In 1970 a Republican president, Richard Nixon, created the Environmental Protection Agency through executive order. Less than 50 years later, a member of Nixon’s party, Rep. Matt Gaetz, would introduce legislation to eliminate the EPA entirely. Whereas Nixon saw the need to embrace environmental protection for electoral advantage, 2016 GOP presidential nominee Donald Trump called the EPA’s work “a disgrace” and campaigned against the wastefulness of environmental regulation.

As is commonly observed, support for federal environmental regulation used to be a bipartisan enterprise. Most major environmental laws were adopted with broad, bipartisan majorities. In addition to creating the EPA, Nixon signed the National Environmental Policy Act, Clean Air Act, and Endangered Species Act into law. Another Republican president, George H.W. Bush, advocated for and signed the 1990 Clean Air Act Amendments, the most expansive environmental regulatory legislation in the nation’s history.

Today, however, federal environmental regulation is a highly partisan and divisive issue. Most of the major environmental statutes have not been reauthorized in decades, and new environmental measures are rarely considered. Democratic officeholders tend to endorse and advocate for more expansive federal environmental regulation, while GOP officeholders resist. There are exceptions, to be sure, but the overall tendency is clear. When President Trump took office, the rollback of federal environmental regulations—particularly those adopted under President Barack Obama—was at the top of his agenda. Indeed, the Trump administration has ushered in the most aggressive environmental deregulatory effort in the nation’s history, largely with Republican support.

**Shifting ideology** / What caused this change? Most explanations focus on the changes within the Republican Party, particularly increased hostility to federal environmental regulation. A common narrative is the GOP about-face is due to corporate influence, the fossil fuel industry in particular. Under this account, Republican officeholders have become beholden to coal barons, oil executives, and the filthy lucre of heavily polluting industries.

In *The Republican Reversal: Conservatives and the Environment from Nixon to Trump*, historians James Morton Turner and Andrew C. Isenberg offer a more nuanced explanation of the Republican Party’s change on environmental policy, grounded in a shift in the party’s ideology. They point to three factors operating in concert: “rise of conservative ideology, the mobilization of interest groups and activists, and the changes in the environment and the regulatory state.” “Republican legislators were not simply bought off by corporate interests,” they argue. Rather, the alignment of particular economic interest groups with the Republican Party occurred in concert with changes within the conservative movement and the lived experience of those regulated by federal environmental laws. They write, “Big money alone does not fully explain the Republican embrace of the gospel of more.” While business groups—resource extractive industries in particular—certainly played a role by supporting candidates and organizations that opposed regulations restricting resource development, there is also a strong grass-root opposition to federal environmental regulation.

Up through the 1970s, Republicans generally shared the belief that environmental problems required urgent government intervention, accepted the professional expertise of scientists and others calling for environmental action, and thought it acceptable for government to intervene in the economy to protect the environment and public health. Over the past few decades, however, many Republicans have come to see many environmental claims as “alarmist and exaggerated,” have “dismissed professional expertise,” and see environmental regulations as economic burdens that constrain individual liberty. More broadly, as the perceived urgency of environmental problems ebbed and regulatory costs became more apparent, it was natural that some would view additional regulation as a bad deal.

In their account, the Trump administration’s environmental agenda “repre-
The Republican Reversal: Conservatives and the Environment from Nixon to Trump
By James Morton Turner and Andrew C. Isenberg
280 pp.; Harvard University Press, 2018

Turner and Isenberg recognize the role of actual ideology in this change. Indeed, part of their project is to situate the shift in Republican attitudes toward environmental regulation within the context of changing views about government and the evolution of conservatism. Any ideological commitment to limiting the size and scope of the federal government will necessarily conflict with much contemporary environmental policy. A general presumption underlying most discussions of environmental law is that the existence of environmental problems requires extensive government regulation, so if one opposes the latter, it becomes natural to question the former. “Republicans drew on conservative ideology to create a vision of an American economy that, if left unfettered by regulation, could be the engine not only of a higher standard of living but of technological solutions to environmental problems.”

Progress and skepticism / Turner and Isenberg do an admirable job identifying often-overlooked factors in the Republican Party’s evolution on environmental matters, yet it is quite clear where their sympathies lie. They understand that as environmental regulation became more costly and intrusive, disrupting not only particular industries but also the ways of life of workers and others dependent upon such industries, it also generated political opposition. What they fail to do, however, is cast much of a critical eye on the environmental policies the nation adopted or the evolution and increasingly partisan behavior of the organized environmental movement.

Insofar as the Republican turn against environmental regulation is reactive—and it certainly is—they show little appreciation for what it is conservatives may be reacting against. It is simply assumed that federal environmental regulation is desirable and opposition to environmental regulation necessarily translates into opposition to environmental protection.

It is certainly true, as a descriptive matter, that a “sense of urgency” helped propel the push for federal environmental regulation in the 1970s. Images of environmental ruin and expert predictions of population bombs and silent springs buttressed the nascent environmental movement’s political strength. But is it really true, as Turner and Isenberg claim, that the environmental laws of the 1970s were “enacted in response to a clear and present danger”? It certainly may have seemed that way to many at the time, but the historical record is less clear. It is incontrovertible that some environmental concerns were exaggerated, including by scientific experts. Some professional experts showed themselves to be professional alarmists. Is it any wonder that those whose livelihoods were threatened by the regulatory response to such alarms would learn to become skeptical?

One thing Turner and Isenberg fail to note is that for many of the environmental problems of greatest concern at the time, progress was already being made. State governments became increasingly aggressive on environmental regulation throughout the 1960s, upping investments in infrastructure and adopting conservation measures, with positive effects. California regulated automobile exhaust before the EPA even existed and urban air pollution concentrations had begun to decline before Nixon signed the Clean Air Act. Images of the Cuyahoga River catching fire may have lit the spark for a federal Clean Water Act, but the most famous of those images was from 1952 and key measures of water quality were improving before the Clean Water Act was passed. Indeed, recent research has found more rapid declines in key measures of water pollution before 1972 than after. Turner and Isenberg cite this study, but do not discuss this finding. They don’t particularly engage with the broader dynamic of environmental politics.
and the role that inside-the-Beltway environmentalist organizations have played in making environmental policy a more partisan issue at the national level. The first President Bush is responsible for one of the greatest upsets in environmental regulation in the nation’s history, yet he received little organized environmental group support. It’s understandable that environmentalists opposed President George W. Bush’s efforts to reform federal air pollution regulations, but he never got much credit for aggressive marine conservation efforts.

At times, the authors exaggerate the partisan aspect of environmental battles or underestimate the role of environmental organizations in increasing the partisanship of environmental policy debates. As they note, the “Contract with America” endorsed by Republicans in 1994 placed a heavy emphasis on limiting regulatory burdens and protecting landowners and local governments from federal edicts. After Republicans took over the House of Representatives that year, Turner and Isenberg write, they “quickly put environmentalists and the Clinton administration on the defensive” by, among other things, placing “riders” on appropriations bills to limit environmental rules. In actuality, President Bill Clinton’s administration was put on the defensive two years earlier, when a bipartisan House majority first rejected the administration’s proposed grazing reforms and then turned on its proposed energy tax. Despite the ambitious plans of then–EPA administrator Carol Browner, the 103rd Congress made clear that federal environmental legislation could only pass with amendments limiting unfunded mandates, protecting property rights, and requiring benefit–cost analysis for new rules. What the authors characterize as a would-be “regulatory counterrevolution” had held bipartisan majority support the year before, when Democrats still controlled the House. Once Republicans were in charge, however, what were once common-sense bipartisan reforms could be characterized as a Republican assault on environmental protection.

This pattern has continued. Like Clinton, Obama was not able to get meaningful environmental legislation through Congress. Despite a significant Democratic majority in the House, a major climate change bill barely squeaked through, demonstrating “it was the opposition to, rather than support for, climate policy that was bipartisan.” At the time, Republicans were not alone in fearing the costs and intrusiveness of unleashing the EPA on carbon dioxide, the most ubiquitous byproduct of modern civilization. Yet, it was not only proposed climate solutions that provoked opposition; on the right there was increasing reluctance to recognize a problem. By the 2010s “climate has been transformed from an environmental or economic issue into a new front in the culture wars of the twenty-first century.” Here as elsewhere, conservatives knew what environmental policies they opposed, but could not identify proactive policies they could support.

**As the ideological and interest-group base has become more narrow and concentrated, it is inevitable that partisanship would increase.**

**Culture war** / In their discussion of climate as elsewhere, Turner and Isenberg recognize that conservative opposition to emission reductions and alternative energy sources cannot be laid wholly at the feet of powerful economic interests. Such a blame game is “easy,” they write, but it ignores the more fundamental challenge posed by climate change policy: “not just reshaping the nation’s energy economy, but challenging an American culture that celebrates independence, abundance, and exceptionalism.” What at one time may have been characterized as a jobs-versus-environment debate has become just as much an “us-versus-them” fight. The debate is as much about “culture and values” as it is about science or economics—a dynamic Trump has learned to exploit.

It is not merely that Republicans became more conservative on environmental issues over time. The evolution of partisan attitudes toward environmental measures since the 1970s has been facilitated by partisan sorting. Earlier divisions on environmental measures divided Americans more by region or class than by party. Those who were once moderate, conservation-oriented Republicans from the Northeast have become Democrats, and western workers in resource-dependent industries who were once Democrats have become Republicans. In other words, it is not that the Democrats who helped defeat Clinton’s environmental initiatives have changed their policy views, as much as it is that they are no longer Democrats. Much the same can be said of conservation-oriented northeastern Republicans: they are no longer Republicans. And as the ideological and interest-group base has become more narrow and concentrated, it is inevitable that partisanship would increase.

The story Turner and Isenberg tell shows that the Republican agenda on the environment is, more than anything else, one of reaction. As they write in their conclusion:

Conservatives have managed to tie their environmental policy ideas to a set of values that many conservative Americans hold dear: a distrust of government, science, and secular intellectuals; and a faith in the market, technological innovation, and perhaps above all, in a God who has provided a cornucopia of resources for human use.

Yet there’s no reason those values must lead to an anti-environmental agenda, any more than environmental problems necessarily entail centralized regulatory responses. But crafting an environmental alternative to the conventional regulatory agenda takes effort and ingenuity, and may not lead to a meaningful electoral advantage.

**Conservatism and conservation** / What does the future hold? As Turner and Isenberg observe, the lack of environmental leader-
ship in Washington, DC has not stopped environmental innovation at the state level. During the Clinton administration, state and local governments sought to innovate as a way to reduce the costs of environmental regulation. Under George W. Bush, states sought to innovate to fill the gap in environmental protection left by a more complacent EPA. This same dynamic continues today, as state policymakers seek political advantage by demonstrating environmental leadership on issues ranging from local conservation to global climate change. With Congress out of the business of enacting environmental legislation, many states have sought to develop the next generation of environmental policy themselves.

A persistent problem for right-leaning office-holders—and the policy intellectuals they draw upon—has been how to reconcile a skepticism of government regulation with an embrace of environmental protection. As they note, both Barry Goldwater and Reagan “struggled to reconcile their conservative ideals with the expanding role of government in protecting the environment.” This struggle remains today. Conservative officeholders are quick to embrace platitudes about the importance of market-oriented conservation, but often come up short with policy specifics. Right-leaning think tanks and policy shops devote more time and effort to attacking new regulatory initiatives (often with some justification) than to specifying the contours of a meaningful alternative. The federal environmental regulatory state is not going away without legislative action, and a market-oriented alternative to conventional regulation requires more than a one-sentence bill to eliminate the EPA.

Turner and Isenberg’s focus on the role of ideas is welcome and refreshing, particularly in comparison to the Manichean tales of sinister corporate influence that so often dominate this space. In recognizing the role of ideology, they open the door to greater consideration of the lived experience of environmental regulation that has influenced perceptions of such regulation’s desirability.

As the shape of regulation goes, the United States and the European Union aren’t all that different. Both are customs unions with a single trade policy, with unimpeded internal commerce hinging on a large degree of internal regulatory harmonization. The extent to which member states can autonomously enact regulations is limited in both unions: by the U.S. government’s constitutional power to regulate interstate commerce and by foundational treaties in the EU that codify the so-called “single market.”

From that similar foundation, however, the two unions have followed very different pathways over the past half century. In the United States, state-level regulation has grown increasingly disharmonious. Intervention-friendly states such as California are blazing regulatory trails in environmental, labor, and digital privacy regulation through what has come to be called the “California effect” (a term coined by University of California, Berkeley economist David Vogel in a 1999 paper), while other states have adopted a light regulatory touch in order to attract jobs and investment in a strategy often called (appropriately or not) the “Delaware effect.” Meanwhile, the EU has relentlessly pushed for increasingly harmonious regulation among its member countries.

Uniform standards are a precondition to any definition of a “single market” but the EU has gone beyond harmonization to stringency. At times, this has merely reflected a catch-up with individual member states whose tightening of regulations impeded trade flows—“upward harmonization” is the EU term of art—but more often stringent standards have been Brussel’s initiative.

The building of this “European regulatory state”—to borrow European University Institute political theorist Giandomenico Majone’s term—has been a political quest for higher standards in everything from food and product safety to digital privacy, aided by an opaque rulemaking process that fast-tracks them into law with nothing like the U.S. reliance on benefit–cost analysis and trust in the market’s potential to correct its own failures. In the EU, the precautionary principle reigns: the sole prospect of market failure is enough grounds for ambitious rules whose costs policymakers often care not to tally up in advance. (See “The Paralyzing Principle,” Winter 2002–2003.)

The EU’s regulatory zeal has been egged on by the awareness that its tightened, harmonized standards can be exported worldwide through market mechanisms as opposed to global campaigns or multilateral deals. The underlying drivers and far-reaching effect of this “unilateral regulatory power” are the theme of The Brussels Effect, which Columbia law professor Anu Bradford intends to be a counterpoint to what she deems the false narrative of European economic decline. In a number of ways, her book echoes Mark Leonard’s Why Europe Will Run the 21st Century, a 2005 broadside on the bloc’s potential to buck U.S. unilateralism and spread EU norms and values through persuasion. Bradford, however, does concede that the EU’s norm-setting power in the fields of democracy and human rights is not now growing but waning, but it does have growing regulatory might.

By its sheer market size and appetite to roll out stringent rules, the EU’s standards automatically make their way to other countries’ rulebooks, where multinationals find it difficult to either forgo the EU’s vast market of 300 million consumers or tailor varying products to different regu-
Regulatory regimes. This is the genius behind the Brussels effect: it is unilateral but relies on market-driven mechanisms (Bradford calls this the “de facto Brussels effect”), sometimes buttressed by accompanying legislative emulation (de jure). American tech firms forced to globally comply with the EU’s General Data Protection Regulation (GDPR), for instance, went from fretting about its costs to lobbying Congress to use it as a template for U.S. privacy legislation, motivated by their desire to reduce their competitive disadvantage vis-à-vis domestic competitors that are not export-oriented.

Regulatory review / This “regulatory imperialism” comes with many drawbacks, not the least of which is its affront to democracy in the countries that undergo it. This does not trouble Bradford, who seems to think that exporting standards she deems morally superior is worth bypassing the democratic process and altering the political economy of sovereign nations. European regulations reflect a tradeoff between higher prices and supposed health, environmental, or privacy benefits, and they’re extended to consumers who’d otherwise make starkly different choices. In fact, it isn’t even clear that EU rules reflect the wishes of European consumers themselves, a problem that Bradford largely ignores.

When consumers report a high appetite for food safety, environmental, or privacy standards, their responses are taken by Bradford and EU regulators to justify virtually any regulatory action, regardless of its costs. Those costs, of course, do not only include money out of consumers’ pockets in the short term, but also a decrease in safer, cheaper, and better products down the line through innovation. In the EU these tradeoffs are rarely acknowledged in public discourse because of the minimal regulatory review done by Brussels. In contrast, in the United States—at both the federal and state levels—regulatory proposals usually face formal public comment and often include sophisticated benefit–cost analysis. The EU and its associated quangos are content with mere “impact assessments,” a watered-down, rushed form of analysis.

Lately, the EU’s regulatory ambitions have aimed for even grander projects, whose costs may be unquantifiable. Far from impressing restraint on regulators, this has only emboldened their zeal. It was only after the European Parliament and the Council of the EU—the bloc’s co-legislators—passed the GDPR that big tech companies and other large data processors began to tally up the expense that revamping their entire data collection practices would entail. They were hardly even consulted on the proposal, and besides, adding up the cost of ensuring that every piece of data is collected GDPR-compliantly couldn’t be measured in the short time it took for the EU to pass the law. This was reflected in a flurry of ex-post dour surveys by global consultancies, which, of course, was too late.

Protectionism? / A common qualm leveled against the Brussels effect is that it is protectionism in disguise. Bradford rejects this by pointing out that the EU has some of the world’s toughest competition rules, with a record of hefty fines on member states indulging in state aid to national champions. With the exception of pan-European giants—e.g., Airbus—this can put large industrial players at a disadvantage vis-à-vis U.S. and Chinese firms. The EU’s antitrust orthodoxy, however, is gradually giving way to increasing talk of a protective industrial policy.

Meanwhile, the EU’s iron-fisted enforcement of competition rules has mostly targeted U.S. firms, primarily in tech. Bradford acknowledges this but argues that hefty fines to Google and Amazon have mostly benefited smaller competitors not from Europe but the United States, which she believes demonstrates that the EU’s competition policy is the opposite of protectionism. Oftentimes there are simply no European champions to benefit from sanctions on U.S. tech giants, thanks to the Brussels effect itself. Consider that Google’s market share in the EU search engine market is its highest in the world, 20 points above that in its home American market (90% vs. 70%). Those decrying the EU’s impotence to compete with American technology should realize that excessive regulation bears a large chunk of the blame.

This is the stunning irony of the Brussels effect: Europe exports regulatory standards that primarily harm small EU innovators that can less afford to cope with red tape than U.S. firms, for whom complying with mandates or paying fines is a costly but survivable obstacle. So, ironically, European regulation can’t be decried for being protectionist, at least in these instances.

In other areas, however, the EU’s protectionist impulses are hard to ignore. Bradford’s narrow focus on regulatory policy blinds her readers to other market forces exporting EU policy, such as the multi-billion-euro Common Agricultural Policy subsidies to European farmers, which oftentimes price developing country competitors out of their own markets, to cite one example. In other cases, what’s been advanced as health and safety reasons to shut out foreign competition has rested on shoddy science. Think of the EU’s bans on hormone-fed beef (1989) and chlorine-washed chicken (1997), both measures for which the scientific consensus did not indicate a danger to public health. (And, it should be noted, in both cases the World Trade Organization ruled against the EU.) EU bureaucrats have been happy to draw on shoddy science to enact protectionism in disguise.

Conclusion / Bradford’s appraisal of the Brussels effect’s future is clear-eyed. The entire EU edifice is now being challenged by sovereignist pressures across the
Slightly Less Democracy Means Slightly More Freedom

O ne of the principles I taught my economics students the first day of class and then applied incessantly thereafter was the importance of thinking on the margin. Garett Jones, an economics professor at George Mason University, has written a whole book in which he does just that. Jones considers what would happen if we made highly democratic countries less democratic and entrusted certain political decisions more to unelected officials. If you think he’s attacking democracy, you’re missing his point. He is calling for slightly less democracy. In short, he is thinking on the margin.

In what will probably be one of the most important books of 2020, Jones argues that if we made the United States and many other countries slightly less democratic, we would get slightly more freedom and slightly better policies. He makes his case by examining the details of central bank policy on inflation, appointed versus elected judges, restrictions on who can vote, the effects of the European Union, and the extreme case of Singapore.

Refreshingly, he knows how to coin humorous but informative lines. For example, in discussing William F. Buckley Jr.’s famous statement that he would rather be governed by the first 2,000 names in the Boston phone book than by the Harvard University faculty, Jones proposes an alternative: “Rather than being governed by the masses of Boston or by the professors of Harvard, I’d far rather be governed by the engineering faculty of MIT.”

I started reading his book as someone who hates having important decisions made by “faceless bureaucrats.” I ended up thinking, along with Jones, that that might be better. He makes clear that basic democracy is good for a simple, important reason: “democracies don’t engage in widespread slaughter of their own citizens.” Thus, he calls for only slightly less, rather than a lot less, democracy.

The evidence / Exhibit A for Jones’s case is the effect of central bank independence on the inflation rate. He references a path-breaking 1993 article by Harvard economists Alberto Alesino and Lawrence Summers that looked at central banks around the world and used simple graphs to show that the more independent a bank was from the political system, the lower the inflation rate. If you dislike high inflation, as most people and most economists do, Alesino and Summers’s article argues for central bank independence.

Evidence from New Zealand was quite striking. In the 1970s and 1980s, when it had one of the least independent central banks, its average inflation rate exceeded 10%. But in 1989 the politicians gave New Zealand’s central bank much more independence. The result: by 1991 New Zealand’s inflation rate was down to 1%.

Jones also considers the effects of having elected versus appointed judges. He quotes from a 1988 book by elected judge Richard Neely of the West Virginia Supreme Court of Appeals:

As long as I am allowed to redistribute wealth from out-of-state defendants to insured in-state plaintiffs, I shall continue to do so. Not only is my sleep enhanced when I give someone else’s money away, but so is my job security, because the in-state plaintiffs, their families, and their friends will reelect me.

If this were just an anecdote, it wouldn’t mean much. But Jones, digging into the academic literature, shows that damage awards granted by elected judges are systematically higher than those granted by appointed judges. Specifically, “the average award paid by an out-of-state defendant was about $140,000 higher when the judge was elected rather than appointed.” He notes that averages can be distorted by a few top-end awards, but the median award for a partisan judge (one running on a political party’s ticket) was $38,000 higher than that for nonpartisan judges (those who were appointed or elected in nonpartisan races). And the difference at the 75th percentile

region, motivated less by a desire for lighter regulation than a complete rejection of “ever-closer union.”

But this is perhaps not the largest threat to Brussels. With Europe’s shrinking share of the world’s gross domestic product, America’s experience with growth-boosting deregulation, and China’s growing potential to export its state-capitalist model to far corners of the globe, it isn’t clear that future regulatory trends will emerge from the EU. More importantly, technological advances are allowing firms to segment their offerings to cater to different regulations. Geo-blocking can allow tech firms to shut only European customers out of content that the EU’s regulations on hate speech or privacy would prohibit. Terminator seeds can prevent genetically modified organisms (GMOs) from adventitiously spreading to farm crops destined for the GMO-intolerant EU. 3D printing allows producers to tailor goods to varying health and safety regulatory regimes.

These trends and innovations will gradually weaken the EU’s regulatory footprint worldwide. But until the bloc’s bureaucracy—for now autonomous and unaccountable—is reined in by common sense or a return to voluntary cooperation between sovereign nation-states, runaway regulation within the EU may go on unimpeded. For European innovators and many consumers, that’s a Brussels defect.
was a whopping $304,000. Jones, a careful analyst, points out that to judge the effects of partisanship negatively, one must assume that—all other things equal—higher payouts are worse. Given the incentives that Neely identified in his quote and based on the literature on liability that I’ve read, I do.

Jones, who reveals in his introduction that he was once an aide to Sen. Orrin Hatch of Utah, also finds a systematic difference in voting between those senators who were in the first four years of their six-year term and those who were “in cycle,” that is, within two years of standing for reelection. He writes, “When a senator is in cycle, she’s 10 percentage points less likely to vote for a trade deal.” Since most trade deals move in the direction of free trade, this means that senators are more pro-free trade when they aren’t as worried about reelection.

Notice, by the way, Jones’s use of “she” even though the vast majority of senators in the sample studied are male. He consistently uses the feminine gender to talk about politicians, people at high levels in business, and judges. I know that publishers are pushing authors to do this, but Jones goes overboard. The one place where he uses the feminine gender where it fits an actual majority is in his discussion of Social Security beneficiaries: women outlive men on average.

People power/On voting, Jones reveals that there is a systematic difference between the knowledge and understanding of formally educated voters and those who have less education. He discusses the work of Italian public opinion researcher Vincenzo Memoli. Memoli measured basic political knowledge using survey questions such as who the Italian prime minister was and which political parties were on the left and which on the right. In a 2001 sample in which he used a scale of 1–9 to measure respondents’ knowledge, with 9 being the most informed, respondents who had a college degree had an average score of 7.7, those who had completed only high school averaged 6.7, middle school 5.3, and elementary school 4.7.

Jones quotes other work showing that more formally educated people are less likely to believe in implausible conspiracy theories such as the idea that there was never a moon landing. Of course, one can be more formally educated and better informed and still believe in bad policies. But Jones cites his George Mason colleague Bryan Caplan’s 2007 book The Myth of the Rational Voter, which finds that the least educated are the most likely to support, among other things, higher tariffs, rent control, and regulations that make it harder for employers to fire workers. Those are three policies that economists broadly oppose because of their harm to general welfare: tariffs hurt consumers; rent control destroys housing and reduces the incentive to build; and laws against firing workers make employers less likely to hire.

Jones cleverly titles the chapter in which he discusses voting “This Chapter Does Not Apply to Your Country.” It’s his way of trying to get us to drop our biases and imagine that we are setting voting policy for another country. Not one to avoid tough issues, he applies his understanding of voting to an issue that has become prominent in the United States: whether to allow felons who have been released from prison to vote. His discussion made me realize that I had regarded this as a moral issue: since these people had “served their time,” I thought they should be allowed to vote. Jones grants that people can have moral views different from his own, but he sees this as a practical issue: what would be the consequences of letting felons vote? He argues against letting them vote because they are on average less educated than non-felons. He quotes a striking finding by Caroline Wolf Harlow, a statistician with the Bureau of Justice Statistics:

About 41% of inmates in the Nation’s State and Federal prisons and local jails in 1997 and 31% of probationers had not completed high school or its equivalent. In comparison, 18% of the general population age 18 or older had not finished the 12th grade.

I found myself agreeing with Jones. (I should note that, for my first 14 years as an adult in the United States, from age 21 to 35, I was unable to vote because I wasn’t a U.S. citizen. When I finally got to vote, in 1986, it was a disappointment.)

Whatever your views on who should be allowed to vote, I would bet you’ll find some of his thoughts stretching your mind and reducing your biases. One of his ideas is to turn the U.S. Senate into a Sapientum, a council of the wise. The path to doing that, he writes, would be to change who gets to vote for senators. For instance, these voters could be limited to those who have a certain level of education, those who have been in a craft trade for at least five years, and those who are military veterans. These would require a certain level of intellectual maturity.

When Republicans took control of the U.S. House of Representatives in the 2010 elections, they fulfilled their pledge to eliminate earmarks—specific spending added to legislation to help constituents in various members’ districts. Jones predicted at the time that the reform would make it harder to rein in federal spending. Earmarks, he notes, were never more than 1% of federal spending, but were useful for persuading various members to vote for bills that reined in spending overall. He admits that he was “wildly incorrect” at first. Congress, along with President Obama, did start to get discretionary federal spending under control. But, argues Jones, in the long run—where we are now—he has been proven right: “In the U.S. Congress, with the decline of earmarks, the biggest games left in
If Only We Listened to Economists

**REVIEW BY SAM BATKINS**

Despite Harry Truman’s crack about the need for a one-handed economist, well-trained economists who advise politicians usually share agreement on many principles. Unfortunately for those who work for politicians, their work often requires them to cobble together and support policies at odds with those principles.

In *When the President Calls*, New York University economist Simon Bowmaker interviews several economists from the Nixon administration to the Trump administration who have been put in that position. The book gives readers a sense of the advisers’ individual personalities and the substantive economic input they provided to the president.

The book offers little-known anecdotes and White House gossip that provide plenty of humor. For example, the late Paul O’Neill, who was treasury secretary in the George W. Bush administration, said this about the president he served: I honestly have no clue how Bush 43 thought about economics. My meetings with him were absolutely unmemorable..... He can’t be very proud of what he did.

Concerning the priorities of Bush’s chief political adviser, Karl Rove, O’Neill said, “It was about winning votes and winning elections. Doing the right thing was more an afterthought.”

Bowmaker spends considerable time on each administration’s crises and how each policymaker provided substantive input to the president. But the gossip is a nice bonus.

**Ties that bind** The first question Bowmaker asks each economic adviser is why he or she got into economics. Despite the partisan and ideological diversity of the group, they are generally free traders, recognize there is no such thing as a free lunch, understand incentives and tradeoffs, and recognize the importance of benefit–cost analysis. There are several unifying traits among the group, as economics is their common “religion” in many respects, not politics.

The book includes plenty of economic giants: Paul Volcker, Alan Greenspan, Joseph Stiglitz, Greg Mankiw, Glenn Hubbard, and John B. Taylor, among others. Greenspan was hardly shy in describing his experiences with different presidents. When naming the two “sharpest,” Bill Clinton and Richard Nixon were his choices. Apparently, Clinton would read three or four books a week as president. Greenspan remarked, “It is an extraordinary intelligence. How he ended up as a politician I do not know, but he is very impressive.” Generally, appreciation for Clinton was strong among the economists surveyed.

Despite the stereotypes of rigid analytical and quantitatively driven minds, many of the economists were in positions of administrative power and had to marshal an array of “soft” skills and abilities. For example, W. Michael Blumenthal, who served as treasury secretary under Jimmy Carter, noted how important emotional intelligence was during his tenure. With a team of other experts in the White House and supporting agencies, economic advisers have to trust their subordinates and rely on their judgment.

Blumenthal remarked, “Politicians are cowards. They are followers, not leaders, in most instances.” For economists trying to dole out good advice, this cowardice sometimes can be an asset, but other times the lack of conviction can lead the nation down a less optimal path. All the advisers provided plenty of candid commentary on this, and they avoided broad platitudes and bland rhetoric.

The interviewees commonly believed that elected officials viewed economists as too wonkish, as being “incompreh-
sible spewers of jargon.” In response, the economists generally viewed their bosses as lacking patience—largely because of electoral pressures—and often disregarded their economic advice when it conflicted with short-term political gain.

Americans’ general understanding of economics, as well as the media’s, is also criticized during rounds of interviews. Harvey Rosen, chair of the Council of Economic Advisers under George W. Bush, remarked bluntly:

The media are awful…. For the most part, they don’t understand economics. Secondly, they think that because you are in the administration, you must be lying to them.

Lament over the lack of economic literacy among media and the general public pervades the book. However, most economists outlined a series of steps and recommendations that could advance collective economic knowledge. Whether it’s educating Americans or convincing politicians, economists face an uphill battle on many fronts.

Differences magnified/There are occasional differences among the interviewees, from their take on supply-side economics to their opinions on federal spending and income support. The outlier interview was of supply-sider Art Laffer, chief economist at the Office of Management and Budget under Nixon and economic adviser to Ronald Reagan. Laffer was especially candid in his interview. On Nixon, he was less than flattering:

Everything he did in economics was the opposite of what should be done! He raised taxes, he put on wage and price controls, he put on tariffs, he put on a buy-American program, and he went off gold when he should have stayed on it.”

Readers can see the parallels to today’s economic environment.

What stands out most from Laffer’s interview is his contempt for former colleagues and critics. Herb Stein, Paul Samuelson, Greenspan, Martin Feldstein, David Stockman, and Washington, DC itself are scorned. Even Milton Friedman isn’t entirely spared: “Milton was the Yoda of economics. He’d always talk about principles, but he didn’t write bills and work on the floor.” Despite Laffer’s successes during the Reagan administration, including the lowering of the top individual tax rate from 50% to 28%, the reader gets the impression that—like O’Neill—Laffer despised his time in D.C., even though he still influences domestic policy decades later.

The book includes, of course, a retelling of the story of the infamous cocktail napkin that produced the “Laffer Curve.” However, Laffer downplays his “invention,” saying it is an insight from generations past, from thinkers as varied as 14th-century philosopher Ibn Khaldun and John Maynard Keynes. The curve was largely forgotten after World War II until Laffer and Reagan popularized it; it has motivated much of the Republican Party’s fiscal thinking ever since.

Having a plan/Moving past Laffer, one takeaway from the book is especially relevant to the recent Democratic presidential race: the value of politicians having detailed policy proposals for all sorts of issues. Some of the advisers believed such plans are a necessity; to quote Gene Sperling, director of the National Economic Council under Clinton, a “plan beats no plan.” This idea was embodied in Sen. Elizabeth Warren’s erstwhile presidential campaign, which had the slogan, “I’ve got a plan for that.” Her campaign was easily the most policy-detailed of any of the 2020 candidates. Even if you disagreed with her ideas, at least you knew where she stood on the major issues. However, when it came to vote totals, all those plans usually left her in the middle of the pack.

On the other hand, many Republicans in recent elections seem to be running on the strategy that having a plan is a disadvantage. It’s unclear whether voters agree. If nature abhors a vacuum, then so does public policy—especially in times of crisis. When Democrats were in power during the Obama administration, they filled perceived gaps in health care and climate policy. Arguably, the GOP response has been little more than to undo them, with no alternative policy prescription, and the electorate seems to be increasingly underwhelmed by that response. While it’s inconclusive how much voters punished Republicans for lacking a climate change policy in 2018, it’s more than clear that GOP votes to repeal “Obamacare” without a viable alternative hurt Republicans in dozens of races. Health care was easily the most messaged campaign issue in the midterms.

To Sperling’s point, the Republican nihilist strategy can be politically effective if the status quo is unpopular, but saying “no” in the face of a popular policy program—or at least on an issue of public concern—is often a strategy for electoral defeat. This fall, we will see if Republicans think they can win by continuing to say “no,” or if they will try a different strategy.

Lessons from the Great Recession/ Scholars of the 2008 financial crisis will appreciate the book’s disparate takes on policymaking in the crisis. Whether the blame for the crisis should go to the Fed, or Fannie Mae and Freddie Mac, or the lack of regulation around derivatives and the mortgage industry, there are plenty of opinions to consider.

When Larry Summers, treasury secretary under Clinton, was pressed on whether reforming the Depression-era Glass–Steagall banking act contributed to the Great Recession, he shot back, “I don’t think it’s remotely plausible to argue that the Gramm–Leach–Bliley legislation, which
President Clinton signed into law and we worked on, contributed meaningfully to the financial crisis.” Likewise, the late Alan Krueger, chair of the Council of Economic Advisers under Obama, put the Great Recession in grim context: “The economy was contracting at an 8 percent annual rate, and we were losing 800,000 jobs a month.”

Sadly, those numbers seem quaint compared to our current contraction. Bowmaker did interview Kevin Hassett, who chaired the Council of Economic Advisers under Trump, and Mick Mulvaney, who headed Trump’s OMB. Bowmaker may want to write a follow-up on their thoughts on what is now arguably the most dramatic contraction in American history.

Conclusion / The book gives readers an appreciation of the awesome task economists face when trying to influence economic policy in the United States, and the utter disappointment they must feel when their views are overruled by political advisors. Despite the distinguished academic backgrounds and professional bona fides of the interviewees, it’s easy to forget they are also human. The book illustrates that frequently, as saying “no” to the president can be difficult.

I, Progressive

FREE ENTERPRISE: AN AMERICAN HISTORY is Cornell historian Lawrence Glickman’s 2019 contribution to a growing body of research called the “new history of capitalism,” which is an often-critical look at race, gender, and the power dynamics within capitalism. Glickman assembles a lot of interesting facts, but the book, and particularly its chapter on Leonard Read’s essay “I, Pencil,” would have benefited from pre-publication feedback from someone with a deeper appreciation of the economic thought behind capitalism. As published, it calls to mind George Mason economist Peter Boettke’s description of Nancy MacLean’s 2017 Democracy in Chains as “a poignant lesson to us all about how ideological blinders can subvert even the sincerest effort to unearth truth in the social sciences and the humanities.” Had Glickman workshopped his chapter on “I, Pencil” with economists who use the essay regularly in introductory courses, he could have avoided a serious misunderstanding of Read’s project.

ENTHUSIASM FOR INTERVENTION / Glickman is right that businesspeople are inconsistent and even hypocritical when they bash “big government” on one hand while reaching out for special privileges, subsidies, and other goodies with the other. This is something that market-friendly economists have criticized for quite some time, of course. Milton Friedman famously argued that businesspeople believe in free enterprise in every industry except their own, which must be regulated and protected in the name of the “common good” or “national security.” My academic work and personal observations find plenty of support for economist Steven Horwitz’s First Law of Political Economy: “No one hates capitalism more than capitalists.” Businesspeople pay lip service to free markets as long as those markets are threatening someone else’s bottom line.

Glickman is also quite right that free enterprise enthusiasts of the mid-20th century were given to apocalyptic, hyperbolic rhetoric when describing the effects of government intervention. That is true of many social movements, though, and perhaps the free marketers can be forgiven for responding to the rise of fascism and communism in Europe and Asia—not to mention the enthusiasm some New Dealers had for totalitarian experiments. Rexford Tugwell, the economist who was probably the most prominent member of Franklin D. Roosevelt’s Brain Trust, admired the order and purpose of Mussolini’s Italy and wrote that “the future is becoming visible in Russia.” And a free-market supporter listening to Roosevelt denounce “economic royalists” or reading about his assistant U.S. attorney general (and, later, his solicitor general, attorney general, and Supreme Court appointee) Robert H. Jackson’s 1937 address on “The Menace of Free Enterprise” to the American Political Science Association (later published with the much less incendiary title “The Philosophy of Big Business”) might be forgiven for thinking himself threatened by very powerful political forces.

Nowhere in the book does Glickman show an appreciation for thoughtful defenses of free enterprise. Rather, to him such defenses are always pietistic projects. He begins discussing “faith” in free enterprise pretty much right off the bat, and he doesn’t mean it as a compliment. From the introduction:

I discovered that the idea of free enterprise is also a myth in another, more important sense: a set of assumptions, narratives, and attitudes that has guided our common sense and, regardless of empirical accuracy, has dramatically shaped how Americans have understood and engaged in politics. [My emphasis.]

Yet, Glickman himself is given to narrative over analysis, such as when he offers the standard progressive catechisms about capitalist exploitation: “debt peonage, labor exploitation, Jim Crow segregation, and violent repression of the labor movement,” “unregulated and violent capitalism of the Gilded Age,” and “unsavory practices of the new class of business titans” in the Progressive Era. With reference to “empirical accuracy,” he offers no discussion at all of empirical research on the effects of the New Deal specifically or of (for example) the “ratcheting” of government intervention that Robert Higgs identified in his
1987 classic Crisis and Leviathan. Nowhere in the book does the reader get the sense that there is any possibility the New Deal might have been fundamentally flawed. To his credit, Glickman acknowledges some of the problems with the New Deal, but its overall wisdom is simply assumed—an article of faith, one might say—and the rest of the book reads as a breathless effort to offer devious reasons for why some people oppose it. Nowhere does he show any familiarity with the empirical work of Price Fishback, Jennifer Roback, H. Gregg Lewis, Richard Vedder, or Lowell Galloway on the narrow issues of labor economics specifically, to say nothing of the empirical work by Higgs, Harold Cole and Lee Ohanian, or even Friedman himself on the Great Depression and the New Deal. There is also no acknowledgment that I can find of the spectacular effect of “free enterprise” on standards of living. Might its advocates be onto something? It is hard for the reader to tell.

Creepy authority / One also gets no sense from the book that people might have been wise not to trust Roosevelt and his Brain Trust with unchecked power. We don’t read anything about the internment of Japanese-Americans during World War II, for example, and the book is silent on important Supreme Court decisions that variously struck down or upheld parts of the New Deal. Roosevelt’s “court packing” scheme is not mentioned. The Schechter decision of 1935 invalidating the National Industrial Recovery Act is nowhere to be found, nor the momentous 1942 Wickard v. Filburn decision that expanded federal regulatory authority under the Commerce Clause or the 1945 United States v. Alcoa decision that created the “relevant market” interpretation for antitrust. That Schechter had to go all the way to the Supreme Court and that Wickard and Alcoa were decided as they were suggest that Glickman might not be wholly correct in claiming that “Free enterprisers fought a New Deal that existed largely in their imaginations.” Moreover, someone going on YouTube and watching the “NRA Official Featurette Patriot-ically Contributed by the Motion Picture Industry,” in which Jimmy Durante sings worshipfully about Roosevelt and the New Deal, might be surprised by the creepy feeling it provokes.

Some of Glickman’s sourcing is curious. In discussing the free marketer lament that taxation is slavery, he quotes not Robert Nozick (who made this argument explicitly) or the economic historian Deidre McCloskey but an anonymous comment by “Chris from NJ” left on the philosopher Gregory Ransom’s blog. I don’t mind the use of unconventional sources of evidence, but it seems like Glickman could have found a better and more credible interlocutor.

He mentions Friedrich Hayek just a couple of times, which is perhaps understandable given that Hayek was European and not really American until he left the London School of Economics for the University of Chicago. He mentions Ayn Rand but doesn’t go into much detail on her work, her influence, or her strident criticisms of communism precisely because she fled the system that so many (like Rexford Tugwell) thought was “the future.” Perhaps he didn’t want to retrace the steps of Rand biographers Jennifer Burns and Anne Heller, but at the very least a little bit of context would have been useful.

I was struck, though, by his criticism of businesspeople who in turn criticized “bureaucracy” and “omnipotent government” without mentioning or engaging with Ludwig von Mises’s 1944 books Bureaucracy and Omnipotent Government. In Glickman’s discussion of “I, Pencil,” he explores Read’s idea that planning would lead to chaos without, again, noting that in 1947 Read’s Foundation for Economic Education publish Mises’s short book Planned Chaos, which was then included as an epilogue to the 1951 edition of Mises’s Socialism: An Economic and Sociological Analysis. The phrase “free enterprise” appears nine times in Omnipotent Government and 23 times in Bureaucracy, which is a little over a hundred pages. These are not Mises’s most notable works, but they are hardly obscure texts: all were published in some form or fashion by the same prestigious academic press—Yale—that published Free Enterprise. These, I think, would be more worthy adversaries than anonymous blog commenters, Fox News talking heads, and op-eds in obscure newspapers—particularly given that Mises fled Europe for the United States in 1940 to escape totalitarianism. Perhaps he knew what he was talking about. We wouldn’t know that the ideas being expounded had any meaningful intellectual provenance apart from a footnote that mentions Quinn Slobo-dian’s Globalists.

Speaking of Mises, one of my favorite quotes from him summarizes the broadly leftist and specifically Marxist or Marx-inspired form of argument that seems to be the method of modern progressivism and much of the New History of Capitalism scholarship: “The enemy is not refuted. Enough to unmask him as a bourgeois.” Mises wrote this with reference to 20th-century Marxism, but it applies to the leftist–progressive methods of today. Free Enterprise is very much not an exercise in refutation; it is an exercise in unmasking, with the assumption that the critics of the New Deal arrive at their flawed conclusions because they are bourgeois.

Misreading Read / Chapter 6 of Free Enterprise is dedicated to a “close reading” of “I, Pencil.” Unfortunately, Glickman completely misunderstands the essay. He makes much of Read’s use of the word “miraculous” to describe the workings of the market and infers from this—indeed, states explicitly—that, according to the free enterprisers, no one can know exactly how markets work. In this he misses the point, and badly. We certainly can and do know how markets
work, and we’ve had a pretty good idea of this for quite some time. Read’s point is that voluntary, market exchange allows each of us to harness knowledge we ourselves do not have for purposes other people need not know. I cannot, for example, describe the chemical composition of the plastics that went into my noise-canceling earbuds or the science behind how, exactly, they muffle the sound of the nail gun being used by the roofing contractor next door. I am able to make use of this knowledge, however, because it is embodied in a product I wanted at a price I was willing to pay—and a product that helped me solve the very particular problem of continuing to get my work done during the COVID-19 epidemic.

Glickman’s understanding of the origins and influence of “I, Pencil” is also incomplete. He seems not to recognize its similarity to the “woollen coat” Adam Smith discusses in *The Wealth of Nations*, and while he mentions its prominence in a 2010 TED talk by science writer Matt W. Ridley, he doesn’t pay any attention to artist Thomas Thwaites’s 2010 TED talk on his Toaster Project, which drew much more directly on “I, Pencil.”

To Glickman, “I, Pencil” is missing something because it doesn’t make mention of the corporations or corporate power that goes into its production. “His ode to the Eberhard Faber pencil strikingly overlooked the part that the Eberhard Faber Pencil Company played in contributing to its creation.” “In cataloguing the nature of the free enterprise system, Read, like most free enterprise, rendered corporations invisible.” “This occlusion of the corporation in ‘I, Pencil’, then, was not atypical.” One can almost hear Glickman saying “Checkmate, free enterprise!” But again, this is one of the ways in which the chapter misses the forest for the trees. First, Read’s exercise is one in exploring how something as mundane as a pencil emerges from a process that is “the result of human action, but not the execution of any human design,” as Adam Smith’s contemporary Adam Ferguson put it. Second, corporations are incidental to the analysis as they are neither necessary nor sufficient for wealth-creating voluntary cooperation.

In any event, the question of the firm is something that economists have dealt with in quite considerable detail, with the classic contribution coming from Ronald Coase’s “The Nature of the Firm.” The most memorable statement of the problem comes from the economist Dennis Robertson, who described firms memorably as “islands of conscious power in an ocean of unconscious cooperation, like lumps of butter coagulating in a pail of buttermilk.” Read, I think, would agree that it is the “ocean of unconscious cooperation” that is most striking and important. The “islands of conscious power,” while interesting, are beside the point.

In “I, Pencil,” Read is also capturing in the context of a simple story something that blows my mind every time I teach comparative advantage to my introductory macroeconomics students: two people can enjoy consumption possibilities in excess of their individual production possibilities simply because of specialization and exchange. If they can specialize and exchange, Britney and Miley trading apples and oranges can get more apples and more oranges. They can get more output with given inputs, or they can get the same output with fewer inputs. In short, they can each deploy the other’s knowledge without actually having that knowledge themselves, and they can care for one another without caring specifically about one another. Asking “What about corporations?” misses these simple but profound points.

Conclusion/When all is said and done, *Free Enterprise* will not convince libertarians (or people sympathetic to the work of Mises, Hayek, Friedman, and others) that they’ve been had. But that’s not Glickman’s aim, nor are we his audience. *Free Enterprise* is intellectual comfort food for progressives who are already wholly convinced by the rightness of their cause. Rising enthusiasm for “free enterprise” may very well have happened because businesspeople were scared by the New Deal, but we should at least think it possible that maybe they had good reasons to be afraid.

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**He Doesn’t Approve**

**REVIEW BY ART CARDEN**

In roughly the last two decades or so, there has developed among historians a body of research known as the “New History of Capitalism,” an often-critical look at race, gender and the power dynamics in capitalism. Eugene McCarraher’s *The Enchantments of Mammon* joins too many contributions to this literature in being defiantly some two decades to write, it is filled with useful and interesting facts, fascinating characters, and intriguing references. In reading it I found my own list of things to read growing and growing—enough, I think, to keep me occupied for the next 20 years if I set my mind to it. McCarraher sketches out his thesis in the context of a detailed history of business literature and personalities who argue—as Deirdre McCloskey and I do in our own forthcoming book—that there is nothing necessarily wrong with buying, selling, and innovating.

McCarraher also explores and explains
the ideas of Romantic critics of capitalism like Thomas Carlyle and John Ruskin, who “turned to precapitalist values and cultures for inspiration.” He does not gloss over Carlyle and Ruskin’s racist views, noting that Carlyle’s denunciation of economics as “the dismal science” was part of his defense of slavery, and he is admirably frank about how “this book partakes unashamedly of [Ruskin’s] sacramental Romanticism.” Readers will learn a lot about how the capitalist world looks through the transcendental frame of Romanticism.

The book begins promisingly enough. McCarraher writes, “Far from being an agent of ‘disenchantment,’ capitalism, I contend, has been a regime of enchantment, a repression, displacement, and renaming of our intrinsic and inveterate longing for divinity.” He promises “an extended essay of the moral and metaphysical imagination: our ideals of self and the common good that emerge from the way we understand the nature of the cosmos—what philosophers and theologians would call our metaphysics, ontology, or cosmology.” This suggests an emphasis on the kind of questions economists are (in)famous for ignoring.

Communicating contempt. The good, I fear, pales in comparison to the bad and the ugly. It is clear that even though the publishers sent me a gratis copy, economists by and large are not invited to the conversation—as participants, at any rate. This would be fine if the book were a treatise on military history or some other topic on which economists might not have much to say. But it is subtitled How Capitalism Became the Religion of Modernity, so the book might want to engage with and really understand the ideas of the economists who figure so prominently as villains in McCarraher’s story.

Alas, that isn’t to be. Perhaps it is buried in footnotes that I missed and that don’t come up in a Google Books search, but I could find no engagement with McCloskey’s “bourgeois era” trilogy, which is a remarkable omission given that McCraher wrote an angry 7,000-word review of the first volume in the series, The Bourgeois Virtues, after it was published. McCloskey replied to his review and tells me he never replied to her. He certainly doesn’t do so now. The Enchantments of Mammon contains no hint of McCloskey’s Bourgeois Dignity (2010) or Bourgeois Equality (2016), which directly address his project. I think he would have benefited from doing so, particularly the chapters critiquing the late Austro-Hungarian economic historian Karl Polanyi, whom McCarraher cites approvingly near the beginning of the book.

McCarraher doesn’t just overlook McCloskey. In a book that features Carlyle and Ruskin so prominently, David Levy’s excellent How the Dismal Science Got Its Name is nowhere to be found. Theologically minded economists are a rare breed, though not perhaps as rare as one might think, and it speaks volumes about the state of the academy that in writing an 800-page book over two decades McCarraher ignores A.M.C. Waterman, Paul Heyne, and Laurence Iannaccone. Especially conspicuous for his absence is Robert H. Nelson; surely books with titles like Reaching for Heaven on Earth: The Theological Meaning of Economics and Economics as Religion: From Samuelson to Chicago and Beyond would have merited at least some attention in a book subtitled How Capitalism Became the Religion of Modernity. (See “An Intellectual Odyssey Cut Short,” Summer 2019.)

Or not. Most of what McCarraher has to say about economists and economics—not to economists, but about economists and economics—is woven into page after page of sneering, indignant invective that, after almost 700 pages of text, is simply exhausting. We read, for example, about “the avaricious and punitive sophistry professed in the dismal pseudoscientific” of economics, which “is not just a dismal but a fundamentally fraudulent science.” A few hundred pages later, we read this about Ayn Rand:

Though written at the meridian of the New Deal era, Rand’s hateful and sanctimonious fables of selfishness supplied an intoxicating fillip for later captains of neoliberal predation. Emboldening the piracies of finance capital, feeding the cyberculture’s exhilarant ambitions of technological sublimity, and bracing a new plutocracy with a conviction of its own existential superiority, her kitschy and melodramatic tributes to greed augured an epoch of spectacular pillage.

The book is strewn with similar passages that would elicit “Amens” from the progressive choir but communicate little more than the author’s contempt for capitalism and its defenders.

Conclusion. I think McCraher’s unfortunate treatment of Ludwig von Mises summarizes the entire book in both content and method. Mises’s essay “Economic Calculation in the Socialist Commonwealth,” later expanded into the book Socialism: An Economic and Sociological Analysis, is dismissed as a “diatribe.” McCraher refers readers to Norman O. Brown’s Life Against Death “for a brilliant critique of Mises,” but what Brown offers is a simple wish for “socialism, as a system which by its very nature transcends the psychology of Homo economicus.”

Throughout the book, McCraher seems to yearn (like Brown, apparently) for a truly radical reorganizing of society according to the Romantic transcendental frame, a reorganizing in which principles like “resources have alternative uses” and “people respond to incentives” no longer apply. It reminds me of Ernst Mandel’s introduction to an edition of the first volume of Marx’s Capital in which he says that, after the revolution, human nature will change and the rules of bourgeois economics will no longer apply. It also reminds me...
More Data Is Good, But...

**REVIEW BY PIERRE LEMIEUX**

Two decades ago, Thomas Philippon came to the United States from France to study economics. He was pleasantly surprised to discover how inexpensive consumer goods were here. But then, over time, the situation reversed. From 2000 to 2017, average prices increased by 15% more in America than in Europe. Broadband prices in America are now about twice European prices. “How did Europe, of all places, become more of a ‘free market’ than the U.S.?” Philippon asks.

Now a finance professor at New York University, he decided to answer that question. His research (often done jointly with his colleague Germán Gutiérrez) and conclusions are summarized in his recent book *The Great Reversal*.

**Europe v. America** The answer, he argues, is that industries have become more concentrated and the economy less competitive in the United States while they have moved the other way in the European Union. “Competition,” he observes, “has declined in most U.S. industries over the past twenty years.” Like for telecoms, passenger air fares have dropped faster in Europe. As regulatory restrictions on market entry have grown in the American economy, they have been accompanied by a reduction in the rate of new business entries in markets. Not surprisingly, in sectors open to foreign trade, competition has not decreased or has decreased less.

Philippon finds that two factors explain this divergence: deregulation and antitrust. Product markets (not necessarily labor markets) have been deregulated in the European single market while regulation has increased in America. He shows how the growth of market restrictions in the United States—measured by use of words such as “shall” and “must” in the Code of Federal Regulations as computed by the Mercatus Center’s RegData database—correlates nearly with a growth in market concentration. As for antitrust laws, they have been enforced more stringently by the EU’s independent supranational agencies while the number of antitrust cases has decreased in America.

The author writes:

To be clear, I don’t think antitrust is necessarily the main channel through which Europe has freed its markets. The broad Single Market agenda goes beyond antitrust, and the lifting of entry restrictions has probably had more impact than merger reviews.

Still, he concludes that more stringent merger control is needed in America.

One objection to antitrust is that large technology firms demonstrate that concentration can coexist with competition and efficiency. Think of the “GAFAMs”: Google, Amazon, Facebook, Apple, and Microsoft. Philippon provides evidence that the GAFAMs minus Amazon are smaller than the “star” companies of previous decades. He also argues that their effect on productivity is small because they are less “integrated” in the economy.

This integration argument, based on using total economic activity instead of value added, I find weak. Philippon under-appreciation of the GAFAMs (and their future equivalents) is illustrated by his comment that “if Facebook’s productivity were to double overnight, you would not notice much difference.” In the same vein, he writes, “The iPhone makes it more convenient to access digital content while traveling. It is nice, but if that’s all it does, it will not move the needle of aggregate productivity.” There must be something wrong here, either in the data or in the theory. Imagine the loss of consumer utility and the increase in business costs if smartphones disappeared.

**Data and values** Perhaps Philippon entertains a too-mechanistic view of competition. As Austrian economists have pointed out, competition is more a process than a result or an equilibrium—even if the concept of equilibrium is a useful heuristic device. It is not obvious that counting the number of firms in a market or their market shares tells us much about whether the market is or isn’t contestable by new entrants.

Philippon does economics the way it is mostly done these days: with data. He quotes the saying, “In God we trust, others must provide data.” “My generation of economists,” he writes, “is less interested in ideology, and we have a lot more data. That is not a sufficient condition for success, but it’s a better starting point, in my opinion.” I would argue that the starting point is a theory that suggests which data to look for. It is good to follow the facts, but how does one choose which facts to follow?
It is too easy to attack quantitative or empirical economics. Philippon does admit that the degree of competition is difficult to measure. With concentration indexes? Prices? Profits? But it is also difficult to determine what is good and what is bad, as any public policy recommendation requires.

In the 1990s, Philippon argues, competition by Walmart led to lower prices. But, he claims, Amazon did not have the same effect, at least for anybody other than “high-earning households” that saved a lot in travel costs. What’s wrong with high-earning households getting benefits from market exchange? And what’s wrong with “predatory pricing,” which in a truly free market can only be profitable if the competitor doing it can create more value that way? Philippon tends to think that this sort of interrogation “shows that regulators must remain vigilant” and that “we need data, more data!” Why isn’t it simply more market freedom that is needed?

Quantitatively minded economists tend to forget that moral judgments—what economists call “value judgments”—are required to make policy proposals, as the old field of “new welfare economics” demonstrated in the first half of the 20th century. Philippon does reveal his own value judgments, which seem to be in the middle of mainstream economics. “I am a free market liberal,” he writes. But he simultaneously claims that he favors “equality,” which does not say much until you define what kind and along what dimension. He also claims that “keeping the markets free sometimes requires government interventions.” Regulate in order to keep an unregulated economic system?

Different sorts of lobbying | The Great Reversal is full of good explanations of basic economic concepts—financial intermediation, for example. The student of economics with some preliminary formal knowledge will learn a lot.

Philippon also emphasizes an important result of public choice theory: regulatory capture—the idea that regulated firms will often capture their regulators and use regulation to block their potential competitors and earn anticompetitive rents. He explains how competition is threatened because its benefits are dispersed (among all consumers and potential competitors), while the advantages of limiting competition are concentrated among a few players who thus have a much stronger interest to lobby and capture government.

Large firms spend a lot more on lobbying in the United States than similar firms in the EU. American steel manufacturers boosted their lobbying expenditures by 20% between 2017 and 2018, just before the Trump administration granted them protective tariffs. It appears, writes Philippon, that “lobbying and regulations explain much of the decline in entry rates over time and across industries.” He argues that increases in lobbying also account for a decrease in antitrust enforcement in the United States. But do lobbying to constrain your market competitors and lobbying to prevent government interference in your peaceful exchange activities have the same moral value? Quantitative economists don’t have a comparative advantage in answering that sort of question.

Philippon observes that “lobbying increases when the stakes are higher,” but he seems to believe that the solution lies in independent bureaucratic agencies like in Europe. He does not consider the real liberal solution, which is to reduce the stakes by limiting government power so that there would be little to lobby for.

Philippon engages in the popular European sport of blaming “too much money” in American politics. According to this criticism, the freedom of individuals and private groups to spend their own money to promote their political opinions during electoral campaigns should be tightly controlled just like in Europe. He quotes George Mason economist Thomas Stratmann who argues that no consensus has developed among researchers about the role of campaign expenditures in the winning of elections. More recently, billionaire Michael Bloomberg’s campaign for the Democratic presidential nomination, on which he may have spent more than $900 million of his own money, suggests that money alone does not win elections.

Dangerous regulations / Regulation often goes wrong. Philippon recognizes this. Entry in financial markets is often limited by “heavy—and sometimes biased—regulations.” He cites the case of Walmart, which was denied a banking license “as if debit cards and savings accounts were magical products that a retail firm could not possibly provide.” Because of barriers to entry, the price of financial intermediation is roughly the same (200 basis points) as it was at the end of the 19th century, despite all the technological progress since then.

He argues that the American health care system is concentrated, very expensive, and produces worse infant mortality and life expectancy rates than in many rich countries. He admits that there are behavioral factors and that “medical care accounts for less than 20 percent of the observed variations in morbidity and mortality.” He does not consider the possibility that medical care in the United States is expensive because of the size of both public expenditures and voluntary private expenditures, each contributing about half of total expenditures. When demand increases, prices increase too. In the difficult problem of health care financing, data are not everything; some normative theory is also necessary to offer policy advice.

Philippon explains that, in 2006, Whirlpool was allowed by antitrust authorities to buy Maytag after it quelled antitrust concerns by arguing that foreign competitors would prevent concentration. Yet, a decade later, the same company lobbied for protective tariffs against foreign competition. (See “Putting 97 Million Households through
Philippon is sometimes sounds like Adam Smith’s “the man of system,” who

is often so enamoured with the supposed beauty of his own ideal plan of government, that he cannot suffer the smallest deviation from any part of it. ... He seems to imagine that he can arrange the different members of a great society with as much ease as the hand arranges the different pieces upon a chess-board.

Philippon speaks of the “real economy” and of “markets that really matter,” seemingly forgetting that productivity is defined in terms of what consumers want. He attacks corporate tax avoidance, which he seems to confuse with tax evasion. Against the GAFAMs he proposes tough antitrust and antimerger surveillance. He strangely claims that “Google, Amazon, Facebook, and Apple in some sense owe their present success to the [U.S. Department of Justice], which prevented Microsoft from monopolizing the internet in the late 1990s.” Really? How do the data show that? Suppose that the Justice Department had won its protracted proceedings that started in 1969 against IBM for monopolizing business computers and had broken up the company. Could we now say that the GAFAMs owe their success to the federal assault on IBM?

Philippon also proposes the strange idea that governments should be allowed to “make mistakes too,” as if they were private entrepreneurs taking risks with their own money in a marketplace of competitors. Couldn’t we say that regulatory capture or occupational licensure (which Philippon correctly criticizes) are mere mistakes of governments? Why believe that Leviathan will increase competition instead of extending crony capitalism?

When a government makes mistakes, which is not rare, it often makes them on a grand scale. As public choice analysis suggests, government failures are usually much worse than “market failures.” I would suggest that Leviathan also “create[s] political and democratic issues” much more than the GAFAMs ever will.

Markets and the state / Philippon is “surprised how fragile markets really are.” This may depend on how “fragile” and “markets” are defined. It can be argued that, to the extent that markets are fragile, it is because of regulation and control, not because of a lack of it.

Many economists have argued that, left alone, free markets are not fragile at all. Smith wrote that “little else is requisite to carry a state to the highest degree of opulence from the lowest barbarism, but peace, easy taxes, and a tolerable administration of justice; all the rest being brought about by the natural course of things.” In a similar vein, Mancur Olson argued that economic development is the natural trend and that, on the contrary, “it takes an enormous amount of stupid policies or bad or unstable institutions to prevent economic development.” Bad institutions are often built on and by government power. And think about how solid black markets are.

How could we have come to believe that what needs to be economically and morally justified is the existence of Google, with which individuals exchange voluntarily, instead of the existence of the state, on which an individual has no discernable influence? As far as the danger of politics is concerned, more data are probably not needed: during the 20th century, according to University of Hawaii political scientist Rudolph Rummel’s count, some 169 million individuals were killed by their own governments outside of interstate wars.

The Great Reversal is an interesting book, mainly for the first part of its thesis, that mounting regulation in America explains why markets are now often freer in Europe.

Protectionism as a Skin Disease ✤ REVIEW BY PIERRE LEMIEUX

There was a time, culminating in the 1960s, when most mainstream economists and public institutions such as the World Bank believed that, although free trade might be good for developed countries, it was bad for underdeveloped ones. The governments of the latter were advised to go the route of import substitution, implementing protectionist measures to substitute domestic production for imported goods. The General Agreement on Tariffs and Trade, the treaty that would lead to the formation of the World Trade Organization, allowed underdeveloped countries to retain many protections. Trade was perhaps good for the rich but certainly exploitative and bad for the poor, it was reasoned.

Economists were not the only ones thinking along these lines. The intelligentsia generally believed that government economic development is the natural trend and that, on the contrary, “it takes an enormous amount of stupid policies or bad or unstable institutions to prevent economic development.” Bad institutions are often built on and by government power. And think about how solid black markets are.

A cracking consensus / Fortunately, with their methodological individualism, understanding of spontaneous order, and penchant for data, trained economists make bad cult members. Starting in the 1960s and especially in the 1970s, they became more and more skeptical of this protectionist wisdom. The dazzling economic takeoff of ardently free-trade Hong Kong and other countries with
some degree of liberalized trade—Taiwan, Singapore, South Korea—contrasted with the stagnation of autarkic countries such as India, which was pursuing democratic socialism, and China, where the government was busy launching the Great Leap Forward and the Cultural Revolution, and achieving economic stagnation and deadly famines.

While the future of democratic-socialist India was deemed rosy, more capitalist South Korea was deemed hopeless. But exports of goods and services as a proportion of South Korean gross domestic product rose from only 4.6% in 1963 to 28.7% in 1973. Over the same period, it fell from 4.5% to 4.0% in India. The South Korean economy grew at an annual rate of more than 9.5% over those years, compared to 3.4% for the Indian economy, observes Columbia University economist Arvind Panagariya in his book *Free Trade & Prosperity*. In Taiwan, Singapore, and Hong Kong, growth was even more impressive.

Economists who had been protectionist or even socialist changed their minds. As late as 1970, Columbia University economist Jagdish Bhagwati and Harvard economist Padma Desai wrote in their book *India: Planning for Industrialization* that government planning was required in India and was compatible “with the basic objectives of a socialist society … which we fully share.” To their credit, they changed their minds.

That same year, economists Ian Little, Tibor Scitovsky, and Maurice Scott, the first two already well-known, published *Industry and Trade in Some Developing Countries: A Comparative Study*. They noted “a number of astonishingly successful exports achievements,” including Taiwan and Hong Kong. They suggested that developing countries would benefit from adopting, in general, a more decentralized approach with greater use of the price mechanism; and, in particular, given that there are good prospects for exports, a more open approach to foreign trade with less protection and use of controls.

These economists did not embrace trade laissez-faire. Even in the less planned developing countries, many controls remained in place and would only be gradually reduced. But the genie was out of the bottle. A new consensus about open trade developed. By the end of the 1970s, even the World Bank had abandoned protectionism.

**The basic argument** / Besides chronicling all these events, Panagariya’s book provides “a unified, coherent, and full-scale defense of pro-free-trade policies with [developing] countries as its center.” The author exposes “the falsehood” of protectionist arguments. “Rapidly expanding trade,” he observes, “almost always accompanies sustained rapid growth.” The reasonable conclusion to be drawn from both theory and empirical evidence, he argues, is that low or declining barriers to trade are necessary, albeit not sufficient, conditions for sustained rapid growth.

Like radical free-trade economists, Panagariya explains that imports, not exports, are what benefit a country. The reader familiar with James Mill will find some of his spirit in Panagariya’s prose:

> However intuitive the preference for exports over imports may seem, it is wholly illogical. ... At a basic level, as Nobel laureate Milton Friedman once graphically pointed out in one of his public lectures, we can eat imports but not exports. ... If other countries would give us imports for free, there would be no reason to export. ... It is the revenue from sales to the country that the trading partners use to buy its products.

> “While politicians commonly seek to achieve bilateral trade balance,” he adds, “there is no economic logic behind it.”

The positive case for trade openness starts with the law of comparative advantage, supplemented by the benefits of economies of scale, product variety, and technological diffusion. Panagariya provides a good and short explanation of comparative advantage, the theory that the vast majority of a country’s residents benefit from specializing in what they can do at a relative lower cost than producers in other countries, even if the latter are more efficient at everything. This way, the consumers in both countries get more of everything.

Panagariya reminds us of the story told by Nobel economist Paul Samuelson about mathematician Stanislaw Ulam asking him to name “one proposition in all of the social sciences which is both true and non-trivial.” Samuelson replied with the law of comparative advantage. “That the principle is logically true need not be argued before a mathematician,” he explained. “That it is not trivial is attested by the thousands of important and intelligent men who have never been able to grasp the doctrine for themselves or to believe it after it was explained to them.”

**Protecting infant industries** / Another remarkable discussion in *Free Trade & Prosperity* concerns “the mirage of infant industry protection,” the idea that new industries must be protected from foreign competition until they are large and efficient enough to compete with long-established foreign ones. The case for infant-industry protection, Panagariya persuasively argues, has no logical or historical basis.

An infant firm with a reasonable prospect of future profitability should have no problem obtaining private financing. Even if its production is to generate positive externalities through, say, worker training or knowledge-building, protection is still not effective or warranted. The protected firm will have no incentive to invest more than the strict minimum. It will instead keep as much as possible of the protection-generated profits and run with them before they are eliminated by new domestic competitors benefiting from the externalities it has produced. This, of course, is why protected infant industries remain infants forever.

Once infant-industry protection is implemented, it will be difficult and costly to remove later. The government has no capacity to determine who will survive future competition and change. Moreover, such policies open up the question...
of whether these firms should also be protected from domestic competition.

Advocates of the infant-industry idea usually borrow their arguments from Alexander Hamilton’s 1791 Report on Manufactures or from Frederic List, a 19th-century German-American economist. They are apparently “unaware of the post-Second World War critiques of the infant industry argument by trade economists” such as James Meade, Harry Johnson, Herbert Grubel, Robert Baldwin, and Douglas Irwin. As for American history, the country “grew not because of high tariffs but despite them.”

List’s dirigiste approach is illustrated by his asking how “can anyone undertake to prove that ... the industry of a country must be left to the unaided and unsupported intelligence and enterprise of private individuals?” Not exactly a paean to free enterprise and economic freedom!

**Growth, prosperity, and inequality** / It is quite clear, as Panagariya argues, that trade openness is a necessary—even if not sufficient—condition for economic growth and reducing poverty. Just one example: an econometric study found that an increase in the trade-to-GDP ratio of 1 percentage point raises per-capita income by 2 percentage points on average. In comparison, protectionists have produced no proof that protectionism is a necessary condition for economic growth. They have often not even tried, for it is a mission impossible.

Trade benefits economic growth and economic growth reduces poverty. Panagariya reviews much empirical evidence that growth benefits the poorest in the same proportion, if not more, than it boosts average per-capita income. “In sum, while there is more than casual evidence that trade openness is conducive to poverty alleviation on average, there is absolutely no evidence showing otherwise.” The dramatic reduction in world poverty during the past four decades, as international trade grew, is an unprecedented event in world history. Only tenured professors and other wealthy residents of the First World can be blind to that.

By any meaningful measure, inequality has not grown with trade openness in developing countries. In labor-rich and capital-poor countries, laborers are the first beneficiaries of trade, according to comparative advantage. And when other policies of economic liberalization do increase economic inequality, the total package including free trade still reduces poverty, which should be the main goal. The author of Free Trade & Prosperity observes that, in virtually all developing countries in the 1960s, per-capita incomes “were below any reasonable poverty line, so an equal distribution would have raised the poverty ratio to 100 percent.”

**Case studies** / The second half of the book is devoted to detailed case studies of poor countries that, with the help of trade liberalization, became relatively rich after the 1960s. Total free trade à la Hong Kong is not required, but an “outward orientation” seems to be a must. As Panagariya argues, there are very few cases where a fast-growing country did not have frer trade; and there are very few cases where countries with negative growth in income per capita had significant or liberalized trade.

Hong Kong and Singapore are uncontroversial cases of countries that took off and grew through international trade. South Korea and Taiwan followed. Annual rates of growth of 8%–10% have been frequent. Poverty dropped and inequality decreased.

With the exception of Hong Kong, frer trade did not mean zero government intervention. On the contrary, elements of industrial policy can often be observed. But, Panagariya claims, the ideal of import substitution was abandoned and industrial policies were not inconsistent with the comparative advantage of labor-rich, capital-poor countries. They specialized in products like textile and light manufacturing. Governments followed the private sector more than it led.

Consider India. After attempts at autarky and central planning (licenses were required for nearly everything) were abandoned, the Indian economy grew rapidly and achieved large decreases in poverty, especially from the 1980s onward. Annual growth rates of GDP exceeded 8% in the 2000s thanks to trade and other forms of liberalization. The late-1980s collapse of the Soviet Union, “on which India had patterned its system of planning and controls,” helped Indians shed their addiction to democratic socialism. It is too bad that Panagariya’s story ends in the early 2010s; I would have liked to know what the Indian-American economist thinks of what’s happened more recently.

The case of China is also interesting. As the government’s visible hand (or “visible fist,” as Murray Rothbard called it) became lighter after the death of Mao Zedong in 1976, the country started opening to world trade. Annual rates of growth of per-capita GDP nearly reached 8% in the 1980s and moved close to 10% until 2013—compared to less than 1.6% from 1952 to 1979. It is difficult to argue that trade liberalization did not play a major role, despite much remaining interventionism. “The fact that continued liberalization was accompanied by some acceleration in the per capita income growth,” Panagariya writes, “suggests that the interventions were a hindrance rather than an aid to growth.”

The experience of the first Special Economic Zones (SEZ), established near Hong Kong and Taiwan in the late 1970s, shows that the Chinese government was acutely aware of the importance of international trade for escaping poverty.

Panagariya tells of more recent success stories of economies in Asia, Africa, and Latin America starting to grow at 5% or more, thanks partly—or mainly—to trade. Among these countries are Vietnam, Cambodia, Bangladesh, Botswana, Uganda,
The Morality of Markets

When humans exchange goods, they expect to better themselves. Over history, this simple act of voluntary trade—entering into market transactions—has faced a surprising amount of criticism. Aristotle, for instance, thought that those who earned their living by commerce were not righteous. St. Thomas Aquinas taught that it was sinful to profit unless trade took place at the “just price.” In the 18th and 19th centuries, critics such as Jean-Jacques Rousseau and Karl Marx argued that markets were divisive and exploitative, bringing out the worst in people. And in the present, a host of scholars and politicians complain that markets prey on the weak and undermine human connections.

Although some scholars have defended the morality of markets, their defenses have often been half-hearted, conceding that economic freedom may bring out bad human traits but arguing that the overall benefits of exchange make it worthwhile. We need an unapologetic defense of the morality of markets and this book by Virgil Henry Storr and Ginny Seung Choi provides exactly that. Storr is an assistant professor of economics at George Mason University and Choi is a senior research associate at the university’s Mercatus Center.

As they see the problem:

Even people who are typically sanguine about markets worry that we risk losing our souls when we engage in market activities. Specifically, the concern is that the more we engage in market activity, the more likely we are to become, at best, selfish and corrupt, and, at worst, rapacious and debased.

The truth, Storr and Choi argue, is the other way around: market activity makes people morally better. It rewards virtues and penalizes vices. They write:

We find that rather than corrupting our morals, the opposite is true. The evidence suggests that the market actually improves our morals. There are two main arguments that we advance in support of this claim. First, we argue that people can improve their lives through markets. People in market societies are wealthier, healthier, happier, and better connected than people in nonmarket societies.... Second, we argue that the market is a moral space that both depends on its participants being virtuous and also rewards them for being virtuous.

The debate over the morality of the market is usually carried out purely at the rhetorical level. Market opponents simply assert that market activity upsets their sensibilities, using loaded terms such as “commodification,” “exploitation,” and even “zombie.” Storr and Choi don’t reply to them with opposing rhetoric, but with evidence-based counterarguments. Enemies of the free market will face a tough challenge from the authors’ case.

Bettering lives | In their opening chapters, Storr and Choi run through the history of the debate over the morality of the market, giving us a sampling of ancient and modern criticism, as well as some responses by defenders. Among the latter, Montesquieu argued that commerce was beneficial in that it cures destructive prejudices but conceded that it tends to make people inclined only to do things for the money. Adam Smith maintained that free markets do enrich people but found no particular morality in the conduct of investors and businessmen. In Smith, there’s a strong suggestion that the public benefits of market activity grow out of private vices. Milton Friedman wrote that a free market system “is the only one that allows people freedom to choose their own projects and paths,” but said that the market itself is morally neutral. Those and other market defenses are inadequate, say Storr and Choi, so they’ve endeavored to set forth a positive argument for the morality of the market.

For one thing, the free market is a
means—and sometimes the only means—for people to better their lives. Desperately poor people have frequently managed to escape poverty by finding ways to profitably exchange what little they have in the market. That even applies to slaves. Storr and Choi give the interesting case of Bahamian slaves who were often able to substantially improve their lives because they were able to sell a few hours of their labor to willing buyers. Were the helpless slaves corrupted by entering into market contracts for their labor? Or were the people who paid them for their work? It’s almost impossible to imagine how anyone would object to the morality of such transactions, although we should never forget that 19th century defenders of slavery like Thomas Carlyle were angered by the arguments of free-market scholars against slavery and its traditional bonds.

Storr and Choi also make useful national comparisons. North and South Korea provide a striking comparison between a market and a nonmarket society. Before the nation was partitioned after World War II, the northern part was more prosperous than the south as a result of greater industrialization. Today, however, the people of North Korea are among the world’s poorest and most malnourished. The government of North Korea is against free markets. The economy is run according to government dictates and people are assigned to classes in a highly stratified society. The state provides for everyone, but those in the upper classes and the military receive far more than do the mass of workers and peasants. No one has to worry about those awful, corrupting “money bonds” the critics complain about, yet every year many North Koreans risk their lives to escape the country. By contrast, South Korea is a market society, the people are far more prosperous, and they are free to come and go as they please. How many market opponents would choose to live in North Korea rather than South Korea, despite their professed dislike for the “immorality” of free markets?

**Peaceful, honest competition** / What about competition, which market critics assail as divisive? Rather than dividing people, the evidence shows that it induces them to find ways to satisfy others. As the authors write:

> Competition ensures that only those who serve others can maintain and accumulate wealth. Stated another way, the more competitive the market, the more becoming and staying wealthy depends on discovering what consumers (including poor consumers) want.

> Competition is an inescapable component of life, but market competition leads to a search for ways of getting ahead by peaceful means. Where markets are absent, competition simply takes other forms, such as the violence and oppression in North Korea.

> Once people have amassed wealth through their market activities, they are able and often quite willing to devote some of that wealth to helping the needy. Storr and Choi write, “At their core, successful market transactions require our recognizing how our actions or possessions can improve the lives of others.”

Bill Gates, for one, has put billions of his fortune into programs in Africa to conquer disease and bring clean water to people. Markets therefore make it possible for people to afford to care about others; take exchange away and there would be far less altruism in the world.

Another morality-enhancing feature of free markets is the way they encourage honesty and punish dishonesty. Market competition not only spurs people to discover new and better ways of doing things, it also helps us to learn about the people we might want to deal with. According to the authors, “Markets are spaces where we not only discover profit opportunities, but also where we discover whether or not the people with whom we are interacting are good or bad people.” In the free market, reputation—whether as a seller or buyer—matters a lot. We want to find out if the firms from which we buy live up to our moral standards and the market provides such information. We also want to know if those to whom we might sell are apt to pay or not, and the market provides that information. Markets thus deter cheating and immorality. In short, they are, the authors argue, “moral training grounds.”

**Criticisms** / There is much more to the case Storr and Choi present in favor of the moralities of markets, but I’d like to focus on what I see as three weak spots in the book.

First, they note in passing that there are moral costs from curtailing market activity. Sadly, they don’t develop that point. The moral costs of interventionism against peaceful economic activity is one of the great problems with all nonmarket systems. At least several pages should have been devoted to exposing the villainy that inevitably erupts whenever we empower government to prevent market activity. A century ago, to cite one example, the United States embarked upon a supposedly noble experiment by outlawing the market for alcoholic beverages. Some people thought that Prohibition would make America a better country, but it led to massive violence and corruption. The same error is being made today with the “war on drugs.” Elitists who rail against markets always ignore the costs of government actions to prevent trade they don’t like. I wish the authors had made a big point of the moral costs of anti-market crusades. It’s crucial to the case against interventionism.

Second, again in the “missed opportunity” vein, the authors never attack the implicit assumption of market opponents that humans are naturally kind, cooperative, and altruistic in the absence of mar-
Rise of the ‘Beltway Bandit’ Lawyers

WASHINGTON, DC and its surrounding suburbs are known for an abundance of “Beltway bandits,” those who make their living by feeding, either directly or indirectly, from the public trough. I recently reviewed a book recounting the storied history of one type of Beltway bandit: the accounting and consulting firms collectively called the Big Four (“Are the ‘Big Four’ on Their Last Leg?” Fall 2019).

This book, White Shoe by John Oller, traces the parallel historical development of the modern law firm. He worked as a “white shoe Wall Street lawyer” in the New York office of Willkie Farr & Gallagher, representing such prominent clients as Major League Baseball. In 2004 he wrote a history of the firm, which was a precursor to this volume.

In the prologue to White Shoe, Oller gives us some background on the curious term that provides the book’s title. It comes from “the white buck shoes worn by generations of Ivy League college men who, as members of the WASP elite, went on to run the leading law, banking, and accounting firms on Wall Street.”

**Modernization of administration** / Oller begins White Shoe with folksy stories about the structure of the late 19th century law firm. He colorfully describes cozy little operations made up of one or two partners supported by a handful of clerks who worked “without pay for a few years, performing secretarial duties in exchange for a desk and access to the partners’ library.”

Those law firms often eschewed the contemporary, emerging conveniences of telephones and typewriters because they were inconsistent with the era’s social operating norms. Telephones were seen as lacking privacy because partners felt that “the only dignified way of communicating between members of the legal profession was for them to write each other in Spencerian script, and to have the message thus expressed delivered by hand.”

Similar attitudes were applied to the use of typewriters.

Documents were drawn up in longhand by men who stood or sat on tall stools at high slanting desks. The best penman would write page after page and pass them down the line to scriveners, who laboriously copied them at long tables.
Finally, as the workload grew in the early 20th century, “firms began hiring female stenographers, secretaries and typists to replace most copyists.”

Oller commits an early chapter to the “Cravath system” for hiring, training, and compensating lawyers, created by Paul Drennan Cravath of Cravath Swaine & Moore. The system would remain popular for the remainder of the century. But as the chapters unfold in White Shoe, we find that Oller’s primary focus is much more than the administrative side of law firms.

Changes wrought during the Progressive Era / After the initial chapters, White Shoe reflects on the history of changes in federal public policy from 1890 to 1920 and traces how those changes transformed the staid law firm that existed at the beginning of the era. Oller tells his story through the partners of a number of white shoe firms, weaving their lives through multiple chapters over the course of the book.

With the emergence of massive corporations, Wall Street partners like William Nelson Cromwell, the “physician of Wall Street,” focused on corporate and bankruptcy law. Cromwell first labored over combinations that led to corporations such as Northern Pacific Railway. Then he stood at the ready to clean up the mess “when they went belly up.” He was also known for going to great lengths in fighting for one of his clients, the French engineer Philippe Bunau-Varilla, to get a canal built in Panama instead of Nicaragua. Some even blamed Cromwell for the Panamanian Revolution, which involved the overthrow of the Columbians who ruled Panama.

Although Cravath is best remembered for his work on the management of law firms, he also represented industrialists like George Westinghouse in his running battle with Thomas Edison over the infrastructure at the heart of electrical power. Westinghouse enlisted Cravath’s legal advice when he was accused of violating Edison’s patent for the light bulb, and when he became embroiled in a conflict over whether Westinghouse’s alternating current or Edison’s direct current would become standard. Cravath and Westinghouse would part ways following the Panic of 1907, as Cravath oversaw a reorganization of Westinghouse Electric that resulted in its namesake losing control of his company.

More importantly from a policy perspective, these were heady days for the emerging class of progressives who were leading changes in a range of policy areas such as antitrust, banking, and Prohibition.

These were heady days for the emerging class of progressives who were leading charges in a range of policy areas such as antitrust, banking, and Prohibition.

Trust Busters! / Antitrust enforcement exploded during this era. Oller first describes the largely hands-off regulatory policies of Presidents Grover Cleveland and William McKinley. He explains that although the Sherman Antitrust Act was passed in 1890, Cleveland and McKinley did not vigorously enforce it.

Cleveland was even in private law practice for a large New York law firm from 1889 to 1893, in the interregnum between his two terms in the White House. He was brought to the firm by his friend and adviser, Frank Stetson, who was said to be the “attorney general” for financier J.P. Morgan. Stetson’s work for Morgan included helping form U.S. Steel, the largest company in the world at the time. This represented the nascent development of the “axis of access,” that corridor of connectedness between New York City and Washington, DC. After Cleveland’s second term, the minimalist enforcement stance continued: “The McKinley administration had been lax in enforcing [the Sherman Antitrust Act of 1890], giving rise to the greatest wave of industrial mergers in American history.”

That would change with the “Trust Buster,” Theodore Roosevelt, and his progressive successors in office. The filing of the Northern Securities lawsuit during his administration was “an end of an era” of antitrust enforcement as his attorney general, Philander Knox, worked to break up the empire, which was brought together through the financial maneuverings of J.P. Morgan. Knox was a former corporate lawyer for Andrew Carnegie, whose steel empire fed into the creation of U.S. Steel. The Supreme Court’s 5–4 decision that Northern Securities was “an illegal restraint of trade in violation of the Sherman Antitrust Act … was a huge victory for the government, … a significant defeat for Wall Street, … and ended the merger wave that had begun around 1890.”

By the election of 1912, there was a triangulation of the antitrust issue:

Taft’s policy was to continue to rely on the judiciary, and ultimately the Supreme Court, to interpret and enforce the Sherman Antitrust Act. … Roosevelt wanted greater federal administrative regulation … under executive branch control. … Wilson took a middle position … through a combination of a
mild-mannered federal commission ... and aggressive federal antitrust enforce-
ment subject to judicial review.

Antitrust became a reliable cash cow for white shoe lawyers.

World War I and Prohibition / Oller commits a number of chapters to foreign policy, especially surrounding World War I. The white shoe lawyers of the day included many foreign policy interventionists who “came to form the ‘Atlanticist’ for-

eign policy establishment of the United States—primarily upper-class lawyers, bankers, academics, and East Coast politi-
cians committed to what has been called ‘Anglophile Internationalism.’” This coal-
ition “believed the United States had inherited England’s role as the conciliator, and if necessary, enforcer, of international disputes.” These elites were the predeces-
sors of today’s proponents of foreign policy interventionism and nation building.

Oller muses openly about whether this group was simply guilty of “warmonger-
ing” or “war profiteering,” as he makes the point that “companies such as U.S. Steel, Bethlehem Steel, and Westinghouse, con-
trolled by bankers such as J.P. Morgan and Co. and represented by lawyers such as Cravath, were profiting enormously from munitions contracts with the Allies.”

One of the last issues Oller assesses is Prohibition, which “at heart was a progres-
sive, reformist movement.” He traces the constitutional challenges to these efforts led by Elihu Root, Roosevelt’s secretary of war and state “who glided easily between the highest levels of government in Wash-
ington and his private legal practice in New York.”

Conclusion / White Shoe is a well-told story. In his concluding chapters, Oller makes the case that these lawyers held a bene-
volent role:

In the thirty years between 1890 and 1920, the steering of a middle course between unchecked capitalism and state socialism owed much to the elite Wall Street lawyers and their firms.... But they also influenced their clients to change with the times to prevent more radical changes from below.

To me, Oller’s history reveals the resil-
ience of this breed of lawyer in adjusting to the rapid changes in industry, policy, and finance.

He does not reflect in detail on the cur-
rent era and the future of the law firm. However, in making references to today’s popular culture, he makes clear that white shoe lawyers of the early 20th century were in a real sense celebrities: “Their advice was eagerly sought by robber barons and pres-
idents alike and they were known to the public to a greater degree than any present-day corporate lawyers.... Few people in 2019 could name the most trusted attorney for Facebook’s CEO Mark Zuckerberg or for Amazon’s Jeff Bezos.”

The Twists and Turns of Tobacco Politics

Sarah Milov’s The Cigarette: A Political History is accurately subtitled. Milov, a history professor at the University of Virginia, has written a first-rate history of the interaction between tobacco companies, tobacco growers, and various levels of government over almost a century. She delves carefully into the details of those interactions and tells you more than you probably want to know about the many decades of inter-

action.

The history itself is fascinating, whether it be about the federal government’s attempt to cartelize tobacco growers early in the 20th century to give them more power in their dealings with cigarette manufac-
turers, the federal government’s promotion of cigarettes to troops during World War II, the many years it took for governments to ban cigarettes from workplaces, or the 1998 Master Settlement Agreement (MSA) under which tobacco companies agreed to fork over hundreds of billions of dollars to state governments. Unfortunately, Milov misses the significance of some early moves the cigarette companies themselves made to publicize the hazards of their competitors’ cigarettes. And, possibly because she likes the result, she doesn’t fully appreciate the significance of the tobacco company cartel formed by the MSA.

While she makes her own dislike of cig-
arette smoking clear, that interferes only occasionally with her narrative. She appears

Defenders and critics / Milov does show some of the biases that are typical of left-
wing historians. For example, she refers to those who defend the rights of tobacco companies as “pro-corporate” rather than “pro-market”; some of those defenders are pro-corporate, but some are pro-market and would not defend corporations when they seek special privileges. The good news is that in many ways Milov tries to tell a straight story and most of the time she does not shade the evidence.

It is common for analysts who oppose a particular program or industry to accept all criticisms of the industry even when the criticisms are weak or off-target. Milov’s work is refreshingly free of that problem. She even makes gentle fun of her fellow tobacco critics when they overstep. A case
in point is her discussion of anti-smoking activist John Banzhaf of George Washington University Law School. About his 1969 petition to separate smokers and non-smokers on flights, she writes, “Following a time-honored pattern of framing children as the primary beneficiary of government protections, Banzhaf’s petition also observed that large numbers of American children suffered from asthma.” She later refers to his petition as “an invitation to imagine turbulent skies indeed: cardiac arrests, wheezing children, and emotional tantrums by frazzled passengers pushed over the edge by the smoker across the aisle.” She also doesn’t hesitate to note that in a Chicago “smoker’s court” that was established to hear cases of people who illegally smoked on government transportation, only two of the 50 cases heard by a judge involved white defendants.

**Safer cigarettes?** / At times, possibly because of her ideology but more likely because she’s an historian and not an economist, Milov misses some of the ways that tobacco companies themselves reduced smoking by advertising the nasty health consequences of smoking. She notes that in 1953, tobacco executives “agreed to set aside the temptation to exploit the health issue against rival firms.” Maybe so, but the more important fact, which she doesn’t mention, is that they didn’t stick to that agreement.

In a 1985 report for the Federal Trade Commission, economist Jack Calfee laid out the history of cigarette companies’ advertising some of the bad health consequences of smoking. In 1952, he noted, Lorillard, with only 6% of the market, introduced the Kent brand, whose “Micronite” filter reduced the amount of tar and nicotine. Kent’s ads noted that “the difference in protection is priceless.” But protection from what? Smokers understood from what. Not for nothing were cigarettes at the time widely referred to as “cancer sticks” and “coffin nails.” Interestingly, per-capita sales of cigarettes in the United States, which had risen every year since 1931, fell by 2.8% in 1953 and another 6.1% in 1954. By the end of 1954, the market share of filtered cigarettes was more than 10%, up from under 2% in 1950. Calfee’s FTC report notes that Brown & Williamson, the only company that concentrated on filter brands, was also the only one to gain sales in 1954. The two largest cigarette makers, American Tobacco and RJ Reynolds, avoided “fear advertising” but did respond competitively by introducing filtered brands. As I noted in a July 1997 *Fortune* article titled “Joe Camel: Brought to You by the FTC,” the “big winner in all this was the consumer, who was told nightly on TV, courtesy of the smaller cigarette companies, that smoking could be harmful.”

For a long time, the FTC was unconvinced that there was any scientific evidence that smoking was harmful. It stepped into the controversy in 1955, publishing rules that prohibited references in cigarette advertising to the “throat, larynx, lungs, nose, or other parts of the body” or to “digestion, energy, nerves, or doctors.” What kind of advertising did the FTC explicitly allow? Advertising about taste and pleasure.

Health-related advertising of cigarettes had one last gasp, so to speak, in the late 1950s. Some medical experts started claiming that reducing the tar content of cigarettes would reduce the risk of lung cancer. That set off the great “tar derby.” Cigarette companies reduced tar and nicotine content and advertised that fact. Calfee notes that between the middle of 1957 and the end of 1959, tar and nicotine levels dropped by nearly 40%. Can you guess what happened next? In 1960, the FTC ruled that because claims about tar were health claims, they could not be made unless substantiated by epide-miological evidence. Thus ended the economic rationale for making cigarettes safer.

Unfortunately, Milov misses all of this. Also, she uncritically accepts the idea that secondhand smoke is an externality. To be fair, she shares that confusion with many economists, but it’s not necessarily an externality. The clearest case where it is an externality is when someone smoking outdoors on government property exhales smoke that is ingested by someone else. But when smoking occurs in restaurants and bars, private property rights solve the problem: the establishment can decide whether to allow, prohibit, or have a special area for smoking. Absent government intervention, the owner has both an incentive and the power to take account of the damage so that there is no externality. I made this point in a September 2007 *Econ Journal Watch* article titled “Smoking in Restaurants: Who Best to Set the House Rules?”

**The MSA** / To her credit, Milov doesn’t miss all the economics. In particular, she is on target when she correctly refers to the euphemistically labeled “supply management” of tobacco as what it really is: a cartel.

One development in her century-long history to which Milov gives too little attention is the 1998 MSA, whereby four major cigarette companies agreed to pay restitution to U.S. state governments for Medicaid expenditures those governments made for the medical treatment of smokers. She mentions but misses the elephant in the room: the agreement created—with the blessing of state attorneys general and the federal government—a cartel to raise the price of cigarettes so that the main payers of that restitution aren’t tobacco companies or their shareholders, but current smokers. Walter Olson, now a senior fellow at the Cato Institute, described this in a January 2000 *Reason* article titled “Puff, the Magic Settlement.”

In a 1998 study published by the Brookings Institution, Stanford economist Jeremy Bulow and Nuffield College economist Paul Klemperer laid out in more detail the cartel
aspects of the settlement. I should note that, in my view, it was unjust for tobacco companies to pay for expenses that the state governments, by joining Medicaid, voluntarily accepted, but it was also unjust to shift those costs onto the smokers themselves.

Having said all that, I should note that I personally benefit from the government crackdown on cigarettes. I had some health problems at age 16 because of my father’s smoking cigars. My doctor at the time told me never to take up smoking. I didn’t. I didn’t realize just how much I had gained from smoke-free restaurants in California, starting in 1995, until I entered the non-smoking section of a restaurant in Amsterdam in 1999 and had to leave immediately because of the smoke.

Conclusion / When I saw the positive blurb on Milov’s back cover by Nancy MacLean, author of Democracy in Chains, I wondered “Uh-oh, is this book going to be as badly researched and as prejudiced as MacLean’s hatchet job on James Buchanan?” (See “Buchanan the Evil Genius,” Fall 2017.) Fortunately, the answer is no. When it comes to history, Milov is old-school. She carefully went through boxes of documents to tell an interesting and well-sourced tale. Her own biases against cigarettes are on display, but they are no worse than the usual biases that historians—and most academics—bring to their work. What would have made the book substantially better is if she had paid more attention to the economics literature.

Two Experiments

A popular T-shirt depicts Alberto Korda’s famed 1960 photo of Marxist revolutionary Che Guevara. Wearers of the shirt probably know almost nothing about Guevara except that he fought for socialism.

There isn’t a similar T-shirt for Sir John Cowperthwaite and I doubt there ever will be one. Relatively few people have even heard of him, although he was the key figure in establishing the governance of Hong Kong after World War II. His battle to preserve laissez-faire capitalism in the colony helped make Hong Kong what it is today.

Guevara and Cowperthwaite are at the center of British businessman Neil Monnery’s book A Tale of Two Economies. It offers a superb comparison of the two men’s radically different philosophies, which set the economic destinies of two societies. Monnery writes:

Both were questioning how to create a better civilization on Earth, using the tools that they had. Since they were united in their question but so divergent in their answer, they are arguably the originators of the most significant natural economic experiment of the last century.

Dynamism and stasis / In the late 1950s, the per-capita incomes in Cuba and Hong Kong were roughly equal. The former had long been under the rule of corrupt oligarchs and military men who were willing to let capitalism operate so long as they got a cut of the profits. The latter was a minor outpost of the British Empire that was recovering from Japanese control during World War II. A speck of land with little more than a good natural harbor, Hong Kong seemed to have scant opportunity for an economic takeoff.

Over the next 60 years, the economic fortunes of Cuba and Hong Kong diverged dramatically. Today, the people of Cuba are about twice as prosperous as they were then, whereas the people of Hong Kong are 14 times richer. The reason for this divergence is that under Cowperthwaite’s direction the Hong Kong government practiced a hands-off approach to the economy that was as close to pure laissez-faire as you’ll find anywhere. At the same time, Cuba adopted an extremely tight communist system that Guevara, in his reading and travels, had become convinced was the best way for a nation to progress equitably.

In short, it was a contest between the ideas of Adam Smith and Karl Marx. Cowperthwaite had studied Smith and other economists who argued for free trade, limited government, and the rule of law. He believed that people would naturally find the best ways of acquiring and using capital; government could only get in the way and impede progress with policies to guide the economy. During this time, however, official British policy was much to the contrary, with Keynesian theory dominant in London. Cowperthwaite often had to fend off attempts by his superiors back home to bring Hong Kong in line with their interventionist thinking about economic planning, minimum wages, progressive taxation, government debt, and so on. He even brushed off British officials who told him that Hong Kong needed to collect economic data, saying, “We have virtually no use for national accounts, partly because we cannot be in control of our economy and partly because our economy has a dynamism that outpaces such accounts.”

That dynamism was first evident in the textile industry. Businessmen invested in the rapidly growing industry and the Hong Kong government had nothing to do with it—or any of the subsequent business successes—except to leave the owners free to manage their operations. Those who competed against Hong Kong firms in international markets often complained about their extraordinary efficiency. As companies prospered, so did their workers. Marx’s “Iron Law of Wages”—that worker compensation must fall to the level of bare subsistence under capitalism—was disproven.

At the same time Cowperthwaite was holding Hong Kong on a free mar-
We cannot arrive at communism through the simple mechanical accumulation of quantities of goods made available to the people. By doing so we would get somewhere, to be sure, to some particular form of socialism. But what Marx defined as communism, what is aspired to in general as communism, cannot be attained if man is not conscious. That is, if he does not have a new consciousness towards society.

To achieve that new consciousness, Guevara persuaded Castro to eliminate monetary incentives and rely instead on medals and other government rewards to incentivize people. To destroy vestiges of the old, exploitative system, private businesses were nationalized and individual labor contracts outlawed. Moreover, Guevara was opposed to international trade. In his view, that was the means by which the United States asserted dominance over Cuba. He therefore wanted Cuba to become as self-sufficient as possible.

Governmental economic control had predictably poor consequences. Among the examples Monnery cites is the state’s purchase of 1,000 sugar cane harvesting machines manufactured in the Soviet Union. Cuban officials, having no business experience, bought machines that were too heavy and ill-suited to irregular terrain. They frequently broke down and were junked after just a few years.

Rather than enjoying increasing prosperity, the Cuban people found their standard of living stagnant or even falling. Food is rationed and the amounts are small. Monnery writes, “Over the last fifty plus years, the monthly quota per person has typically been set at around 3 pounds of meat, 6 pounds of rice (although the ration was a low as 2.5 pounds per month in the late 1970s), 1.5 pounds of beans, 1–2 pounds of fat, 5–15 eggs, a small amount of butter, 3 pounds of condensed milk, 1 pack of detergent, 1 small tube of toothpaste, and 2 bars of soap.”

Cubans not content with the state’s meager allotments can spend their pesos in government stores, the black market, or engage in barter. Despite its abundant arable land and mild climate, Cuba is a poorly fed nation.

Legacies / The lack of immediate success for Guevara’s hardline Marxism led to a “Great Debate” among Cuban leaders in the mid-1960s. One faction favored adopting a more Soviet “state capitalism” approach that made use of markets. Guevara countered that the people had not yet achieved his higher state of consciousness. As Monnery explains:

Guevara argued that the solution lay in developing the New Man, who would act for the benefit of society rather than respond to personal incentives. What was needed was better communication, leadership and vision and moral incentives. At the time, Castro was persuaded to stick with his vision, but in 1970 he announced a policy change to a “more serious, mature, profound phase.”

Guevara was not around to feel the sting of that rejection. Tired of administrative work, in 1965 he left Cuba for Africa, to promote the spread of Marxist revolution. He joined communist forces fighting to bring down the U.S.-backed government in Congo. That effort failed and Guevara’s health was badly damaged.

The next year, he went to Bolivia where he joined up with a revolutionary group. He expected peasants to rise up to aid his forces, but instead they kept the government informed of his movements. In October 1967, government troops trapped him at Yuro ravine. Twice wounded and with his gun jammed, he surrendered, telling his captors, “I am Che Guevara and I am worth more to you alive than dead.” Fearful that he would escape, the Bolivian president ordered that he be killed. The execution was botched and Guevara was shot nine times before dying miserably at age 39.

Cowperthwaite, on the other hand, lived to 90, enjoying grandchildren and golf to the end.

Recent decades have seen some liberalization in Cuba. Guevara’s fantasy of a nation filled with pure-at-heart Marxists never came to pass despite the regime’s complete control over education and communication. Since coming to power in 2006, Raul Castro (Fidel’s younger brother) has allowed changes that would have appalled Guevara, especially the 2011 reform allowing Cubans to be self-employed. Some 600,000 people now work for themselves rather than the state, and enjoy far higher earnings. It’s evident that Cuba will continue to move away from Guevara’s dream of a nation where the people are suffused with the spirit of collectivism.

Monnery writes:

For any government interested in increasing the prosperity of its people, if given the choice between copying the economic policies of Hong Kong or Cuba, there could be only one rational choice. In two generations, Hong Kong has moved from relative poverty to become one of the richest nations on
Earth. Cuba has moved from being one of the richest countries in Latin America to become one of the poorest.

He is optimistic that the lessons of Hong Kong and Cuba are slowly being learned, noting that in the 1960s, 40 nations operated under the Marxist model of central economic planning and totalitarian control, while today only two do.
The cover of A Tale of Two Economies contrasts the glittering modern skyline of Hong Kong with the crumbling old buildings of Havana. The laissez-faire approach taken by Cowperthwaite enabled the people of Hong Kong to modernize and prosper, while the omnipotent government approach of Guevara has kept Cuba mired in the past. The choice, Monnery correctly says, is between market dynamism and state stasis. People who still think that economic freedom is to be feared while a government-controlled economy is the path forward ought to read this book.

In Search of ‘Real’ Socialism

The Wikipedia page for “cryptozoology” defines it as “a pseudoscience and a subculture that aims to prove the existence of entities from the folklore record, such as Bigfoot, the chupacabra, or Mokele-mbembe.” Kristian Niemietz’s Socialism: The Failed Idea That Never Dies explores cryptozoology’s politico-economic analog, the never-ending hunt for successful socialism, which he likens to a unicorn hunt. Socialism’s endless failures haven’t stopped people from claiming it’s an economic, political, and moral ideal.

The book couldn’t come at a better time. It was released last year, 30 years after the Berlin Wall fell. Next year will mark the 30th anniversary of the end of the Iron Curtain, and 2023 will be the 30th year since the Soviet Union disintegrated. Yet, here we are, in 2020, with people who should know better touting the theoretical glories of socialism. What gives?

Love story/ Niemietz, of London’s Institute of Economic Affairs, provides a thick, informative, and delightfully pugnacious book that you can download for free from IEA’s website. The book explores intellectuals’ romantic attachments to socialist experiments in the USSR, China, Cuba, East Germany, Cambodia, North Korea, Albania, and Venezuela. Each of these romances begins with the belief that “this socialist experiment is supposed to be the fulfillment of the vision and the pattern for the future,” and ends with the determined conclusion that this “wasn’t real socialism” once the regime’s failures become too obvious to ignore.

The romance progresses through three stages, according to Niemietz. There is the honeymoon period in which socialists tout the various purported successes of the new regime. They write articles extolling the experiment and perhaps tweaking nay-sayers who said “socialism can’t work” but who were clearly proven wrong by the workers’ paradise du jour.

The next stage, which begins when the first signs of failure and oppression start to appear, he calls “the excuses-and-whataboutery period,” where apologists for the workers’ paradise try to explain away the problems. They are claimed to be the fault of people who can’t stand to see socialism succeed (e.g., the Central Intelligence Agency, major corporations) and to factors outside the Visionary Leader’s control (falling oil prices).

Finally, there is the “not-real-socialism” stage. Niemietz writes:

Eventually, there always comes a point when the experiment has been widely discredited, and is seen as a failure by most of the general public. The experiment becomes a liability for the socialist cause, and an embarrassment for Western socialists.

This is the stage when intellectuals begin to dispute the experiment’s socialist credentials, and, crucially, they do so with retroactive effect. They argue that the country was never socialist in the first place, and that its leaders never even tried to implement socialism. This is the deeper meaning behind the old adage that “real” socialism has never been tried: socialism gets retroactively redefined as “unreal” whenever it fails. So it has never been tried, in the same way in which, in Orwell’s Nineteen Eighty-four, the government of Oceania has always been at war with East Asia.

Thus do we have intellectual leaders like linguist Noam Chomsky who claim that the USSR was in no way “socialist” and the presumption among many that it is gauche to bring it up in discussions of whether or not socialism is or isn’t advisable. That this or that experiment failed simply shows that it wasn’t real socialism. That socialism is good, true, and beautiful is an axiom, not a hypothesis.

The reasoning is as follows: If it is real socialism, then we will see peace and prosperity. We don’t see peace and prosperity. Therefore, it couldn’t have been real socialism. Chomsky, for example, identifies socialism as “the liberation of working people from exploitation.” Since we did not see the working people liberated from
exploitation in the USSR and elsewhere, then they did not practice real socialism, or as British political commentator and Labour Party activist Owen Jones defines it, “the democratisation of every aspect of society.” As an idea, socialism is simply immune to criticism. That it “works” when implemented completely and faithfully is taken for granted and cannot be refuted. The conclusion is baked into the constantly shifting definitions.

**The thought that counts** / As Niemietz notes, the socialists have a habit of speaking in terms of the aspirations of the system rather than its concrete institutional characteristics. I would argue that it is free-market capitalism that represents “the democratisation of every aspect of society” because people vote with their money. As for whether capitalism is “democratic,” in it mass culture tends to win. Jones, no doubt, would disagree, but what are the specific institutional characteristics of a society in which “every aspect” has been “democratised?” As Niemietz puts it in describing an opinion column by commentator and avowed socialist Elizabeth Bruenig, she “merely talks about a set of aspirations—and even then, only at a very high level of abstraction—and effectively defines her version of socialism as ‘a system that would fulfill those aspirations.’”

This helps us to understand why the failed idea never dies. Niemietz begins with a pair of epigrams from Eugen Richter’s 1893 book *Pictures of the Socialistic Future*, which if more people had read it and paid careful attention, we might have avoided a lot of the problems we’ve had since the Russian Revolution. Pictures begins with optimism about “this new reign of brotherhood and universal philanthropy” and ends with the narrator writing:

> An order has just been issued to reduce the bread rations of the entire population by one half, and to do away with the meat rations altogether... I am regarded with such increasing suspicion that a search might be made, and my papers confiscated at any moment.

Richter’s book paints an uncannily accurate picture of the transition from hope to horror in the socialist society, and it’s a story that was rewritten in the blood of victims time and again throughout the 20th century.

**Fading stars** / Very cleverly, Niemietz concludes his book with a series of imagined newspaper dispatches from an alternative history in which East Germany remained communist through the 1990s. They are only barely imagined; as Niemietz notes, many are inspired directly by actual apologia for socialism. Predictably, once our alternative-history East German socialist experiment fails, it is abandoned as “not real socialism.” Deliciously, in this alternative timeline the writers dismissing socialism as having not actually been tried in East Germany express enthusiasm for and optimism about the visionary “socialism for the twenty-first century” of a rising star in Venezuela named Hugo Chavez.

> We know how that one turned out: much the same as in the USSR, China, and elsewhere. And now, Venezuela wasn’t “real socialism,” just like the others.

> The thing is, every time it was “real socialism.”

Niemietz carries us through the stories of the Soviet Union, China, Cuba, North Korea, Cambodia, Albania, East Germany, and Venezuela. The Soviet Union very much was deemed real socialism in the wake of the Bolshevik takeover. American journalist Lincoln Steffens said of it, “I have seen the future, and it works!” Rexford Tugwell, probably the most prominent member of Franklin D. Roosevelt’s “Brain Trust,” wrote, “The future is becoming visible in Russia.”

> Once it became clear the USSR was failing—people turned sour on Stalinism after Nikita Kruschev’s 1956 speech—they turned to Mao’s China. Comparing the mainland to Taiwan, Niemietz writes, “The difference between the two is that Taiwan became a magnet for Western investors, while mainland China became a magnet for Western intellectuals.” Those intellectuals later became less enthusiastic about the Chinese experiment when pro-market reforms led to the greatest mass movement out of extreme poverty the world has ever seen.

And so on, through North Korea, where according to the economist Joan Robinson “Prime Minister Kim Il Sung seems to function as a messiah rather than a dictator” and where the country’s successes were obscured by a “curtain of lies.” North Korea is now deemed to not be “real” socialism, which is to say that it is undeniable that the country is a brutal, repressive, and impoverished dictatorship. Or consider Cambodia, which Jan Myrdal, son of Alva and Gunnar Myrdal (the latter co-recipient with F.A. Hayek of the economics Nobel in 1974) called “the kingdom of justice.” In Niemietz’s words:

> Khmer Rouge socialism was once seen as a romantic, agrarian, back-to-the-roots socialism by some mainstream Western intellectuals. Their absolute numbers were never large, but they included some of the leading scholars in the relevant academic disciplines.

> There was Albania under Enver Hoxha, another example of “this time is different/that wasn’t ‘real’ socialism.” And East Germany, where intellectuals practise the inverse of damning with faint praise: they praise with faint damnation. The shoot-to-kill order at the Berlin Wall becomes “a lack of travel possibilities,” police state repression becomes “a climate of uncertainty,” etc.

And of course, there’s Venezuela, which became the socialist darling du jour after Chavez rose to power. (He was the subject of a lot of fawning eulogies after his death in 2013.) Niemietz quotes Canadian political writer Naomi Klein, writing in 2007 (the year she published her book *The Shock Doctrine*):

> The new leaders in Latin America are also becoming better prepared for the kinds of shocks produced by volatile markets... Surrounded by turbulent financial waters, Latin America is creating a zone of relative economic calm and predictability.
Slavery Economics

**REVIEW BY ART CARDEN**

University of California, Berkeley business historian Caitlin Rosenthal’s *Accounting for Slavery* is a prominent contribution to the growing academic literature on the “New History of Capitalism,” the often-critical analysis of race, gender and the power dynamics in capitalism. The book divides its attention between New History historians and their critics, and Rosenthal laudably tries to give each side a fair hearing. The book is not without its problems, but *Accounting for Slavery* represents an important contribution to our understanding of economic and business history. Remarkable for its brevity—only about 200 pages of tightly organized text—the book earns the high praise bestowed on it by one reviewer: “If a reader comes away from a history of accounting wishing it were longer, it is clear that the author did something extraordinary.”

Rosenthal decisively refutes the late Harvard business historian Alfred Chandler’s claim that 18th- and 19th-century plantation management was unscientific, unsystematic, and “pre-modern.” We have known since the pioneering work of Alfred Conrad and John R. Meyer in the 1950s that slavery was profitable and viable, but Rosenthal makes it clear that plantations were sophisticated operations worthy of a place in the history of business and management. It is easy to see why her dissertation on which the book is based won the Krooss Prize for authoritative capacity and pursuant to government policy or high command.” However, as Niemietz notes, people don’t reason like judges and weigh the evidence carefully and dispassionately. We reason like lawyers: we start with what we want to believe and then reverse-engineer an argument for it.

This might mean, of course, that Niemietz and I are being uncharitable and unfair. After all, we have been told repeatedly that real socialism has never been tried, and we keep being told that next time things are sure to be different.

**Conclusion**

His book’s title is blunt, but it probably needs to be. He refers to socialism as “the failed idea that never dies.” It strikes me as insane that societies are once again playing footsie with an ideology and system that led the scholar R.J. Rummel to invent the term “democide” to describe “the intentional killing of an unarmed or disarmed person by government agents acting in their personal interest and without regard to the victim’s welfare.”

Democide is a prominent contribution to the growing academic literature on the “New History of Business and Management.” It is remarkable for its brevity—only 130 pages of tightly organized text. We have known that slavery was profitable and viable, but Rosenthal makes it clear that plantations were sophisticated operations worthy of a place in the history of business and management. She writes:

This is not an origins story. I did not find a simple path where slaveholders’ paper spreadsheets evolved into Microsoft Excel. The narrative that emerged was far more complicated: many businessespeople in different geographies were developing new data practices independently.

Her second sentence is especially important: even though at times she seems to want to tell a story about management with slavery front-and-center and even though some of her interpreters want to trace modern hourly workers’ time on the clock to American slaves’ *Time on the Cross*, she is identifying just one instantiation of the much larger move toward quantification. She claims, “Slavery was central to the emergence of” capitalism, which she goes on to define and discuss in a footnote later in the book. Slavery and “capitalism” were certainly evolving together, but I still think it is a mistake to put slavery anywhere close the center of the “emerging capitalism” narrative.

Slavery, after all, is ancient, and what was new in the 17th, 18th, and 19th centuries was the more widespread embrace of business and especially quantification. What Rosenthal identifies and explores is one way the new zeal for quantification—Bristol probate inventories show a switchover from Roman to the much-easier-to-use Arabic numerals in the 17th century—was combined with chattel slavery. There is a dark side to the history of innovation and measurement, both of which can be used for great evil as in the experiments by Mississippi plantation owner Francis Terry Leak or in the eugenics movement discussed in Princeton economic historian Thomas C. Leonard’s 2016 book *Illiberal Reformers.* While Rosenthal speculates about the possible relationship between planta-
tion management and the “scientific management” movement by noting that Gantt chart inventor Henry Gantt was born into a slaveholding Maryland family in 1861, reviewer Paul Rhode points out that the most prominent advocate of scientific management, Frederick Winslow Taylor, was born to a family of abolitionists.

**Economics and freedom** I am a little confused by Rosenthal’s periodic references to abolition and restrictions on slavery as “regulation.” That seems to obscure what most advocates of “capitalism” (myself included) would say is the defining characteristic of the system: that it relies on *voluntary interaction*. Hence, Rosenthal is exactly right that enthusiasts for free markets “assume that a free market does not include slavery.” She continues, though, that “the freedom to enslave was an economic freedom... Viewed in this light, the abolition of slavery was a triumph of market regulation that restricted [planters’] economic freedoms even as it offered freedom to so many others.” Amelioration and abolition can be thought of as waves of market regulation, a lens that casts planters and overseers as entrepreneurs playing at a game of regulatory arbitrage. Seeing abolition as a form of market regulation recognizes the ways it restricted slaveholders’ property rights: abolition prevented the sale of men and women and thus restricted the right to contract.

For one group, yes, but this seems like a cockeyed way to think about “market regulation” and “economic freedom.” Elsewhere in the book, we learn that “in Barbados, following a plot by enslaved Africans to overthrow their masters, planters sought to restrict access to literacy and Christianity,” and “the Barbados Slave Code of 1661 included a ‘ticketing clause to curtail runaways.’” It is well-known that slave schooling was sharply proscribed in the American South. There is a discussion of some of the postbellum Black Codes that were explicitly enacted in order to interfere with the labor market. Were these “market regulation” in the same way?

**Getting it right** In his review of Rosenthal’s book, the economic historian Howard Bodenhorn writes: "Getting it right is a serious work of economic and business history that will, I suspect, become a standard addition to graduate and undergraduate reading lists in these fields. Other reviewers have remarked that the book leaves a lot of important questions unanswered. Maybe Rosenthal would have gotten to them in Accounting for Slavery if she had decided to write a longer book. I hope she will take them up in later work, along with the students and scholars who find Accounting for Slavery on their syllabus."

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**Working Papers**

**BY PETER VAN DOREN AND IKE BRANNON**

A SUMMARY OF RECENT PAPERS THAT MAY BE OF INTEREST TO *REGULATION*'S READERS.

**Smoking**


In late October 2019, the U.S. House Ways and Means Committee approved—with bipartisan support—an e-cigarette tax on nicotine content that would be proportional to the federal tax on cigarettes. The current House bill specifies a tax rate of $0.028 per milligram of nicotine. How much would the tax increase e-cigarette prices and how would e-cigarette and traditional cigarette consumption change as a result?

Using retail scanner data from the years 2011–2017 and existing state taxation rates, the authors of the first paper calculate that pass-through of taxes on e-cigarettes to the retail price is more than the tax (160% of the tax), which the authors attribute to the highly concentrated, less-than-competitive structure of the industry. The authors calculate that the proposed House tax increase would be $2.54 per milliliter of vaping liquid. One pod—good for about 200 puffs—from e-cigarette maker Juul contains 0.7 ml of nicotine and is currently priced at $4, so the price increase would be at least 44% with a conservative 100% pass-through rate. The authors also find that the demand for e-cigarettes is elastic, with an estimated price elasticity of -1.5 (the quantity of e-cigarettes purchased is reduced by 1.5% for every 1% increase in price). Thus, a 44% increase in price would result in a 66% decrease in Juul pod purchases, a result consistent with the goal of those who support the tax.

Decreased e-cigarette sales are not the only consumer response,
however. The authors also determine that traditional cigarette sales increase following an increase in e-cigarette prices, with a cross-price elasticity of demand of 0.9. The authors calculate that if the House bill were to become law, the purchase of traditional cigarettes would increase by 6.2 extra packs for every one standard e-cigarette pod no longer purchased, a result probably not consistent with the goals of those who support the tax.

Turning to the second paper, the medical literature finds that menthol reduces the harshness and irritation of smoking and changes the structure of nicotine receptors. The result is that menthol makes traditional smoking easier to start and harder to quit. For that reason, anti-smoking groups have long advocated banning menthol flavor in traditional cigarettes. In late February, the U.S. House of Representatives approved a bill banning the use of menthol in both traditional cigarettes and e-cigarettes.

What effects would such a ban have? The paper discusses evidence from Canada. Between May 2015 and July 2017, seven Canadian provinces enacted bans on menthol (Nova Scotia and Alberta in 2015, Quebec and New Brunswick in 2016, and Ontario, Prince Edward Island, and Newfoundland and Labrador in 2017) while three provinces (Saskatchewan, British Columbia, and Manitoba) did not.

Provincial menthol bans eliminated legal traditional menthol cigarette sales. But young people substituted non-menthol cigarette smoking. Adults avoided the ban by evading it: they bought menthol cigarettes on Indian reservations unaffected by the ban. The net result was that the provincial menthol bans had no significant effects on population rates of cigarette smoking or quit behaviors for either youths or adults.

—Peter Van Doren

Soda Taxes


Mexico’s tax on non-diet soda has been hailed for reducing consumption with possible long-term health benefits. In a previous Working Papers column (Winter 2017–2018) I discussed a paper that argued that the reduced-soda-consumption effect was likely overstated because of substitution from expensive soda brands to cheaper store brands.

This paper utilizes Mexican retail scanner data containing weekly purchases of 47,973 barcodes by 8,130 households to examine the effect of the soda tax as well as a companion 8% sales tax on high-caloric-density food (defined as containing more than 275 kilocalories per 100 grams). The taxes are relatively large (about three times that of the average state-level soda tax in the United States) and have a fairly broad base: they apply to 39.4% of food products and 46.3% of beverage products in the data. Taxed products account for about 23% of expenditures, 33% of total calories from packaged goods, and 39% of total food expenditures. But certain staples such as oil, milk, and bread are exempt from the tax.

Prices of taxed drinks increased by 9.7%, and caloric consumption from taxed drinks decreased by 2.7%. Prices of taxed foods increased 6%, and caloric consumption from taxed foods decreased by 3%. So, the tax did slightly reduce the consumption of high-calorie foods.

But there was substantial substitution from taxed to untaxed food. The result was that total calories in all food purchases (taxed and untaxed) were unchanged. Increased caloric consumption of non-taxed drinks and food offset the decrease in the taxed items.

—P.V.D.

Banking


Financial institutions are more highly leveraged than other firms. That is, their capital structure has more debt and less equity than non-financial firms. Why?

Some scholars argue that finance is special, i.e., financial intermediation requires such a capital structure. Others say the high leverage is the result of governmentally provided deposit insurance that socializes the losses from leverage and privatizes the gains. If the former view is correct, then governments reduce efficiency by imposing minimum equity standards on banks, while if the latter is true, then capital requirements are simply an attempt to control the adverse effects of subsidized deposit insurance. (See Working Papers, Winter 2010–2011).

This paper compares the capital structure of traditional regulated banks with unregulated “shadow banks.” Traditional banks accept deposits that are federally insured, issue loans, and are subject to safety and soundness banking regulations and examinations. Shadow banks (Quicken Loans, for example) do not accept deposits; they raise money from investors in the capital markets. And they are not protected by deposit insurance or subject to safety and soundness regulation.

The average equity-to-asset ratio for traditional banks is approximately 11%. Shadow banks’ average equity-to-asset ratio is more than twice as high at 25% and resembles that of pre-deposit-insurance banks in the United States and Germany. But the average for nonfinancial firms is almost 50%.

Short-term debt (i.e., retail deposits) comprises 85% of bank debt funding. Shadow banks’ debt is almost exclusively (98%) short-term (rather than longer-term corporate bonds), but is provided by a few large banks.

These stylized facts suggest that short-term debt is an essential characteristic of financial institutions and not the result of regulation or deposit insurance. Even unregulated financial intermediaries are funded with substantially more debt than
non-financial companies.

But other facts suggest the effects of deposit insurance: shadow bank leverage increases substantially with size while bank leverage hardly changes with size. Small banks are highly leveraged relative to small shadow banks and are the main beneficiaries of deposit insurance. (See “Too Small to Succeed,” Winter 2019–2020).

The authors write, “The most parsimonious model that explains why bank capitalization is about half of shadow banks and, at the same time, why capitalization across banks is so homogenous, is the following: banks borrow as much as they can, subject to capital requirements, because they have access to subsidized debt funding.”

Health Insurance


Support for the Affordable Care Act (ACA) relies on the conventional wisdom that private individual health insurance policies don’t and can’t “work” given the skewness and concentration of health care expenditures. The lowest 50% of the population in terms of health care expenditures had average annual spending of $276 per person and accounted for only 2.8% of aggregate health care expenditures in 2016. The top 10% of the population, in contrast, had average annual spending of $33,053 per person and accounted for 66% of aggregate spending.

Many conclude from these facts that in the individual market, the healthy will obtain coverage at low rates while the “sick” will be unable to obtain coverage or only at prohibitively high rates. Thus, they argue, individual insurance coverage must be mandated to ensure “pooling” of healthy and sick so that the price is simply the population average, with limited variability by age (community rating).

Bradley Herring and Mark Pauly demonstrated in a 2006 Journal of Health Economics paper that markets could provide guaranteed renewable individual health insurance contracts because high-cost conditions are rare and do not persist. However, though such contracts are possible, they are hardly ever purchased because of the dominance of tax-subsidized employer-provided coverage in the United States.

The authors of this paper take the discussion further by examining the robust system of private guaranteed renewable contracts that exists in Germany, where 10% of the population has such coverage. Compared to the ACA system in the United States, the German individual market is less regulated. Applicants freely choose their level of coverage in terms of benefits and cost-sharing amounts within some very loose limits. There are thousands of different health plans among the 8.8 million policyholders. And the market has been stable and providing insurance for millions of people for decades.

The authors write: “An unquantified advantage of the German long-term contract is its simple design, combined with low information requirements. Moreover, the market has been stable and providing insurance for millions of people for decades. We believe that our findings, coupled with these facts, strengthen the case of the German design as an appealing policy option.”

IP Boxes


An “intellectual property box” (or IP box) is a preferential tax rate regime for income accruing to intellectual property such as royalties from patents. The rationale for an IP box is simple: if mobile capital can escape a country’s tax jurisdiction easily while fixed capital cannot, then it may make sense for the country to tax the return to mobile capital less heavily than fixed capital.

IP boxes have been around in some form for at least a decade, and there are over 20 countries with IP boxes (which these days are more often referred to as “innovation boxes”) across the world. Many of the EU countries, as well as China, employ some form of one. They vary widely in terms of qualifying income and rates.

The Joint Committee on Taxation staffers who wrote this paper want to know how foreign IP boxes affect the real economic activity of multinational firms. Knowing that would help U.S. policymakers better understand the efficacy of our own tax policy. Because countries adopted IP boxes in different years, the authors used a difference-in-differences approach to estimate the effect the tax policies had on sales, wages, and investment of multinational firms in the United States.

There are two ways a U.S.-based multinational could react to the creation of an IP box in a different country. First, the corporation could transfer activity currently done in the United States to the IP-box country. For instance, some pharmaceutical companies have indicated that Switzerland’s generous IP box is why they (re)located research and development there. This is more than a simple “P.O. Box” change; it is a boost in investment in the firms’ Switzerland operations at the expense of operations elsewhere.

But that substitution effect may bring with it a scale effect: a firm may react to the reduction in its worldwide tax bill from the IP box by increasing economic activity both in the IP-box country and in the rest of the world. In other words, while an IP box encourages more capital investment in the country that implements one, it may also boost economic activity at company locations around the world. The result is that countries that
don’t implement an IP box may lose tax revenue but not much overall economic activity.

The paper notes that while it may seem intuitive that the substitution effect would invariably reign supreme with an IP box, Duke University economist Juan Carlos Suarez Serrato found that the 2006 ending of generous tax breaks for U.S. manufacturers operating in Puerto Rico served to reduce the overall activity of U.S.-based corporations. The IP box may have the mirror-opposite effect.

A recent working paper—“The Effect of Innovation Box Regimes on Income Shifting and Real Activity,” by Shannon Chen, Lisa De Simone, Michelle Hanlon, and Rebecca Lester (November 2019)—finds considerable evidence that IP boxes do what they are intended to do: retain and attract mobile capital. It also notes that it is unclear whether attracting this capital results in more real economic activity, as that would depend on whether firms find it advantageous to co-locate production activities with their intellectual property. In research that I published with Hanlon, we found evidence that for the pharmaceutical sector there does appear to be economic incentives to co-locate production and certain intellectual property.

The authors of the Joint Committee paper obtained data on Foreign-Owned Domestic Corporations (FODCs) by examining Internal Revenue Service statistics of income reported on Form 5472 (filed by businesses that are at least one-quarter foreign-owned) and then linked those data to IRS Form 1120, the U.S. corporation income tax form. FODC assets represent 19% of corporate assets and receipts and 14% of taxes paid in 2012.

The authors find that foreign IP-box implementation does appear to increase overall economic activity, which they presume is due to the FODCs reducing their effective U.S. tax rate via IP boxes. In effect, they manage to increase gross receipts in the United States but not net income because their deductions increase. The authors conclude that the firms leverage up their U.S. operations with debt from the parent corporation, which boosts their (deductible) interest payments, thereby transferring income elsewhere.

In the 2017 tax reform, the United States took steps both to make it more attractive to keep capital in the country—by sharply reducing the corporate income tax—as well as make it less remunerative to shift profits abroad. Whether this combination serves to maintain both the stock of U.S. corporate investment and the corporate tax base is unclear, but the rapid changes in both corporate tax rates and regimes in the last few years indicate how difficult it is to impose taxes on corporation income.

—Ike Brannon
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