IN REVIEW

The Rise and Results of 'Megaproviders'

REVIEW BY PHIL R. MURRAY

David Dranove is an economist at Northwestern University's Kellogg Graduate School of Management. Lawton Burns is a sociologist at the University of Pennsylvania's Wharton School. The two have been studying the health care industry for decades. In their new book *Big Med*, they have a clear goal: "We want everyone to recognize that megaproviders are harming the health care system and begin discussing what we can do about it."

The authors describe "megaproviders" as "giant health care systems" that operate multiple hospitals and outpatient centers, affiliate with doctors, and may even sell health insurance. In economics jargon, a megaprovider is a horizontally and vertically integrated firm in the health care industry. The three biggest U.S. megaproviders, ranked by revenue, are the University of Pittsburgh Medical Center, Partners Health, and Sutter Health. Observe Dranove and Burns, although "the hospital systems are nearly all nonprofit," they manage "to post solid profits."

Integration / The authors offer two reasons for blaming megaproviders for the high cost of health care. One is based on what megaproviders do: they acquire market power, which enables them to charge higher prices. The other is based on what they do not do: effectively manage doctors, whose decisions influence the bulk of expenditures on health care, in ways that will reduce costs.

Health care has been expensive for a long time. During the Great Depression, several government agencies and private foundations created the Committee on the Cost of Medical Care to study both the cost and quality of U.S. health care. Its 1932 report "condemned the high and often wasteful spending that made health care inaccessible for most Americans," note Dranove and Burns.

They write at length on the history of the health care industry in America. A watershed moment was the emergence of the "managed competition movement," sparked by the work of economists Alain Enthoven of Stanford and Stephen Shortell of California, Berkeley. Their ideas formed the basis of the Clinton administration's 1993 attempt to remake U.S. health care. Although the administration's Health Security Act never passed, it motivated hospital executives to act. Their response was a strategy of "integration."

Hospitals grew into "integrated delivery networks." Hospital mergers and acquisitions are examples of horizontal integration. Hospitals employing doctors is an example of vertical integration. One rationale for this integration was to achieve economies of scale and scope. Another rationale was to gain "control of referrals" by doctors whose decisions influence spending.

Hospital executives initially attempted integration in the early 1990s. Neither economies of scale nor scope materialized. One reason for this is that, "because every hospital was making the same investments, no one could ramp up their volumes." Various difficulties plagued vertical integration of doctors. Hospitals paid too much to employ doctors or acquire their practices. The doctors who were more likely to accept employment with hospitals were less motivated to work. Hospital executives neglected to incorporate "productivity incentives" in the agreements they signed with doctors. The initial attempt to integrate wound down by the end of the 1990s as hospital revenues fell short of expenses.

After the start of this century, hospital executives made another attempt to integrate, egged on by health policy experts. New rationales were based on government policies. Two stand out: the Centers for Medicare and Medicaid Services (CMS) implemented "pay for performance," while the Affordable Care Act promoted the creation of accountable care organizations (ACOs). Both take advantage of CMS financial incentives to hospitals to lower the cost of care and increase the quality.

Megaproviders now earn profits based on integration. Their gain appears to be at the expense of consumers. "Prices are up," Dranove and Burns inform us, "quality is unchanged at best, and the quest for efficiency continues." The authors cite numerous journal articles to support their charges. Their reading of the literature on the horizontal integration of hospitals leads them to conclude that "mergers between competing hospitals do not appear to generate cost savings." Worse, their review of the literature on the

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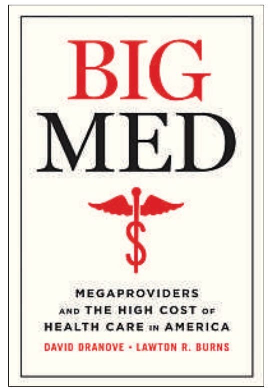
vertical integration of hospitals and doctors convinces them that prices are higher as a result. And quality does not improve from these changes, though it also does not decrease.

ACOs achieve mixed results. An abundance of studies concludes that "roughly half of the ACOs reduced spending." Part of the problem is that doctors do not directly benefit when they cut costs. And they are unhappy with integration in general: hospital executives call on them to exercise business skills, but they would rather get to know their patients and solve their health problems.

Competition / Given the profits megaproviders earn, the high prices they charge, and the unhappy lot of doctors they employ, Dranove and Burns ask of these entities, "If they are so successful, how can they be so bad?" Their answer: "Too many megaproviders face too little competition, and too many of their executives seemingly do not know how to manage the complex process of organizing and delivering health care." The former is a steppingstone to the authors' discussion of antitrust policy in the health care industry.

Hospital mergers have drawn the attention of the Federal Trade Commission, the Department of Justice, and state attorneys general. Merging firms testify that their market is vast, with many competitors. Antitrust agencies argue the opposite. To resolve this, the DOJ adopted a standard created by economists Kenneth Elzinga of the University of Virginia and Tom Hogarty of Virginia Tech (and later the American Petroleum Institute) to define a geographic market. If my understanding is correct, the "E-H test" deems a market area to be appropriately sized when it is large enough that the percentage of patients traveling outside the area for care, and the percentage of outside-the-area patients receiving care in the area, both fall below a certain benchmark, typically 10%. In a landmark case employing this test, when Rockford Memorial and Swedish American hospitals of Rockford, IL attempted to merge in the 1980s, the DOJ opposed it. In 1989, the trial judge decided that the combination would result in too much market power and ruled against it. The ruling was upheld on appeal.

Ironically, merging hospitals learned that the E-H test enabled them to define markets so geographically broad that they would defeat challenges from the antitrust agencies for several years. Economists—including Elzinga—eventually showed that the test was an unreliable means to determine the relevant boundaries of markets for hospital facilities. Their analysis shifted to documenting that past mergers resulted in higher prices and the recognition that insurers play a larger role in setting prices with hospitals than consumers. "If a merger increases the bargaining leverage of providers," the authors explain, "they will command higher prices." The FTC used that reasoning along with testimony from insurers to argue that Evanston Northwestern Healthcare possessed unacceptable pricing power in and around Chicago. The FTC won its case; however, it decided to regulate Evanston Northwestern rather than break it up.



Big Med: Megaproviders and the High Cost of Health Care in America

By David Dranove and Lawton R. Burns

335 pp.; University of Chicago Press, 2021

Dranove and Burns mention another technique to demonstrate market power that Dranove helped to devise in previous work: willingness to pay (WTP). The gist is that "WTP captures a hospital's ability to negotiate higher prices, and the extent to which two hospitals can command higher prices than they can when they are separate." By employing WTP in the courtroom, the FTC has thwarted several attempted mergers around the country.

Equipped with this new theory of how hospitals and insurers bargain with each other and empirical evidence of how integration increases prices, antitrust agencies prevent some but not all new mergers in more narrow, geographically smaller markets. Among the problems that persist, hospitals that had merged in the 1990s and early 2000s still wield market power and search for additional mergers and acquisitions in geographically larger markets. And they engage in "questionable conduct" to maintain market power.

Now that the FTC has persuaded judges that the appropriate market for hospital merger and acquisition activity is about the size of a city, either the agency will prevent hospital executives from merging or acquiring another health system within a city or the executives will not even bother trying. Instead, executives planning to integrate will look for partners or targets in other cities. A few researchers claim that these "cross-market mergers" empower hospitals to increase prices. One theory of how this happens begins with patients' expectations to choose among a variety of hospitals. Employers in turn aim to fulfill those expectations when negotiating with insurers on behalf of their employees. "Some megaproviders are so [geographically] large that insurers cannot easily meet these standards without them," write Dranove and Burns. A cross-market merger thus gives a hospital an advantage over insurers when negotiating prices.

Another theory is that a cross-market merger is a way to raise prices without drawing scrutiny from regulators. The authors put it this way: "Rather than charge extremely high prices where the systems truly have power, they only charge very high prices across the board."

Value chain / The "questionable conduct" that hospital executives engage in refers to techniques that inhibit consumers from finding lower prices or higher quality. A "must-have provider" is a hospital known for high-quality care, medical research, or expertise in a given area such as cancer treatment. In an "all-or-nothing contract," "insurers must include every system provider in their networks, or none." Hospital executives with must-have providers negotiate all-or-nothing contracts with insurers. Insurers evidently want to guarantee care for their customers so much that they are willing to accept bad returns for their money: paying for services at hospitals that charge higher prices or provide lower quality. By stipulating "gag rules," hospitals prevent insurers from sharing the prices they pay, which hinders consumers searching for better deals. This foreshadows the authors' suggestions for antitrust policy: "These tactics seem blatantly anticompetitive."

The idea of a "value chain" forms the basis of Dranove and Burns' suggestions for antitrust policy. "In health care," they explain, "the value chain represents the formal and informal linkages among payers and providers that govern the entire medical care process." The authors want to promote competition among value chains because they believe the payoff in terms of reduced health care expenditures is significant.

They propose to evaluate mergers and acquisitions by asking and answering the following:

- Can the market support three value chains?
- Are there three organizations that could serve as foci for organizing the chains?

If the answer to both questions is yes, then the agencies should scrutinize any deal that threatens to reduce the numbers to two. If the answer to either is no, then the market is already concentrated and all deals involving focal organizations should be scrutinized. Based on the cases they describe, Dranove and Burns reason that a combination of providers with different value chains will mean the elimination of one, and therefore such a merger should be blocked.

The authors do not think big hospitals are necessarily bad or all bad. "As long as markets support competition among three or more value chains," they specify, "we would leave the megaproviders alone." Otherwise, they endorse breaking up large hospital systems that possess market power or regulating their prices. They would prohibit all-or-nothing contracts and gag rules. Readers who think that publicly available prices are a feature of markets that work well will be interested in their reasons against "mandatory price disclosure." The authors have a lot to suggest. "The point," they emphasize, "is that we need a new bible for health-care antitrust enforcement."

Big Med is a valuable survey of the health care industry. Dranove and Burns arguably succeed in causing the reader to think about what causes the high cost of health care in America, as well as government policies and business strategies that might halt that trend. Readers will contend with the economics of industrial organization, business practices such as anti-steering and bundling, and an abundance of acronyms. That may make the book too demanding for the wide readership the authors hope to attract. *R*

A Wide-Ranging Libertarian Philosopher, Reasonable and Radical

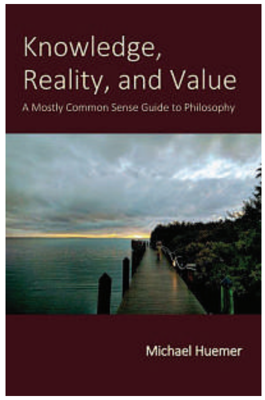
REVIEW BY PIERRE LEMIEUX

Michael Huemer, professor of philosophy at the University of Colorado, is one of the top philosophers and theorists of anarcho-capitalism, the idea that a stateless capitalist society is desirable. His interests, however, are much wider, as demonstrated by his recent book *Knowledge, Reality, and Value: A Mostly Common Sense Guide to Philosophy*, an introductory text for college students. In it, he reviews and discusses the main branches of philosophy: epistemology (the theory of knowledge), metaphysics, and ethics. He wants to teach college students to think rationally, like philosophers. If you are more interested in political philosophy, you will find it in his older book, *The Problem of Political Authority: An Examination of the Right to Coerce and the Duty to Obey* (Palgrave Macmillan, 2013). In this essay, I will review both books.

Reason / If a reviewer could summarize *Knowledge, Reality, and Value* in a few hundred words, there would be no place left for professional philosophers. Instead of this mission impossible, I will focus on a few landmarks and highlights of the book, especially in the area of ethics, which is the foundation of political philosophy.

Most people, and not only college students, think confusedly, says Huemer. Even experts are confused when they think outside their own fields or about "the larger implications of the discoveries in their own fields." A philosophy book such as *Knowledge, Reality, and Value* helps its readers to think logically and rationally. In the search for truth, "rationality is the master intellectual virtue, the one that subsumes all the others." Rationality requires objective thinking, which means avoiding biases, including ideological, emotional, or identity-group biases.

Errors of logic and logical fallacies must be avoided, but Huemer points out that some practices are wrongly labeled as fallacies: "Sometimes a 'fallacy' is not a fallacy." For example, the admonition to avoid ad hominem arguments should not justify disregarding "negative information about an individual [that] is very relevant to whether you should believe what they say." Cranks are not good guides to the



Knowledge, Reality, and Value: A Mostly Common Sense Guide to Philosophy
By Michael Huemer
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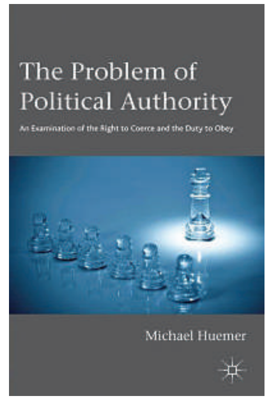


The Problem of Political Authority: An Examination of the Right to Coerce and the Duty to Obey
By Michael Huemer
365 pp.; Palgrave Macmillan, 2013

truth, and arguments from "smart and reasonable people" should be given much more weight.

According to the "phenomenal conservatism" espoused by Huemer, the rational presumption is that things are what they appear to our senses, memory, introspection, or intuitions, "unless and until you have specific grounds for doubting that." Science and analysis often provide such grounds.

God and metaphysics / Huemer reviews the different metaphysical arguments for and against the existence of God. He considers the old theological paradox about whether God can make a stone so heavy that He cannot lift it. The short answer is no and perhaps He cannot be literally omnipotent after all. The author of *Knowledge* ends up arguing that the presence of evil in the world—small children with terrible diseases, for example—is "*strong evidence* that there is no God," or at least not an omnipotent, omniscient, and omnibenevolent God. Huemer's final stance is agnosticism.

However, he also argues that immaterial souls exist because otherwise nothing can account for the identity of an individual from conception or sometime before birth to death, even when losses of memory occur along the line. This conclusion is just one of many surprises, along with their supporting arguments (and objections and counter objections), that await the reader of *Knowledge*.

Another major problem of metaphysics, with some ethical and political implications, is determinism vs. free will. Is everything determined in advance by physical causes or do individuals have free will to choose (at least sometimes) among alternatives? If only because of quantum randomness, physicists are divided on physical determinism. Another argument: If everything is determined, even deterministic ideas must be predetermined, so why believe them?

Huemer sides with theories of "soft determinism" that leave room for free will. If everything is strictly predetermined, you don't have the choice of throwing this magazine through the window. But introspection reveals that you can do this if you want to. The reconciliation between free will and determinism seems to be that a person's own choices are part of the multiple causes that affect the real world. The fact that individuals are held at least partly responsible for their actions (murder, for example) also suggests that free will is inseparable from human existence. There are different degrees of freedom and one can maximize his free choice "by being more self-aware."

Utilitarianism / Huemer reviews different meta-ethical theories about the objective truth or lack thereof of ethical statements. He sides with "ethical intuitionism" as the most sensible theory. It is a form of moral realism (as opposed to nihilism or relativism) according to which objective ethical truths exist, at least some of which are attainable through our considered (or "checked") intuitions of what is morally good or bad. For example, "You should not torture babies for fun" is an uncontroversial moral statement.

Turning from meta-ethics to ethics proper, Huemer examines two major Western ethical theories: utilitarianism and deontology. Concerning the former, he considers consequentialism a sort of utilitarianism. Perhaps under the influence of economics, it seems to me more fruitful to do the converse and take utilitarianism in a narrow sense, as a special sort of consequentialism, the latter consisting of the set of all theories according to which consequences count in judging the value of an action. In this perspective, utilitarianism is a more precise way of measuring and weighing the consequences of different actions.

For a utilitarian in this narrow sense, "the right action in any circumstance is always the action that results in the greatest total quantity of well-being," where well-being can be understood in terms of enjoyment or desire-satisfaction. The famous Trolley Problem asks us to imagine a runaway trolley on the verge of hitting and killing five persons on the tracks, but it can be diverted to another track where it would only hit and kill one person. A utilitarian seemingly would favor switching the trolley and save five lives at the cost of one.

That seems right. But now consider a doctor who has five patients: three who need, respectively, a heart, two lungs, and a liver, and two who each need a kidney. Following the same utilitarian logic as in the Trolley Problem, shouldn't he coercively harvest the five organs from one healthy patient? That doesn't seem right, and it violates Huemer's ethical intuition. His books are full of these thought experiments familiar in ethical philosophy.

Typically, we want to evaluate different consequences across individuals and we need a method to compare those consequences. Utilitarianism provides one: the right action is the one that "produce[s] more utility rather than less." More generally, including when the consequences are more complex than just counting lives lost, the utilitarian method requires what economists call interpersonal comparisons of utility or well-being. It is necessary to compare, for each alternative, the well-being gained or lost by different individuals and to calculate a net total. As economists have discovered over the past hundred years, this fundamental problem is scientifically unsolvable, notwithstanding the gauche attempts of benefit–cost analysis. Contrary to what Huemer may seem to suggest, it is scientifically meaningless to add positive utility and negative utility across individuals. This is especially clear in modern economics, where utility is viewed as merely a ranking of preferences in each individual's mind.

Economists—at least those who have reflected on the issue—recognize that moral criteria are necessary to justify individual actions and public policy. We should expect moral philosophers to provide arguments that do what economics as a science cannot: bear a normative judgment on consequences across different individuals. Philosophers should not be content to recycle old economic-utilitarian arguments that have no scientific justification. To be blunt, philosophers should not simply mimic bad economics and try to maximize welfare by adding up "utils" (fictitious units of utility) and choosing the alternative with the larger net number of them. Huemer's argument in this respect could be much improved.

Huemer admits to being tempted by utilitarianism, but he realizes that some of its implications violate clear ethical intuitions. I think he dismisses too summarily *rule utilitarianism*, where what is right and wrong is determined by general rules, as opposed to *act utilitarianism* (discussed thus far), where each decision depends on a specific utility calculation. For example, the general rule to not kill an innocent person is intuitively preferable to a morality that permits such killing for the "greater good." In this perspective, morality assures the coordination of individual actions, rather than trying to realize some impossible maximization of well-being.

Deontology / The second category of moral theory is called "deontology" and emphasizes moral duties or obligations that are at least partly independent of consequences. An absolute deontologist like Immanuel Kant thinks that some actions are morally wrong whatever their consequences; for example, killing an innocent to save the rest of mankind would be wrong. The notion of individual rights, notes Huemer, "is a particularly popular deontological concept."

But then, he argues, absolute deontology also has implications that are intuitively wrong. Suppose that saving mankind from a deadly disease requires plucking one hair from the head of an immune girl to synthesize a medicine that will cure everyone. The girl and her parents do not consent. Taking one hair from the girl is a rights violation, albeit a small one by any account, but it appears to be morally impermissible in absolute deontology.

Huemer defends moderate deontology, a "middle ground position between consequentialism and absolute deontology." In place of absolute rights, this view proposes to substitute "prima facie rights," which "may permissively be violated in extreme circumstances."

It is precisely to determine these circumstances and their threshold that Huemer's moderate deontology can be useful. But he may be too much of a moderate because he suggests that it would still be permissible to kill one person if the alternative were between his death and the annihilation of mankind. Given the "radical uncertainty" (to use George Mason University economist Tyler Cowen's expression) of future consequences, it seems to me that such behavior would be clearly immoral. We simply cannot know the consequences of this murder, a general idea emphasized by Friedrich Hayek, notably in *Law, Legislation, and Liberty*. Rules are an adaptation to our ignorance, and assuming perfect knowledge is not useful.

Huemer sometimes seems to be a prisoner of simplistic economic utilitarianism, although he finally offers this prudent conclusion: "I judge the problems for moderate deontology to be the least bad."

He argues that there is a moral duty or obligation to privately contribute significant money to charity. In a similar way, you have a moral obligation to save a child from drowning in a pond if you can do so at a low cost for yourself. This moral duty, Huemer notes, is particularly stringent toward the global poor—the poor in poor countries—who are much more in need of assistance than poor Americans, who are comparatively rich. An important caveat is that moral duty does not entail legal obligation.

Against political authority / Huemer derives moral and political philosophy from the moral intuitions of common people—or, at least, of common people in an advanced Western country such as the United States. "I rely on clear, mainstream intuitions," he writes. For example, lying and stealing are usually wrong, but not in all circumstances. "The foundation of my libertarianism," he writes, is "common sense morality." A brilliant application of this approach is developed in his earlier book, *The Problem of Political Authority*, which outlines his political philosophy.

The first part of this book is a philosophical argument against political authority and in favor of anarchy. Political authority is the hypothesized moral property that allows governments to "coerce people in certain ways not permitted anyone else." It has two aspects: the legitimacy of government rule and the ethical obligation of citizens and residents to obey.

Concerning the first aspect, the state (all levels and branches of government) has no authority to rule that is independent of the content of its bans and decrees. It only has authority to mandate something that is already an ethical obligation that any individual or private group may force others to follow. For example, the state is only allowed to prevent murder because any individual has the right to do so—notably by defending himself and others. But the state is not allowed to steal from the rich to give to the poor (or the other way around) if no individual has such authority. To answer that the state may do things that individuals may not do presupposes what has to be demonstrated, which is the fallacy of circular reasoning.

Huemer argues that political authority cannot be anchored in a social contract nor in democratic approval. Pace old contractarian theorists like John Locke, an actual social contract does not exist and thus cannot serve as a foundation for the legitimacy of the state and the obligation to obey. A merely hypothetical contract—as defended by contemporary philosophers like John Rawls—is not sufficient to create a general obligation to obey. Huemer appeals to moral intuitions. An emergency surgeon is presumed to have an unconscious patient's implicit consent to perform a life-saving operation barring contrary directives. But a presumptive social contract cannot apply to conscious individuals who are unlikely to consent. Just think of anarchists who have publicly declared that they have signed no social contract submitting them to political authority.

A democratic majority cannot justify the coercion of a minority. In a group of five individuals, a majority of three may not claim political authority over the other two. As for an idealized "deliberative democracy" where everybody can be heard equally and a consensus is somehow reached, this is a "purely hypothetical scenario" that cannot justify political authority.

If the state has no legitimate political authority, it follows that "no state is legitimate, and no individual has political obligations." No one is morally obliged to obey the state. "I claim," Huemer writes, "that one may break the law when what the law commands is not independently morally required and no serious negative consequences will result." The state may ban murder because any individual may ban it. But the state may not ban victimless crimes, such as consuming drugs, tobacco, or alcohol, or hiring somebody's services at a mutually agreed wage. "No one is obliged to obey a command merely because it comes from their government."

Individuals' submission to authority is widespread and dangerous. Stanley Milgram's experiments at Yale University in the 1960s found that a large majority of people will follow orders and inflict pain and possibly even death on others simply because an authority figure requests it. Another example Huemer invokes is the horrible My Lai massacre, a war crime committed during the Vietnam War.

The symbols, rituals, and propaganda of the state make the "citizens" emotional, pliable, and obedient. Huemer illustrates this by citing "the use by private citizens of the word 'we' to refer to the government, as in 'We invaded Iraq in 2003.'" The realization that political authority has no clear foundation except in a pro-authority bias in the human mind defeats the idea that "just obeying orders" is a morally acceptable excuse.

From all that, it follows that anarcho-capitalism is the ethical alternative, Huemer argues.

Moral critique / His moral defense of anarcho-capitalism is impressive but not without weaknesses. Coercion revolves around violence and threats of violence, but he admits he cannot completely articulate the so-called "nonagression principle." He thinks he can build the case for anarcho-capitalism on mainstream moral intuitions about specific cases of coercion. But what if most people think that they derive a net benefit from government and thus accept its coercion?

Individuals' submission to authority is widespread and dangerous. Political authority has no clear foundation except in a pro-authority bias.

Many people seem to reject the sort of moral intuitions that he proposes. For example, they have no objection to a government-imposed minimum wage, which forbids a demander and a supplier of labor to agree on terms of employment. Many other contemporary beliefs could be cited as examples.

Another weakness lies in Huemer's use of simple economic utilitarianism to compare the state and anarchy. He seems tolerant of interpersonal comparisons of utility. He mentions "marginal social benefit" and even the "total utility of society," as if he believes these expressions have an ascertainable meaning. If this apparatus is questionable for justifying government intervention, it is not useful for arguing against government intervention either.

Violating a person's property rights is permissible only "provided that doing so is necessary to prevent something *much* worse from happening." This "*much* worse" might attenuate the problem, but how much worse? I suspect that Huemer is making a *moral* comparison, but then why make a detour through highly contestable economic constructs? Here again, the reader would have liked him to explain more clearly how alternative consequences are to be compared.

Huemer remains intellectually humble before such complex problems, which is refreshing for a libertarian. "I am unsure what to make of this," he writes at one point. He is both a reasonable and a radical philosopher.

I remain suspicious of the argument that anarchists don't want to sign any social contract. How would we really know? Do anarchists really exist? Talk is cheap and people claiming to be anarchists may just be bluffing to get a better deal such as lower taxes or higher subsidies. But let's entertain the idea that a few political philosophers are serious anarchists. We would only really know that if they actually chose to live in an anarchic society. It is true that this is currently impossible in a world paved with states, but one could counter that this fact makes the anarchist's bluff even cheaper.

Speaking about the social contract, Huemer does not consider the contractarian theory that may be the most challenging: that of James Buchanan (see his 1975 book *The Limits of Liberty: Between Anarchy and Leviathan*). In fact, *The Problem of Political Authority* does not even cite or mention Buchanan. The Nobel laureate proposes an implicit social contract based on the necessity of individuals to agree on some basic conditions of life in society: the definition of property rights, the delimitation of "public goods," and the creation of a state to enforce the individual rights defined in the social contract.

One function of the state in classical liberalism and in most libertarian theories (including Buchanan's) is defense against foreign tyrants and thugs. In a Huemerian way, we can argue that any individual has this self-defense right and thus the state must have it too. The implications for state-waged just wars may be wider than many libertarians believe because self-defense is not exclusively passive. If an individual threatens to make me his slave and to shoot me if I resist, I don't morally need to wait until the bullet is out of his gun to open fire in self-defense.

Economic arguments for anarchy / The second part of *The Problem of Political Authority* presents the standard anarcho-capitalist argument that whatever is required by social order, liberty, and prosperity would be done better by private cooperation in a stateless society. After the philosophical part of the book, this is the economic part.

Huemer recognizes that "anarchists face a significant challenge of avoiding utopianism." But, he adds, statists—even those on the side of liberal democracy—face a similar challenge. To be realistic, any social theory must avoid negating what we observe is basic human nature. The state must be analyzed as it works in the real world, not as a sort of ideal entity that stands "above the empirical human world, transcending not only the moral constraints but also the psychological forces that apply to individual human beings." Huemer argues that if you compare anarchy as it is likely to work in the actual world with the state as it is, the state does not win.

Crimes—real crimes, not victimless crimes—create injustice and, in the current system, more injustice for the poor than the rich. "The question," Huemer notes, "is whether anarchy faces a greater problem or a greater injustice than government systems." He goes on to argue that anarchy is a "superior alternative" to government even if we try to minimize the latter's "exploitation and abuse." His economic argumentation is reminiscent of Santa Clara University economist David Friedman, who is often cited in *The Problem of Political Authority*. (See, among other works, Friedman's 1973 classic *The Machinery of Freedom*.)

In an anarchic society, public protection as well as the resolution of contractual disputes and eventually of criminal cases could conceivably be solved by private protection agencies and arbitrators. These services would be offered on the market to individuals and probably to voluntary groups such as homeowners associations. Arbitrators would develop a body of law the way the common law evolved, although different legal rules could arise in different places. Thomas Hobbes exaggerated the potential for continuous violence when contending parties have roughly equal power. Armed conflict would be rare because it is costly and in the interest of few people. If protection agencies fought too often, they would lose their employees and their profits; there is no conscription in a free society. Apprehending criminals, forcing them to compensate their victims, and jailing those who cannot compensate would satisfy market demand.

"Under certain favorable conditions," Huemer argues, even the external defense of a stateless society would not be impossible. A society without a government army would not threaten any foreign power and may be less subject to aggression. At least 15 countries currently have no military forces, including Leichtenstein and Costa Rica. Moreover, the conquest of an anarchic society would be difficult because the conqueror could not use an existing government structure (including government bureaucracy) to impose its rule. No official surrender would be possible. The possibility of guerrilla resistance would provide a further disincentive to a potential invader. Murray Rothbard defended similar ideas in his 1973 book *For a New Liberty.*

Compare these possibilities with the internal and external danger of standing armies and the risk that war now creates for the very survival of mankind: "The apparatus we have devised for rendering ourselves secure against foreign aggression is itself the primary source of the greatest danger that the human species has ever faced," Huemer notes. During the 20th century, some 140 million individuals died in interstate wars. In comparison, death forecasts from climate change are next to nothing.

Contrary to conventional wisdom, Huemer argues that anarchism presupposes a much less utopian view of human nature than statism. During the 20th century, besides the war dead, 123 million individuals were killed *by their own governments*, mainly communist and fascist. That is nearly five times the estimated number of non-governmental murders over the same period.

Huemer takes human beings to be "only approximately rational and only approximately egoistic." He observes that violence has been on a secular decline. He notes that "once one has an advanced, prosperous, liberal society, the continuing need for government is far from clear."

Doubts about anarchy / It seems to me that *The Problem of Political Authority* would have benefited from incorporating some of Anthony de Jasay's philosophical and economic insights. Philosophically, de Jasay was also an anarchist looking for arguments that, as he wrote, make "a lesser demand on our moral credulity." He offered a strong critique of "social justice." (See "The Valium of the People," Spring 2016.) Economically and politically, de Jasay emphasized the neglected but crucial fact that most—he would say all—government interventions harm some individuals to favor others, which is the essence of governing. (See his seminal 1985 book *The State*.)

That said, both Huemer and de Jasay may underestimate the risk of anarchy. One problem is that social coordination in a stateless society may require stifling norms to replace laws. The experience of primitive stateless societies with their "cage of norms" is not encouraging. (See "A Shackled Leviathan That Keeps Roaming and Growing," Fall 2021.) The argument for a constrained state is that it minimizes violence by squeezing it into a formally controlled domain.

Huemer's counterargument is that anarchy would not face this sort of problem in an advanced society where moral rules can be expected to be liberal.

Like most anarchist theorists, Huemer sidesteps the argument of economist Mancur Olson that a "stationary bandit" under the disguise of a central state is less destructive of liberty and prosperity than a swarm of warlords or "roving bandits." (See, among other writings, Olson's 1993 *American Political Science Review* article "Dictatorship, Democracy, and Development.") The stationary-bandit state will not loot and kill, or will do it at a lower degree, because it will want to maintain taxable matter for future exploitation. A roving bandit, on the contrary, knows that whatever he does not loot will be looted by the next roving bandit passing by and will thus not be available for future looting. It is not implausible that roving bandits would thrive in a stateless society.

External security would probably remain the number one problem in an anarcho-capitalist society, at least as long as the world is paved with states—a fear expressed by both Friedman and de Jasay. Isn't it likely that ISIS or the Taliban or a similar group would be attracted by the wealth of an anarcho-capitalist society and angered by its liberal culture? In 2015, two Islamists claiming to be part of the al-Qaeda network massacred a dozen staffers and visitors at the satirical magazine *Charlie Hebdo* in Paris. The attack was in revenge for the magazine's cartoons mocking the Prophet. We can doubt the argument seemingly endorsed by Huemer that Islamists only attack us because our own states have previously attacked them. Indeed, as was often said, it is arguably at least as much because "they hate our freedoms."

"The overwhelming majority of human beings are strongly opposed to murder," Huemer observes. Reportedly, only about 2% of the population are sociopaths. But the exceptions do count, especially when supported by world terrorist organizations or rogue states.

It is relatively easy to defend the efficiency and justice of anarchy if all members of society are anarchists who favor justice. But this may not work if others who like wealth but not liberty are free to move there. Like many libertarians, Huemer argues for open immigration, but immigration can change the culture of a society and prevent it from remaining an oasis of liberty. For similar reasons, Buchanan opposed open immigration. The problem seems more complex than many libertarians think.

We know that lots of things can go wrong with the state. But lots of things could also go wrong with anarchy, and we don't really know just how many and how wrong because we don't have any experience with such a system in an advanced society. Hayek argued that spontaneously developed laws may drift into unjust and unacceptable consequences, the rapid correction of which requires legislation. Couldn't the same happen with laws developed by private arbitrators, especially if vastly different legal systems resulted in the same society? Imagine if radically different criminal laws applied when you travel from one neighborhood to another.

In *For a New Liberty*, Rothbard argued that if anarchy does not survive, the worst that can happen is that we get the state back: "In trying freedom, in abolishing the state, we have nothing to lose and everything to gain." But we could get a much worse state that the current one, which at least has roots in classical liberalism and partly escaped the tyranny traditionally exercised by political power. Huemer is more prudent than Rothbard and does not make the latter's argument. He may still be too optimistic about anarchy.

Getting there from here? / The concluding chapter of *The Problem of Political Authority* argues that abolishing the state and establishing an anarcho-capitalist society is not implausible. Future generations may view state coercion as an outdated immorality. Large changes in values have already happened in economically and technologically advanced societies. Anarchy will emerge if and when enough individuals are persuaded that it is the best ethical and economic alternative.

Other conditions are necessary for the emergence of an anarchic society. Huemer hypothesizes that anarchy is likely to appear in a small, advanced, liberal society where the activities of the state would gradually and consensually wither away. The new anarchic society would be located in an area surrounded by liberal democratic countries that would not oppose the experiment. These surrounding states would provide a buffer against foreign aggressions. Once it has demonstrated the desirability of anarchy, the model would likely spread in the world.

All this may take decades if not centuries to play out. And it would only happen if, as Huemer points out, the state does not bring mankind back to the cave ages with a nuclear war or some other action that destroys the conditions of human liberty. He does believe that, given voters' rational ignorance and other features of democratic systems, the establishment of anarcho-capitalism is more realistic than the dream of seriously reforming the current system. Perhaps.

Epistemic humility is one of the lessons of these two books. Another one is that rational philosophical inquiry is useful for trying to understand the universe (or the multiverse) as well as the way humans should behave toward each other. Third lesson: there exist serious philosophical and economic arguments against political authority and in favor of anarcho-capitalism.

The jury is still out on anarchy, and it will remain out until an actual experiment is realized. Perhaps classical liberalism or non-anarchist libertarianism is as far as we can go toward anarchy? In his 1969 book *Éloge de la société de consommation* (*In Praise of Consumer Society*), French philosopher Raymond Ruyer suggested as much: "Real anarchism, feasible and realized … is simply the [classical] liberal economy." Certainly, we should at least aim to maintain or recover the "feasible and realized anarchy" and push the limits of classical liberalism. The ideal is anarchy, not authority. R

IN REVIEW

Markets and Dematerialization

REVIEW BY JONATHAN H. ADLER

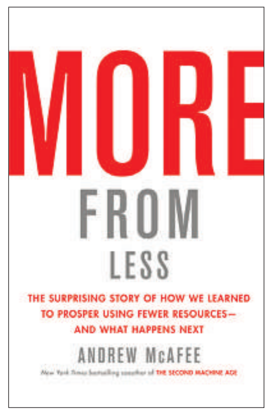
Dematerialization may be the most important, yet unsung, example of environmental progress in the 21st century. It is commonplace to observe that the relentless drive to do more with less has led to more efficient resource use, so that a soda can today is made with a fraction of the metal required 50 years ago. But dematerialization is not merely a story about increased efficiency or per-capita reductions.

What is now being observed represents a fundamental decoupling of resource consumption from economic growth, such that as mature economies grow, they not only use fewer resources per unit of output, but they also consume fewer resources overall. In short, economic growth in the most developed nations increasingly coincides with a net reduction in resource consumption. The United States in particular is "post-peak in its exploitation of the earth," according to Andrew McAfee in *More from Less: The Surprising Story of How We Learned to Prosper Using Fewer Resources—and What Happens Next.*

McAfee, a principal research scientist at MIT, explains, "We're now generally using less of most resources year after year, even as our economy and population grow." The United States uses less gold, steel, aluminum, copper, stone, cement, and even paper than it did at the start of this century, despite the continued increase in gross domestic product. Annual consumption of all but six of the 72 resources tracked by the U.S. Geological Service are "post peak." We also use less fertilizer and water while growing more crops. Plastic consumption is up, as is energy use, but these two appear to have been decoupled from population and economic growth as well.

How does this dematerialization occur? Some examples may be useful. The dematerialization of soda cans is relatively easy to grasp, particularly for those of us who can remember the heavier cans of the 20th century. Aluminum cans weighed 85 grams when introduced in the 1950s. By 2011, the average can was under 13 grams. Cans today are not only thinner and lighter, they are produced more efficiently, with fewer separate sheets of metal.

Substitution can be an even more powerful source of dematerialization. Consider telecommunications. A single fiber optic cable made from less than 150 pounds of silica can carry the same volume of information as multiple 1-ton copper cables. And were that not enough, satellite and wireless technologies enable us to bypass the use of physical cables altogether. We can communicate more and yet use vastly less material to do so. This not only saves copper, but other resources too. Think of all the paper saved by e-mail, e-banking, and e-readers.



More from Less: The Surprising Story of How We Learned to Prosper Using Fewer Resources—and What Happens Next
By Andrew McAfee
352 pp.; Scribner, 2019

Markets or Malthus? / It was not expected to work out this way. Throughout the modern era, doomsayers have predicted the imminent depletion of one resource or another. Human impact on the natural environment was to increase inexorably with the rise of wealth, technology, and population, inevitably colliding with the earth's natural carrying capacity. It seemed "logical and inevitable" that "the planet's finite stock of these resources would someday be exhausted."

Yet, this is not what happened. Instead, "capitalism and tech progress are now allowing us to tread more lightly on the earth instead of stripping it bear." The Malthusian "limits to growth" have not merely been delayed or forestalled; they have been transcended.

This was neither planned, nor anticipated, nor is it the product of the ecological agenda advanced by the modern environmental movement. Since the first Earth Day in 1970, environmental advocates have called for constraints on consumption, limits on technology, and greater recycling. None of those impulses, in McAfee's view, did much to encourage dematerialization. Indeed, he suggests, pushing for recycling *may have cut the other way*, insofar as recycling dulled the price signals that incentivized producers to do more with less. The environmental policies born of the 1970s may have "worked amazingly well" to reduce pollution and related environmental harms, but they played just a bit part in the story of dematerialization.

We do more with less not because of government regulation or administrative direction, but because of capitalism and technology. These are the dominant forces driving dematerialization in the most developed countries and they could unleash similar gains in the rest of the world. We "want more all the time, but not more resources," McAfee notes. We want more of *what resources can provide*, and one way to get more is to do more with less. Market capitalism both facilitates and enhances the underlying incentives that drive efficiency gains and technological advance. This not only leads to dematerialization but also promotes "critical aspects of well-being," including health and prosperity.

What's left to be done / While celebrating dematerialization and dramatic improvements in many measures of human well-being, McAfee acknowledges there is more to be done. He devotes the latter part of the book to considering the challenges that remain. Dematerialization has occurred in the wealthiest nations, but it has yet to reach much of the world. Some types of pollution are declining, but others—including plastic waste and greenhouse gases—are not. He also worries about the potential effects of economic concentration and "disconnection among people and declines in social capital." Not everything wrought by capitalism and technological advance has been positive, even if the net result is a good one.

McAfee is an optimist, but he sees serious storm clouds on the horizon. He is particularly concerned about the atmospheric increase in greenhouse gases and writes that reducing "the carbon intensity of our economic activities" is "the most important task for responsive governments."

He is right to be concerned about climate change, but his discussion of the policy options is somewhat thin and disconnected from the central thrust of his book. Market-driven capitalism and accompanying technological advances drove dematerialization and could drive decarbonization as well, particularly if carbon emissions are priced. The proper suite of policies could facilitate a decarbonization in energy to rival the dematerialization we observed in telecommunications. Yet, the nature of any government interventions matters. Ill-conceived policies could blunt the market incentives that drive more efficient resource use.

McAfee gives such questions relatively little attention, however. He also is too quick to credit regulatory interventions for prior environmental gains, such as the reductions in air and water pollution over the past half-century. Those trends often began before the regulatory measures he celebrates, and some regulatory measures may well have caused more harm than good.

McAfee did not set out to write a wonky treatise on environmental policy, and *More from Less* is not one. The book tells the story of capitalism's triumph over material scarcity with clarity and insight. He ably explains how modern society has achieved material ecological sustainability, and market capitalism was the cause. At a time when capitalism is viewed with suspicion, *More from Less* rises to its defense. Global challenges remain, but *More from Less* suggests solving such challenges will require more capitalism, not less. R

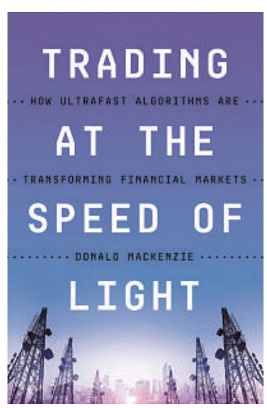
Trading, from Open-Outcry to Microwave Wireless

REVIEW BY VERN MCKINLEY

The pop culture view of high-frequency traders (HFTs) has been formed primarily by books and movies. I previously reviewed Michael Lewis's best-selling book *Flash Boys* ("Finance According to Non-Academics," Spring 2015), which scrutinized the front-running trading strategies of HFTs who, according to Lewis, "rigged" the market by shaving nanoseconds off their execution time. Sony planned to make the book into a movie, with the screenplay by Aaron Sorkin, but the project got stuck in development hell; Netflix is now giving it a shot. Another attempt to put HFTs on the big screen was 2019's *The Hummingbird Project*, starring Jesse Eisenberg and Salma Hayek, though it failed to break $1 million at the box office.

A less pop-culture effort is sociologist Donald MacKenzie's new book *Trading at the Speed of Light*. It applies a material political economy approach to the corporate history of trading. He previously authored 2006's *An Engine, Not a Camera: How Financial Models Shape Markets*.

MacKenzie's research for this book extends back over a decade. He recollects an early *New York Times* story about HFTs: "It is the hot new thing on Wall Street, a way for a handful of traders to master the stock market, peek at investors' orders and, critics say, even subtly manipulate share prices." His primary research method was in-person interviews. He conducted 337 in all, in all the trading centers of the world, including Chicago, New York, London, and Amsterdam. He spoke with founders and employees of high-frequency trading firms; staff of exchanges and clearinghouses; algorithmic trading practitioners; suppliers of communications and technology; regulators, lawyers and lobbyists; and dealers and brokers. Nearly all of his quotations in the book are from anonymous sources, who are branded with initials for identification.



Trading at the Speed of Light: How Ultrafast Algorithms Are Transforming Financial Markets

By Donald MacKenzie

304 pp.; Princeton University Press, 2021

Before automation and electronic trading / Before addressing today's fast-moving, high-tech trading world, MacKenzie commits several early chapters to the bygone days of the trading pits and open-outcry trading at Chicago's Board of Trade and Mercantile Exchange (CBOT and CME), reminiscent of scenes from the movie *Trading Places*. As a bridge between the eras, the reader hears the story of Leo Melamed, who started his career as a runner in the trading pits in 1953 and whose first job entailed delivering orders to floor traders. MacKenzie notes that Melamed, who ultimately became chairman of the CME, "had not always been an enthusiast of electronic trading," but a 2012 photo in the book shows an aging Melamed at the CME's data center.

The transition to automated trading was a more abrupt transition for some players in the industry than others. "A bank or even an institutional investor might no longer have to pay a broker simply to bring its orders to

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market but could itself enter its orders at a computer terminal," MacKenzie writes. "In contrast to brokers, traders might hope to continue to flourish in electronic markets."

Globex and Aurora were two early competing systems for electronic trading of futures, led by the CME (managed by Melamed, jointly with Reuters) and CBOT, respectively. The visual representation of the two systems differed dramatically, with Globex having a mundane screen view showing prices, bids, and buttons, while Aurora, which ran on an Apple Macintosh, had traders visually represented by an icon to "simulate a trading pit." Globex won the technology battle—though, interestingly enough, because Aurora "would overburden the then-available bandwidth of global digital communication."

The beginning of the race / A parallel set of movements was afoot on the share-trading side of the market. MacKenzie digs into the archives of the New York Stock Exchange to produce a sample of its order books, which "were until the 1980s handwritten on pre-printed forms." One pioneer on the share-trading side was Instinet, which was one of the earliest electronic trading systems in the 1970s and focused primarily on allowing institutional investors to trade with each other via teletype machines. Another was Automated Trading Desk, which came along in 1989 and was founded by then–Rutgers University finance professor David Whitcomb after Instinet neglected to adopt some of his proposals for early-stage trade execution algorithms.

By the late 1990s, another key player in the development of the high-frequency trading industry, Island, entered the fray by appealing to day traders and so-called "bandit" traders who searched for and profited from stale price quotes. Island was known for perfecting its real-time software called Watcher. MacKenzie explains that it

> began as just a program to watch for incoming executions and keep track of a trader's position, [but later evolved into] a full-blown trading system that gave traders market news and up-to-date information on NASDAQ dealers' changing bids and offers, permitted traders to enter orders, and allowed them to send messages to other individual users or to all the traders using Watcher.

Trades through Island's system were executed in less than 10 milliseconds (thousandths of a second). Island was also a leader in co-location, "encouraging trading firms to place their servers in its Broad Street building, even in the basement alongside [its] computer systems" so as to gain a trading advantage by having a shorter distance for its electronic commands to travel to the NYSE.

For high-frequency traders, technology combined with algorithms became the all-consuming focus of trading to achieve advantage.

The race reaches the outer limits / For HFTs, technology combined with algorithms became the all-consuming focus of trading to achieve advantage. MacKenzie puts the technology in perspective by comparing how quickly each of the evolving methods was able to transfer data between the CME's data center in Chicago and the NASDAQ data center in New Jersey. For Spread Networks, known for buying up rights to lay direct fiber-optic cables, the required time for transmitting a trade in 2010 was 6.65 milliseconds, which bested the previous technologies' 8 milliseconds. Glass-fiber technologies reduced that time to 5.79 milliseconds. Microwave technology improvements cut it to 3.98 milliseconds by 2016. The reference in the book's title to "trading at the speed of light" refers to the theoretical Einsteinian constraint to transmit at the speed of light in a vacuum, which is 3.94 milliseconds. These dueling technologies were the focus of *The Hummingbird Project.*

Algorithms are, in MacKenzie's words, "a recipe that achieves a goal or solves a problem in a finite number of precise, unambiguous steps." (See "Algorithms: The Life Blood of the FANGs," Fall 2020.) In the case of high-frequency trading in particular, algorithms go through the requisite steps for bidding to buy or offering to sell shares or other financial instruments, or for canceling or modifying an existing bid or offer. The algorithm is "taking in the world's information and being able to translate that to predict the next [price movement]." The secret, according to MacKenzie, is revealed in an exemplary case of the "making" and "taking" strategies for all the choices to compete on price for bids to buy (ranging from $29.45 to $29.49) and offers to sell ($29.50 to $29.54) for a typical security. The strategy boils down thus

> to post bids at higher prices and offers at lower prices than others do … [and] getting good places in the queue … [because] an order at or near the back of the queue is at greater risk of being executed in adverse circumstances.

This risk materializes when bids are being executed or canceled and not replaced, which indicates prices are "about to fall and it is therefore a disadvantageous moment at which to buy."

At one point in this chapter, MacKenzie warns, "This section is a little technical.… It can be skipped if desired." I would agree that this material gets into the weeds as far as detail and would be difficult for a non-technical reader to absorb.

Conclusion / In his concluding chapter, Mackenzie re-emphasizes that the specialized issues discussed in *Trading at the Speed of Light* are "esoteric," and I believe its content will appeal to only a small segment of readers interested in finance. Throughout the book and again in the concluding chapter, he scrutinizes the public policy considerations for high-frequency trading in the context of "material political economy," a methodology he introduces in the first chapter. This method puts "a focus on how the material world is ordered, on the possibility of alternative orderings, on the often political nature of the issue of which of these orderings becomes real, and on the economic consequences of that issue."

I am not convinced of the political nature of this particular type of trading and believe that he overstates that political nature. HFTs are highly sophisticated investors who are not clearly in need of Securities and Exchange Commission oversight or other protections, and their trading techniques have an immaterial adverse effect on average long-term investors.

In the book's final pages, MacKenzie argues that a "sphere to which material political economy unequivocally applies is decentralized cryptocurrencies such as bitcoin and ethereum." That is a topic for another day. *R*

Let the Rich Play

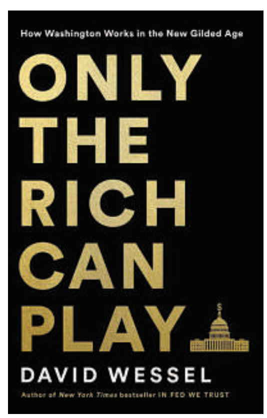
REVIEW BY DANIEL KOWALSKI

David Wessel, director of the Brookings Institution's Hutchins Center on Fiscal and Monetary Policy and a longtime *Wall Street Journal* writer and editor, is out with a new book, *Only the Rich Can Play*. The volume is yet another example of the literature purporting to give the titillating "inside story" of how tax legislation becomes law. It's in the tradition of Jeffrey Birnbaum and Alan Murray's *Showdown at Gucci Gulch*, a public policy classic chronicling President Ronald Reagan's 1986 tax reform, published early in Wessel's *Wall Street Journal* career.

Only the Rich Can Play reports on the efforts of billionaire Shawn Parker, of Napster and Facebook fame, to get a tax proposal enacted. Parker pushes the idea of granting capital gains tax relief to investors who invest in an "Opportunity Zone" (OZ) in a low-income community. The initiative is in the tradition of the Enterprise Zones championed in the early 1980s by the late congressman Jack Kemp (R–NY).

An OZ initiative was a late insertion into the 2017 Tax Cut and Jobs Act (TCJA). It originated in the Senate-passed version of the bill and remained in the conference agreement signed into law. The initiative provides three tax incentives for realized capital gains that are then invested in designated communities: First, taxes on gains that are timely invested in an OZ are deferred until the earlier of the sale of the OZ investment or December 31, 2026. Second, taxes on such deferred gains are reduced by 10% for an OZ investment held for five years prior to the end of 2026, increasing to 15% for an investment held for seven years. (OZ investments made after December 31, 2021, will lose this kicker provided to early adopters.) Finally, any appreciation on an OZ investment is not taxed if the investment is held for 10 years. The ability to invest new money in OZs ends at the end of 2026, but the ability to hold an investment and earn tax-free returns runs through 2047.

Wessel's book is divided into three parts. The first, comprising more than a third of the volume, details Parker's creation of a bipartisan think tank, the Economic Innovation Group (EIG), and the work of Parker and EIG staff (referred to in the book as the "EIG boys") to develop congressional interest in a new place-based economic incentive. This part of the book is full of the tales of boozy dinners and logs of political donations that one would expect in an "inside story," as well as an anecdote of Sen. Tim Scott (R–SC) asking President Donald Trump to "help me get Opportunity Zones in the tax bill." It also tells of the unveiling of the Joint Committee on Taxation's very modest $1.6 billion estimate for the cost of the provision. Wessel bitterly criticizes the gaming of the score. (I assume he'll offer a similar critique of the gaming of the Congressional Budget Office score for the spending provisions of President Joe Biden's Build Back Better initiative.)



Only the Rich Can Play: How Washington Works in the New Gilded Age
By David Wessel
352 pp.; PublicAffairs (Perseus), 2021

The next part of the book details the Trump administration's implementation efforts. Wessel takes issue with the Treasury Department's faithful implementation of the statute, which authorized the chief executives of the 50 states, the District of Columbia, and the territories to select any tracts that meet the statutory requirements for designation as OZs. He seems to want Treasury to second-guess the worthiness of roughly 8,000 nominated OZs, even though attempting to do so would be controversial given the statutory text and would undoubtedly cause Treasury's determination process to take far longer than the 90 days allowed in the statute.

The remainder of the book provides anecdotal reporting on the effects of OZ incentives and the author's judgement of the program. Wessel's reporting finds more bad examples than good ones. He devotes a chapter each to Portland, OR, and Baltimore. In Portland, "nearly all of the central business district was designated as Opportunity Zone territory," and money has flowed to the seven designated OZs for development projects that may have been accelerated by the tax benefit but likely would have happened anyway. In Baltimore, Wessel determined that the 42 designated OZs were "mostly well-chosen," but they are hard-pressed to obtain OZ capital even though the "city looked for places that were most likely to draw money." Location matters.

D.C. culture / Wessel believes that Parker and the EIG boys should have consulted more with Beltway experts to put together a policy that would have had fewer unintended consequences. His final analysis is that the incentive in its current form "is doing more to help wealthy investors and real estate businesses reduce their tax bills than help residents of the neighborhoods it was supposed to revive."

One ultimately gets the impression that he dislikes OZs because they are not the product of the D.C. culture. His book does not explore any role that previous government interventions may have had in the persistent poverty found in these low-income communities. It does suggest that good lobbying and poor legislative text do not lead to the best outcome on the ground.

Wessel wants a powerful federal bureaucracy to save Congress from itself when poorly drafted legislative language becomes law. I disagree with that remedy but agree that the OZ initiative is a cautionary tale about legislative text that has not been widely vetted. In this case, the consequences of error are relatively small: $1.6 billion over 10 years. In contrast, the wasteful consequences of the poorly drafted American Recovery Act and Build Back Better (should it become law) are in the hundreds of billions of dollars.

Wessel repeats the phrase, "Don't blame the players, blame the game," when describing how specific cases are contrary to the intent for OZs but squarely within the letter of the law. A successful game comes with a clear set of rules that have been thought through. Congress's job is to provide those rules. The book would be more helpful and influential to the policymaking process if it had noted that, in a free society, billionaires who wish to dabble in policy are free to do so (like everyone else), but their efforts must be fully vetted by Congress. OZ failed in this regard. *R*

An Objectivist Rewrite of the Founding Documents

REVIEW BY GEORGE LEEF

Here is a thought experiment: Suppose that we could rewrite America's two founding documents, the Declaration of Independence and the Constitution. Some people believe that both (but especially the Constitution) are flawed in their emphasis on individual rights and the need to restrict government power. They have in large measure overcome those supposed defects through judicial interpretations of the Constitution to expand the scope of government authority, so this thought experiment probably wouldn't interest them. Other people, however, think that the two documents didn't go far enough in defending people's liberty and keeping government within proper bounds, and they would want to rewrite the documents to strengthen those protections.

In the latter camp is Brian Simpson, who chairs the Department of Accounting, Finance, and Economics at National University in LaJolla, CA. His book, *A Declaration and Constitution for a Free Society*, analyzes both documents line by line, focusing on whether they serve to protect individual rights.

Simpson is a proponent of Ayn Rand's philosophy of Objectivism, which holds that the only function of government should be to protect people's rights, not to pursue "social justice," environmentalism, racial equality, or any other goal that calls for the use of coercion against peaceful individuals. Simpson holds the Declaration of Independence and Constitution in high regard as history's first and greatest efforts at crafting a government that protects its citizens rather than aggresses against them. But, he argues, the documents could be improved.

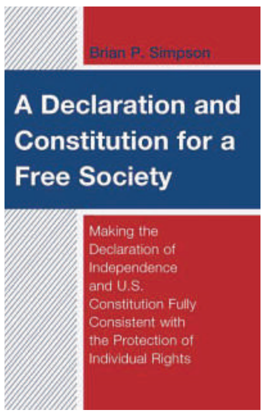
The Declaration / The Declaration of Independence needs only minor modifications, in Simpson's view. First, he would remove all its religious references, arguing (as one would expect from a Randian) that we should not rely on superstitions when we set forth the case for an ideal government. His stance against religion might cause some readers to shut the book in annoyance because his language is rather abrasive, but that would be a mistake. Theists and a-theists should not fall out over their differences when it comes to government, which, as Simpson makes clear, must protect the rights of everyone to practice religion or not.

The other change he would make to the Declaration is to specify that property rights are as unalienable as life, liberty, and the pursuit of happiness. "Man's ability to survive and flourish," he writes, "fundamentally depends on the protection of property rights." It is just as important for government to protect a person's use of his property as his life, his liberty, and his pursuit of happiness.

The Constitution / Turning to the Constitution, Simpson would add a sentence to the Preamble stating that the only proper function of government is to protect individual rights and freedom. Also, he'd eliminate the phrase "promote the general welfare" because the job of political leaders is to protect the freedom of each person to peacefully live as he chooses, not to try to legislate for the "general welfare."

In Article I, Simpson would eliminate the age restrictions for election to the House and Senate, arguing that any person who has reached legal adulthood should be allowed to serve. His point is that the Constitution should stand for legal equality, which is violated by arbitrary age requirements of 25 and 30 years, respectively.

Of far greater importance are the changes he recommends for Article I, Section 8, which enumerates the powers of Congress. Here again, we find the phrase "for the general welfare." He correctly notes that the drafters of the Constitution did not mean by that to give Congress authority to do anything that they thought would be beneficial for the country as a whole, but the Supreme Court has held that rights-violating laws such as Social Security are constitutionally valid under this General Welfare Clause. Simpson regards those decisions as politically driven mistakes; therefore, the clause must be stricken.



A Declaration and Constitution for a Free Society

By Brian P. Simpson

307 pp.; Lexington Books, 2021

Next, Congress should be deprived of the power to tax. Simpson views taxation as unjustified coercion that deprives people of their property. Instead of taxation, he would rely on voluntary payments by individuals and businesses. In 2018, he observes, Americans donated some $428 billion to charities; if they weren't subject to the current load of taxes, they could and presumably would give large sums of money to the federal government. Simpson doesn't go so far as to say that voluntary donations would make up for the loss of tax revenues in full. He also doesn't address the "free-rider" problem that would likely result. The government would have to dramatically scale back many of its expenditures—and that would be good because much of what it does is inconsistent with its job of protecting people's rights.

While on the subject of money, Simpson would eliminate Congress's power to "coin money and regulate the value thereof." With no power to create money, the government would have to utilize whatever money or monies come about on the free market. He would, however, give the government power to declare which of those monies are legal tender. That, it seems to me, is a mistake. Though government should be able to determine what money it will accept as payment, it should let individual transacting parties decide what money they will use.

While on the subject of money, he would stipulate that Congress has no authority to lend. That is wise. Even though the Constitution never granted that authority, Congress doles out enormous sums to students, businesses, home purchasers, and others. Politicians are prone to taking foolish risks with funds and the law should forbid it.

Perhaps the most important change Simpson proposes is eliminating the Commerce Clause, which enables Congress to "regulate commerce among the several states." The intended meaning was to keep commerce "regular" among the states, not allowing them to pass laws that impede trade across state lines. It was not meant to give Congress plenary power to dictate the details of business operations, but that is exactly how things have turned out, owing to a string of Supreme Court decisions. The Commerce Clause has been used to justify a vast array of federal mandates and prohibitions upon business. It should be stricken.

Another power of Congress that he would retain but I think is unwise is the power to confer patents and copyrights. Simpson supports this power because it gives people legal right to their writings and inventions. Many scholars have, however, argued that patents and copyrights do more harm than good by obstructing innovation and creativity. Rather than protecting property, they create privileges enforced by the state. At the very least, this power should be carefully scrutinize and debated.

The Amendments / In the rest of the original Constitution, Simpson suggests only a few minor revisions. In the amendments, however, he takes out his pencil—and his eraser.

The First Amendment needs to be improved, he argues, by specifying that the government can make no laws impinging upon freedom of association, which includes the right *not* to associate. With that language added, laws that compel association, such as those against single-gender clubs and those that require workers to be members of a labor union, would be unconstitutional. Also, Simpson would rewrite the amendment so it clearly protects commercial speech, an area where the courts have been remiss.

He would revise the Second Amendment to make clear that it protects the right of *individuals* to own firearms. He would eliminate the confusing language about "well regulated militias" that has opened the door for gun control advocates to claim that the amendment does not ensure the right of individuals to own weapons for self-defense, hunting, or other lawful activities.

The Fifth Amendment allows the government too much power, Simpson argues, by sanctioning the taking of private property. Eminent domain has been widely abused, as in the infamous *Kelo* case where private property was taken so that it could be transferred to a commercial enterprise that was expected to generate more tax revenue than the homes that were occupying the ground. Rather than attempting to separate permissible taking from impermissible ones, Simpson would ban all of them. He argues that little harm will be done if the government must forgo some projects because it cannot get all of the property owners to sell without coercion.

The Fourteenth Amendment was supposed to protect people against actions by state governments that violate their rights. The language it uses, however, refers to actions that "abridge the privileges or immunities of citizens of the United States." That language proved to be woefully inadequate, as the Supreme Court (in an 1873 decision) read it as applying only to the small number of "privileges or immunities" recognized as exclusively federal. Simpson's solution is to rewrite the amendment so that it prevents state and local governments from violating the rights of individuals.

As for the Sixteenth Amendment, allowing the federal government to impose income taxes, it must be repealed entirely.

The Twenty-First Amendment repealed the disastrous Eighteenth, which imposed Prohibition of alcoholic beverages. Even so, the Twenty-First Amendment must be changed. Simpson points out that Section 2 of the amendment permits state and local governments to continue interfering with the market for alcoholic beverages. That must go.

So should the Twenty-Second, which limits presidents to two terms. Simpson thinks that term limits are an arbitrary and ineffective means of controlling "excessive" government power (which would be better accomplished by adopting his proposed constitutional changes). If the electorate wants to re-elect a president who has already served two terms, they shouldn't be prevented from doing so.

He then urges the adoption of several new amendments to further protect people's rights against government encroachment. Among them would be a prohibition on laws that interfere with the freedom to produce and trade (which would make such measures as occupational licensing and minimum wage laws unconstitutional), an amendment stating that each individual has the right to control his own body (making laws against the use of drugs or laws mandating vaccinations illegal), and an amendment against government ownership of or financial assistance to business of any kind (thus eliminating a wide swath of what the government now does, including Social Security and educational subsidies).

Lastly, Simpson would create a new amendment specifically prohibiting all units of government from creating money or issuing bills of credit. This he combines with the existing constitutional language that the government may not "impair the obligation of contracts." On that last point, I don't think he goes far enough. Despite that language, units of government have done great damage to the law of contracts, for example by declaring that labor contracts must contain certain elements and may not contain others. I think that a more robust amendment against any and all government interference with people's freedom to contract is in order.

Conclusion / This is certainly an interesting thought experiment, but is it a useful one? I think so, and as more than an intellectual exercise. Obviously, one or more of Simpson's ideas might gain some public support and eventually become amendments, just as 27 other ideas already have.

Beyond that, newly formed countries may look to his book for ideas as they craft their constitutions. And, as dramatic as this might sound, the current divisions roiling the United States may open the way for a broader rewriting of the Constitution, in the hope of easing the bitter social battles. Simpson's book offers some good ideas for how to do this. *R*

Meritocracy Under Siege

REVIEW BY GEORGE LEEF

Something we often take for granted is that innovative, hard-working individuals will use their talents to get rich, while at the same time improve the lives of others. As Adrian Wooldridge, the political editor of *The Economist*, points out in his new book *The Aristocracy of Talent*, this is a pretty recent discovery.

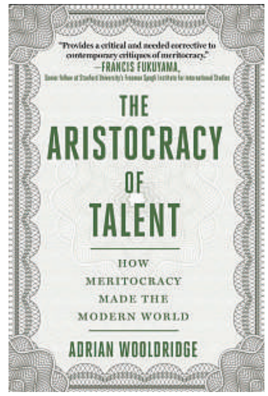
Going back just a few centuries, human societies were static, bound by tradition, inimical to progress. The ruling aristocracy liked things the way they were and the people below them were expected to fulfill the roles that their forebears held. Social mobility was regarded as dangerous; the stratification of classes made it almost impossible.

How humanity escaped from those stultifying conditions and replaced them with meritocracy is Wooldridge's subject. He celebrates the ways in which meritocracy has enabled talented people to use their minds to produce what University of Illinois, Chicago economist and historian Deirdre McCloskey (who has explored this subject extensively but is not cited by Wooldridge) calls "the Great Enrichment." Wooldridge is worried, however, about two things: the attacks on meritocracy that are coming from the political left and right, and the possibility that today's "meritocrats" are taking us back to the old days when wealth and privilege were inherited and those who were born poor would stay poor.

Meritocratic revolution / The idea that people ought to be free to use their talents to better themselves was, Wooldridge notes, revolutionary. For most of history, humans did as they were told. Education was only for an elite few; if the poor were to become educated, they could become discontented with their circumstances. The English jurist Sir Edward Coke (1552–1634) expressed the prevailing view when he warned, "Hold all new ways and innovations suspicious." So how did the meritocratic revolution get going?

Fortunately, there were a few places in northwestern Europe where the aristocracy was less dominant and new thinking was tolerated. That was especially the case in Holland, where Jews were allowed to live without harassment and apply their painfully acquired knowledge of business and finance. The Dutch realized that commerce and profit-making were not bad and lowly, but beneficial and praiseworthy. That attitudinal change made its way to England, where the spirit of liberalism took hold. At the same time, the Protestant Reformation encouraged education so people could read the Bible and taught that hard work and success were good. The genie of merit was out of the bottle. Liberal philosophy began to corrode the feudal order.

In England, humble men with little or



The Aristocracy of Talent: How Meritocracy Made the Modern World

By Adrian Wooldridge

482 pp.; Skyhorse Publishing, 2021

no formal education used their ingenuity to transform the country. Wooldridge writes:

> James Brindley was the son of a Midland yeoman farmer who was barely able to read or write. He built many of the canals which allowed Manchester and Liverpool to flourish. Richard Arkwright was the son of a tailor. He built the spinning jenny, which helped to power the cotton industry.

The same was true in America, where self-made men led the booming economy. After quoting the historian Louis Hartz to the effect that America was "born liberal," Wooldridge answers, "It would be truer to say that it was 'born meritocratic.'" This might seem a minor quibble, but I think Hartz had it right. The liberal spirit of America allowed for the success of individuals on their merits, but it also produced other key aspects of the upstart nation: minimal government, the rule of law, personal responsibility, religious tolerance. Meritocracy flourishes only under the protection of liberal philosophy and governance.

Leading the country / Sadly, there have always been intellectuals who think that government must improve on the results of liberalism. Before long, they begin arguing that it should actively seek out the best and brightest young people and provide them with education so they can better contribute to the country's well-being. In England, the otherwise staunchly laissez-faire Richard Cobden wanted government intervention in education to maximize the nation's strength, while the fervent socialists Sidney and Beatrice Webb wanted the same thing in order to lead the country into their egalitarian utopia. They disagreed with Cobden on *economic* central planning, but all three favored *educational* central planning to enhance meritocracy.

In the United States, Thomas Jefferson thought that government needed to find and educate the "natural aristocracy," and he founded the University of Virginia as a result. (John Adams disagreed, arguing that the wisest and most talented would rise without any assistance; with it, they'd become a force against liberty.) Later, many political leaders, from Woodrow Wilson to Lyndon Johnson and up to the present, would press for widespread "investment" in higher education and for policies that would entrust an educated meritocracy with power to figure out the solutions to national problems. (See "A College Education: Who Pays and How?" p. 54.) As the Webbs said, "Society must be nurtured by the state, ruled by educated bureaucrats guided by science."

Wooldridge has sympathy for the idea that government should find and train the smartest people. He writes, for example, that John Maynard Keynes "invented a way of saving the economy from depression." In truth, Keynes did nothing of the sort, but Britain, America, and other nations have repeatedly made the mistake of allowing statist intellectuals a free hand in directing public policy. Highly intelligent people often have blind spots, especially for their own limitations.

Academic leaders long ago decided that they should be the ones to discover the most capable young people, then educate them to be of the greatest service to the nation. They embraced standardized testing and sought to become, as Harvard president James Conant put it, the "training ground for the new elite." America had done very well in the time when the Ivy League was mostly a playground for the sons of wealthy families, with little academic rigor, but that changed—somewhat—from the 1950s on. I say "somewhat" because, as Wooldridge notes, the Ivies still admit a great many students because they have family and money connections.

That disturbs him. He thinks we are losing out on potential meritocratic brainpower by holding elite university places for "legacies" and athletes rather than finding smart kids from poorer families and giving them a chance. In this, he falls for the notion, carefully cultivated by those universities, that they provide a far superior education. Actually, the kinds of students he favors would often get a better education at a small college or mid-level state university where the faculty is more committed to working with them than at a purportedly elite university where the undergrads are largely ignored by the "superstar" professors. Wooldridge claims that "selective schools are more successful than non-selective schools because they are in the business of educational transformation," but that is just marketing hype. Graduating from an elite school is neither necessary nor sufficient for success in life.

Under siege / Despite its tremendous advances for humanity, meritocracy is under attack today. Wooldridge sees dangers both from the left and right. The populist right, led by Donald Trump or at least Trumpists, is a threat because of its supposed rejection of expertise, although Wooldridge admits that those people are mainly opposed to being under the thumb of snobbish, authoritarian intellectuals on the other side. The egalitarian left is more worrisome (I think to the author and certainly to me) because it rejects the liberal order in favor of government-engineered "equity." Philosophers like John Rawls and Michael Sandel argue that meritocracy is unfair and their case against it finds support these days in the Democratic Party. The leftist attack is having quite an effect, for instance, in university hiring decisions, where barely qualified candidates join the faculty because they add to "diversity."

Wooldridge also frets that today's meritocracy is trying to make itself permanent and hereditary, as in centuries past. How? By getting its children into the top schools. He makes much of the recent "Varsity Blues" scandal where wealthy parents resorted to deception and bribery to get their kids into prestigious universities, as well as the continuing tendency among the elite schools to favor the sons and daughters of the wealthy and politically connected, rather than better-qualified applicants (particularly Asians).

In my view, that concern is overblown. Merely having a degree from a prestigious university doesn't ensure success. Just as the Jewish students that Harvard used to reject often beat Harvard grads in courts and for Nobel Prizes, so today do students with degrees from less prestigious schools (or none at all) frequently enjoy better careers than do Ivy Leaguers. The elite schools don't provide a better education and, after graduation, people succeed or fail on their own merits, not on the basis of their educational pedigrees. To avoid the possibility of the meritocrats "pulling up the drawbridge," all we need do is retain liberalism, thus protecting the freedom of all people to advance.

At the end of the book, Wooldridge suggests that we should make a national policy out of identifying the most promising young people and educating them in top universities for free, in return for a period of service in the public sector. That idea has its roots in Plato's *Republic*, but it strikes me as appallingly bad. We already suffer from too much intellectual influence over government. As Hoover Institution economist Thomas Sowell observes about intellectuals:

> There always has to be some crisis—some reason why their superior wisdom and virtue must be imposed on the unthinking masses.... They go from one [crisis] to the other. It meets their psychological needs and gives them a reason for exercising their power.

Instead of siphoning the smartest young people into elite universities (where they're apt to fall under the spell of "progressives") and then into government (where they will probably push more authoritarian policies), we should downsize the state and revive true liberalism. R

A College Education: Who Pays and How?

REVIEW BY VERN MCKINLEY

It takes decades to make a convoluted, entrenched, and immovable mess in Washington. Earlier this year, I addressed one example of this with my review of Judge Glock's book *The Dead Pledge*, tracing the history of the U.S. mortgage market since Woodrow Wilson's administration. ("Assessing a Century of Mortgage Market Interventions," Fall 2021.)

In her new book *Indentured Students*, Elizabeth Tandy Shermer provides a blow-by-blow history of another market that has been thoroughly upended by Washington interventions and incremental tinkering since the 1950s: the educational lending market. If anything, this market is more challenging to address than the mortgage market because of the lack of any underlying loan collateral, the questionable capacity of early-career borrowers to repay what they owe (which totals some $1.7 trillion), and the recent government takeover of much of the student lending market. Shermer is an associate professor of history at Loyola University in Chicago and the author of the 2013 book *Sunbelt Capitalism: Phoenix and the Transformation of American Politics.*

From land-grant universities to student loans / Shermer's subtitle references government-guaranteed loans, but this gives a misleading sense of the contents. The book provides a broad description of federal involvement in higher education, beginning with the development of the land-grant universities in the 19th century. They were the product of the 1862 Land-Grant College Act, which was "designed to establish at least one college in every State upon a sure and perpetual foundation, accessible to all, but especially the sons of toil."

Indentured Students also gives a history of how students typically paid for that education, whether at a land-grant or other university. Shermer tells of the traditions brought from Europe "of offering scholarships, discounts, jobs, and loans to the talented poor." She also tells of Stanford University, which "was tuition-free for more than thirty years" after its establishment in 1885, but it and many such universities that were tuition-free "levied fees as they began to attract wealthier applicants and needed to pay for expansions." Funding was done through what Shermer calls "working one's way through college." She offers the example of "University of Chicago students ... [who] spent their time clerking, lighting streetlamps, minding children, reading to the elderly, working in railroad stations, staffing newspaper offices, and even collecting debts."

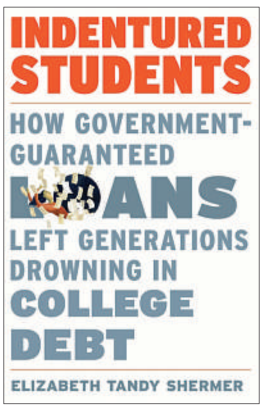
Students did not begin to borrow for their educations until what she labels the "speculative Roaring Twenties." The universities themselves did not undertake much of this lending, but many "clubs, business associations, churches, individuals, and philanthropies" did.

All the way with LBJ / Shermer's history is a long and winding road, beginning with the government getting involved in college financing with the New Deal's National Youth Administration (NYA) "work study" program. This was at a time when some of the country's universities were on the edge of bankruptcy and took such desperate measures as accepting IOUs or engaging in barter in lieu of payment. The NYA was created under the oversight of the Works Progress Administration and funded with $50 million on the basis of a 1935 executive order. It was part of Franklin D. Roosevelt's effort to "do something for young people"—those between the ages of 16 and 25—by helping "a lot of impoverished students enroll and stay in school."

Shermer notes that a report after the demise of the NYA foreshadowed an issue that haunts educational spending to this day:

> One analysis suggests that NYA unintentionally drove much of the 60 percent hike in state school tuition rates that occurred between 1932 and 1940. Schools could charge more as portions of the student body earned additional money to afford fees, books, and living expenses.

One historical figure who appears throughout *Indentured Students* is Lyndon Johnson. Shermer leverages his decades-long involvement in the issues of financing education: First, as a student at the Southwest Texas State Teachers College during the 1920s, he paid for his education in part by working "a dozen different jobs." He also borrowed, completing school with $220 of debt ($3,400 in today's dollars). Next, he was the Texas state director of the NYA. Then, as Senate majority leader, he worked with the Eisenhower administration on the first federal loan program in the late 1950s. Finally, as president, he signed the Higher Education Act of 1965 (HEA), which will be discussed below.



Indentured Students: How Government-Guaranteed Loans Left Generations Drowning in College Debt

By Elizabeth Tandy Shermer

400 pp.; Harvard University Press, 2021

GI Bill and student loans / The next historical milestone was the passage of the Servicemen's Readjustment Act of 1944, better known as the GI Bill, which has in different forms continued to this day as a work benefit for veterans. Without it, supporters "feared massive unemployment and political instability, the ingredients for another calamitous depression," following service members' return home from World War II. The most heralded of its benefits included university tuition and housing reimbursement, combined with a stipend, for returning veterans. By 1948, more than a million GIs had matriculated, equal to half of that year's graduating class.

Shermer notes the GI Bill's effect on non-GIs: "Many Americans found themselves priced out of higher education after administrators across the country raised fees to take advantage of tuition reimbursements." She cites a few universities that increased fees by one-third.

It was not until the 1950s, in the wake of the Soviet Sputnik launch, that a broad-based student loan program like what we know today was set in motion under the National Defense Education Act of 1958. That law had its genesis in the 1948 Zook Commission report, which warned that as the first of the baby-boom generation would be entering high school, college would become "a prerequisite to occupational and social advance at a time when the ladder of educational opportunity rises high at the door of some youth and scarcely rises at the door of others."

To that end, Title II of the act provided for "campus loan funds for a limited, self-perpetuating program. Campuses had to annually apply for their share." Loans were approved for up to $1,000 a year and $5,000 over the course of undergraduate study, with no interest accruing during enrollment. Repayment started one year after graduation and borrowers had 10 years to pay back the loan, with deferments available for those returning to school or joining the military. Public school teachers could take advantage of forgiveness provisions.

Sen. Barry Goldwater (R–AZ), in commenting on early versions of the act, presciently noted that "the legislation will mark the inception of aid, supervision, and ultimately control of education in this country by Federal authorities." The response from universities and students alike was "overwhelming" and "astonishing," but Shermer makes clear that the program "largely aided white, middle-class, male students." Most of the recipient schools "had never made or collected a loan before, had had no experience with need analysis, and indeed had no person, trained or untrained, vested with the responsibility to administer student aid."

Government-guaranteed loans and beyond / By the 1960s, "borrowing [for college] became more commonplace and accepted." President John F. Kennedy, in a 1962 Message to Congress on Education, lamented that "the average cost of higher education … was up nearly 90 percent since 1950 and still rising." Leveraging a bank-centric model that had been applied to federal mortgage lending, the federal-guarantee aspect of student lending was integrated into the HEA. Like other Great Society programs, what Shermer calls "fiscal jujitsu" and "creative bookkeeping" were applied to "hide spending increases."

The 1972 reauthorization of the HEA included the creation of a government-sponsored enterprise, Sallie Mae, that supported the loan market like its mortgage siblings, Fannie Mae and Freddie Mac. After this legislation, the industry "exploded":

> By the millennium's turn, many citizens, including those from the shrinking middle class, proclaimed themselves trapped by the debt they owed for their educations. The most indentured were low-income enrollees, women, and borrowers of color.

Average tuition rates again rose faster than the Consumer Price Index, leaping over 40% between the 1993–1994 and 2003–2004 school years. Student loan defaults soared.

The next milestone was the introduction of direct lending by the government as Shermer recounts the demise of bank-centric guaranteed student loans that "had been part of the country's public–private social safety net for decades." The direct lending movement began amid scandals during the early 1990s involving "unscrupulous schools" that applied high-pressure tactics to get students to borrow heavily for educations that were often of dubious value. President George H.W. Bush's budget head called the idea of direct lending "insane," but arguments that direct lending would somehow lead to "deficit reduction" held sway and legislation Bush signed included "$500 million to be spent on a direct lending tester."

Direct lending was a plank in Bill Clinton's 1992 presidential campaign and was implemented on a limited scale early in his presidency, until the subsequent Republican Revolution shut down progress for a time. The tug-of-war was resolved with President Barack Obama's signing of the Health Care and Education Reconciliation Act of 2010, which ended what Shermer labels the "once revered Guaranteed Student Loan Program LBJ had signed into law" and replaced it with direct lending by the government. In Obama's words, with guaranteed student loans, "lenders get a big government subsidy with every loan they make." This "sweetheart deal … essentially gave billions of dollars to banks."

In a brief epilogue (compared to the book's other chapters), Shermer argues that college should be "free." She cites the promise by Sen. Bernie Sanders (I–VT) of "free college," cites the activist group Strike Debt's desire to "make all public higher education completely free," and cites "other experts [who] have outlined ways to make public colleges and universities tuition free." The history ends with the student debt moratorium under Presidents Donald Trump and Joe Biden for millions of borrowers who claimed the COVID pandemic left them unable to repay their student debts, as well as the ongoing discussion of wiping out $10,000 to $50,000 per student of those debts. Shermer closes the book with the very clear statement that the "American Dream will remain elusive unless education and other basic necessities are finally recognized and treated as rights critical to forming a more perfect union."

A logical conclusion? / General statements that college should be free or is a fundamental right, given the history of government failure on education finance, are not a satisfying way to close the book. Shermer's arguments are notable for what they don't say, as opposed to what they do: They don't make clear whether the government should always pay for a student's advanced education. They don't make clear why students and parents should avoid being first in line to contribute to funding an education, given that the obvious beneficiary of that education is the student. They don't say whether a student should be able to get a free undergraduate degree, followed by a free master's degree and a law degree. They don't say whether a student should be entitled to just free tuition, or whether room, board, and a stipend should be included. Whenever the government provides a massive pot of money, there is always going to be abuse, as evident in the increasing tuition and questions of value not only for fly-by-night, low–quality colleges but also the most elite of universities.

What is entirely ignored in Shermer's analysis is that school systems are not fully preparing students for the college experience. As a result, students flunk out or otherwise quit college with a load of debt, and even those who complete school have little comprehension of the financial commitments they have made.

Indentured Students provides a thorough history of education financing, and for that alone it is worth a read. However, in my opinion, it will be too detailed for most readers (40 to 50 pages per topical chapter), including an exhaustive discussion of the legislative process. Another criticism: Shermer often writes of "cuts" to the educational budget, but she offers few charts, and they provide little data to assess whether she means actual spending decreases or just that increases weren't as large as initially planned.

Like the mortgage market, the educational finance market is entirely removed from a free market and is riddled with distortions and imbalances. Shermer lays out 60 years of government-backed programs and somehow concludes that more intervention is the answer. These programs are a mess and the "sons of toil"—and daughters and descendants—have been truly ill-served throughout that history. R

Great Stories and Weak Economics

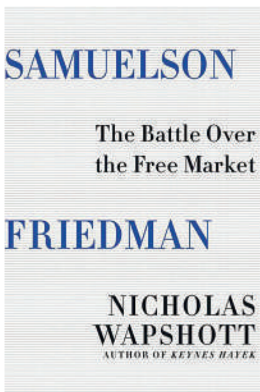
REVIEW BY DAVID R. HENDERSON

British journalist Nicholas Wapshott, who earlier wrote *Keynes Hayek: The Clash that Defined Modern Economics*, is out with a new book, *Samuelson Friedman: The Battle Over the Free Market*. Wapshott traces the differences in views between MIT's Paul Samuelson and the University of Chicago's Milton Friedman and tells of their interactions over the eight decades they knew each other, especially from the 1960s to Friedman's death in 2006.

The two were the most important players in economics in the last half of 20th century. From the 1950s through the 1970s, Samuelson, a Keynesian, thought fiscal policy was more powerful than monetary policy as a tool to manage the economy. Throughout his career he believed in a large amount of regulation, taxation, government spending, and redistribution. Friedman believed monetary policy was more powerful than fiscal policy and believed that the United States and other countries should reduce government intervention substantially and bring all countries' economies much closer to free markets.

Although Friedman and Samuelson never agreed on the proper role of government, in the 1980s Samuelson did come around to Friedman's view on the power of monetary policy and also to Friedman's view that there was no long-run tradeoff between inflation and unemployment.

Misunderstanding monetarism / Many of the stories that Wapshott tells are fascinating, but he does not understand economics well enough to explain Friedman's views. Wapshott seems to be an unreconstructed Keynesian and so explaining Samuelson's views comes relatively easily to him. But he never shows a solid grasp of Friedman's monetarism and so, in explicating Friedman's thinking, tries to do the analysis within a Keynesian framework. My criticism is not that Wapshott doesn't agree with monetarism, although he doesn't appear to; it's that he doesn't seem to understand this school of thought.



Samuelson Friedman: The Battle Over the Free Market
By Nicholas Wapshott
367 pp.; W.W. Norton, 2021

One of Friedman's biggest contributions to economics was his 1963 book with Anna J. Schwartz, *A Monetary History of the United States, 1867–1960*. In it, they showed that one of the important contributors to the Great Depression was the 30% reduction in the money supply that the Federal Reserve allowed to occur between 1929 and 1933. Yet, here's how Wapshott explains their finding: "Had the Federal Reserve eased interest rates earlier, many of the businesses which had gone bust could have borrowed to remain open." But Friedman and Schwartz said little about *interest rates*; their focus was on *the money supply*. Indeed, interest rates during the Great Depression were quite low and Federal Reserve officials mistakenly saw them as an indicator of a loose monetary policy.

Wapshott repeats his mistaken interpretation several times. Later in the same chapter, he writes:

> At the heart of their argument was the long-abandoned quantity theory of money, which suggested that the more money in circulation, through low interest rates and cheaper borrowing, the more the value of money would decrease. Similarly, the less money in circulation, because of high interest rates, the more money would maintain its value over time.

Wapshott gets the "more money" and "less money" parts right, but he fails to appreciate Friedman's point that while the immediate effect of more money is a lower interest rate, the later effect is the opposite: higher rates as people begin to anticipate higher inflation.

In a chapter titled "Money, Money, Money," Wapshott refers to Friedman's "big idea" that "inflation was caused solely by the velocity of money." It's hard to get Friedman more wrong because his actual big idea, which he first stated in 1963 in a speech in India and repeated countless times, was that "inflation is always and everywhere a monetary phenomenon." In one sense this statement is tautological: the fact that inflation is, by definition, a reduction in the value of money means that inflation necessarily is a monetary phenomenon. But Friedman always made clear that he meant much more than that: his argument was the empirical one that one could not find a persistent inflation not caused by a persistent growth in the money supply. Friedman thought that the velocity of money was important too, but far less important than the growth of the money supply.

Respect and affection / Wapshott, appropriately, draws heavily from the regular columns in Newsweek that Friedman and Samuelson wrote from 1966 to the 1980s. He describes the different styles of the two: Samuelson was more the literary writer drawing on literature ranging from Rudyard Kipling to Charles Dickens to the Old Testament. Friedman's desire was to "engage with the reader directly and make his case in practical terms." With that, Wapshott put his finger on why I prefer Friedman's style (content aside) to Samuelson's: Friedman seems to be talking to me.

One of the nicest parts of the book is the quotations from public statements each made about the other's work and from highly complimentary letters that Friedman and Samuelson wrote each other from the 1960s through the early 2000s. They had known each other since the 1930s, when Friedman was a graduate student and Samuelson an undergrad at the University of Chicago.

After the announcement of Samuelson's Nobel Prize in October 1970, Friedman wrote in Newsweek that Samuelson was "a brilliant and original mathematical economist" who was "the leader in creating a great center of economic study and research at MIT, raising a run-of-the-mill department to one of the premier departments in the world." After Friedman's Nobel was announced in October 1976, Samuelson used his *Newsweek* column to congratulate Friedman for "his scientific contributions and his scholarly leadership." Then Samuelson gave a more personal appreciation, writing:

> What I have failed to convey is Milton Friedman's bounce and gaiety, his rapier intelligence, his unfailing courtesy in debate. The world admires him for his achievements. His intimates love him for himself.

Has anyone ever said it better?

Their respect and affection for each other carried over to their personal correspondence. In 1995, Samuelson wrote to Friedman that they had met "62 years ago" when "I was a lowly sophomore and you were already spottable as a scholar of destiny." Friedman replied that he and his wife Rose "were very touched" by Samuelson's letter. But, always the exacting empiricist, he added: "I do have one correction to make.

It must have been either 63 or 61 years ago that we first met; I suspect 63 years."

Theory vs. empiricism / While much of the book is on the two economists' differences on macroeconomic policy, Wapshott does a reasonable job of laying out their differences on the appropriate levels of taxation and government spending and the appropriate amount of regulation. Samuelson believed in high taxation and government spending and extensive government regulation. There was a limit, though: Wapshott points out that Samuelson was relieved in 1961 when newly elected president John F. Kennedy did not appoint left-wing economist John Kenneth Galbraith as his top economic adviser.

Friedman believed in a great deal of economic freedom in the form of low taxation, low government spending, and little regulation. One thing that doesn't come across in the book is the extensive empirical case that he made for his policy conclusions. In his professional work, by contrast, Samuelson, ever the theoretical economist, rarely if ever made an empirical case for his policy conclusions. His case was more philosophical, with little attention to detail. In that respect, Wapshott is faithful to Samuelson's views. He quotes, for example, Samuelson's statement on coercion: "Libertarians fail to realize that the price system is, and ought to be, a method of coercion." He also quotes Samuelson's provocative statement in which he undercut the importance of freedom:

> My privacy is your loneliness. My freedom to have privacy is your lack of freedom to have company. Your freedom to "discriminate" is the denial of my freedom to "participate."

Ad hominem / Disappointingly, Wapshott doesn't understand that an ad hominem attack is a criticism of someone's views based not on those views but on the character of the person espousing them. He tells of a June 1980 speech that Friedman gave at a monetary conference held by the American Bankers Association in which he scathingly critiqued the monetary policy carried out by then Federal Reserve chair Paul Volcker. Friedman claimed that Volcker's monetary targets were a "particularly egregious example of the contrast between talk and action." Friedman also stated that Volcker's monetary policy was "incredibly restrictive." Wapshott calls this "a brutal ad hominem assault on a friend and colleague." It was brutal, but it was an attack on Volcker's policies, not on Volcker as a human being.

By contrast, Wapshott himself engages in actual ad hominem against Friedman, calling him "an Archie Bunker with brains." Archie Bunker, recall, was the bigoted anti-hero in the classic 1970s TV series *All in the Family*. Yet, Wapshott gives zero evidence that Friedman was racist or bigoted. Such evidence would be hard to provide; I knew Friedman well and I never saw evidence of any bigotry. Indeed, he was one of the first white academics to hire a black secretary.

Libertarian laissez-faire? / In the last chapter of the book, "Capitalism Teeters," Wapshott covers both the 2007–2008 financial crisis and the 2020–2021 COVID crisis and commits several important mistakes on both. For example, in examining monetary policy during the financial crisis, he makes a key error of omission, one that many economists have made: he fails to note that in October 2008 the Federal Reserve started paying interest on banks' reserves. So, what looked like expansionary monetary policy by then Federal Reserve Chair Ben Bernanke really was not.

Unfortunately, Samuelson, despite his earlier warmth to Friedman, became more hard-edged after Friedman's death. In that chapter, Wapshott quotes Samuelson's statement:

> At the bottom of this worst financial mess in a century is this: Milton Friedman–Friedrich Hayek libertarian laissez-faire capitalism, permitted to run wild without regulation. This is the root source of today's travails. Both of these men are dead, but their poisoned legacies live on.

Had Hayek and Friedman been alive, they would have been surprised to learn that in 2007 the United States had laissez-faire capitalism. And those of us economists who *are* alive and pay attention to details would be surprised, too.

This statement, though, is consistent with Samuelson's style: making broad literary statements with little or no factual backing. At no point does Wapshott challenge Samuelson's claim. Indeed, he hops on the Samuelson bandwagon, stating that the small-government movement for which Friedman provided intellectual justification "successfully altered the [Republican] party from one of traditional middle-of-the-road conservatism to one of unabashed libertarianism." Of course, Wapshott gives no evidence for this. That would be hard to do for a party that, along with Democrats, voted to add $600 a week in federal money to state unemployment benefits during the COVID pandemic and that paid employers hundreds of billions of dollars to keep their employees in place.

On COVID, Wapshott is even further off the mark. He claims that amid the pandemic the federal government "was now in total control of the market, and decided which businesses were allowed to operate, which lived, and which died." In fact, state governments exercised a lot of that power, though the feds did impose price controls on some medical equipment, prevent foreigners from entering the United States, and guarantee a market for COVID vaccines.

The book has many other errors, some trivial, others not. An important one is Wapshott's claim that the federal deficit in the 1990s fell "from 47.8 percent of GDP in 1993 to 31.4 percent in 2001." In fact, the numbers he gives are for the federal *debt*, not the *deficit*, which is a pretty big difference.

Wapshott is a good storyteller. Read his book if you want to follow the fascinating history of interactions between Friedman and Samuelson and want to know of an era in which ideological opponents could be friendly. But don't read it if you want to understand economics. *R*

The Administrative Presidency Encounters Opportunistic Federalism

REVIEW BY JONATHAN H. ADLER

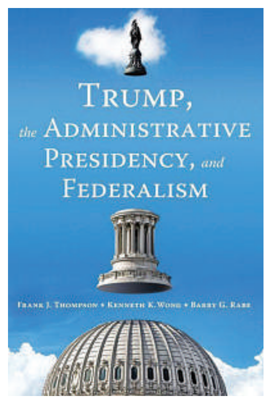
The Trump administration had broad and far-reaching policy ambitions, but never had much of a legislative agenda. Building on the practices of his predecessors, Donald Trump relied upon the executive power and presidential control of the administrative state to push policy change. This eliminated the need to seek policy consensus, but also made policy changes legally brittle and easy to undo. Such are the consequences of rule by administrative presidency.

In many respects, the administrative presidency came of age during Bill Clinton's administration. While prior presidents had sought to assert greater White House control on the federal bureaucracy, Clinton crossed a Rubicon of sorts. As Justice Elena Kagan chronicled in her 2001 *Harvard Law Review* article "Presidential Administration," the Clinton White House sought to make federal agencies "an extension of the President's own policy and political agenda." Once his political party lost control of Congress following the 1994 election, Clinton relied upon administrative processes to pursue reforms across a wide range of policy areas. Where Congress refused to act in accord with administration priorities, Clinton instructed the bureaucracy to act. To make such efforts effective, the administration exercised greater oversight of agency actions, centralizing power and decision making in the White House.

Subsequent presidents have expanded upon the Clinton precedents, strengthening White House control of administrative agencies through centralized review of administrative action. When Barack Obama announced he had "a pen and a phone," he was acknowledging the political reality of presidential administration. Against this background (and given his authoritarian impulses), it was unsurprising that Trump thought he had the full bureaucracy of the executive branch at his disposal, to push his policy agenda.

The rise of presidential administration, and its consequences for separation of powers within the federal government, has been the subject of extensive study by political scientists and legal academics. Less explored has been the effect of these trends on American federalism. Previous studies have considered the implications for interbranch relations, but few (if any) have plumbed the effects on federalism, particularly in those spheres in which much policy implementation is handled by state and local governments.

Trump, the Administrative Presidency, and Federalism seeks to fill that gap. In this book, Frank Thompson (Rutgers University), Kenneth Wong (Brown University), and Barry Rabe (University of Michigan) focus on how presidential administration affected federalism during the first three years of the Trump administration. Specifically, they examine how his White House's approach to administration affected and exploited federal–state relations, with a particular focus on those policy areas within each of their distinct expertise: health care, climate change, and education.



Trump, the Administrative Presidency, and Federalism

By Frank J. Thompson, Kenneth K. Wong, and Barry G. Rabe

256 pp.; Brookings Institution Press, 2020

Disabling previous policy / The Trump administration's policy agenda departed significantly from that of its predecessor. Perhaps more significantly, the administration sought to push policies at odds with longstanding agency practices and missions. Accordingly, the authors characterize the Trump effort as something of a "hostile takeover."

In two of the areas under study, climate and health care, Trump's aim was less to reorient the federal government's focus than to disable it. His administration did not merely seek to reorient health care policy; rather, it sought to "sabotage" Obama's signature Affordable Care Act through administrative interpretations and waivers that would enable states to depart from the legislation's aim of expanding federally prescribed insurance coverage. As these aims were accomplished neither through legislative enactment nor judicial fiat (as the administration sought), they are unlikely to last now that Trump is out of the Oval Office.

The focus on climate change is particularly interesting because, in the absence of federal climate legislation, all meaningful climate policy has been developed within the executive branch (with the occasional assist from the courts). Under Obama, the Environmental Protection Agency developed a series of climate policies designed to reduce emissions of greenhouse gases. As there were few express statutory mandates to contend with, it was relatively easy for the Trump administration to reverse these efforts through what the authors characterize as a "search and destroy" mission—at least temporarily. But delay was all that was accomplished because little was done that the Biden administration cannot undo through the same administrative levers—if the courts do not toss out Trump's actions first.

Opportunistic federalism / A theme that emerges from the study is that federalism concerns were, in and of themselves, no more than ancillary to the Trump administration's agenda. The occasional rhetoric of administration officials notwithstanding, there was no principled or consistent approach to federal–state relations. The administration sought to give states more authority where states were expected to align themselves with administration policies, while constraining state authority if states might pursue a different course. Any principled concern for state autonomy took a back seat to partisan political objectives. This was not cooperative federalism so much as "opportunistic federalism."

In addition to highlighting the brittle nature of administrative presidentialism, this book highlights the gulf between federalism rhetoric and practice in modern American governance. States are celebrated and given voice so long as they stay on the right team. Waivers and other administrative measures remain potent tools through which an administration can reward its allies and frustrate its opponents, but they are not the basis upon which to build a principled or stable federal–state relationship.

Although completed before Joe Biden's election, *Trump, the Administrative Presidency, and Federalism* helps explain why so little of the Trump regulatory agenda produced lasting change. Administrative opportunism may be politically convenient, but it can only accomplish so much. If future administrations want to chart a new course, particularly in those areas in which federal–state relations matter, they might have to turn away from presidential administration and relearn how to pursue meaningful legislation.

From the Past

The Future of Economics in the 1930s

REVIEW BY PIERRE LEMIEUX

The new year marks the 90th anniversary of the first edition of Lionel Robbins's *An Essay on the Nature and Significance of Economic Science.* In the 1930s, Robbins was close to the Austrian school of economics and was instrumental in bringing the future Nobel laureate Friedrich Hayek to the London School of Economics.

The *Essay* defined economics as the science that studies human behavior in allocating scarce means among competing ends, a definition that has become standard. We get a glimpse at this definition's influence when we realize that it was adopted by Gary Becker, the standard bearer of mathematical and empirical economics, which is the polar opposite of the Austrian school.

For this review I will use the 1935 edition, which is considered the definitive version. It is viewed by some, such as Auburn University economist and Ludwig von Mises Institute academic vice president Joseph Salerno, as less Austrian than the first edition. On the other hand, University of Toronto economist and Robbins biographer Susan Howson claims that the second edition "took further account of Austrian views." Robbins argued at the time that his opinions had not really changed from the first edition and that the modifications were meant to elucidate his original position. At any event, reviewing the definitive edition might give us better insights into the book's lasting influence.

An Essay on the Nature and Significance of Economic Science

By Lionel Robbins

156 pp.; Macmillan & Co., 1932

Scarcity and value / According to the *Essay*, the fundamental economic fact is that the means to satisfy human desires are relatively scarce. The individual does not and cannot have the means to obtain everything he wants and do all he would like to do. Means include all resources, including time, necessary to satisfy the individual's ends, which are defined by his preferences or values. Given scarcity, choices must be made as to which ends will be satisfied and to what degree. Scarcity implies the necessity of choice, which is a corollary of Robbins's definition. This is, he argued, what economists actually study.

Consider the simple case of the market for a particular good, where the ends or preferences of an individual are reflected in the demand he brings on the market. His means are his income, which can also serve to buy other things on other markets. He must choose how much of the good to acquire according to his scale of preferences. If the latter change, for whatever reasons (which are of no concern to the economist), his demand will change.

The ends can be material goods (say, beer) or non-material goods (a seat at the theater) or non-market activities (spending time with one's child). "Our economic subjects," Robbins writes, "can be pure egoists, pure altruists, pure ascetics, pure sensualists or—what is much more likely—mixed bundles of all these impulses."

The subjective desirability of a good is what gives it value. The fact that individuals attach different values to different things is "the fundamental concept of economics." But "why the human animal attaches particular values to particular things," Robbins writes, "is a question which we do not discuss. That is quite properly a question for psychologists." Economists take "the things which psychology studies as data of their own deductions." As Hayek would do a few years later (in "Scientism and the Study of Society," a series of three articles in *Economica*, 1942–1944), Robbins criticizes the false scientistic approach that refuses, in the field of social science, to start from the subjective preferences that motivate individual choices.

Markets and aggregates / It follows that, contrary to what Adam Smith and many older economists believed, all activities that produce goods or services desired by somebody are productive in the sense that they yield what is valued by individuals.

"As every first-year student knows," Robbins writes, "prices and costs are the reflection of relative valuations." Costs and supply, and not only demand, reflect the valuations of all individuals—an important point to grasp. Whoever has inputs to sell, whether his labor services or some materials, will decide to sell more or less depending on the wages or prices he gets for them. The value of an input sold on the market will also reflect its productive contribution to all goods or services demanded on markets. If the productivity (calculated in money value) of an input is higher when used in the production of good *B* than good *A*, the market will reallocate it to *B* until, through Law of Diminishing Returns, productivity has been equalized between the two goods.

Robbins defended the Austrian idea that aggregate statistics of production or income mean nothing as "expressions of order of preferences." For example, we cannot say that a higher level of national income is preferred to a lower one, because its distribution is unlikely to be the same. Statements about broad economic aggregates (like in macroeconomics) are value judgements that cannot be proven right or wrong. Although this idea may appear radical, it is close to what later welfare economists ended up arguing.

Economic laws / What are economic laws, or "generalizations" as Robbins calls them? They cannot be simply inductions from observed facts because without theory we don't know which facts are relevant. Theory must come before the observation of external facts. "Any attempt to reverse the relationship must lead inevitably to the nirvana of purposeless observation and record," he writes.

According to Robbins, economic laws are logical deductions from general postulates that reflect "very elementary facts of general experience," including introspection about how humans make choices. "Economic laws describe inevitable implications. If the data they postulate are given, then the consequences they predict necessarily follow." From that point, economic laws function just like other scientific laws. This apriorism looks typically Austrian but Robbins (like Hayek) was not allergic to quantitative methods, contrary to most members of that school. (On this and other aspects of Robbins's overall contribution to economics, see Howson's excellent 2011 biography, *Lionel Robbins*.)

Interpersonal comparisons of utility / An external observer cannot get into an individual's head to observe his preferences. But we can still say something about them. Robbins insisted that individual preferences cannot be viewed as a cardinal scale of satisfaction—that is, a scale on which arithmetical operations can be done. This economic idea was already firmly established. Although the author still invoked the concept of marginal utility, the second edition of the *Essay* cited the seminal 1934 *Economica* article of John Hicks (another future Nobel prizewinner) and R.G.D. Allen, who noted that "if total utility is not quantitatively definable, neither is marginal utility." Instead, indifference curves were becoming a standard analytical tool of economics. The only assumption that economists need to make, Robbins correctly explained, is that each individual ranks his preferences in the order of their (ordinal) intensity.

This theoretical idea has monumental consequences. Because each individual has his own subjective ordering, there is no scientific way to compare orderings between different individuals. You and I may both prefer oranges to apples, and I may appear to like oranges more than you do, but it makes no sense to say, for example, that I prefer them two times as much as you do. Two times as much of what? Not of so many dollars, because we are talking of subjective preferences before prices and incomes combine with them to motivate choices. As economists say, interpersonal comparisons of utility are impossible.

One important implication emphasized by Robbins is that economics cannot justify the redistribution of income on the claim that the marginal utility of money is larger for a poor individual than for a rich one. The intuition that $100 taken from a rich woman and given to a poor man produces an increase in total utility is just that: an intuition, with perhaps some moral underpinnings. Perhaps the rich woman would have used the $100 to buy a ticket for a Mozart concert, while the poor man will buy beer and chips for two weeks? "There is no way of comparing the satisfactions of different people," Robbins explains. People do make judgments about that sort of thing, but they are never unanimous and their judgments cannot be scientifically proven.

Economics and ethics / That leads us to ethics. Robbins emphasized that "economics is entirely neutral between ends. … The economist is not concerned with ends as such. He is concerned with the way in which the attainment of ends is limited" by scarcity. Ends are the data from which economic analysis starts; their evaluation belongs to the field of ethics. In this sense, economics is value-free.

Robbins is consistent, as economic reasoning generally impels us to be. Although he was a lifelong defender of free trade, he argues that the economist *qua* economist cannot say that it constitutes a good public policy because some individuals might be harmed by foreign competition. More generally, that certain conditions can be economically proven to lead to a better satisfaction of demand or more individual freedom does not by itself prove that they are desirable. A moral judgment is necessary to jump to a policy conclusion, which depends on how the ends of individual freedom and the satisfaction of individual preferences are ethically valued.

For Robbins, the significance of economics lies in its capacity to explore the consequences of pursuing different ends. It helps "us" to choose efficient means to attain chosen ends. It can also help find out if the ends are consistent with each other. For example, if the end chosen is general prosperity, obstacles to trade are counterproductive. But if the end is national security in time of war, barriers could be justifiable. Even choosing "between alternative *systems* of society" requires the economic analysis of their consequences. In brief, economics helps to make better public choices.

Robbins also believed that the significance of economics depends on an ultimate value: that "rationality and ability to choose with knowledge is desirable." He espoused that value.

Buchanan's challenge / As noted by George Mason University economist Peter Boettke in his *Living Economics* (Independent Institute, 2012), a major challenge to Robbins's conception of economics was raised by Nobel economics laureate James Buchanan. Buchanan argued that choice is more intimately linked to trade and thus to markets than to the ends–means allocation problem. Thus, trade or exchange should be the focus of economics. His approach does allow the economist to pronounce on free trade:

> If I observe someone with apples and somebody else with oranges, I don't want to try to say a particular allocation of oranges and apples in a final position is better than in the other allocation. If I observe them trading without defrauding each other, whatever emerges, emerges, and that is the way I define what is efficient.

The configuration of society *emerges* from exchange, not from maximization decisions and equilibrium positions.

In a limited sense, Buchanan was more accepting of *homo economicus* than Robbins. Methodological reasons account for that stance. If an individual is only assumed to maximize his ends and since these subjective ends can only be inferred from what he does, what we are really saying is that, obviously and uninterestingly, the individual does what he does. There is no room for empirical testing in a pure logic of choice. By restricting individual preferences to what is expressed in trade and markets, the *homo economicus* device allows empirical testing. Buchanan was as pure a subjectivist as Robbins, but he welcomed economics as a behavioral science instead of a pure logic of choice. (See "Not the Average Economist," Fall 2019.)

Buchanan's focus on trade opened the way to considering politics as a market, an idea that was at the source of public choice economics and "constitutional economics." This approach emphasizes that the choosers are always individuals even in public choices. In Robbins's conception of economics, Buchanan argues, "society" often seems to creep into the choices.

Politics and legacy / This is not to say that Robbins had no good intuitions about politics. "Scratch a would-be planner," he wrote, "and you usually find a would-be dictator." As Hayek was later to explain, economic planning means overwriting individual preferences and choices. (See "Where Are We on the Road to Serfdom?" Fall 2021.)

But Robbins did not go as far as Hayek, neither in the *Essay* nor after. In her biography, Howson summarizes Robbins's political philosophy as follows:

> He remained an old-fashioned liberal. He was never a libertarian and he never followed his friend Hayek in that direction. … He had longstanding reservations about the way Hayek's political views were developing after 1940. He thought the welfare state in Britain had been a benefit and did not agree with the *inevitability* thesis of *The Road to Serfdom*; he also differed from Hayek over utilitarianism. He was himself a utilitarian in his political philosophy and was always willing to *consider* government intervention if it could bring about things not well done by individuals left to their own devices.

The reader may be forgiven for thinking that this pragmatism bears a bit too much resemblance to the intelligentsia's muddled philosophy that ultimately engendered today's progressive generation. There is no doubt, though, that Robbins would not have accepted the wokes' intellectual sloppiness and rejection of liberal values.

Disregarding politics and focusing on economic methodology and Robbins's scholarship, we may say that the *Essay* represents what was the best in both Austrian economics and neoclassical economics. Robbins emphasized subjectivism but did not shy away from the advances of neoclassical economics. And he raised questions and proposed answers that are still inspiring. *R*

Working Papers ➾ BY PETER VAN DOREN AND IKE BRANNON

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

Electricity Markets

■ **"Large-Scale Battery Storage, Short-Term Market Outcomes, and Arbitrage," by Stefan Lamp and Mario Samano. SSRN Working Paper no. 3844751, May 2021.**

Wind and solar sources of electricity are not dispatchable. That is, their output cannot be varied to match demand in real time, which is required in an alternating current electricity system. The implication is that as these renewables' share of electricity production increases, so will the requirement for natural-gas-fired generation to serve as backup. Thus, the shift to renewable production has a hidden fossil fuel component that detracts from any environmental benefits provided by renewable sources.

An alternative non-fossil-fuel backup for renewable generation instability is large-scale lithium-ion battery storage. These are the batteries used in electric cars like the Tesla. There were 1,236 megawatt-hours (MWh) of battery storage in the United States at the end of 2018. For comparison, the average new natural gas combined-cycle generation plant had 800 MW of capacity in 2016, which would equal the output of all U.S. battery storage in an hour and one-half.

This paper examines the role of lithium-ion battery storage in electricity supply in California, which had 47 of the 172 such U.S. facilities from May 2018 through February 2020. The authors asked: Do such storage facilities discharge when load is high? Do they charge when wholesale prices are low and sell when they are high as optimal arbitrage would predict? And do storage facilities lower the equilibrium prices in electricity markets? They conclude that the facilities make decisions whose outcomes are highly consistent with those of price-takers that maximize arbitrage opportunities and reduce prices by about 31¢ per MWh, or 0.8%.

In the paper's model, battery storage was predicted to be highly profitable, netting $2.5 million over 10 years. But the actual California data suggest 10-year losses of $800,000. Without other sources of revenues, profit-maximizing firms will not enter this market.—**Peter Van Doren**

Conventional Air Pollution

■ **"Why Are Pollution Damages Lower in Developed Countries? Insights from High-Income, High-Particulate-Matter Hong Kong," by Jonathan Colmer, Dajun Lin, Siying Liu, and Jay Shimshack. SSRN Working Paper no. 3896141, August 2021.**

Reducing exposures to particulate matter (PM)—whether 10 microns in size or smaller (PM10) or "fine" particulate matter of 2.5 microns or smaller (PM2.5)—is believed to deliver significant health benefits. For instance, PM2.5 reduction accounts for 90% of the estimated benefits of the U.S. Environmental Protection Agency's conventional air pollution regulations. (See "The EPA's Implausible Return on Its Fine Particulate Standard," Spring 2013.)

The EPA's estimates of the mortality benefits from PM2.5 reduction come from two studies: the American Cancer Society Study and the Harvard Six Cities Study. Both have been the subject of much methodological criticism. (See "The Fight over Particulate Matter," Cato-at-Liberty blog, April 22, 2019.)

Economists have responded to the methodological weaknesses of these observational studies by investigating the results of natural experiments in which people are exposed to pollutants in a manner that is plausibly random and the resulting health effects are observed. One such research design involves random changes in prevailing wind direction that briefly expose different populations of people to pollutants. I described one such study in the Winter 2015–2016 Working Papers column and another in Spring 2017.

A new study of PM10 effects examines birthweight and infant mortality outcomes in Hong Kong from 2001 through 2014. Hong Kong offers the unusual combination of both high pollution and high income. Hong Kong's particulate matter levels are close to those of mainland China, India, and Pakistan, yet its per-capita income levels compare to the United States. Average gestational exposure to PM10 levels in Hong Kong was 54 micrograms per cubic meter per day (μg/m³/day), the minimum exposure was 30μg/m³/day, and the maximum exposure was 94μg/m³/day. The World Health Organization suggests that the annual average of PM10 exposure should not exceed 20μg/m³/day. To put that in perspective, the average in 2019 in Los Angeles County was 19μg/m³/day.

The source of plausible exogenous variation in PM exposure is thermal inversions in which warmer air aloft traps pollutants in cooler air closer to the surface. The study calculates the number of thermal inversions during the 270 days of gestation. Inversions are more common in winter, so the study controls for monthly and neighborhood location fixed effects. Conditional on these controls, the incidence of thermal inversions is plausibly exogenous.

The study finds that higher gestational particulate matter exposure is associated with significant reductions in birthweight and significant increases in low birthweight. These marginal PM–birthweight effects are substantial; a 10μg/m³ increase in particulate matter is associated with the equivalent of the estimated effects of smoking 15 cigarettes per day during pregnancy.

But there are no increases in infant mortality. The authors speculate that Hong Kong's wealth and health institutions facilitate post-natal health interventions that offset pollution exposure effects. The authors write: "Conventional wisdom suggests that marginal pollution damages are high in less-developed countries because they are highly polluted. We provide early evidence that marginal particulate matter damages are high in less-developed countries because they are more polluted and because they are less developed." —**P.V.D**

Pharmaceutical Innovation and Antitrust

■ **"Paying Off the Competition: Market Power and Innovation Incentives," by Xuelin Li, Andrew W. Lo, and Richard T. Thakor. SSRN Working Paper no. 3870420, June 2021.**

In the early 2000s, many pharmaceutical companies paid potential generic competitors to delay their entry. In 2013, in *Federal Trade Commission v. Actavis*, the Supreme Court ruled that such agreements were subject to FTC antitrust jurisdiction. Such a ruling was arguably unexpected because lower courts had approved such "pay-for-delay" contracts.

The plausibly exogenous nature of the court decision allows researchers to examine how brand-name pharmaceutical company innovation responded. The paper gathers detailed data on public pharmaceutical firms and their drug development portfolios from 2005 to 2016 to construct a firm-specific measure of the amount of generic drug competition each branded incumbent faces.

Prior to the 2013 ruling, incumbent firms responded to potential entry from direct competitors by reducing their innovation activity and initiating a smaller number of new drug trials. After the ruling, incumbent firms increased their number of new drug trial initiations and decreased the number of suspensions of existing projects in response to generic entry filings. Once incumbent firms could no longer lengthen the term of their monopoly power through legally risky pay-for-delay agreements, they expanded innovation activities. **—P.V.D.**

Zoning

■ **"The Impact of Local Residential Land Use Restrictions on Land Values Across and Within Single-Family Housing Markets," by Joseph Gyourko and Jacob Krimmel. NBER Working Paper no. 28993, July 2021.**

Edward Glaeser and Joseph Gyourko did landmark work in the early 2000s on the negative effects of zoning on housing supply. (See "Zoning's Steep Price," Fall 2002.) In this paper, Gyourko and coauthor Jacob Krimmel provide an important update.

The intuition behind the research is based on the "law of one price," also known as the "law of arbitrage." In a completely unregulated market, there should be no difference in the value that an existing homeowner or homebuilder places on an extra square foot of land. That is, if the value an existing homeowner puts on having a bit more land (known as the intensive margin value in economics) is less than the value a builder places on the same amount of land with the right to build on it (known as the extensive margin value), then the owner-occupier should subdivide and sell the vacant land to the builder. Unless there are regulations preventing that increase in density, there should be no gap between land values on the intensive and extensive margins.

The innovation in this paper comes from access to data on sales of vacant land to builders. The earlier work had to infer land values by subtracting construction costs from sales of parcels with houses on them. The new data provide direct observation of prices paid for individual parcels of vacant land purchased by builders for single-family housing units. The data are for 2013–2018 for 24 major U.S. metropolitan areas: Atlanta, Boston, Charlotte, Chicago, Cincinnati, Columbus, Dallas, Deltona (FL), Denver, Detroit, Los Angeles, Miami (FL), Minneapolis, Nashville, New York City, Orlando, Philadelphia, Phoenix, Portland (OR), Riverside–San Bernardino (CA), San Francisco, San Jose, Seattle, and Washington, DC. There are 3,640 observations on vacant parcels purchased with the intention of building single-family housing units across these markets. The paper found at least 20 valid vacant land purchases for single-family development over the 2013–2018 period that also were within 30 miles of the centroid of each metropolitan area.

The extensive value of land for developers is calculated by dividing the value of a parcel by the number of homes planned by the builder. For example, a 54.5-acre parcel near Atlanta with 96 planned homes sold for $6,479,937, so the extensive margin value of land per intended housing unit is $67,499 ($6,479,937 ÷ 96), or $2.73 per square foot.

The intensive land value is calculated through a regression estimated from 1,000 observations of sales of properties over 2013–2018 that are physically close (averaging within a mile) to the vacant parcel site. The home sale prices are regressed on the lot size, home size, house age, age-squared, and dummy variables for multi-story, townhome, and census tract. From the coefficient on lot size, the paper estimates the intensive margin price per square foot as $1.72. The average lot size of the 100 new houses closest to the vacant land and built during 2013–2018 was 16,866 square feet, which multiplied by $1.72 results in an intensive land lot value of $29,010. The estimate of the zoning tax is the difference between the extensive lot value of $67,499 and the intensive lot value, which comes to $38,489.

The paper then standardizes these estimates for quarter-acre lots. The gap between extensive and intensive margin land values of a quarter-acre plot of land is about $400,000 in San Francisco, ranges between $150,000 and $200,000 in Los Angeles, New York, and Seattle, and is over $100,000 in San Jose. The zoning tax is $60,000–$80,000 in Chicago, Philadelphia, Portland, and Washington, just under $50,000 in Boston, and $35,000–$40,000 in Miami and Riverside–San Bernardino. In the other markets, the median zoning tax per quarter-acre lot is less than $25,000, which the authors describe as negligible to small. **—P.V.D.**

Securities Regulation

■ **"Regulatory Costs of Being Public: Evidence from Bunching Estimation," by Michael Ewens, Kairong Xiao, and Ting Xu. NBER Working Paper no. 29143, August 2021.**

In 1975, the United States had 4,927 publicly traded firms. That number rose over the next two decades, peaking at 7,576 in 1997. But by the end of 2018, the United States had only 3,613 listed firms. Why the decline?

In the Spring 2020 Working Papers column, I reviewed a paper that argued the cause was the increased importance of intangible rather than physical assets in business as well as more liberal treatment of private partnerships, which could only have 100 investors in 1982 but 2,000 after 2012.

Another possibility, not considered in that paper, is increased regulation of public firms. The current paper describes three regulatory thresholds for the market value of the publicly traded stock of a firm ($25 million, $75 million, and $500 million) below which firms face lower disclosure and compliance costs. The data clearly show a "bunching" of firms below these regulatory thresholds achieved through the substitution of debt for equity, without changing their operations or insider ownership. That suggests it is valuable for firms to avoid the disclosure and compliance costs. (See Winter 2016–2017 Working Papers for a prior use of this technique.)

Using private as well as Securities and Exchange Commission sources of firm expenditures on regulatory compliance, the median

U.S. public firm spends 0.3% of its earnings before interest, taxes, depreciation, and amortization (EBITDA) on enhanced disclosure compliance, 0.9% on tightened internal control, and 2.1% on a combination of disclosure and internal control rules every year. Regulatory costs as a percentage of EBITDA increased from 0.15% before the Sarbanes–Oxley Act of 2002 (SOX) to 0.23% after SOX. Since 2005, though, there has been a steady decline. By 2018, regulatory costs relative to EBITDA have dropped to their pre-SOX levels.

Using data on the 21,066 U.S. venture capital (VC)-backed firms from 1992 to 2018, out of which 1,957 went public, the authors estimate a model of the effect of regulatory costs on the likelihood of going public. They then use the model to estimate the increased number of firms that would have gone public if various regulations had not been enacted and increased costs. Removing SOX only increases average initial public offering (IPO) likelihood after 2000 from 0.95% to 0.96%. This result may appear surprising given that SOX costs are substantial; however, 82% of VC-backed firms would have a public float below the SOX exemption threshold upon IPO. Removing all regulatory costs would increase post-2000 IPO likelihood among VC-backed firms from 0.95% to 1.4%. The average yearly number of VC-backed IPOs over 2000–2018 would increase from 50.2 to 70.6. While the effects are real, removing all regulatory costs after 2000 increases the average yearly number of IPOs over this period by 20.4, which offsets only 22% of the decrease in yearly IPO volume from pre-2000 to post-2000. **—P.V.D.**

E-Cigarette Taxation

■ **"Intended and Unintended Effects of E-cigarette Taxes on Youth Tobacco Use," by Rahi Abouk, Charles J. Courtemanche, Dhaval M. Dave, et al. NBER Working Paper no. 29216, September 2021.**

Previous Working Papers columns examined the effects on tobacco use of a ban on e-cigarette sales to minors (Summer 2016) as well as taxes on e-cigarettes (Spring 2020). The ban caused tobacco cigarette use among 12- to 17-year-olds to increase. A large tax on e-cigarettes in Minnesota resulted in more tobacco cigarette use because of a decrease in quitting among adults.

The current paper examines the effects of e-cigarette taxes enacted by 10 states as well as two counties (Cook County, IL and Montgomery County, MD) on adolescent smoking behavior. They conclude that adolescents reduce their e-cigarette use because of higher taxation, but 68% of them switched to tobacco cigarettes.

Currently, Congress is considering doubling the federal cigarette excise tax to $2.01 per pack and taxing e-cigarettes equivalently (a roughly $2.01 tax per 0.7 fluid mL of nicotine, assuming a Juul pod is equivalent to a pack of cigarettes). Using the results of their research, the authors suggest that this would reduce youth e-cigarette use by 5.5 percentage points but increase traditional cigarette use by 3.7 percentage points. **—P.V.D.**

Value of a Statistical Life

■ **"The Value of a Statistical Life: A Meta-Analysis of Meta-Analyses," by H. Spencer Banzhaf. NBER Working Paper no. 29185, August 2021.**

The most important facet of most regulatory benefit–cost analyses is the value assigned to preventing the loss of a life. But specifying what that value should be is a difficult political task and a fiendishly complicated economic chore. In this working paper, Georgia State University economist Spencer Banzhaf offers some estimates by drawing on previous efforts to determine this value.

Since most regulations seek to improve safety or working conditions, most of the benefits accrued have to do with lives saved. Economists have produced hundreds of studies that attempt to estimate the value that people themselves place on their lives by the decisions they make, such as the wage premium they demand to take riskier jobs and how much they are willing to pay for safety devices that reduce risk. Economists also conduct surveys that ask people to contemplate such tradeoffs, which we call Contingent Valuation studies.

In general, regulatory agencies and executive-branch departments would like to use a large Value of a Statistical Life (VSL) because that would help them justify more regulations from a benefit–cost perspective. From a public choice perspective, the agencies tend to want to produce more regulations. On the other hand, higher VSLs result in businesses and consumers spending increasingly more on safety and necessarily sacrificing other things they may prefer. For instance, a city that wants to ensure that every house can be reached by an emergency responder within five minutes of a call may need to increase taxes or else spend less on roads, schools, or parks in order to meet that standard.

Constraining federal agencies is Executive Order 12866, issued by President Bill Clinton, that requires executive branch agencies to do a benefit–cost analysis for each major regulation (those that have an economic impact of over $100 million). That analysis must pass muster with the Office of Information and Regulatory Affairs (OIRA).

There is no one standard VSL used across government agencies. The Environmental Protection Agency has spent the most time and effort studying the issue, and it has financed numerous studies on the issue over the last two decades. Banzhaf identifies 800 "unique estimates" that he includes in his analysis. These VSLs vary widely, from a few hundred thousand dollars to nearly $20 million.

There are now a number of meta-analyses that attempt to elucidate a representative number from all this research, but these also have a broad range of meta-estimates, ranging from $3.7 million to $12.3 million. Two decades ago, a meta-analysis by Januz Mrozek and Karen Taylor produced an estimate of roughly $3 million. Several executive branch agencies chose to use that number at the time, but the EPA—which had adopted a number almost three times higher than that—chose instead to finance more studies on the issue, and those later studies ultimately supported its choice of a much higher VSL.

Banzhaf argues that despite the wealth of literature surrounding this topic, most of this work has been more or less ignored by the agencies. He reports that several of them arrived at their VSLs via the use of a small number of studies, some of which are decades old. Two decades ago, when I worked for OIRA, I reached this same conclusion when I conferred with agencies to help them with their VSL choices.

It's tempting to say the agencies cherry-pick the studies that support the number they want to use. Banzhaf is more charitable, pointing out that the literature is complicated even for an economist, and is especially difficult for the non-economist policymakers who must ultimately make this decision. Relying on a small number of studies at least makes the decision tractable.

Banzhaf suggests that we need to devise a way to simplify how the agencies approach this. His solution is to construct, in essence, a meta-analysis of the meta-analyses, and to devise a way for the agencies to use the studies collected in all of the meta-analyses to estimate a number based on their methodological preferences, or to update their VSLs by easily incorporating new studies into the mix.

His model generates a mean VSL of $7 million—about 25% less than what the EPA and other agencies use—and his confidence interval ranges from $2.4 million to $11.2 million.

He is right that the sheer quantity of VSL studies is both a blessing and a curse; as someone who spent nearly a year doing almost nothing but reading VSL studies for OIRA two decades ago, I can attest to that. His approach offers a way for agencies to simplify how they approach their adoption of a VSL but without focusing on a small number of studies. What's more, this may very well be the first step toward a future where the agencies and OIRA agree to coalesce on a single estimate that truly reflects the preferences of society and makes federal regulations more rational and cost effective.**—Ike Brannon**

Trade and Domestic Manufacturing

■ **"Do Not Blame Trade for the Decline in Manufacturing Jobs," by Stephen J. Rose. Center for Strategic and International Studies Report, October 4, 2021**

A narrative that both Democrats and Republicans seem to agree upon is that unfair trading practices by China and other U.S. trade partners have destroyed millions of well-paying American jobs and helped impoverish the nation's middle class.

In a new CSIS policy analysis on trade, Urban Institute scholar Stephen Rose does not defend China's trade practices, but he also does not find that trade guilty of immiserating the middle class or destroying U.S. manufacturing jobs. Instead, he identifies a different culprit for the loss of those jobs: rising productivity growth. He points out that manufacturing productivity increased by 600% from 1980 to 2020. In steel, considered a key industry for manufacturing, productivity went up even faster: it took over 10 hours of labor to produce a ton of steel in 1980 but just 1.5 hours last year.

This is a good thing. Being able to produce more goods with fewer workers means the displaced workers can undertake other activities that benefit the economy. Not everyone sees it that way, though, and Schumpeter's notion of creative destruction is anathema to many people who say they want to protect the middle and working classes.

Rose does not see the reduction in manufacturing as an economic problem to be solved. He notes that the loss in manufacturing jobs—7.5 million fewer people worked in manufacturing in 2020 than in 1980—was swamped by the creation of 40 million new service jobs during that time. Most other developed countries also saw manufacturing employment fall over this period, so this isn't solely a U.S. phenomenon. Rose also observes that the areas of the country that have lost the most manufacturing jobs in the last 40 years—New England and the Mid-Atlantic— currently have the most robust economies in the United States.

He draws on his previous research to show that what has become an almost universally accepted narrative—that middle- and working-class workers are earning less than they did two generations ago—is unsupported by the data. Rose estimates that male average compensation went up by as much as 50% from 1979 to 2014. He specifically criticizes economists Thomas Piketty, Emmanuel Saez, and Gabriel Zucman, whose work has played a crucial role in pushing this false narrative, for obfuscating reality. His observations debunk the conventional wisdom that Americans have suffered a decline in living standards over the last six decades:

> Real GDP per capita in 1960 was one-third the value in 2019; life expectancy was eight years less; houses were smaller; and amenities such as air conditioning were rare. In terms of pay, median-income blue-collar workers in manufacturing in 2019 were paid nearly 50 percent more than their inflation-adjusted median in 1960.

Because of such observations, Rose is not championed by many politicians in either major American party. Democrats resent him for undercutting their message of economic exploitation of the working class. Republicans are wary of him because he offers progressive solutions such as stronger unions and a higher minimum wage to the problem of working-class poverty. Regardless, his work sheds light on a contentious issue and helps everyone who reads him to better understand the forces that truly are affecting the U.S. economy. If we are to have political fights over what needs to be done, we need both sides to understand and agree on what really is occurring in the economy. **—I. B.**