IN REVIEW

Beware of Bureaucrats Bearing Gifts

REVIEW BY GEORGE LEEF

Thomas Jefferson wrote that, in order to prevent government from becoming tyrannical, it was necessary to "tie it down with the chains of the Constitution." But over the centuries, those who want an expansive government have loosened the Framers' chains in many ways. In his new book *Purchasing Submission*, Columbia University law professor Philip Hamburger explores one of those ways: the federal government's using money and power to augment its control over Americans. He makes a persuasive case that those tactics have enabled it to undermine federalism and freedom.

Hamburger has written previously about the unconstitutional spread of federal power. His 2014 book *Is Administrative Law Unlawful?* argues that the vast administrative state — the "fourth branch" of government — is inconsistent with the Framers' concept of good governance. This harkens back to the kinds of star chamber proceedings in England that the drafters of our Constitution wanted to prevent. The people were only supposed to obey laws enacted by their elected representatives and face punishments by properly constituted courts of law, but "administrative law" violates both of those precepts.

In *Purchasing Submission*, Hamburger shows that the problem of unconstitutional control goes far beyond the visible administrative state, which at least must comply with statutes and is somewhat subject to judicial oversight. But when the federal government dangles money in front of state or local governments or private entities with conditions that Congress could not legislate directly, that subverts our constitutional order. He calls this a "transactional mode of control" and declares, "It is a strange mode of governance, in which Americans sell their constitutional freedoms — including their self-governance, due process, and speech — for a mess of pottage."

The Framers did not consider that the government might infringe upon people's rights by putting conditions on the receipt of largess.

Unimagined power / The Constitution places many restraints on federal power, but the Framers did not consider the possibility that the government might infringe upon people's rights by putting conditions on receipt of its largess. That's likely because the Framers never imagined the federal government having anywhere near the money and authority it now holds. No authority to dole out money or favors was enumerated. Why take precautions against the abuse of a non-existent power?

But as government took on additional authority, it became possible to use that authority in novel ways. Consider, for example, the Federal Communications Commission. It licenses broadcasters, and its permission to operate is conditional upon their compliance with regulations that restrict their freedom of speech. The First Amendment, of course, prohibits Congress from enacting legislation that abridges freedom of speech, but the federal government accomplishes this nonetheless by putting content restrictions on TV and radio licenses. To the objection that the government owns the airwaves and therefore is entitled to place restrictions on their use, Hamburger responds that the airwaves do not belong to the *federal government* but to the *people*.

Doesn't it matter, however, that the broadcasters *consent* to the FCC's rules when they apply for a license? No, Hamburger argues, explaining: "The Constitution is a law publicly enacted by the people. It therefore cannot be altered or excused by the consent of states or private persons." While the Supreme Court has at times come close to grasping this point, its decisions in cases involving conditions upon federal largess have been "all over the map," meaning inconsistent and confused. We should regard this book as a guide to future litigants who might challenge this federal overreach.

Shouldering aside / One of the cases Hamburger uses to show the Court's unsatisfactory jurisprudence is *South Dakota v. Dole* (1987). The issue there was whether the federal government could insist that states adopt a drinking age of 21 if they wanted federal highway funds. The Court upheld the Department of Transportation's condition, weakly saying that it was "germane" and therefore permissible. Hamburger maintains that Justice San-

About Our Reviewers:

JONATHAN H. ADLER is the inaugural Johan Verheij Memorial Professor of Law and director of the Coleman P. Burke Center for Environmental Law at the Case Western Reserve University School of Law.

RYAN BOURNE holds the R. Evan Scharf Chair for the Public Understanding of Economics at the Cato Institute and is the author of the recent book *Economics in One Virus* (Cato Institute, 2021).

THOMAS GRENNES is emeritus professor of economics and agricultural and resource economics at North Carolina State University.

GEORGE LEEF is director of research for the James G. Martin Center for Academic Renewal.

PIERRE LEMIEUX is an economist affiliated with the Department of Management Sciences of the Université du Québec en Outaouais.

VERN MCKINLEY is a visiting scholar at the George Washington University Law School and coauthor, with James Freeman, of *Borrowed Time: Two Centuries of Booms, Busts and Bailouts at Citi* (HarperCollins, 2018). McKinley has been an intermittent financial stability adviser for the International Monetary Fund since 2008.

PETER VAN DOREN and THOMAS A. FIREY are, respectively, editor and managing editor of *Regulation* and senior fellows at the Cato Institute.

dra Day O'Connor's dissent on the ruling ought to have carried the day:

> When Congress appropriates money to build a highway, it is entitled to insist that the highway be a safe one. But it is not entitled to insist as a condition … that the state impose or change regulations in other areas of the state's social and economic life because of an attenuated or tangential relationship to highway use or safety.

South Dakota highlights Hamburger's great concern: the federal government is shouldering aside the states and localities, where much of our policymaking is supposed to take place, when it uses its money to dictate matters that are not properly within its purview under our federalist system. The book is full of examples of this. Consider the way that Congress has dictated state education policy through the No Child Left Behind Act. It provides just 8% of states' educational funding but requires the states to reshape their curricula and metrics to suit federal overseers. Another education-related example is the way Title IX regulations have been used to compel colleges and universities to obey federal Department of Education dictates regarding limits on free speech and the adjudication of cases of alleged sexual harassment. If Congress were to pass these dictates as legislation, they would run afoul of First Amendment and Due Process protections. But because these are only stipulations on the use of federal funds, the government can get away with them because college administrators are eager for the public dollars.

Purchasing Submission: Conditions, Power, and Freedom

By Philip Hamburger

311 pp.; Harvard University Press, 2021

Empowering the bureaucracy / Similarly, federal money for academic research enables government to impose speech restrictions on Americans through institutional review boards. These boards demand institutions adopt wide-ranging restrictions as a condition of receiving the money. Hamburger writes,

> By means of these conditions, the federal government turns funded academic institutions into agents to regulate third parties, even researchers who do not receive government funding — subjecting them to licensing of academic speech and publication.

He contends that a great deal of harm is done by the squelching of discussion about research findings.

His disapprobation of these extensions of federal power might be met with the response that the government's spending power to promote the general welfare allows it to place conditions on the entities that accept its money. But, Hamburger argues, *there is no general welfare spending power in the Constitution*. Congress is authorized to tax for certain purposes, and only a "progressive" reading of the Constitution has allowed the broadening of that power. It is bad enough that the Supreme Court has chosen to read the Constitution so as to give Congress almost carte blanche spending authority, but worse still to allow the federal government to trample upon federalism and the rights of citizens when it puts conditions on those who receive the money.

When such mandates are created and implemented by the bureaucracy, it not only displaces Congress, where the legislative power is supposed to lie, but also the courts. The agencies that impose the conditions also decide when these mandates have been violated and what penalties to impose, thus usurping the judicial function. Sometimes the agency decision is subject to judicial review (and sometimes not), but the government has a bag of tricks to deter parties from challenging it. These tricks are variants on a simple threat: "If you don't like this, wait to see what we can do to you next." Inducing fear allows the bureaucracy to avoid the need for formal procedures and to expand their power.

Why isn't this problem more widely perceived? Hamburger thinks it is because the unconstitutional action does not appear to be that of the federal government at all. It is ultimately state and local officials, along with leaders of various private institutions, who tell people what they may or may not do. The government is working through agents, so its role is obscured. That, however, should make no difference. A legal maxim that applies here is *qui facet per alium, facet per se:* What one does through another, he does himself. It is past time to expose and stop the government's scurrilous expansion of its proper authority.

But how? Hamburger addresses that question in his concluding chapter. Our judges — including those on the Supreme Court — have been remiss in dealing with this alternate mode of governance. They have too often ignored it or excused it. Many probably see this "purchased submission" as a good thing because it ostensibly is rule by expert civil servants overseen by administration appointees. Hamburger hopes to convince jurists (and all other readers) that it is not. Here is his plea: When the federal government acts through imposed conditions, it creates

> a uniform phalanx of public and private power, often in pursuit of unconstitutional restrictions. Indeed, largely through conditions, the federal government increasingly creates an alignment of federal, state, local, educational, corporate, and other private bureaucracies. It is an unbroken wall of power that discourages legal and political resistance and renders private life vulnerable.

In ancient Athens, Demosthenes delivered a series of speeches on the looming threat of King Philip II of Macedon, in hopes of alerting Athenians while there was still time to act. Philip soon took control of Hellas. With *Purchasing Submission*, Hamburger has done very much the same thing for us. *R*

IN REVIEW

The New World and the Ukraine–Russia Breadbasket

REVIEW BY THOMAS GRENNES

The Russian invasion of Ukraine has reminded the world that war in Europe isn't just the stuff of history books. It also demonstrates how war can affect the world's food supply, as both Ukraine and Russia have long been major global suppliers of wheat and other grains.

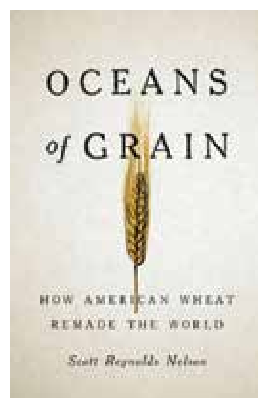
This makes the new book *Oceans of Grain*, by University of Georgia history professor and Guggenheim fellow Scott Reynolds Nelson, especially timely. Nelson has written five other history-oriented books, including the award-winning *Steel Drivin' Man: John Henry, the Untold Story of an American Legend* and *A Nation of Deadbeats: An Uncommon History of American Financial Disasters.*

Oceans of Grain covers some 14,000 years of human history, beginning with the origin of bread, with an emphasis on the era in which the modern wheat market developed, from the 18th century to the end of World War I.

New World food / The book focuses on the breadbaskets of the United States, Russia, and Ukraine, though it also gives a little attention to Canada, Argentina, and Australia, and passing mention of South and East Asia. Nelson often writes as if Russia and Ukraine are one land, in part because the border between them has shifted many times throughout history. His use of the word "grain" is nearly synonymous with "wheat," though he does offer limited discussions of corn (maize), oats, barley, and rice.

Grain has been crucial to human life for millennia. Expressions such as "Bread is the staff of life" and prayers such as "Give us this day our daily bread" illustrate the historical importance of bread and wheat. Technical change that has raised productivity in grain production has increased the standard of living for hundreds of millions of people, and negative shocks to the grain sector have caused crises and wars.

Expansion of grain production in the 19th century to the then-newly settled regions of the United States, Canada, Argentina, and Australia greatly benefited grain consumers around the world, but it harmed traditional producers in Russia and elsewhere. The benefits for Europe were previously described in a 1997 *Journal of Economic History* article by Kevin H. O'Rourke as the "distributional effects of Christopher Columbus." According to O'Rouke, transport innovations such as steamships and railroads "exported New World land to Europe, embodied in New World food."



Oceans of Grain: How American Wheat Remade the World

By Scott Reynolds Nelson

369 pp.; Basic Books, 2022

Geography and transport / Geography has been crucial to the location of grain production and the pattern of world grain trade. The fertile *chernozem* (Russian for "black soil") of Ukraine, parts of Russia, and neighboring lands was conducive to early grain production. Ancient "black paths" used by oxcart drivers led from the interior of Ukraine to Black Sea ports. Centuries ago, grain was shipped through the Turkish Straits on both ends of the Sea of Marmara to the Aegean Sea and then onto the ancient Greek and Roman civilizations along the Mediterranean. Control of those straits, the Bosporus and Dardanelles, has long been crucial and has led to many wars involving Russia and Turkey. Even today, following the Russian invasion of Ukraine, access to the Turkish Straits by Russian ships is a crucial military issue.

Transport innovations have had a major effect on the pattern of world trade. Improvements in navigation and sailing ships were followed by the transition to steam ships. The development of Odessa on the Black Sea was a major contributor to Ukrainian grain exports. Grain ports have been described as the children of empires, and Nelson points out the Greek term *emporion* — "marketplace" — is the etymological root of both "emporium" and "empire."

Other innovations also played important roles. Improvements in communication, such as the telegraph and undersea cables, aided long-distance trade. Improvements in explosives (nitroglycerin) contributed to the construction of deep-water harbors that can handle bigger ships. Better explosives also helped build the Suez Canal. Completed in 1869, it reduced travel time from London to Calcutta from six months to 30 days. The shortcut from the Mediterranean Sea to the Indian Ocean permitted the bypassing of the southern tip of Africa.

Grain policy / Government policies have had an important effect on the pattern of world grain trade.

Russian Tsarina Catherine II (1762–1796), better known as Catherine the Great, sought to develop a more grandiose Russian empire by making the country a major grain exporter. Russia's partitioning of the Polish–Lithuanian Commonwealth added territory from the Baltic Sea in the north to the Black Sea in the south that included fertile wheat-growing land.

According to Nelson, Catherine was influenced by the French Physiocrats, led by François Quesnay, who thought that agriculture was the main source of wealth.

Catherine believed that Russia's becoming a large grain producer would free its citizens from having to rely on other countries for their basic food. She also admired the benefits received by Poles from transporting grain down the Vistula River to Gdańsk. By increasing Russian production and exports of grain from Black Sea ports through the Turkish Straits, Catherine expected to convert Constantinople to "Tsargrad."

She promoted Russian wheat production in various ways, including increasing the power of landlords over serfs that made the serfs more like slaves. She also followed the anti-Semitism of earlier tsars who restricted Jews from living in old Russia. Jews were underrepresented as grain growers and overrepresented as middlemen in the grain sector. According to Nelson, this made it easy for Catherine to believe they were "leeches" who profited off the work of others. She limited the area where Jews could live to an area called the Pale of Settlement, which mostly came from land recently acquired from the partition of Poland–Lithuania. The Pale included Ukraine, with its rich black soil for growing grain, and Odessa was founded during her reign. Adding the Jewish population of the Pale made Catherine the ruler of the largest Jewish population in the world.

A grain "invasion" / At the time of Catherine, the United States had not become an important grain exporter. But after 1865, the American Great Plains were settled, the U.S. rail network expanded, and ships and communication improved. Those innovations contributed to the United States becoming a major producer and exporter of grain.

O'Rourke's 1997 article described the expansion of U.S. exports as a "grain invasion" of Europe. Train tracks substituted for the ancient black paths, carrying the Plains' bounty to U.S. ports and then onto Europe. Development of multinational grain companies like Archer Daniels Midland, Bunge, Cargill, and Louis Dreyfus (known collectively as ABCD) also contributed to a major change in the pattern of trade. The migration of labor from Europe to the United States and other emerging exporters aided the production of the newly settled farmland.

This grain invasion increased the world supply of land devoted to wheat. That harmed European landowners, and they sought protection from their governments. German landowners successfully lobbied Chancellor Otto von Bismarck, who responded with protectionism in the form of tariffs. He was supported in this by ultranationalist politician and history professor Heinrich von Treitschke, who blamed cheap imports for the fall of the Greek and Roman empires.

This grain invasion increased the world supply of land devoted to wheat. That harmed European landowners, who sought protection from government.

Russian leaders, including Prime Minister Sergei Witte and Finance Minister Ivan Vyshnegradsky, sought to regain Russia's export prominence. They promoted a long and costly railroad expansion through Siberia to Port Arthur in Manchuria, believing it would become a major port for Russian grain exports to the Pacific. Japan resented the Russian encroachment in their neighborhood and defeated Russia in the Russo–Japanese War of 1905. The defeat was an embarrassment to the government of Witte and Vyshnegradsky, and the Marxists used it in their calls for revolution. Frequently stated goals of the Bolshevik revolutionaries were "Peace, Land, and Bread." Nelson suggests that the humiliating military defeat may have contributed to Russia's participation in World War I and drove Russia into revolution.

The United Kingdom was a prominent exception to grain protectionism. Parliament did impose the protectionist Corn Laws ("corn" in British English encompasses all grains) in 1815, but the beginning of the Irish Potato Famine (1845–1852) led to the laws' repeal in 1846. British grain production fell as a result, but the broader economy prospered. Land devoted to grain production decreased and real wages rose. Many British cities, including London and Liverpool, doubled in size between 1845 and 1860. European workers gained from greater access to grain, and European socialist parties generally supported free grain imports.

Parvus / Nelson illustrates the connection between developments in the grain sector and politics by following the colorful life of Israel Lazarevich Helphand (sometimes spelled "Gelfand"; 1867–1924), who used the pseudonym "Alexander Lvovich Parvus" or just "Parvus." He was the odd combination of a widely read journalist with a doctoral degree in political economy from the University of Basel, a Marxist theorist and practitioner, and a wealthy grain trader. According to Nelson, Parvus was the thinker whom Vladimir Lenin, Leon Trotsky, and Rosa Luxemburg most admired. Parvus was born in a shtetl in Belarus and his family moved to Odessa, where his father became a grain trader. Odessa was also the home of David Leontyevich Bronstein, who raised and traded grain. His son, Lev Davidovich Bronstein, would later take the pseudonym "Leon Trotsky."

Parvus has been rediscovered recently, and he was the subject of recent television series in both Russia ("Demon of the Revolution," 2017) and Turkey ("The Last Emperor," 2017–2020). Nelson claims that both series distorted and glorified Parvus's true role in the Russian Revolution.

Conclusion / *Oceans of Grain* is a good read. It is imaginative and bold in suggesting that shocks to the grain sector may have contributed to wars and revolutions. Relevant data are usually presented to support the hypotheses. Even though they are not always convincing, they do stimulate thought.

There are inevitable omissions, but all good stories must leave out some details. Nelson's extensive focus on the emergence

of U.S. grain production and exports is appropriate given the resulting negative effects on European grain producers and positive effects on European grain consumers. However, his limited attention to Canada, Argentina, and Australia is disappointing because they contributed to those effects on Europe. Failing to examine the competing producers in some detail could exaggerate the effects of American grain exports to Europe.

The current Russian invasion of Ukraine certainly gives this book special relevance. Putin aspires to control the territory of the old Russian Empire, and he considers Russia and Ukraine inseparable. Nelson tells the story of how the combined Russia/Ukraine once dominated grain trade with Europe, and how the United States and other newly settled grain exporters successfully challenged that dominance. Russia and Ukraine remain among the world's largest wheat exporters today. The fertile black soil north of the Black Sea continues to be a major source of wheat and daily bread for millions of people. R

Caplan on Labor

REVIEW BY RYAN BOURNE

Bryan Caplan is not reluctant to take controversial positions on public policy issues. The George Mason University economist's recent books have advocated for completely open borders and slashing education spending. He's now at work on a book that purportedly argues the poor are largely to blame for their poverty.

Always guaranteed to be economically well-grounded and thought-provoking, his popular works tear down conventional wisdoms that lead to anti-market thinking. He is unafraid to focus on the thorniest of thorny subjects where misguided economic ideas result in immense social harm. His new book, *Labor Econ Versus the World*, is true to form, bringing together some of his best blog writing against the "central tenets of our secular religion" of anti-marketism in relation to work, education, and immigration.

Combating misperceptions / The book begins by republishing a 2015 piece outlining eight common misconceptions about labor economics. Is the main reason that workers are richer these days because of government interventions? No, says Caplan; rising worker productivity, coupled with the competition for labor between firms, is the secret sauce to the past century of rising pay. Does keeping out low-skilled migrants prevent poverty or inequality, as commonly believed? Not one bit, he explains. Restrictions on movement keep the poorest in the world poorer by locking out foreigners from opportunities for betterment here, worsening global inequality. Americans, meanwhile, are also made worse off without the specialization that comes from a deeper labor market of more people.

If those two topics do not pique your interest, Caplan outlines six more faulty yet widely held opinions, including the belief that education is a key driver of economic health and the view that government regulation is necessary to curb discrimination. Large parts of the book debunk each claim, with the re-published blogs split into sections addressing labor market policy, immigration, education, and poverty. As a collection, the essays cover a much broader range of topics and ideas that permeate our public discourse.

One of Caplan's strengths is highlighting the flaws of conventional wisdom using analogies. Take unpaid internships. The U.S. Department for Labor outlines rules about their permissibility, which include the requirement that "the employer that provides the training derives no immediate advantage from the activities of the intern." That is absurd when you think about it. Why would companies provide unpaid internships if they are to derive no benefit from doing so? What the rule really reflects is a common impulse that unpaid internships are exploitative and should be de facto banned. That is a clearly hypocritical position given what internships really are: vocational education. Caplan asks, "If schools can educate students in exchange for their tuition, why can't businesses educate students in exchange for their labor?" It's a question deserving of an answer.

Another example of his effective use of analogy occurs when he compares the labor market practice of at-will employment with the world of dating. Conventional wisdom says that because of "inequalities in bargaining power" between employers and employees and differences in each group's knowledge of risks, we shouldn't accept a job market that tells workers, "If you don't like it, quit." This supposed market failure is used to justify government regulation to protect people from alleged exploitation. But this line of thinking isn't extended to the world of dating, even though the theoretical bargaining and information problems are arguably much, much worse in the market for a mate. Massive inequalities of bargaining power exist between certain good-looking people with decent prospects and unattractive people with bad prospects. People also keep all sorts of secrets about their past and behavioral traits hidden from potential (or actual) partners. Yet, nobody — or at least very few people — advocate for extending government regulation of who we "go out" with. We accept the principle "If you don't like it, quit" as perfectly reasonable advice when it comes to dating.

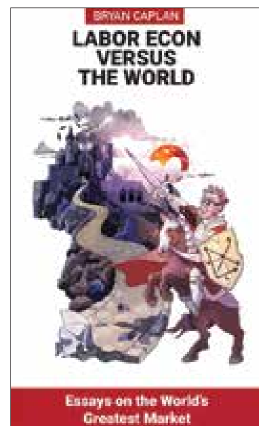
Keynesian inconsistencies / If Caplan deploys analogy with aplomb, he is equally as effective at spelling out the logical implications of conventional theories.

Keynesian models of the macroeconomy are predicated on nominal wage rigidity, the idea that because of workers' reluctance to accept reductions in money wages, contractionary shocks to demand produce unemployment. Yet, for some reason, Keynesian economists don't tend to be at the forefront of efforts to make labor markets more flexible to prevent this, nor do they explicitly spell out the implications of their theses about how best to get to full employment: wages must fall!

In pointing this out, Caplan has proven prescient. No prominent Keynesian demanded wage restraint in the early period of the COVID-19 pandemic when demand collapsed. Instead, they were all about pumping up aggregate demand via expansive macroeconomic policy, which in a supply-constrained economy brought the predicted consequence of high inflation. Now, real wages are falling. Yet, few claim this as a feature of their model; it is presented as an unforeseen bug.

Another example of failing to think through the implications of a model occurs in the labor market. Many commentators and even economists simultaneously think that minimum wage hikes do not kill jobs while also believing that low-skilled immigration has no effect on wage rates. A lot of robust studies of migrant flows do indeed suggest that the net effect of immigration on wages is weak for low-skilled workers. This implies the demand curve for their labor is fairly elastic. But if this is indeed the case, then theory suggests that minimum wages applied above market-clearing levels for this group will lead to highly significant unemployment effects. And yet, the conventional wisdom of many, particularly on the left, is to presume minimum wage hikes have no effect on employment levels, while also thinking that migration has little effect on low-skilled workers' wages. Caplan skewers the inconsistency.

Caplan applies the remorseless logic of economic analysis to a range of other interesting topics throughout the book. He explains how the costs of COVID-19 lockdowns indicate the destructive consequences of immigration restrictions. He highlights why finding evidence of "corporate greed" would predict less discrimination in a market economy, not more. And he's not afraid to take libertarian economists to task on why unemployment is something that should animate them more as a public policy issue, even if he agrees that the best solutions remain pro-market ones.



Labor Econ Versus the World: Essays on the World's Greatest Market
By Bryan Caplan
258 pp.; independently published, 2022

The book's range and piercing clarity on all this would make it a worthy addition to labor market syllabuses — not to mention a good read for anyone curious about how economics can inform public policy. The focus on popular economic errors makes it all the more fruitful as an educational tool.

Countering culture? / Does the book have any misfires? Caplan's Mason colleague Tyler Cowen has praised it but suggests that Caplan is too quick to write off the prevalence of phenomena such as discrimination in labor markets. True, markets might disincentivize acting on prejudice, Cowen suggests, but disparate outcomes can still reflect huge inequities caused by our broader cultural environment that shapes labor markets downstream. To hammer that point home, Cowen contends that Caplan downplays important cultural considerations that make immigration and education policy concerns messier than a stylized analysis of the market economics would suggest. In just focusing on the end market, in other words, Caplan neglects some forces that might dominate everything else and make us think differently about the role for government.

There is obviously truth to the observation that culture shapes decisions and, by extension, labor market outcomes. And yet, does it matter? Without getting into Caplan's mind, I'd imagine that he'd argue his book is not about culture and that, when it comes to public policy, we pretty much are resigned to taking cultural factors as given. The question then is which policies or regulations produce better outcomes conditional on any given culture. The answer surely is open markets, as Caplan's analysis implies.

The problem with "culture" as an explanation for why we might want policy to be more interventionist is that it's extremely difficult to show what the effects of cultural realities are, or to even work out what we'd expect labor market outcomes to be in some undefined culturally pure or neutral world.

Do market outcomes that fail to comply with our values automatically imply some societal flaw that requires government correction? That seems to be the logic behind the complaints we see about, say, the existence of a gender pay gap. Yet, in countries that have passed extensive regulations to equalize opportunities between men and women, gender-based disparities remain or are even heightened. How, then, would we know if we have corrected or accounted for cultural factors? The possibilities for mischief, once you allow for culture as a get-out-of-jail-free card for bad policies, are endless.

Caplan ponders a final important question related to all this. Why does the public have such a glowing view of government's role in labor markets in particular? He believes that the vaguely defined nature of what is being traded (work), the heterogeneity of the product (different workers), and the centrality of jobs to our identities mean that it's inevitable there will be more resentment over labor market outcomes than, say, in the market for consumer products. When grievance is felt at work, it's natural to look toward the government for salvation or imagine that life would be far

worse without the body of state regulation that already exists to "protect" us.

In making this point, he compares labor market economics with that of industrial organization. The self-evident consumer benefits that big business must provide us to attract our patronage, coupled with the rise of internet reviews, mean people are usually willing to scrutinize sellers' reputations when buying products rather than demanding government protection against being ripped off. "What modern consumer fears Amazon or Starbucks?" Caplan asks.

Well, the recent panic about "big tech" firms suggests that at least some do fear big business, although Caplan is no doubt right that the demand for security from consumers is far less strong than that of workers. But that the rot has seeped into debates about markets where the consumer welfare benefits of innovation are so evidently large perhaps suggests anti-market sentiment lies deeper in our psyche, even if it is more likely to be triggered in considerations of our labor. We should just be thankful to have Caplan's excellent book as a means of pushing back against our worst instincts. R

Could Fintech Crash the Economy?

REVIEW BY VERN MCKINLEY

So far in his presidency, Joe Biden has struggled to fill several leadership positions at the major banking authorities. The two most high-profile examples of this are the withdrawn nominations of Cornell law professor Saule Omarova for comptroller of the currency and attorney Sarah Bloom Raskin for vice chair for supervision on the Federal Reserve's Board of Governors. With a few glaring exceptions, these nomination battles were fought over the direction of banking policy that the two legal scholars would have pursued and what role the government should play on a host of emerging topics.

In *Driverless Finance*, American University law professor Hilary Allen weighs in regarding one of the major issues of disagreement: the use of technology to augment or replace traditional financial services. Allen has worked for several prominent law firms and also spent time on the staff of the Financial Crisis Inquiry Commission (FCIC), a body responsible for investigating the causes of the 2007–2009 financial crisis. This is her first book, and in it she tells the brief history of the rapid expansion of fintech and conveys her concerns about where its uncontrolled growth might lead.

The book's title gives readers the vision of fintech as a driverless car careening down the road, wiping out innocent financial bystanders who happen to cross its path. Although the fintech world is mostly focused on the micro level and financial innovation for individual consumers, Allen's argument is that we must be wary of fintech from a broader financial stability vantage point.

An ugly future? / *Driverless Finance* starts with a segment lifted from an imagined FCIC-style report produced in the year 2031. Allen imagines a financial crisis sparked by the fictional HAL Bank, a name inspired by the scary algorithmic-driven computer in *2001: A Space Odyssey*. In Allen's version, HAL is a too-big-to-fail bank that owns a subsidiary, BotWay, that develops an algorithm that assimilates data from the cryptoasset markets into a trading program. The scheme goes awry, leading to instability and a bailout for HAL Bank. The cause of the crisis according to Allen's imagined report:

> We conclude that the growth of the cryptoasset market was a key cause of the crisis.… We conclude that the government and the Federal Reserve were ill-prepared for the crisis and therefore struggled to contain the fallout.

An introductory background chapter provides Allen's preventative for such crises: financial stability regulation — a system of so-called "precautionary regulation" "ensuring that the institutions and markets that make up the financial system are robust enough that they will continue to be able to help people manage risks, invest, borrow, and make payments even if some kind of unexpected shock occurs." She laments the view of those who "see crises as organic parts of the business cycle that cannot be avoided and therefore must simply be endured." Her idea is to intervene before a crisis has a chance to unfold to "make financial crises less likely and less severe." Of course, efforts to achieve this have a long history, dating back at least as far as the Panic of 1907 and the 1913 Federal Reserve Act approved in its aftermath.

The 2000s crisis / Allen gives readers a better sense of her approach by presenting her narrative of the 2007–2009 financial crisis. Her description faults "mortgage lenders" and "mortgage-backed securities" for causing the crisis, with nary a mention of the role that government-sponsored systemic giants like Fannie Mae and Freddie Mac played in driving the growth of mortgage products. For the financial authorities and policymakers who contributed to this risk-laden environment, botched the supervision of the largest banks and financial companies, and were blindsided by the magnitude of the crisis, she gives praise, referring to the "Herculean and imaginative crisis response efforts from the Federal Reserve and other government bodies."

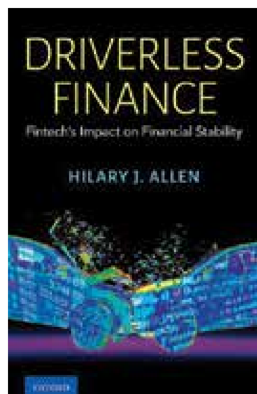
Allen further displays her preference for government-driven solutions to financial instability during a later discussion of banks and bank runs. She claims that bank runs and panics "were largely eliminated by the introduction of government-backed deposit insurance in 1933." "Largely" does a lot of work here, given the final report of the FCIC, the committee she worked for, which detailed runs in 2007–2008 at five large institutions covered by the Federal Deposit Insurance Corporation: Countrywide, IndyMac, Washington Mutual, Wachovia, and Citibank. (See "Run, Run, Run," Cato Policy Analysis no. 747, April 2014.)

Lurking financial stability dangers / In contrast to her comfort with the solutions provided by historical government interventions, Allen has a great deal of discomfort with the "potential for fintech innovation to undermine financial stability." She provides a case study of mobile payments service Venmo and its digital wallet feature. She notes that Venmo balances are not protected by the FDIC or its resolution procedures. Her conclusion: the company could be vulnerable to a run triggered by negative press. She worries that even though Venmo is microscopic compared to today's too-big-to-fail institutions, "as mobile payments services become more popular" and its customers get "more comfortable storing large amounts of money in their digital wallets," company instability could be transformed into systemic instability.

How would precautionary regulation of fintech unfold? The process would involve an initial licensing review process for fintech innovation. On this, Allen follows Omarova (whom Allen cites throughout the book), who proposes that innovations should go through a three-pronged licensing approval process: an economic purpose test, an institutional capacity test, and a systemic effects test. Omarova's approach would have regulators vet new fintech products before they can enter the market, rather than leave them to the market alone. All of this would be imposed even though fintechs in most cases are not part of the government financial safety net.

Allen is comfortable with government intervention but uncomfortable with the "potential for fintech innovation to undermine financial stability."

A second aspect of Allen's precautionary regulation would be policymakers determining when and how to intervene in financial markets before a crisis has a chance to unfold. She would place a lot of responsibility on the existing Office of Financial Research (OFR), a sleepy and little-known agency currently housed in the Treasury Department. The OFR would take on an expanded role as "a scientific and technological expertise hub." What she does not mention is that the OFR has accomplished little in its 10-year history, notwithstanding an annual funding level of $75 million. One accomplishment she does mention is its maintaining a Financial Stress Index, but that is not very different from an index maintained by the Federal Reserve Bank of St. Louis.



Driverless Finance: Fintech's Impact on Financial Stability

By Hilary J. Allen

296 pp.; Oxford University Press, 2022

Allen's idea is to build a "deep bench" of expertise at the OFR — presumably by hiring several academics or practitioners in fintech — as a prelude to market interventions to avoid a future crisis. But we've been following that strategy for over a century. Her proposal is a plan for throwing more good money after bad.

Her argument for intervention is based on the potential systemic risk that fintech products present. The analogy to a driverless car and the discussion of the potential for damaging bank runs is meant to scare policymakers into action. This is reminiscent of the "Chicken Little" arguments supporting the financial authorities' bailout mentality in 2008.

Concerning Allen's example of Venmo, I believe the company itself and the FDIC should make clear that its accounts are not federally insured. Then, if its customers still put their money at risk and lose, that risk-taking is their choice. The same applies to "stablecoin," cryptocurrency financial products that are often asset-backed.

Allen cites examples like Venmo and others as a rationalization for precautionary regulation. She questions the need for even considering the low likelihood and speculative nature of such scenarios, lamenting that it is "very difficult to quantify the benefits of financial stability regulation," and claiming that "we can't assign a value to avoiding that future crisis," and "if regulation can be even partially successful in preventing or mitigating them, then it is worth pursuing." As a result, her case studies are wildly speculative about what might happen without making any estimate of the probability that Venmo or a similar mobile payments service will cause a systemic disruption. The studies also do not cite any critical function they provide that would cause them to require a systemic designation. Countless times throughout the book, she relies on descriptions of what "can," "might," "could," or "has the potential" to happen.

Ultimately, the question is whether fintech's development should be driven by markets or regulatory authorities. Thus far, fintech has been a phenomenon of a decentralized marketplace. If readers think the market is better at sorting out these issues, they will have sharp differences with Allen's policy arguments because she wants to rein in fintech and thus change its nature. *R*

IN REVIEW

A Progressive Defense of Cost–Benefit Analysis

REVIEW BY JONATHAN H. ADLER

Is cost–benefit analysis (CBA) a tool of the political left or right? At one time, conservationists and taxpayer advocates used it to attack wasteful and environmentally destructive public works projects. A negative CBA is even credited with helping seal the argument against placing a dam in the Grand Canyon.

Then economists began training their cost–benefit sights on federal regulation. Throughout the 1980s, 1990s, and 2000s, CBA often served as a speed bump — if not a firm barrier — against expansive federal regulation, environmental regulation in particular. Not surprisingly, this made progressives suspicious of the tool. Among other things, they worried that it failed to account for hard-to-quantify, yet real, benefits of regulatory interventions for public health, ecological systems, and the less fortunate. Concluding a regulation would cost too much in relation to its expected benefits was a way to let corporations off the hook, they argued. Critics of regulatory proposals often reinforced those fears, citing CBA results as evidence that much regulation was excessive and even did more harm than good.

Not all progressives were willing to jettison CBA, however. In their 2008 book *Retaking Rationality,* University of Virginia law professor Michael Livermore and New York University law professor Richard Revesz maintained that "progressive opposition to cost–benefit analysis was ineffective and counterproductive." They sought to rehabilitate it as a tool of progressive government. They argued that there was nothing inherently anti-regulatory about CBA and challenged their progressive colleagues to mend, rather than end, the federal government's reliance upon it in regulatory policymaking. Shorn of unnecessary anti-regulatory biases and focused on the full range of potential benefits, they argued, CBA could be a powerful tool

Much of what they urged was taken up by the Barack Obama administration. Under the leadership of noted law professor Cass Sunstein, Obama's Office of Information and Regulatory Affairs pursued an aggressive regulatory agenda while retaining a central place for CBA. While there were differences in the way the tool was used by Obama and his immediate predecessors, Livermore and Revesz argued that the overall approach represented a consistent emphasis on rigorous analysis of the likely effects of regulatory decisions, leading to better regulatory outcomes.

The result, in their view, was an assault on "norms in the American system of government that have constrained and informed agency decision making."

Along came Trump / And then, they say, everything changed, prompting them to write this book, *Reviving Rationality.*

Donald Trump's administration broke with business-as-usual regulatory analysis. Under Trump, Livermore and Revesz argue, "what is called cost–benefit analysis in a Republican administration is all but unrecognizable." CBA was no longer a tool to ensure policymakers were aware of potential regulatory consequences, but a game in which analyses were to be twisted and spun to support predetermined policy conclusions.

The result, in their view, was not simply the adoption of incoherent and harmful policies, but an assault on longstanding "norms in the American system of governance that have constrained and informed agency decision making." That, in turn, demoralized the federal workforce. What is needed now, they argue, is an effort to "double-down" on the Obama administration's approach and go "even further to integrate cost–benefit analysis with a progressive regulatory agenda."

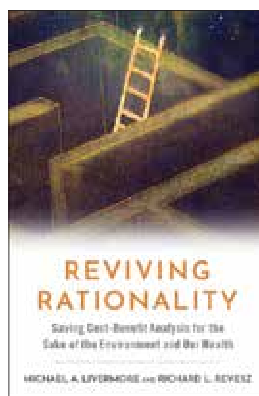
Much of *Reviving Rationality* is devoted to critiquing the Trump administration for its ill-grounded and poorly executed deregulatory initiatives. According to the authors, many Trump actions were undertaken with insufficient analytical grounding and without regard for relevant legal constraints and procedural requirements. As a consequence, the administration lost early and often when its actions were challenged in federal court. The Environmental Protection Agency, in particular, suffered numerous early defeats in court and ultimately accomplished little in the way of lasting change, deregulatory or otherwise.

The authors' detailed critiques of several specific Trump administration initiatives are forcefully presented and often compelling. Some of their broader claims about the role of regulatory review and CBA are less powerful and are less likely to persuade those who do not share their progressive outlook and regulatory sympathies. It is one thing to excoriate the Trump administration for its disregard of the legal and administrative norms governing regulatory agency activity. It is another to brush aside concerns for aggregate regulatory burdens or suggest that *ex ante* cost–benefit assessments should be the central focus of regulatory policy.

It is certainly true that we should want the benefits of any given regulatory proposal to exceed the costs. Government interventions should do more good than harm. An expectation that benefits exceed

costs is the least we should demand of governmental interventions that constrain or direct private decision-making, particularly when we recognize that even the best-intentioned interventions can do harm.

One benefit of a liberal market order is economic dynamism and discovery. Governmental interventions tend to foreclose avenues and constrain private choice, which is why many presidencies, perhaps starting with Jimmy Carter's, have operated on the assumption that private market ordering is to be preferred and that governmental intervention is only necessary when there is a market failure to correct. There is little evidence in *Reviving Rationality* that the authors share this intuition, potentially limiting their argument's appeal to those less enamored with regulation.



Reviving Rationality: Saving Cost–Benefit Analysis for the Sake of the Environment and Our Health

By Michael A. Livermore and Richard L. Revesz

304 pp.; Oxford University Press, 2020

CBA's limitations / One purpose of centralized regulatory review is to discipline agencies, check their inherent tendency toward tunnel vision, and ensure that regulatory interventions are consistent with prevailing law and administration policy. CBA can play an important role in this process, but it need not be the lodestar of regulatory analysis.

CBA's precision and sophistication have improved over the last 50 years, but it remains far from perfect. Many regulatory consequences are difficult to quantify. Further, as progressive critics like to note, agency CBAs often overestimate the costs of compliance. Yet, as retrospective review has shown, agency CBAs tend to overestimate the benefits as well. An oft-cited Office of Management and Budget report found "a greater tendency for costs to be overestimated than underestimated" in the rules it analyzed. Less often cited is the same report's finding that the benefits of regulatory interventions, including lives saved, tend to be overestimated as well, and that, overall, the ratio of benefits to costs is overstated more often than the reverse.

CBA is imprecise because such analyses are always conducted with imperfect information, particularly concerning how market actors are likely to respond to regulatory constraints over time. As the sage Yogi Berra supposedly remarked, "It's tough to make predictions, especially about the future." Market conditions, technological constraints, and consumer demands all change over time in ways that are difficult to foresee. If a problem has attracted the attention of a federal regulatory agency, there is a decent chance it has attracted the attention of firms, consumers, and activists as well, perhaps triggering non-regulatory or non-federal responses.

The Obama administration's Clean Power Plan (CPP) is perhaps a case in point. This ambitious effort utilized Section 111 of the Clean Air Act to justify regulating greenhouse gas emissions from the power sector. Issued in 2015, the CPP was to reduce power sector emissions 32% below 2005 levels by 2030, at an initial cost of $1–$2 billion per year. Such costs were justified, according to the EPA, because the plan would quickly generate net benefits that would only increase over time, both by reducing the risk of climate change as well as by curtailing other forms of air pollution generated by fossil fuels.

The CPP was never enforced, however. It was first blocked by the Supreme Court in 2016 and then put on ice once the Trump administration took over the regulatory reins. And yet, the power sector's greenhouse gas emissions dropped to 33% below 2005 levels by 2019. The plan's purported benefits were obtained without imposing any of its costs — which was not what the EPA had expected.

It should not be surprising that private action and state-level regulatory interventions are sometimes capable of achieving dramatic environmental or other gains at far lower cost than federal regulations. However well-intentioned, regulatory impositions often constrain dynamic market responses to emerging problems. The imposition of permitting or approval regimes, in particular, hamper the development and deployment of welfare-enhancing technologies and business practices. Incentives created by regulatory interventions sometimes work against their purposes. Insofar as such developments may have been unforeseen, they will not have been accounted for in prospective CBAs, no matter how rigorously they were conducted.

Criticisms of Trump / Livermore and Revesz are particularly critical of the Trump administration's focus on regulatory costs and steps taken by OIRA toward the creation of a regulatory budget, not unlike the fiscal budget the OMB produces. The "one-sided" emphasis on costs "makes a mockery of cost–benefit analysis" and risks having a "pernicious" effect on needed health and environmental protections, they write.

The authors are particularly exorcised about the administration's attempt to impose a regulatory cost cap on federal agencies and demand that agencies repeal two existing regulations for each new regulation adopted. Trump's "one-in, two-out" requirement was admittedly a gimmick and vulnerable to agency gamesmanship (perhaps fitting, given the president), but this critique is overstated. Concern for the aggregate federal regulatory burden was hardly unique to the Trump administration, and there is value in having agencies consider repealing old regulations before adopting new ones.

The focus on costs as a primary metric defies common sense, the authors claim, writing:

> In our daily lives, we might decide that it is not worth spending $50 to prevent a stubbed toe. But we are likely to feel

> quite differently if, instead, the result is the loss of a limb. To set a goal of saving $50, no matter the consequences, is obviously foolish.

This does not quite make their point. Few people would risk life or limb to save a mere $50, but this does not mean such costs are irrelevant. Most of us, in our daily lives, operate under budget constraints, so if it is necessary to spend $50 to save a limb, we may need to make up for that cost somewhere else. Cost constraints often require families and firms to consider tradeoffs and divert resources from one set of worthy purposes to another.

When operating under a budget, it is not enough that a given expenditure or investment will produce a positive return. There must also be funds available. Individuals, families, and firms never have sufficient resources to make every potential investment with an expected positive return. Choices must be made. CBA is useful — perhaps even essential — in the prioritization process, but so is an awareness of the ultimate cost constraint.

The federal government generally operates under fiscal constraints when it comes to taxing and spending, but not when it comes to regulating. This often creates pressure to accomplish through regulatory diktat what could better be achieved through fiscal means. Adopting a regulatory budget is a means to constrain regulatory appetites and account for the extent to which governmental decisions command and direct private resources. The authors persuasively show how the Trump administration lacked sufficient underlying analyses, but they overshoot in suggesting that concern for regulatory costs is misplaced.

Like many critics of the Trump administration's regulatory policies, the authors note the federal government's poor record in defending Trump-directed initiatives in court. Such critiques are more than fair, as is their claim that, at least in some instances, "the Trump administration's rejection of expertise and evidence has tarnished what might otherwise have been an attractive opportunity to pursue deregulatory actions." Going forward, it will be interesting to see whether such legal failures were an artifact of the Trump administration or are signs of larger problems within the administrative state, including Congress's failure to update and revise the statutes delegating rulemaking responsibilities to federal agencies. If the Biden administration likewise struggles in court, it may be a sign of deeper rot and not something that was particular to Trump. Early signs are mixed.

Conclusion / At its best, *Reviving Rationality* identifies the potential value of sensible CBA and identifies many of the foibles of CBAs gone wrong. Livermore and Revesz's detailed analyses of several Trump administration regulatory actions are insightful, even if one thinks they occasionally overstate their case.

At times, the authors seem to suggest CBA has more to offer than is actually realistic, and they too readily accept the argument that net economic benefits suggest there is a market failure that government must correct. They nonetheless offer hope that serious CBA can constrain at least some regulatory excess within progressive administrations. (Indeed, it is a shame, at this point, that neither author has been tapped to lead Biden's OIRA.)

While *Reviving Rationality* might not convince CBA's fiercest critics, it is an important entry in the relevant literature. It firmly establishes Livermore and Revesz as the leading progressive advocates of cost–benefit analysis. R

Was It Really Triage?

REVIEW BY VERN MCKINLEY

After the initial stages of the 2007–2009 financial crisis, it did not take long for the first books about the crisis to reach store shelves (virtual and brick-and-mortar). The first significant collapse and bailout was Bear Stearns in March 2008, and by March 2009 William Cohan's *House of Cards* was out, chronicling the whole ugly episode. The *Wall Street Journal*'s David Wessel followed in July 2009 with *In Fed We Trust*, which covered the major failures of what was by then recognized as a global financial crisis. (See "Will We See Another Bumper Crop of Financial Crisis Books?" Spring 2021.)

We are now starting to see a wave of books about the COVID-19 pandemic and the bounce-back from a very deep, but also very brief, recession in the spring of 2020. Nick Timiraos's *Trillion Dollar Triage* is one of these books, examining the Federal Reserve's pandemic response, and in particular the role that Chairman Jay Powell played in the response. Timiraos is the *Wall Street Journal*'s chief economics correspondent and not coincidentally his beat is the Federal Reserve and U.S. economic policy. *Trillion Dollar Triage* is his first book.

Powell: the early years / The first third of *Trillion Dollar Triage* provides important background information. Chairman Powell's early career path is described, with a focus on his stint at the Treasury Department under Secretary Nicholas Brady, including during the instability in the commercial and residential real estate markets in the early 1990s. There is also a concentrated history of the Federal Reserve, from the Panic of 1907 that brought the Fed into existence to the term of Chairman Ben Bernanke, who presided over the response to the housing bubble collapse. The book describes the horse-trading that led to Powell's nomi-

nation to the Fed's Board of Governors by President Barack Obama in 2011, as well as Powell's efforts to turn back the "Audit the Fed" movement during his full term on the board that began in 2014. Also included is a telling of President Donald Trump's interviewing of Fed chair candidates after he decided not to reappoint Janet Yellen in 2018. Among those on the short list were Stanford's John Taylor and former Fed governor Kevin Warsh, as well as Powell. After Powell's ascension to Fed chair, Trump asked his advisers if he could fire Powell just like he had become accustomed to doing on his TV show *The Apprentice.*

Echo chamber / As expected from a book on the pandemic, the early, turbulent months from late February to the end of April 2020 occupy most of Timiraos's remaining narrative. In tabular form, he tracks for the reader the number of COVID-19 cases and deaths over time, as well as the Dow Jones Average and the VIX Fear Index, which indicates the extent of market volatility.

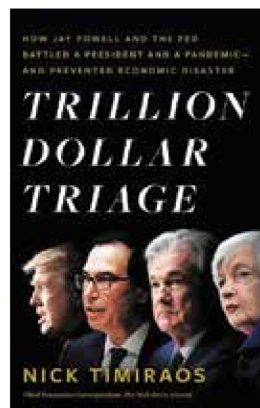
Timiraos does a good job explaining exactly how over-the-top Powell's monetary and lending interventions and his support of a fiscal spending spree actually were. Those first days made clear that the Fed would be reversing its long-promised normalizing of conditions after the 2007–2009 crisis, with interest "rates back to zero and the [Fed's] balance sheet growing again."

Powell was also building a team of crisis fighters. He chose Fed governor Lael Brainard to work on preparing lending backstops like those used in response to the financial crisis. Timiraos explains, "Powell knew Brainard also shared his activist monetary approach to the oncoming storm."

Timiraos does not consider it, but this strategy of pulling together like-minded thinkers may have led to groupthink and may have been part of the reason that the Board would later prove so wrong on its inflation assessments. There was rarely a dissenting voice at the table when it came to monetary policy and Fed lending. Timiraos describes one of the pandemic's more hectic weeks: "With the Treasury market melting down, Powell faced little opposition to these market-stabilizing measures." A later decision to accept short-term municipal debt as collateral for funding facilities took all of two hours to go from initial suggestion to approval to public announcement.

This strategy of pulling together like-minded thinkers may have led to groupthink and contributed to the board's wrong inflation assessments.

Brainard in some ways was even more aggressive than Powell or his predecessors in expanding the Fed's lending programs, as soon nearly every sector of the financial market was poised to benefit from a bailout: "Brainard was pushing the Fed and the Treasury to accept more risk." One by one, Powell and Brainard justified new support programs, sometimes by merely pointing to other previously supported sectors. "If the Fed was going to buy corporate bonds, it needed to do something for municipalities too," Brainard rationalized in her no-sector-left-behind strategy. Because she did not really know much about the municipal market, she reached out to Kent Hiteshew, who Timiraos describes as one of the crowd of "well-off New Yorkers with second homes outside the city." During the Obama years, Hiteshew managed the Treasury Department's response to Puerto Rico's fiscal and debt crisis, and Brainard peppered him with questions about what was happening in the municipal market. Soon she was asking him to work for the Fed for a few months.



Trillion Dollar Triage: How Jay Powell and the Fed Battled a President and a Pandemic and Prevented Economic Disaster

By Nick Timiraos

352 pp.; Little Brown, 2022

Many of the pandemic interventions went well beyond the scale of those used in response to the financial crisis. Concerning the purchase of municipal bonds, Timiraos writes, "It represented another foray across red lines that Ben Bernanke hadn't been willing to cross in 2008, when Fed officials considered but rejected the idea of purchasing muni securities."

The interventions did not stop there. The Fed agreed to purchase exchange-traded funds (ETFs), "one of their most controversial decisions," according to Timiraos. The ultimate controversy occurred when

> Powell began toying with an even more provocative question: whether to purchase the debt of companies that weren't rated investment grade — so called high yield or junk debt. Years of relying on easy credit and low rates … had encouraged companies to load up on debt.

Powell and Brainard recommended that the Fed extend its lending to companies rated triple-B and purchase ETFs that invest in junk debt: "Powell decided it was better to err on the side of doing too much than not doing enough.… Sometimes you have to save the undeserving few to protect the deserving many," explained one high-ranking official.

Powell and fiscal matters / Timiraos chronicles how Powell stepped out of his lane and engaged in advice on the fiscal front, telling House Speaker Nancy Pelosi and other lawmakers: "Think big, interest rates are low.… This is the big one. Whatever fiscal support you can provide, do it now, and do it in the form of grants and not loans." Congress led the way on this, with little push-back from the

Trump administration. Unlike most scenarios where the White House leads, "the Treasury had no plan [and] the White House had no plan." This unconstrained approach no doubt caused the ultimate price tag to be higher

This lack of constraint played out in the case of a Treasury backstop for loans to airlines, cargo carriers, and other firms affected by the virus. The negotiations began with a $50 billion spending cap, but it quickly expanded to $500 billion, only a fraction of which would go to the original targeted industries. When the deal was presented to Republican lawmakers, "there was no pushback." Powell expressed sympathy for the plight of these risk-takers: "Their business isn't closed because of anything they did wrong. This is what the great fiscal power of the United States is for — to protect these people as best we can from the hardships they're facing."

Were we really at risk of a Depression? / Throughout the book, Timiraos makes the case that "it was hard for economists and other policymakers to grasp just how suddenly and dramatically the economy was slamming to a halt." But clearly the 1918 Spanish flu pandemic provides some precedent, as that period saw a deep drop of the economy into recession by August 1918, and it emerged out of recession by March 1919. Despite its severe depth, through 2019 that was the second shortest recession on record, totaling all of seven months. Yet, Timiraos concludes about the COVID contraction, "Quick action stopped a financial panic and averted a potential depression in March 2020." This is a conclusory statement with no supporting evidence that a depression is the most likely outcome of a pandemic.

Powell fan / I have been tracking the promotion and release of *Trillion Dollar Triage* since the early months of 2021, when I noticed Timiraos took a break from Twitter and I suspected he was writing a book on the pandemic response. I was somewhat stunned when I read one of the publisher's initial promotional write-ups on the book in September 2021:

> How is it possible that a once-in-a-century pandemic that left millions of Americans jobless didn't destroy the American economy? The short answer: Jay Powell and the Fed. TRILLION-DOLLAR TRIAGE is the inside story of our least well known national hero…

This gushing description is no longer being used to market the book, although it lingers in the deep corners of the internet. The book's subtitle is in the same vein, although the praise is toned down a bit. It is not aging well, given the current economic situation and rising inflation. You might dismiss this as the work of an overzealous publisher, but usually authors review promotional materials and subtitles.

Besides, the book makes clear that Timiraos believes that Powell and the Fed struck a proper balance in their response during those critical months. Timiraos credits Powell for "his sound leadership during the pandemic" and for being the "the architect of a bold rethinking of monetary policy." He also praises Trump treasury secretary Steven Mnuchin for following Powell's lead in taking an aggressive stance to support market interventions: "Someone from the administration was finally providing a measured message to reassure markets — one that the combative Trump seemed incapable of delivering." Timiraos applauds Mnuchin for lobbying for a waiver of bank capital requirements to support a program to backstop money market mutual funds. Mnuchin got wind of resistance from another Trump appointee, comptroller of the currency Joseph Otting. Showing borderline hysteria in his zeal for the waiver, Mnuchin challenged Otting: "What do you mean you're not doing it, Joe? Yes, you are doing it. This is a matter of national security we're talking about, and you are doing it." Otting relented.

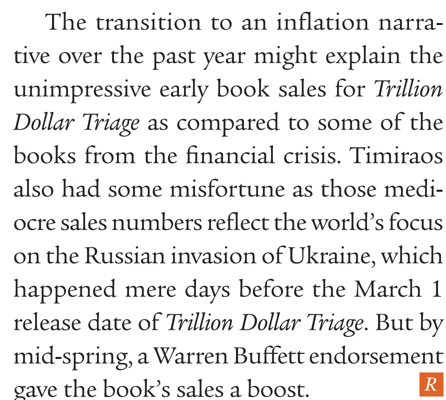
On fiscal issues, Timiraos compliments Powell and the Congress for their many interventions:

> He may not have been an economist, but Powell's background almost perfectly suited him to the moment.… [The American People needed answers and hope] in part from a major relief package that Congress had put together with lightning speed over the past seventy-two hours.

Timiraos shares with readers his lessons learned from the 2007–2009 crisis, which closely track Powell's aggressive 2020 philosophy: "Lesson one: Go big. Lesson two: Go fast." My personal preference is to read a historical summary from an author who takes a more critical approach.

Conflict with the evolving narrative / The Fed's pandemic response was so big and so fast that I believe it contributed greatly to inflation gaining a foothold in the U.S. economy after a 40-year slumber. When Timiraos was finishing the book in 2021, the prominent narrative was that the mix of Congress's fiscal response and the Fed's 2020 accommodative policy propped up the economy and the financial system, with a minimum of ill effects. But now it seems that Powell overdid the monetary stimulus, the lending programs, and support for fiscal stimulus. He was spectacularly wrong on labeling the inflation "transitory," a statement that economist Mohamed El-Erian has described as "probably the worst inflation call in the history of the Federal Reserve." The Fed failed in its pandemic response in one of its primary mandates under law: price stability. By encouraging fiscal profligacy, Powell no doubt made inflation worse.

The transition to an inflation narrative over the past year might explain the unimpressive early book sales for *Trillion Dollar Triage* as compared to some of the books from the financial crisis. Timiraos also had some misfortune as those mediocre sales numbers reflect the world's focus on the Russian invasion of Ukraine, which happened mere days before the March 1 release date of *Trillion Dollar Triage*. But by mid-spring, a Warren Buffett endorsement gave the book's sales a boost.



A Serious, Untimely Book

REVIEW BY RYAN BOURNE

In his 2001 Nobel lecture, economist Joseph Stiglitz outlined many ways in which markets might not be as efficient as suggested by textbook models that assume perfect information. After explaining why informational asymmetries might deliver more "market failures" than previously thought — that is, deviations from perfectly competitive outcomes — he concluded that this "implies there is a potentially important role for government."

Stiglitz made his point with scholarly care, but for a long time a stronger claim has been made by intellectual leap: that markets are widely imperfect, and their outcomes can be improved by the state. This feeds into the current policymaking zeitgeist, in which governments are assumed to be well-placed to make corrections. Almost all modern policy proposals, from childcare subsidies to fuel efficiency standards, are justified at some point by some theoretical market inefficiency, taking for granted that the government can eliminate or mitigate it.

When the 2018 Nobel in economics was awarded to Paul Romer and William Nordhaus, the committee noted the pair's "findings put the spotlight on a specific market failure. Both laureates thus point to fundamental externalities that — absent well-designed government intervention — will lead to sub-optimal outcomes." "Market failure necessitates government solution" is the mantra of interventionists in both major American political parties and, these days, much of the economics profession too.

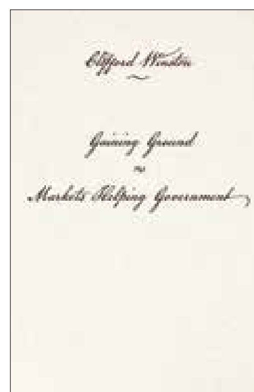
More markets, less government / In his new book *Gaining Ground*, veteran Brookings Institution microeconomist Cliff Winston offers a much-needed corrective, reminding us how much this interventionist framework represents a backslide in good economic thinking.

Citing hundreds and hundreds of studies on federal, state, and local governments' policy records across numerous functions, Winston shows that markets are often more robust at reducing inefficiency than governments' corrective efforts. His extensive survey of the academic literature on economic and social programs suggests an expansion of markets, not their curtailment, would better deliver on our widely shared political goals of improving material living standards, broadening opportunity, and protecting families from unforeseen hardships.

For example, while there is scant evidence of antitrust laws enhancing consumer welfare, he documents how free trade, consumer clubs, and technological advances have provided market-led means of delivering more choice, better information, and lower prices to customers.

In transportation, he shows that government entry regulations on the U.S. airline sector, including restrictions on foreign airlines obtaining cabotage rights, raise prices and reduce choice for passengers. In contrast, previous airline deregulations were a boon for consumers. There's good reason to suspect that allowing worldwide low-cost carriers to enter the U.S. aviation market would deliver large consumer gains as networks are restructured to reflect the new competition.

Even in areas as diverse as customer information regulation and the provision of public goods, Winston brings evidence to bear that markets do better and governments worse than commonly acknowledged. In genuinely thorny areas where intervention seems most justified, such as dealing with externalities like pollution and carbon emissions, government policies often bring their own inefficiencies, achieving any benefits at too high a cost relative to realistic alternatives.



Gaining Ground: Markets Helping Government

By Clifford Winston

306 pp.; Brookings Institution Press, 2021

Winston explores how programs such as the 2009 "Cash for Clunkers" car-buying subsidy, energy insulation programs, and land-use policies intended to reduce congestion are all extremely costly relative to their environmental benefits. He contrasts those interventions with market responses such as satellite navigation systems like Waze and their congestion-reducing guidance, the double-dividend of cheaper energy and lower carbon emissions from the shale revolution, and the potential for more market-led road pricing and carbon tax systems. By contrasting market responses and command-and-control regulations, he effectively asks, "What is there to fear from more markets and less government in our lives?"

Evidence and reason / Just 25 years or so ago, economists of even the center-left recognized that government failures — or at least unintended consequences — were ubiquitous. There are, as Winston documents, instances where policies don't improve welfare because there is little inefficiency to begin with (again, see the antitrust laws), instances where policies bring large economic welfare costs (such as price and entry regulations), and instances where policies simply have costs that exceed benefits relative to some reasonable alternative (such as externality "corrections" or anti-poverty programs). Yet, today we appear to be unlearning what we previously knew on all these fronts.

This isn't just true where economic efficiency goals are concerned. Whether it

is reducing poverty, delivering "fair" outcomes in labor markets, or the provision of goods with clear broader benefits to society (so-called merit goods), many government social programs either fail to achieve their objectives or else bring important and large unintended consequences. Though nobody pretends that all market outcomes are just, there usually are incentives to weed out discrimination or unfair dealing. New apps and websites that include consumers' product ratings and reviews, for example, can help overcome racial biases or barriers to entry that impede social progress.

None of this will be news to free-marketers who lament the growing scope of government. But Winston is not writing for us. There are no paeans to the inherent virtues of economic freedom or to the structural benefits of the price mechanism or profit motive in weeding out bad outcomes. Instead, the tome, which brings together much of the author's life work, is written as an appeal to evidence and reason. I suspect it is targeted at the increasingly interventionist center-left, perhaps even some of Winston's colleagues at the Brookings Institution. Here is a collection of findings documented to highlight the instrumental benefits of markets in achieving what the author believes are universal economic and social goals. Winston sees himself as the disinterested expert raining down truth bombs about the likely consequences of the interventions, juxtaposed against the many positive effects of markets.

Why government failure? / This framework, however, has its limitations. Winston simply presumes that we all share the same high-level goals of economic efficiency, financial security, and wealth-creation, but self-evidently we do not. Some people value dynamism over security, others want the government to reduce economic inequality even if it means less material prosperity, and still others elevate other values. Last year, for instance, *New York Times* columnist David Brooks suggested that we should all support President Biden's "Build Back Better" agenda, even though Brooks doubted many of the new programs would work, because the package would at least "redistribute dignity back downward." How do you trade-off efficiency for a hazy concept such as dignity? With great difficulty, it seems.

But that's the point: politics in part is a clash of philosophies in action. Winston writes with a degree of wonkish innocence in assuming that all, or even most, people share the same goals, allowing us simply to look to the evidence of costs and benefits of proposals to decide what to do.

Winston sees himself as the disinterested expert raining down truth bombs about the likely consequences of government intervention.

This instrumental, rather than principled, approach also produces gray areas regarding the scope of government. Milton Friedman was clear, for example, that businesses' role is to produce goods and services people want and need in pursuit of profits. Any broader social objective chosen by politicians should be undertaken explicitly and honestly by taxpayer-funded programs.

Winston instead muses about the potential for a quid-pro-quo of business tax cuts in return for businesses delivering social objectives such as a "living wage" or more training for workers — in other words, for governments to incentivize certain business behaviors regarded as desirable. It is not clear why incentivizing businesses to set wages that do not reflect the underlying supply and demand dynamics in the labor market would be good for economic health overall. Perhaps he is unwittingly indicating his own ideological preferences.

Winston's book is overall much stronger on documenting how government fails than why. He holds up convincing research showing that neither professional lobbying nor campaign contributions — bête noires of the populist left — go far in explaining the continuation of bad policies. But the role of interest groups is much broader than that. And while his evidence about the lack of competence in government, the ideological rigidness of politicians and officials, and the status quo bias of a permanent bureaucracy are well-taken, he downplays the more inherent problems of intervention, such as the subjectivity of value or the knowledge problems that policymakers face.

A timely, untimely book / All that said, the book is both a brave endeavor given the current climate and a strong, fact-based antidote to the coming revival of economic and social interventionism. American policymakers on both sides of the aisle have fallen out of love with market approaches to dealing with economic and social problems. COVID-19, despite highlighting the limitations of government fulfilling functions with the clearest justification for intervention, has merely accelerated this process. Winston has optimistically pitched this book as a guide to how an agenda to expand markets could improve economic and social outcomes. But right now, free-marketers must be on the defensive.

While reading the book, I was struck simultaneously by two sad emotions. First, it felt as if I was reading an old text from an age where government failures and policymaking generally were taken much more seriously. But second, it also felt as if I was reading a premonition of all the problems that will materialize in the coming years as the scope of government expands.

Don't get me wrong. I sincerely hope a "coalition of the sensible" will heed Winston's warnings and champion his causes. U.S. economic and social policy would be better for it. But his conclusion that it "would be useful to have a large commission … [to] write detailed and granular proposals … [of] where markets potentially could help government" seems completely at odds with the moment we are living through. R

From the Past

A Celebrated and Puzzling Book

REVIEW BY PIERRE LEMIEUX

Eighty years ago, publisher Harper & Brothers released the first edition of *Capitalism, Socialism and Democracy* by Harvard economist Joseph Alois Schumpeter (1883–1950). The book, whose last edition appeared in 1950, is as famous as its author, for whom *The Economist*'s business column is named. This last edition is used for this review.

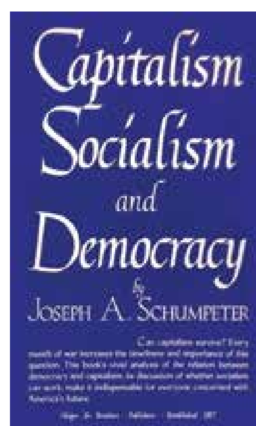
In the book, Schumpeter argued that capitalism will naturally evolve into socialism, that socialism can work, and that it is not logically incompatible with democracy. I will argue against all three of these claims.

What is capitalism? / Schumpeter is perhaps best remembered for his idea of "creative destruction." He believed that capitalism had generated the highest standard of living ever known because it continually creates new consumer goods and services, new methods of production and transportation, new markets, and new forms of industrial organization, while destroying obsolete ways of doing things. In other words, capitalism is a process of invention and innovation that constantly disrupts the economy and improves people's standard of living.

A related idea is that the capitalist businessman is always competing against other disruptors and threats of disruption, even if his industry is a monopoly or an oligopoly. Capitalist competition or threats of competition will "enforce behavior very similar to the perfectly competitive pattern" dear to economists. The relevance of this observation cannot be underestimated and extends to today's economy.

The only "plausible capitalism" that Schumpeter could imagine, however, was a system made of large corporations. He argued that monopoly or oligopoly is the rule, perfect competition is the exception. The latter would in fact be less efficient and it has "no title to being set up as a model of ideal efficiency." It is thus a mistake to think that government should regulate businesses to make them work as if they were small businesses in perfect competition.

Large businesses are the product of creative destruction, and they typically are both more efficient and more stable. Because of the strategic control they exercise on their prices and outputs, they are more adaptive and fare better in recessions. As for their market power, Schumpeter observes that cases of long-run monopoly are rare. Monopolies will not last long "unless buttressed by public authority" — another important observation. Given the organizational efficiency of big corporations with market power, he denies that their prices are necessarily higher and outputs smaller than they would be in some perfectly competitive industry. Thus, he correctly argues, there is no general case for trust busting.



Capitalism, Socialism and Democracy

By Joseph A. Schumpeter

431 pp.; Harper & Brothers, 1942

Although there is much truth in his characterization of capitalism, it focuses too narrowly on big business and underestimates the diversity of free markets and the constant competitive pressure and threat from small competitors. Of course, one may put the label "capitalism" on whatever one wants, but how useful is a definition that ignores the rest of free-market businesses, including those that are not yet big? The economic system that produced a standard of living unrivaled in the history of mankind encompasses not only big business but all free-market activities.

Creative destruction is as much a product of small entrepreneurial firms as of the large ones that Schumpeter emphasizes. Walmart did not exist in 1968 nor Apple in 1975 nor SpaceX in 2001. Big corporations were once small and disruptive, and it is because of their disruptive success that they became large. And after some time, such firms are often pushed back down the ladder. Only 10% of *Fortune*'s largest American corporations in 1955 were still on the list in 2021, according to an analysis by Mark J. Perry of the American Enterprise Institute. Large companies often go bankrupt or are acquired or broken up: think of Pan Am, Borders, Sears, Blockbuster, etc. Many divest themselves of chunks of their businesses in order to survive: General Electric is a recent case. Except for growing regulation and protectionism, which favor incumbents, the churning of the business world continues.

Obsolete entrepreneurs / Another indication that Schumpeter's concept of capitalism does not exactly correspond to the real world is his prediction of the obsolescence of entrepreneurs. We may think of them as the source of creative destruction, but he viewed future innovation as coming from "teams of trained specialists" that run the "giant industrial units" — a force of bureaucratization and automatization. Entrepreneurship and innovation would become routine. Economic growth would become more and more automatic. In brief, he thought that corporate bureaucrats would be the new entrepre-

neurs. Large firms would be so efficient that they would gradually eliminate the very function of the entrepreneur. Capitalism would "make itself superfluous."

Schumpeter's bureaucratic capitalism seems to leave little room for the messy free market and the individual liberty that goes with it. But experience, if not theory, shows that managers and entrepreneurs are two different animals, both important. We may thus suspect that the Schumpeterian concept of capitalism will prove too narrow for a meaningful comparison with socialism and democracy.

Efficiency of socialism / A commercial society, Schumpeter explained, is based on private property of the means of production or capital — that is, buildings, equipment, and other investments in future production — and on regulation by either private contract or by the private planning of large corporations. A socialist society, by contrast, is based on a central authority's ownership of, or control over, the means of production. This definition is close to the Marxist definition, the softer idea of "control" being an addendum by Schumpeter. It is also important to understand that, for him, socialism (at least in its centralist version) and communism are synonymous.

Schumpeter said he did not advocate socialism nor prophesy or predict it, but that he was simply trying "to diagnose observable tendencies and to state what results would be, if these tendencies should work themselves out according to their logic."

So how did he expect socialism to work? He made the "bold assumption" that the central socialist authority would give its agents enough latitude and initiative to run production efficiently: no micromanagement of businesses. Starting from this assumption, he demonstrated — or claimed to demonstrate — that Austrian economist Ludwig von Mises was wrong to judge efficient socialism as impossible. On the contrary, claimed Schumpeter, the "socialist blueprint" can be as logically coherent as the market system.

His blueprint works as follows: The government would redistribute "incomes" — that is, claims to consumption — and then let consumers express their demands on the market. "There exists no more democratic institution than a market," he writes. The "central [planning] board" would simply allocate "the means of production" to industries according to consumer demand. Maintaining optimality of the system in the face of economic change, Schumpeter recognized, would require either some inequality of incomes (paying workers more to produce goods heavily in demand) or the coercive assignment of workers to the jobs necessary to satisfy consumer demand; he preferred the former.

Socialism would surpass capitalism in productive efficiency, he claimed. Industries and state firms would be better coordinated. Uncertainty would diminish, which would facilitate forecasting. Less unemployment and waste would result. Specifically criticizing Friedrich Hayek (another Austrian economist and 1974 Nobel economics laureate) and Hayek's former London School of Economics colleague Lloyd Robbins, Schumpeter emphasized that economic planning is as efficient in the public sector as in "capitalist" firms. Assisted by "a huge bureaucracy," the planning board would do "a survey of the available resources and technologies" and compare them to demand using "a general knowledge about what kind of people the comrades are." Given consumer demand, he argued, the distribution of inputs among different industries automatically follows. Adjustments would be made by trial and error. He wrote:

> Paradoxical as it sounds, individualism and socialism are not necessarily opposites. One may argue that the socialist form of organization will guarantee "truly" individualistic realization of personality. This would in fact be quite in the Marxian line.

Schumpeter found many exceptions in how the socialist blueprint could work in practice. He recognized that the political authorities could deny consumer choices to avoid "outright beefsteak socialism" — that is, to avoid the proletarians wanting something other than what the state thinks they should consume. He also seemed to admit the necessity of a central authority to evaluate the "economic significance" of the factors of production (inputs), including labor, in the absence of a free market. So, coercing workers might, after all, be in the cards.

And note my italics in the following quotes from *Capitalism, Socialism and Democracy:* In case of unemployment, "the ministry of production will be in a position — *whatever it may actually do* — to redirect the men to other employments which, *if the planning lives up to its possibilities*, might in each case be waiting for them." "In the socialist order, improvements could *theoretically* be decreed and inefficiencies be promptly eliminated." But Schumpeter added:

> Of course, the likelihood of this particular advantage … being realized by a bureaucracy is another matter. … That possible superiorities might in practice turn into actual inferiorities must be kept in mind throughout.

Capitalism is doomed, regardless / However socialism compares with capitalism matters little, anyway, because the latter is doomed, claimed Schumpeter.

Can capitalism survive? "No," he answered.

> I don't think it can. … Its very success undermines the social institutions which protect it, and "inevitably" create conditions in which it will not be able to live and which strongly point to socialism as to the heir apparent.

This is a major Schumpeterian idea: capitalism destroys itself because of its very efficiency, which eliminates the function of the entrepreneur in favor of big-business bureaucracy. The system automatically moves toward bureaucratic socialism. I've already reviewed his reasoning on this, but other reasons also doom capitalism.

Those reasons relate to the self-destruction of the institutional framework of capitalism. Because of its efficiency, big-business capitalism cannibalizes "the lower strata of the capitalist indus-

try": the small producer and trader; the small and medium firms. Private property is blurred by big units. Freedom of contracting is replaced by "stereotyped, unindividual, impersonal, and bureaucratized contract"; the labor contract is an example. Truly "private" (the scare quotes are from Schumpeter) economic activity fades.

The intellectuals give a voice to, and nurse, any resentment against capitalism. Intellectuals are those people who wield the power of language, "have no direct responsibility for practical affairs," and may have the best chance of asserting themselves by being a nuisance. It was capitalism that let them loose. The "bourgeois class" protects them "because the freedom it disapproves cannot be crushed without also crushing the freedom it approves." Only a socialist or fascist society would be strong enough to control intellectuals. On top of all that, the expansion of higher education increases the number of unemployable and thus resentful intellectuals.

According to Schumpeter, state planning would also make the nature of economic phenomena clearer. With all due respect, if this is not satire, it looks naïve.

"Extra-rational values" fuel the anti-capitalist social atmosphere. Hostility to capitalism, Schumpeter wrote, has become "almost a requirement of the etiquette of discussion."

His whole argument on the demise of capitalism depends at least partly on what capitalism is and whether it is naturally becoming a socialist-like bureaucracy. It hopefully also depends on what people learn about economics and about socialism.

Problems with socialist planning / Let's come back to Schumpeter's argument on the economic efficiency of socialism, which is also problematic. Didn't the reservations he expressed overcome the putative advantages of socialism? Why didn't he see that? One hypothesis echoed by Harvard business historian Thomas K. McCraw in his introduction to the 2008 edition of the book is that Schumpeter's praise for socialism was irony. He had to camouflage his conservative opinions lest his socialist readers put it down. In this view, apparently shared by other scholars, we would have to read the satire between the lines. At times, this interpretation does make sense, as when he scorns the "socialist religion," "the Faith," "the creed," "the faithful." But he still defends their system. So, what did Schumpeter really believe?

He had a good opportunity to settle that issue in the chapter he devoted to "the human element." He might have emphasized his previous doubts that ordinary individuals may not behave like the socialist religion demands. But he did not. He continued to argue that the socialist alternative survives the comparison with capitalism, depending on what the historical circumstances are. In a society ready for socialism, he explained, most people's work would not change. The corporate bureaucrats would painlessly switch from the private to the public sector. If income inequality in their favor were not deemed acceptable under socialism, the high-level bureaucrats could be "compensated not only by honors but also by official residences staffed at the public expense, allowances for 'official' hospitality, the use of admiralty and other yachts," and such. OK, perhaps we can find some satire there!

The central authority, Schumpeter said, will be able to enforce worker discipline much better than capitalist firms can: "A strike would be mutiny." It is the principle of the required discipline that matters, he explained, not the particular form that it had taken in the Soviet Union. The "socialist order" will command "moral allegiance." State planning will also have the benefit of making the nature of economic phenomena clearer — for example, the primacy of imports over exports. With due respect for the great economist, if this is not satire, it looks naïve.

Other problems mar Schumpeter's discussion. Except for reminders that capitalism has created a higher standard of living than was ever possible before, his comparison focused on productive efficiency rather than on consumers' satisfaction, ignoring that the latter is essential to the economic concept of efficiency.

Some of his statements are either obscure or strain credulity. For example, he wrote that "planning of progress" would allow "the systemic coordination and orderly distribution in time of new ventures in all lines." Does this mean that, like New-Dealer Rexford Guy Tugwell believed in the 1930s, committees of bureaucrats should decide what new industry — say, automobiles or, to use more recent illustrations, maritime containers, iPhones, or online shopping — will be allowed? (See "Total Regulation for the Greater Whole," Fall 2014.)

What of Schumpeter's claim that the "freedom of consumers' choice" could be greater under socialism? This idea, dear to economists who advocated "market socialism," appears optimistic at the very least. For sure, with more equal incomes, the individuals on the right side of the redistribution could consume more than otherwise; but those on the wrong side would see their consumption decrease. Ignoring this problem, a major one remains: how to make sure that employees move to the jobs that produce the (continuously changing) configuration of goods and services that consumers want? We are back to the problem of labor allocation, with which Schumpeter seemed to struggle.

In his 1944 book *The Road to Serfdom*, Hayek convincingly argued that economic planning would require the coercive allocation of labor if remunerations were not set on free labor markets. But such markets defeat the politically determined redistribution under socialism. (See "Where Are We on the Road to Serfdom?" Fall 2021.)

More generally and fundamentally, *Capitalism, Socialism and Democracy* ignored the demonstration that Ludwig von Mises and Hayek had provided in the 1920s and 1930s to the effect that socialist "calculation" is impossible. The problem is how to calculate what to produce and how to produce it if there are no prices to

signal the conditions of demand and supply in both the product markets and the input markets. In his 1945 *American Economic Review* article "The Use of Knowledge in Society," Hayek pointed out that Schumpeter's book had not answered that question and he further explained why socialist efficiency is impossible.

In a nutshell, Hayek's argument is that market prices incorporate essential information about demand and supply conditions. Without such information, it is impossible for the planning authority to know not only what consumers want, given their preferences and what they are willing to pay, but also which factors of production are more or less scarce and how to use them efficiently. He criticizes Schumpeter for assuming (as we saw) that once the planners have hypothetically found how many units of, say, TV services consumers want and are willing to pay at each possible price, the required prices of the necessary inputs would be known automatically. This is not true, because every input can also be used for producing other goods and services. In other words, the supply of inputs (say, labor) matters in determining their prices (wages in the case of labor). Moreover, different types of inputs have different productivity in producing different goods. Without market prices, there is no way to determine the most efficient combination of factors to use — say, more labor or more machines.

Because neither capitalism nor socialism works as Schumpeter believed, his theory that mature capitalism will naturally evolve into socialism is unsound.

Even with today's computers, central planners cannot make these calculations. The necessary information is dispersed among the participants in the economy. It is not a matter of scientific information, but of information of time and place on the myriads of local conditions of production and of information on the consumption tradeoffs consumers are willing to make. This information does not, and cannot, reside in a single person's head — or in a bureaucratic committee. Notwithstanding Schumpeter, no survey and no planner's intuition can reveal this information, which changes continuously. Hence, socialist calculation is impossible and planning decisions cannot be rational and efficient.

Because neither capitalism nor socialism works as Schumpeter believed, his theory that mature capitalism will naturally evolve into socialism is unsound. This, of course, does not imply that the other cultural and institutional factors he invokes may not threaten capitalism or free markets in general.

True and false democracy / Democracy is the third pole of analysis in *Capitalism, Socialism and Democracy*. What is democracy and is socialism compatible with it? To answer those questions, Schumpeter developed a theory of democracy that was quite ahead of its time. Despite some loose ends, it may be the most interesting part of the book.

He argued against the classical Rousseauian conception of democracy. It cannot be the rule of the people. The people do not have a common will because there is no unanimous common good, only different individual conceptions of what good is. It follows that a political decision cannot represent what people really want in any meaningful sense; it may even be "distasteful to all of the people." The will of the majority is only (at best) the will of the majority, not the will of all the people. This analysis prefigured the economic theory of social choice that would be launched by Kenneth Arrow and popularized among political scientists by William Riker decades after *Capitalism, Socialism and Democracy*. (See "Populist Choices Are Meaningless," Spring 2021.)

Schumpeter remarked that there is more rationality in economic decisions than in public choices because the latter are detached from personal responsibility. He came close to the notion of voters' "rational ignorance" later developed by public choice theorists. He wrote:

> [The private citizen] is a member of an unworkable committee, the committee of the whole nation, and this is why he expends less disciplined effort on mastering a political problem than he expends on a game of bridge. …
>
> The typical citizen drops down to a lower level of mental performance as soon as he enters the political field. He argues and analyzes in a way which he would readily recognize as infantile within the sphere of his own interests.

It is consequently easy for "groups with an ax to grind" to manipulate the "will of the people." The mythical classical doctrine of democracy is still generally accepted because it is a sort of religious belief or because politicians benefit from the myth.

In Schumpeter's conception of democracy, the role of the voters is only "to produce a government." Democracy is simply a method for choosing the leaders through a competitive struggle for votes. This competition is analogous to economic competition: "Everyone is free to compete for political leadership … in the same sense in which everyone is free to start another textile mill." Schumpeter, McCraw tells us in his introduction, "was known for his good cheer, polished manner, and mischievous wit."

So far so good for democracy, except that *Capitalism, Socialism and Democracy* shows little or no classical-liberal conscience of the necessity of limiting government power. For Schumpeter, political parties are "the essence of politics" and "democracy is the rule of the politician."

It is a puzzling book. The Harvard professor went on to argue that this sort of democracy could be compatible with socialism under certain conditions. Society must be "mature" in the sense that the "socialization" — a soft word for "nationalization" — of the economy is already advanced and that a large bureaucracy can prevent inefficient interference from politicians. But maintaining

democracy may be "extremely delicate." "After all," he wrote, "effective management of the socialist economy means dictatorship not of but over the proletariat in the factory." The workers are "sovereign" only at election time.

Lest the workers use their electoral sovereignty to relax the necessary discipline of the factory, a socialist government "may" decide to reduce political competition. Interestingly, economist and political philosopher Anthony de Jasay would later independently develop a similar but more radical theory: after abolishing political competition, Leviathan, which would be the employer of all "citizens," would establish a sort of plantation state, he explained in his 1985 book *The State*. Although not as pessimistic (or realistic), Schumpeter observed that few socialist parties in the world made democracy their main goal.

Schumpeter's vision of democracy has only a tenuous relation to individual liberty. He saw "individual freedom" (previously identified with "individual self-government") as guaranteed by political competition because "in most cases though not in all" it implies "freedom of discussion *for all*." He added that "it is all there is to that relation." This narrow political freedom, the vanishing freedom of the entrepreneur, and the very uncertain freedom of the consumer seem to be all there is about individual liberty in *Capitalism, Socialism and Democracy*.

Conclusion / Schumpeter's hypothesis that socialism and democracy could, under favorable conditions, be compatible is difficult to defend. Individual liberty has fused into socialist politics, just as capitalism naturally dissolves into economic socialism. In the narrow Schumpeterian definition of capitalism, creative destruction self-destructs.

As we saw, it is often not clear what the book's conclusions are. Perhaps McCraw is right that we must read the satire between the lines, but he himself seems a bit confused about political ideologies. He states that "Hayek and Schumpeter considered themselves conservatives," seemingly unaware that Hayek, five decades before, had titled the postscript of his 1960 book *The Constitution of Liberty*, "Why I Am Not a Conservative."

Did Schumpeter's methodology lead him astray? Probably under the influence of Marx, whom he thought was an important economist, he was tempted by historicism, the idea that there exist immutable laws of historical development. For example, Schumpeter wrote that "things and souls shape themselves for socialism automatically, i.e., independently of anyone's volition and of any measures taken to that effect." And he often used concepts that are foreign to methodological individualism, such as "social class," "collective mind," the "social body," or "the soul of the nation."

What are we left with? For the discerning reader, the book does defend some important ideas: the efficiency of creative destruction, the errors of antitrust laws, the irrationality of anti-capitalist hostility, and the mistaken conception of democracy as the rule of the people. This book is not necessarily easy to read, but its many challenging ideas do provoke reflection on fundamental questions of political philosophy. Perhaps, after all, it is a long, devastating satire against socialism. *R*

Working Papers

BY PETER VAN DOREN AND THOMAS A. FIREY

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

Health Care

■ "What Do Health Insurance Deductibles Do to Health Care Spending Growth and Its Efficiency?" by Claudio Lucarelli, Molly Frean, Aliza Gordon, et al. SSRN Working Paper no. 3985356, December 2021.

The rationale for high deductible health care insurance accompanied by individual health savings accounts is the simple principle taught to all undergraduates in Economics 101: when consumers have their own money at stake, they are more careful with their spending. But health care seems to be different. Managed care and higher patient cost-sharing have all been shown to lower the level of spending as they are phased in, but after an initial implementation period, spending growth resumes its former rate.

Across the member countries of the Organisation for Economic Co-operation and Development, the rates of growth of health care expenditures since 1960 are remarkably similar despite large differences in industrial organization. From 1960 to 1998, the OECD median real per-capita health expenditure growth rate was 4.5% per year while the U.S. rate was 4.4%. From 2005 to 2019, the OECD real per-capita health expenditure growth rate averaged 2.2%; the U.S. rate was 2.1%, Switzerland 2.2%, Canada 2.1%, and the United Kingdom 2.1%. The conclusion I draw from the similarity in growth rates across developed countries, whose health care systems range from single-payer government systems, to largely private, and everything in between, is that policy differences matter less than all the political chatter about health care would suggest.

This paper asks whether high-deductible health care insurance plans with higher levels of cost-sharing generate a permanent reduction in the rate of growth of spending. The data come from claims from 2015 to 2018 from a large national insurance company and compare the spending of populations that have remained in high- or low-deductible health insurance plans for at least four years. Those enrolled in high-deductible plans do not experience a lower rate of spending growth for medical claims

but do experience a lower spending growth rate for prescription drugs. The reduction in spending was for less cost-effective drugs (cost per quality-adjusted life year [QALY] above $50,000); there was no reduction in the growth rate for highly cost-effective drugs (cost per QALY below $50,000). The findings were robust to controls for the non-random nature of those who enroll in high- and low-deductible health plans (so-called selection effects).

Minimum Wage Effects on Low Wages

■ **"How Important Are Minimum Wage Increases in Increasing the Wages of Minimum Wage Workers?" by Jeffrey Clemens and Michael R. Strain. NBER Working Paper no. 29824, March 2022.**

Minimum wage policy discussions suggest that the decision by states to increase the minimum is the important determinant of wage increase for low-wage workers. In this paper, the authors use Current Population Survey data from 2010 to 2019 in which the same respondents are asked about their wages 12 months apart. For those who were employed at both times, wage growth can be calculated.

Of those workers with wages within 50¢ of the minimum during the first interview, more than 70% of those employed 12 months later had a higher wage. For those who received an increase, their wages rose an average of $2.05 an hour. Thus, a large majority of low-wage workers cannot be described plausibly as "career minimum wage workers."

The paper compares the wages of those in states that increased the minimum wage to the wages of those in states that did not. The effect of state minimum wage increases is real but small. Around 71% of minimum wage workers in states that did not increase their minimum wage at any point in the 2013–2018 period got a raise in any given year, compared to around 79% of minimum wage workers in states that did increase their minimum wage. In other words, minimum wage increases account for about 8% of the wage increases realized by minimum wage workers across the full sample period.

Consumer Credit Cards

■ **"Credit Cards and the Reverse Robin Hood Fallacy: Do Credit Card Rewards Really Steal from the Poor and Give to the Rich?" by Todd Zywicki, Ben Sperry, and Julian Morris. SSRN Working Paper no. 3984298, December 2021.**

Many credit cards offer cash-back or other rewards for use. Some consumer advocates claim that, because merchants pay a higher interchange fee to process these cards, the rewards impose a hidden tax on consumers who pay cash because they pay the same prices as card-users. Cash-payers, in turn, are presumed to be lower-income than the card-users, which would make the reward schemes regressive. This paper assesses the evidence on whether this "reverse Robin Hood" theory is true.

Some stylized facts about cash and card transactions: First, consumer use of cash also imposes costs on merchants. The average retailer spends more than 9% of the value of its cash transactions counting, auditing, and depositing cash. Electronic transactions have lower transaction costs for merchants. Second, consumers who pay with cards spend two to four times more than those who use cash. The average transaction for those using rewards cards is 25% to 60% larger than those using non-rewards cards. And premium rewards-card transactions are 30% larger than regular rewards cards. So, merchants benefit from those who use rewards cards.

A necessary condition for the reverse Robin Hood hypothesis to be true is that consumers with different incomes buy the same goods at the same stores at the same prices and higher-income consumers pay with rewards cards while lower-income consumers pay with cash. If consumers with different incomes shop at different stores or buy different goods, merchants cannot pass on costs created by one type of consumer to other types. For example, if cardholders buy premium products, and cash users buy generic, and merchants charge higher margins for premium products, cardholders pay for their own rewards.

Even for those products bought by both cash and card customers within the same store, why don't merchants offer cash discounts? Federal law guarantees merchants the right to do so. Most merchants do not, apparently because the costs of handling cash are real and substantial.

A final requirement for the reverse Robin Hood hypothesis to be true is that, for items within a store that both cash and card customers purchase, the interchange fees charged to merchants for card use are passed through to *all* consumers through price increases. How much of the interchange fees are passed on to consumers through price increases?

Evidence from taxes on producers or changes in foreign exchange rates suggests that the pass-through rate for these charges is about 50% in the long run. More directly analogous evidence comes from the cap on debit card interchange fees mandated by the Durbin amendment to the 2010 Dodd–Frank financial reform legislation. (See Working Papers, Summer 2019.)

Did consumers benefit from the interchange fee reduction? The large banks affected by the debit-fee rule totally offset their $6.5 billion loss in debit card interchange fees by charging higher checking account fees. Monthly maintenance fees on checking accounts doubled, decreasing the share of consumers with free checking accounts from 60% to 20%. And an intensive study of gasoline stations found no reduction in prices for consumers. So, reductions in debit-interchange fees did not benefit consumers. Thus, the original incidence of such fees when they were first imposed may well have been largely on merchants.

But let's assume the best case for the reverse Robin Hood

hypothesis: cash and card consumers buy the same products in the same stores, and prices increase to reflect all card interchange fees; thus, cash customers pay a "tax." Are card customers higher-income and cash customers lower-income? Two-thirds of adults earning less than $40,000 per year have credit cards. Some 98% of credit cardholders own a rewards card, including 82% of cardholders earning less than $20,000 per year. So even if cash customers pay a "tax," the relationship between rewards card ownership and income is very weak. The distributional consequences are not obviously regressive.

The authors offer a more neutral summary of the evidence regarding the effects of rewards cards:

> Those with better credit scores, regardless of income, benefit from rewards programs, which are partially "paid for" by interchange fees charged to merchants. Those interchange fees, in turn, may or may not be passed on to consumers who use cash, depending on whether those consumers buy the same goods and services from the same merchants as those using credit cards. But even then, the pass-through is a proximate result of decisions by merchants not to offer cash discounts, often because the administrative cost of doing so is greater than any benefit they would reap through larger margins on cash transactions.

Environment

■ **"Why Are Marginal CO_2 Emissions Increasing for U.S. Electricity? Estimates and Implications for Climate Policy," by Stephen P. Holland, Matthew J. Kotchen, Erin T. Mansur, and Andrew J. Yates. Working paper, November 2020.**

From 2010 to 2019, coal-fired electricity generation declined 48% and natural gas generation increased 58%. Coal combustion results in more carbon emissions per unit of electricity generated, thus average annual emissions declined 3.5%. This has led many to believe that electrification is the solution to all climate problems — including replacing natural gas use. In July 2019, Berkeley, Calif. became the first city in the nation to ban natural gas hookups in new construction or substantially renovated structures. Since then, other localities have also banned natural gas, including Brookline, Mass., San Jose, Calif., Seattle, Sacramento, and New York City.

Even though average carbon emissions have declined, marginal emissions have increased during the day as electricity use rises from its nighttime lows. How is that possible?

Historically, because of its lower marginal cost, coal-fired generation has been used to meet base load. Natural gas generation historically has had higher marginal cost but low fixed cost, and so it has been used to follow marginal increases or decreases in consumption during the day.

But the composition of natural gas electric generators has changed over time, from natural gas turbines to more efficient natural gas combined cycle units in which the waste heat from the turbines is used to make steam and generate additional electricity. Combined cycle's low total cost has resulted in it displacing some baseload generation, meaning that now some coal-fired plants are available to follow demand during the day — and, in turn, produce higher carbon emissions when they are dispatched.

Since 2010, marginal carbon emissions increased 6% in the East and 15% in the West. The increase in marginal emissions for the United States overall was 7% over the last decade. This has occurred even though average emissions declined 28% over the same period, as combined cycle replaced baseload coal.

Public Attitudes Toward "Extreme" Vaccine Demand

■ **"Vaccine Hunters and Jostlers May Have Hurt the COVID-19 Vaccination Effort," by Johanna Mollerstrom and Linda Thunström. SSRN Working Paper no. 4012923, March 30, 2022.**

In the early months of 2021, as a limited supply of COVID vaccine became available and was earmarked for high-risk people, news stories began appearing about the lengths to which non-prioritized people would go to get a shot. Some stopped by pharmacies at the end of the day, hoping to get a dose of the perishable vaccine because it would otherwise be discarded; others falsely posed as priority recipients to get a jab. The stories became such a sensation that the police procedural *Law & Order: Organized Crime* featured a plotline about a mob-orchestrated theft and distribution of a truckload of the vaccine.

One might expect that stories of extreme demand would increase people's preference to receive the medication. To measure that, Johanna Mollerstrom of George Mason University and Linda Thunström of the University of Wyoming conducted a survey experiment of the effect of exposure to stories of "hunting" (attempting to get about-to-expire vaccine) and "jostling" (improperly receiving the vaccine). They conducted the experiment twice, first with a group of 1,503 participants (though only 1,117 of them were ultimately relevant to the hunting/jostling issue), and then a follow-up study of 800 more. The samples were representative of U.S. age, gender, and race/ethnicity demographics, though not education (survey participants were more likely to have a four-year college degree).

Surprisingly, Mollerstrom and Thunström found (95% confidence) that exposure to stories of extreme demand made survey participants *less likely* to want to receive a jab or recommend it to friends and family, either immediately or within two months. This result from the initial survey prompted the researchers to assemble the follow-up, which asked participants about their emotional responses to the stories of vaccine hunting and jostling. Respondents exposed to such stories indicated increased feelings

of sadness, anger, and disgust.

Mollerstrom and Thunström interpret the results as indicating that stories of extreme demand may "negatively affect[] the general public's enthusiasm for getting vaccinated and/or recommending others get the vaccine." This seems unnecessarily pessimistic. Among their other survey results, they found that respondents who were exposed to the hunter/jostler stories were as interested in receiving further information about the vaccine as respondents who did not read of hunters and jostlers. The overall sample indicated a higher willingness to be vaccinated than the broader public expressed in other surveys. This suggests that the extreme demand stories only made people more likely to "wait their turn" to receive the vaccine, not that their "enthusiasm" for vaccination was dampened.

Pandemics, Liberal Democracy, and Quality of Life

■ **"Can Governments Deal with Pandemics?" by Vincent Geloso and Ilia Murtazashvili. SSRN Working Paper no. 3671634, December 3, 2021.**

In the first year of the COVID-19 pandemic, the United States was criticized (often by Americans) for its high infection and mortality rates as compared to other developed countries. In the second year, after vaccines against the coronavirus became available, "red states" — those that went to Donald Trump in the 2020 presidential election — were chastised (often by Joe Biden supporters) for their lower vaccination rates and higher current infection and mortality rates than blue states. Critics charged the disease inflicted its heaviest tolls on places where people allegedly have outsized concern for (to borrow the mocking phrase of *The Bulwark* executive editor Jonathan V. Last) "muh freedom."

Now, two-and-a-half years into the pandemic, the correlation between politics and the disease's progress has attenuated somewhat. The United States still leads the Group of Seven developed countries in mortality rate from the disease, but its performance isn't much worse than fellow G7ers Italy, the United Kingdom, and France, and those numbers periodically shift as different variants of the virus strike different areas. The same goes for U.S. states: the disease had some of its highest mortality rates in the "red" states of Alabama, Louisiana, Mississippi, and Oklahoma, but it also hit hard in "purple" Arizona and "blue" Michigan, New Jersey, and New York.

Still, the "muh freedom" critics have a point. Though liberal democracies like Australia, New Zealand, and Japan are on the low end of the international COVID mortality rate spectrum (and, worth noting, are islands), they are joined there by illiberal China, Cuba, Belarus, Vietnam, and Pakistan. In a pandemic where testing, quarantining, vaccination, and disclosure of health status can slow the spread of the disease, more coercive governments seem to have advantages over more liberal governments in combating this negative externality.

In this working paper, Vincent Geloso of King's University College (Canada) and Ilia Murtazashvili of the University of Pittsburgh find empirical support for the coercive government–COVID policy correlation. Within the United States, they cite a 2021 *Southern Economic Journal* article by Joshua C. Hall and Bryan C. McCannon (both of West Virginia University) finding that states with heavier economic regulation were quicker to adopt stay-at-home orders to fight the pandemic. Internationally, Geloso and Murtazashvili use an ordinary least squares regression to find a negative correlation between the adoption of "stringent" pandemic policies and countries' Economic Freedom of the World scores (99% confidence) and Polity Index scores (90% confidence). So, more freedom, less pandemic-suppressing policies.

However, Geloso and Murtazashvili argue, there is more to the story. It's wrong to think about the benefits of coercive countries' COVID policies without appreciating the broader harm of coercive government: "A government that can use coercion for good can also use it for less enlightened reasons." More- and less-free countries adopt "institutional bundles" of policies that either nurture or suppress social and economic freedom. Such freedom may limit pandemic response, but it nurtures economic growth that provides more nutritious food, more fruitful research and development, better and safer infrastructure, and plenty of other goods that boost human health and happiness. In health care alone, communicable diseases cause only a small percentage of human deaths; plenty of other causes are suppressed by innovation nurtured by economic freedom. Write the authors, "Economically free democracies tend to enjoy faster economic growth, which in turn leads to better health outcomes with respect to noncommunicable diseases." (I suppose it should be noted that the United States' economic abundance also contributes to some of its leading causes of death.)

It's even possible that, in the long term, these bundles of freedom will result in a *better* outcome for the COVID pandemic. Citing a 2021 *Review of Austrian Economics* article by Mark Pennington (King's College, London), Geloso and Murtazashvili write that "the coronavirus pandemic is an example of what Hayek called a complete policy problem, with uncertainty arising from the epidemiology of the virus, its interaction with political, economic, and cultural arrangements that affect its spread, and the differing attitudes, time horizons, and belief systems that influence the spread of the disease." Those are all positively affected by market signals. Though the authors don't mention it, this is exemplified by the two breakthrough mRNA vaccines, one created by American biotech firm Moderna and the other brought to market in part by American pharmaceutical giant Pfizer. Contrast their timeliness, safety, and effectiveness with vaccines developed and administered in far more coercive China and Russia.

"It is clear," the authors write, "that the institutional frontier of economically free democracies is a bundle of institutions that have costs on certain margins.... Understanding these tradeoffs is the first key to analyzing any pandemic." R

HARNESSING THE POWER OF INCENTIVES TO

IMPROVE CONSERVATION OUTCOMES

The home of
Free Market Environmentalism

LEARN MORE @ **PERC.org**