserted a red herring. He does nicely move on to note the further consequence that cutting imports will not cut the funds to hostile states, whoever they may be. His section on oil prices correctly denies that OPEC countries consciously engineer very high prices, but his later long-term instability argument is that the politics in OPEC countries will lead to underinvestment in oil. This is a speculative conclusion, but it has zero policy implications. Non-OPEC producers are far more capable than consuming-country governments at anticipating and responding to such errors. Again, Lee has raised a problem that does not involve market failure.

His treatment of price instability has one superficial paragraph on the problem and no citations of the vast literature on both sides of this contentious issue. He spends most of his time discussing the drawbacks of the purported three available cures. Lee starts with a poor discussion of the role of hedging. He predictably concentrates on its political unpopularity and ignores that hedging ratifies, rather than prevents, profound supply changes. He goes on to mishandle treatment of the strategic stockpile: He recognizes that a satisfactory release policy has not been devised and adds that some unnamed analysts have concluded that the stockpile should be sold off. Despite the facts and criticism, he believes that a good management policy for the stockpile can be devised, and he follows Jay Hakes in proposing reliance on an independent authority. Of course, such a policy is futile. (See my "Return of Jimmy Carter," Spring 2009.)

Lee throws in a gratuitous observation that Saudi Arabia's spare capacity helped to stabilize oil prices in the past, but that may not continue in the future. He discusses political and military interventions over oil, which he seems to support. In the next section, on the foreign policy effects of oil, he notes that such effects exist but their size and value are unclear. He then adds the expected note that global warming should be curtailed.

The middle third of Lee's paper tries to explain why there have been no serious policies to reduce oil use. He naturally ignores that the reason for this is because the concerns are dubious. He has five alternative explanations: the size of the problem, resistance to higher oil prices, faith in "the Elusive Technological Silver Bullet," difficulty in getting international cooperation, and belief that more domestic oil and gas drilling will solve the problem. All of Lee's discussions in this section are unsatisfactory. The arguments, if they had been properly developed, would have added up to the conclusion that the energy action proposed by this book and many others involves enormous costs to produce benefits whose value may be nonexistent.

The most interesting of his statements is his discussion of new technologies. Lee properly notes that these options are not easily made commercial. He debunks one half of the "Manhattan Project" metaphor for alternative energy development that is so beloved in policy discussions: Lee notes correctly that in building the nuclear bomb, there was one customer that had no concern about costs, while most of humanity has reason to be concerned about the cost of "green" technology. However, he misses the more-troubling other half of the metaphor: the bomb involved no radical scientific breakthroughs; the atom had been split before Hitler invaded Poland, while the green technologies that advocates visualize will require numerous dramatic scientific breakthroughs. What is more problematic is the fiction Lee adopts that it is public belief that these developments in energy are simple that impedes action. Indeed it is the advocates of radical change such as Al Gore and his Repower America who are peddling the notion that green energy is a free lunch. President Obama has trumped this by saying that the United States can pay off its "investment" in green technology by exporting its advancements to other nations, particularly China and India, who will be entranced by the American wonders. The true barrier to "action" is justified fear of shifting to these unknowns.

The final third of Lee's paper stumbles through the problem of devising solutions. He begins by proposing and backing away from three clear nonstarters: heightened mileage standards, the development of alternative fuels, and limits on miles traveled. This reminds him that new infrastructure is needed, and a superficial treatment follows. He concludes that either a cap and trade system for carbon or a carbon tax should be imposed. However, he acknowledges the problem of public acceptance of such a regime. He offers a possible solution of sneaking in action by mandates — which seems to me to be very dishonest public policy. Lee then presents another list (the chapter is full of them) — in this case, policy options such as regulation, taxing automobile purchases, and congestion fees. The treatment of the last two is a fairly straight-forward discussion of drawbacks. After multiple readings, I think (but am not sure) that Lee argues that regulatory options will not work; he certainly could have said so more clearly. His effort, later, to return to the subject further muddies the discussion; he first claims that the problem with existing regulations is the division of authority among established cabinet agencies, and then concludes the chapter with the call for breadth in technology promotion, if regulation is adopted. In short, he embraces the traditional alibi that government failure can be avoided by better policymaking.

Lee gives us one final list: what government should do — ease financial burdens for green technology innovation, set and enforce goals, subsidize research and development, and negotiate with other countries. He discusses none of these and instead deals with further issues such as the land-use impacts of these proposals. Here he postulates the need for planning, despite the absence of externalities in the land-use choice. Again, the literature citations are pathetic.

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OTHER OFFERINGS A quick look at some of the other papers:

William Schrag, professor of planetary science and environmental engineering, offers a paper on carbon capture. His effort starts with a solid discussion of the pros and cons of carbon sequestration. He then proposes a routine interventionist solution: subsidies for demonstration plants and, if they succeed, further subsidies for wider adoption and federal efforts to clarify the laws and overcome resistance by the states.

Laura Diaz Amadon and John Holdren produce the expected call for U.S. superiority in new energy technologies and government aid. The one unexpected element in their paper is a gratuitous discussion of broader policy options, in which they propose several energy mandates inconsistently followed by a call for carbon pricing.

William Hogan's paper seems dragged in from one of the many electricity policy symposiums that have been held in the last few decades. He first discusses the inherent inability to forecast demand accurately. The bulk of the discussion relates to the evolution of the electric power industry and its regulation. The key is the radical reversal in the 1970s of rapid growth and falling rates. Ever since, the industry and its regulators have struggled to reorganize in order to respond better to these changes. These efforts seem inadequate. In particular, the situation may impede efficient levels of investment. This seems an all too tacit warning to the other participants about government ineptitude.

Max Bazerman, a business school professor specializing in conflict resolution, ends the book with a predictable interventionist case for action. His first relevant argument is the perennial that consumers cannot decide correctly what energy sources to use. He relies on the newest form of this argument, the fad for behavioral economics. He then trips over the question of whether the government can do better. He obfuscates by stressing why the existing agencies cannot do the job; the usual faith is displayed that better organizations can overcome this problem. Bazerman ends with his list of options, which are essentially a call for a sound but flexible policy.

His effort is fouled by digressions and resorts to extremist rhetoric, e.g., "Experienced at subverting good ideas, leading organizations from the automobile, coal and oil industries (for example, Exxon Mobil) have succeeded in distorting energy policy and keeping the United States from implementing wise practices regarding climate change." It is deplorable that a professor at a great university should resort to these familiar, but totally invalid, charges and then singles out the oil company that dared to resist the propaganda barrage. (The leading oil company green-energy rent seekers, BP and Shell, joined a predictable list of foundations to fund this effort.) The "usual disclaimers" will not do; this should never have gotten outside the editing process. The statement stands as the quintessence of why this book fails.

In short, the book is a failure. It is must reading only for those few who need to know what influential observers are saying about the issues treated. It might be a useful assignment for a course in which the errors of analysis are exposed. R

Not a Big Deal

Reviewed by David R. Henderson

OFFSHORING OF AMERICAN JOBS: What Response from U.S. Economic Policy?
By Jagdish Bhagwati and Alan S. Blinder; edited by Benjamin M. Friedman
141 pages; MIT Press, 2009

In 2006, Princeton University economist and former Federal Reserve vice chairman Alan Blinder made a splash with his claim that 30 to 40 million American jobs could become vulnerable to offshore competition over the next two decades. What made this estimate striking, besides the magnitude, was the person who said it. Blinder is one of the most strongly committed free traders in the economics profession, a profession that itself is strongly committed to free trade. Indeed, Blinder is so good at laying out the case for free trade that I had him do just that in *The Fortune Encyclopedia of Economics*, with an updated version in the follow-up book, *The Concise Encyclopedia of Economics.*

So, was this committed free trader starting to doubt his belief in free trade? Actually, no. All he was doing was laying out his fear that the cost of free trade — the wrenching transition many people go through as they lose their jobs to foreign competition — might soon be coming to a neighborhood near you.

But there was enough controversy over both Blinder's prediction and its implications for government policy that the organizers of a 2007 symposium on public policy devoted the proceedings to the issue. The result is *Offshoring of American Jobs*, edited by Harvard University's Benjamin Friedman, with major essays by Columbia University's Jagdish Bhagwati and Blinder, and comments from other scholars.

I will spare you the suspense. The book's major conclusion is that this increased vulnerability of American jobs, if true, does not undercut the case for free trade. The other important conclusion, which sometimes gets lost in the shuffle, is that the 30 to 40 million number, even if true, is not such a big deal in the context of the larger, dynamic U.S. economy. Those are the two pieces of good news. The bad news is that virtually all the book's participants favor increased government subsidies to bail out the "losers" from free trade.

SHAKY ALLEGATION In the lead essay, Bhagwati — who is probably the world's most prominent economist-advocate of free trade — alleges that Blinder actually *opposes* free trade and takes him to task for it. However, Bhagwati offers no evidence

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for this allegation, which is a bad strategy for someone who cares about truth, which he generally does.

It is a particularly bad strategy when the person about whom he makes the negative comments is the author of the next essay. In that essay, Blinder makes clear numerous times that his concern about American jobs becoming vulnerable to foreign competition is not to be confused with advocacy of protectionism. Take, for example, his discussion of his view that in some service occupations, the United States will lose its comparative advantage to India. Blinder writes, "Of course, even if lost or fading comparative advantage is the problem, protectionism is not the solution."

Blinder ends with an analogy between the Indians and the British, with himself playing Paul Revere: The Indians *are* coming! But the crucial difference, he points out, is that "we *don't* want to fight them off" because the Indians are "doing exactly what they should be doing — developing their own country by exploiting their comparative advantage and, in the process, making the world as a whole immensely better off." He adds, "We should shake their hands and wish them well — which is not exactly how the Minutemen greeted the Redcoats." Sounds pretty clear, doesn't it?

JOBS LOST, JOBS FOUND So, rest assured that the interesting debate in this book is not about whether free trade is desirable. Neither of the main essay writers, Bhagwati or Blinder, questions free trade. Nor do the four economists who comment on the main essays — Richard Freeman, Douglas Irwin, Lori Kletzer, and Robert Lawrence — question whether free trade is desirable. There is also no dispute that the effect of free trade on jobs will be approximately zero. As economists since David Ricardo have shown, the effect of free trade is on the *types* of jobs people have, not on whether they have jobs. The real controversy in the book is about how many Americans will actually have to switch jobs or occupations, and how big a deal this is.

So let us consider that controversy. Blinder starts by stating that 30 to 40 million jobs either lost or threatened by new foreign competition is a big deal indeed. Yet, he admits that if this happens, it will be over a couple of decades, and that 30 to 40 million jobs threatened by competition does not mean 30 to 40 million net jobs lost. Blinder also admits that more than four million Americans now lose their jobs every month. This is what economists call the job "churn." In response to comments about these numbers by Robert Lawrence of Harvard's Kennedy School and Dartmouth's Douglas Irwin, Blinder writes:

> [T]hey both observe that the volume of job change that I anticipate is small relative to the normal job churn in the highly fluid U.S. labor market. I accept these points as meaningful qualifications to my warnings about how difficult the coming transition is likely to be.

That is a big admission. So what is left of Blinder's argument? One factual claim that he backs up and two policy proposals that he does not. Blinder's factual conclusion is that the effect of new foreign competition on domestic wage rates is likely to be large. He presents data that show that U.S. workers currently threatened by foreign competition earn wages that are 13 percent below what they would otherwise be. Commenter Robert Lawrence, however, points out that the most careful studies of the effects of trade on wages find that the wage penalty is only six percent or less. And in the lead essay, Bhagwati writes, "the vast numbers of empirical studies (including those by [Paul] Krugman) had shown that trade with poor countries had a negligible impact on our workers' absolute real wages (as against the relative wages of the skilled and unskilled)."

MORE GOVERNMENT? In response to the coming threat to U.S. jobs, Blinder advocates two main policies. The first is to have the government school system change what it teaches so that graduating students will be better prepared for the new world of work. The second is that the United States needs much more of a welfare state (my term, not his) to handle people's transition from old jobs to new jobs.

Blinder simply asserts the desirability of those policies but does not make an argument for them. On schools, he does not say how he will get a system controlled by government, which in turn is heavily influenced by labor unions, to change its curriculum. He might as well have just rubbed a magic lamp and made a wish.

How about the expanded welfare state? Blinder advocates better unemployment insurance (by which I think he means higher benefits and for longer terms), a higher (he uses the word "generous") Earned Income Tax Credit, greater portability of pensions (presumably by law), and "wage-loss insurance." This expansion, he writes, "should be uncontroversial" but "apparently, it is not." Given his recognition that it is controversial, one might have expected Blinder to handle the controversy by actually making his case. He does not.

The other authors agree with him to varying degrees. Bhagwati and Irwin advocate trade adjustment assistance by the government, although Irwin also expresses his skepticism that government job-retraining programs, which Blinder advocates, can accomplish much. Lori Kletzer of the University of California at Santa Cruz signs on to all of Blinder's proposed government programs. Lawrence advocates "the right safety net and redistribution policies," but does not specify what those "right" policies would be. Harvard's Richard Freeman advocates giving unions more monopoly power but does not specify how this would help, and advocates socialized health insurance and higher taxes on "the rich." None of these economists actually makes a case for any of these proposals. None points to examples of these policies that have worked in the past, and none deals with any of the potential negative consequences of such policies. All treat government as a deus ex machina that somehow will make things work.

This intellectual abdication is disappointing. I know of no major economist in international trade who discusses trade policy without taking account of governments' perverse incentives to impose trade barriers at the behest of concentrated interest groups. For instance, in dealing with Laura Tyson's argument that "industries with [positive] externalities ought to be protected," Bhagwati points out that "it is very hard for policymakers, and very easy for lobbyists, to decide which industries have the externalities." I would bet that most of the other contributors to this book share at least some of Bhagwati's skepticism. Unfortunately, none of this skepticism about the perverse role of interest groups carries over to their discussion of their favored government tax, subsidy, and regulatory schemes. R