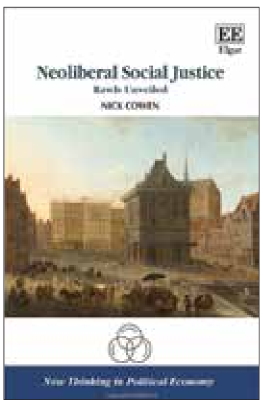
IN REVIEW

On Rawlsian Neoliberalism

REVIEW BY ART CARDEN

When I read political philosophy, I'm regularly struck by just how naive the analyses are. Frequently, political philosophers commit what UCLA economist Harold Demsetz called the Nirvana Fallacy: comparing the actually existing world with an ideal that only exists in our imaginations. They also regularly indulge what Notre Dame political economist James Otteson calls the Great Mind Fallacy: assuming a super-brain of some kind can plan and create a good society. Together, these are part of self-styled philosopher-kings' presumption that their moral and intellectual superiority entitles—indeed, *obligates*—them to boss other people around. What else are you to do when you are more equal than others?

University of Lincoln political scientist Nick Cowen's *Neoliberal Social Justice: Rawls Unveiled* takes these presumptions to task and explains how classical liberal institutions accomplish high liberal goals. Rawlsian equality, Cowen argues, is classically liberal—or at least more classically liberal than many Rawlsians think, and they should take economic liberty much more seriously than they do.



Neoliberal Social Justice: Rawls Unveiled
By Nick Cowen
256 pp.; Edward Elgar, 2021

Intentions and outcomes / Cowen grounds his argument in Robust Political Economy. It approaches institutions very much like public choice does, on the assumption that people don't suddenly change their motivations and abilities too substantially when moving from the commercial to the political sphere. Importantly, he criticizes the conviction that bad outcomes result solely from bad intentions and the related conviction that "the social problem" is more dispositional than it is institutional. As he explains, "Coordination problems emerge from even the most unselfish cooperative agents." He offers the example of someone serving nuts to someone with an allergy. I'm reminded of people at the pond in my local park throwing white bread to ducks and geese despite the large sign that reads, "Thank you for not feeding us bread," and explains how bad it is for them. While we can know and monitor one another pretty efficiently in very small groups like families or groups of friends going on a camping trip together, the problem, Cowen argues, is epistemic: "Coordination problems are bound to emerge as communities of unselfish cooperators get larger."

What does this mean for our obligations to one another? As befits a scholar who spent some time with Mario Rizzo at New York University, Cowen develops this point by considering the well-known problems we have understanding and acting in accordance with our own interests:

> If people can easily miscalculate their own interests, then it is a mistake to suggest that people's failure to anticipate what their obligations entail is fundamentally a motivational problem. At its extreme, such logic would have parallels with an attitude amongst Soviet managers that associated all errors in production with counter-revolutionary sabotage.

Or, as the late Austrian School economist Don Lavoie put it in his 1985 book *Rivalry and Central Planning*, "The problem is not that people will be insufficiently motivated to do the right things but, more fundamentally, they will not know what the right things to do are, even if they passionately wanted to do them."

Useful institutions / Cowen argues that this is true in political action as well as economic planning. Context and institutions, which generate local knowledge, are indispensable. A productive asset's capital value—and whether it will be "productive" at all—depends on the institutions, which affect people's incentives to do productive things. For instance, I don't want to write this review right now; I want to go play Xbox. The institutions, fortunately (?), are set up so that I have pretty powerful incentives to write the review. Markets, as imperfectly and incompletely as we let them function in the United States, are loci of the bids and offers that help me understand what my time is worth and, perhaps just as importantly, what I would need to give up if I wanted to get a new Xbox.

As Cowen points out, the fact that capital goods like tools and factories don't have institution-independent "value" gets lost in arguments for government ownership (or redistribution) of the means of production. As he puts it, "Even the kingdom of heaven needs institutions." In his analysis of economic democracy, he

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points out that "by requiring firms to steward capital assets, but never reduce their value, economic democracy is asking the impossible since the value of capital assets changes as part of the process of trial and error." I would argue that capital assets only have intelligible value when they are bought and sold in free markets. Without free markets and voluntary exchange, the social knowledge people need in order to make coherent, meaningful plans does not exist as data.

Dollars and votes / *Neoliberal Social Justice* is a valuable contribution that should get readers thinking harder about several issues. First, it's striking how much time and energy political philosophers spend on material equality and worrying that political outcomes will reflect the rich's preferences. It's not clear that's a bad thing; if, as George Mason University economist Bryan Caplan and others have suggested, income and education help people think like economists, then this should lead to better public policy, holding everything else constant.

Second, it's also striking how little time and energy political philosophers spend thinking about markets as moral, and even democratic, spaces. Cowen evaluates "cases for requiring democratic control of capital assets in the place of private firms and investors." I don't think the scholars he criticizes give enough weight to the implications of consumers' sovereignty. The private firms and investors don't have nearly as much power as their critics imagine. In a free market, the consumers call the tune. No amount of "corporate power" could make New Coke or the Ford Edsel profitable, and now they serve as cautionary tales in entrepreneurial and managerial blundering.

In any case, markets are radically "democratic" insofar as every dollar is a vote. Amazon founder Jeff Bezos may have more dollars than any single person in the middle or lower class, but the middle and lower classes have far more dollars than Bezos and his friends at the top of the *Forbes* 400. Those middle- and lower-class members vote with those dollars, making Walmart, action movies, and Big Macs ubiquitous. Given that the critics don't see economic liberties as "basic," they would likely have no problem with suppressing the votes that *hoi polloi* cast in the marketplace. Citing Brown University political theorist John Tomasi, Cowen writes, "A great many liberties that are basic according to 'high liberals' seem to presume a set of life plans." "Basic liberty" to choose only what I know is good for you is not really liberty, is it?

Neoliberal Social Justice brings important considerations like the knowledge problem and entrepreneurial discovery into debates about how the just society "should" be organized. The result is an analysis and set of public policy recommendations that are much more classically liberal than the ones that have emerged from the Rawlsian tradition. Economic liberties, Cowen argues, are a lot more "basic" than many political philosophers seem to think, and utopia—to paraphrase Georgetown University political philosopher Jason Brennan's *Why Not Capitalism?*—is classically liberal. *R*

Facing the Cryptoasset Revolution

REVIEW BY GREG KAZA

The intensifying push for cryptocurrency regulation is giving renewed relevance to books on the subject that have been published in recent years. One of those books is 2019's *Cryptoassets*, a collection of scholarly essays edited by Georgetown University law professor Chris Brummer.

Are cryptoassets alternatives to traditional safe-haven assets like gold and silver? Or are they, in the words of Warren Buffett, "probably rat poison squared"? Do they facilitate exchange between free individuals? Or are they stalking horses for central bank digital currencies (CBDCs)? These debates are now intensifying. Brummer's collection of 28 essays could serve as a standard reference for these topics.

Challenging longstanding models / A basic description of cryptoassets is that they rely on cryptography and technologies such as blockchain (a ledger shared on a digital network) to provide both security and proof of ownership. These assets range from cryptocurrencies like Bitcoin and Ethereum to initial coin offerings (ICOs) and CBDCs. One example of cryptoassets' emergence: In 2016, Delaware law was amended to allow blockchain technology for stock ledger administration. Overstock.com later became the first public company to issue stock via blockchain. In a 2016 Securities and Exchange Commission filing, the firm explained its issuance of preferred stock consisted "of 126,565 shares of Series A Preferred.... Series A Preferred are digital securities."

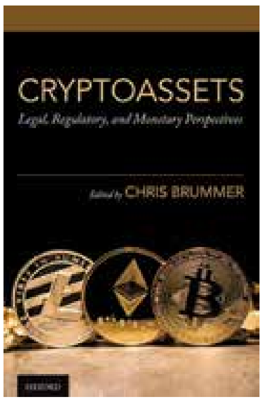
Cryptoassets can serve as mediums of exchange, devices for accessing an online service, investments, or all three at once, according to Brummer, who is a member of the Commodity Futures Trading Commission's Subcommittee on Virtual Currencies. The assets' reliance on blockchain reduces the need for intermediaries, but that worries regulators because of alleged volatility, financial instability, and potential for money laundering. In sum, Brummer notes that cryptoassets "challenge longstanding economic models and regulatory strategies."

The book covers a wide range of topics: cryptoassets' potential effect on commercial banks, legal issues such as whether they are securities or commodities, methods of valuation and potential roles as mediums of exchange, taxation, and how to integrate blockchain into derivatives markets to achieve market transparency under the Securities Act of 1933.

Book contributor Benjamin Geva of the international law firm Torys traces payment intermediation's evolution from ancient Mesopotamia to the current era. In the cyber-age, new forms have emerged: electronic payments, e-money, and access to central bank balances. "Ultimately," Geva observes, "efficiency is bound either to turn payment institutions into banks or for banks to take over payment institutions, either directly or as subsidiaries, so as to eliminate this unnecessary layer of intermediation." The broader regulatory question is whether new forms of intermediation will supersede commercial banks.

In *SEC v. W.J. Howey, Co.* (1946), the U.S. Supreme Court found a financial instrument qualifies as an "investment contract" when an individual invests money "in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party." In 2018, SEC official William Hinman stated that Bitcoin and Ethereum are not "securities transactions" because of their "sufficiently decentralized" structure. Yet, SEC chair Gary Gensler said in 2021 the agency considers many cryptocurrencies to be securities under *Howey*. The pending case *SEC v. Ripple Labs, Inc. et al.* may resolve this issue.

St. Mary's University law professor Angela Walch, in her contribution to the book, notes legal implications are inescapable in technology discussions, yet decentralization's "uncertain meaning makes it ill-suited for a legal standard." The term "decentralization" has ideological undertones rooted in "the cypherpunk, crypto-anarchist roots of Bitcoin." Scholars grapple with "appropriate legal treatment" for "people acting together" in a blockchain. Regulators face a complex and undefined environment. One example: "hashing" is cryptography that converts data into a unique text string. How can regulators address concentration in the hashing market?



Cryptoassets: Legal, Regulatory, and Monetary Perspectives

Edited by Chris Brummer

456 pp.; Oxford University Press, 2019

21st century currency / Should cryptoassets be separated into different asset classes? Finance writer Nic Carter argues that "the jury is out" on whether the value of these assets derives from network usage demand, speculation, or even their "commodity-like cost of production." Can a virtual, non-sovereign currency achieve stable valuation without managed exchange rates or a state to support it? Can value accretion be forecast or does it simply emerge, and if so, what discount rates are appropriate? Academics are still wrestling with these issues and tend to lag technological developments. But they have "begun to reckon with cryptoassets and virtual currencies as assets in their own right rather than … passing manias," writes Carter.

Fiat currencies "are not well suited to 21st century commerce … (because of) high handling and exchange costs," argues MIT mathematician and finance scholar Alexander Lipton. Regulators may soon "allow competition between various business banking models[:] … hotly contested races between fractional reserve banks and narrow banks, digital cash and physical cash, fiat currencies and asset-backed cryptocurrencies, and, most important, centralized payment systems and distributed payment systems." Lipton concludes "only regulatory compliant fiat-backed tokens" are likely viable in the long run.

An ICO involves issuance of a cryptoasset token. The issuer does not necessarily receive money for the coin, as with stocks and bonds. Instead, Bitcoin or Ethereum could be exchanged on a ledger. There are differences between ICOs and other financing sources such as IPOs, crowdfunding, and venture capital. A regulatory sandbox framework would allow regulators to work with issuers to develop applicable law as technology evolves in this lightly regulated market. Singapore Management University professors Aurelio Gurrea-Martinez and Nydia Remolina Leon note in their chapter that China and South Korea ban ICOs while the United States, Singapore, and Switzerland allow them with the caveat that issuers must comply with securities laws if the token is classified as a security. In Mexico, regulators authorize ICOs after a review.

Regulatory discovery / A contractual model is one possible way to exclude tokens from the scope of regulators while protecting tokenholders who wish to participate in an ICO. Publicly disclosed white papers would explain the tokens to buyers and make their issuance subject exclusively to the law of contracts. The model could reduce regulatory costs associated with the tokens' issuance. By contrast, a ban model would empower regulators to decide whether "to prohibit the participation of retail investors due to higher asymmetries of information." One possible outcome of such a regulatory regime is that commercial banks and pension funds would not be allowed to purchase tokens because any potential failure could have consequences for the financial system and taxpayers.

"Ventures succeed and fail in a capitalist system," write Brummer, Digital Investment Group lawyer Trevor Kiviat, and Davis Polk attorney Jai Massari. "It is not the job of regulators to play favorites, or to ensure that any one investment succeeds. What is problematic is the lack of quality information available (to investors)." U.S. regulators are trying to bring ICOs within the regulatory perimeter of the Securities Act of 1933 by requiring "promoters to undertake the same extensive disclosures that other issuers do when offering securities to the public." They argue ICO tokens fit the definition of an "investment contract" under *Howey*: the coins are transactions where an individual "invests his money in a common enterprise and is led to expect profits (primarily) from the efforts of the promoter or a third party." *Howey*, they contend, stands "for the proposition that when such asymmetric information and power imbalances arise, U.S. securities law will step in to fill the void, and allow investors to better price and evaluate investment opportunities."

The general securities disclosure document, Form S-1, dates to the New Deal. Yet the S-1 is built on "assumptions about securities issuances that are not always applicable to emerging ICO tokens," they write. Merely recognizing ICO tokens as "securities" will not necessarily improve the disclosures made to investors. Instead, they conclude, "such decisions comprise, at best, the initiation of a long-term process of regulatory upgrades that will be needed to fine-tune protections for the retail public and preserve the efficiency of capital formation in global financial markets."

This idea of a *long-term* process of regulatory discovery is evident throughout the book. Government regulators face technology and new markets that they do not always understand.

Fundamental regulatory changes will be needed to integrate blockchain into derivatives markets to achieve transparency. Noting the absence of CFTC expertise, Deloitte managing director Petal Walker writes that the current regulatory infrastructure will have to change in order to not inhibit "the great promise that blockchain has for market efficiency and transparency." Blockchain transparency allows for real-time analyses. A blockchain-based derivatives market would include interoperable ledgers, smart contracts, and automation visible to all participants, including the CFTC, in near-real time. Such a "golden record" could reduce risk. One obstacle: a language gap between coders and legal professionals.

How should tax authorities treat cryptoassets? The United States, Ireland, and Singapore are among nations "generally supportive of—or at least neutral toward—the crypto industry," argues Walker. Most jurisdictions treat cryptoassets as property versus money for income and capital gains purposes, even when they are used as means of exchange. To date, the Internal Revenue Service has released limited guidance.

U.S. regulators may look elsewhere for answers. In Venezuela, individuals use cryptocurrency to preserve their assets in a hyperinflation. The Maduro government created the petro, a CBDC backed by commodity reserves including oil. In China, citizens were once allowed to trade in Bitcoin while warned of the risks, though that ended in 2021 when the government banned non-state-approved cryptocurrencies. Today, China classifies them as "virtual commodities," not currencies.

Cryptoassets are nascent in terms of regulation. In mid-2022 the combined market cap of the world's 20 top cryptocurrencies exceeded $800 billion. This fact alone suggests they will continue to attract regulatory attention. Brummer's book makes it clear that U.S. regulators have more questions than answers. *R*

Permanent Stagflation?

REVIEW BY ROBERT D. ATKINSON

Every few years, elites anoint an economics book as a "must read." In 2013 it was Thomas Piketty's *Capital*. Four years later it was Robert Gordon's *The Rise and Fall of American Productivity*. Now it's Berkeley economics professor Brad DeLong's *Slouching towards Utopia*. In *The Atlantic*, Annie Lowry gushes that the book is "sweeping and detailed, learned and accessible, familiar and strange." (It certainly is sweeping and strange.) *Vox* calls it a "magnus opus."

Piketty, Gordon, and DeLong all argue that economic growth is no longer an engine of widespread prosperity. This is a big reason for their books' acclaim: rejecting growth and markets is now de rigueur among much of the Western intelligentsia.

Slouching is a fundamentally subversive book because it seeks to undercut the core Western values of economic growth and advancement. If enough believe that the West had a good 140-year run but now "it is over," as Lowry apparently does, then the path to rejecting entrepreneurs, firms, and markets is clear. We can transform the economy into a system focused on reducing greenhouse gas emissions, redistributing income, and engendering small-scale localism. We may not, however, have much to redistribute or localize.

A slouch at best? / DeLong dismisses growth and rejects markets for two reasons. First, he believes that market economies are illegitimate. He writes, "Capital is dead labor, which vampire-like lives only by sucking living labor, and lives the more, the more labor it sucks." Oops, my mistake; that was Marx. But DeLong seems to channel Marx when he asserts:

> Unmanaged, a market economy will strive to its utmost to satisfy the desires of those who hold the valuable property rights. But valuable property owners seek a high standard of living for themselves… Moreover, … the market economy sees the profits from establishing plantations.

Plantations?

He goes on to claim that "the only conception of 'justice' that the market economy could deliver was what the rich might think was just, for property owners were the only people it cared about." Beside anthropomorphizing the market, this is a strange notion because unless capitalists care about providing value to customers, they will soon go bankrupt. For DeLong, the "creative destruction" that Joseph Schumpeter said powers growth *is not* creative but *is* destructive: "Great wealth is cre-

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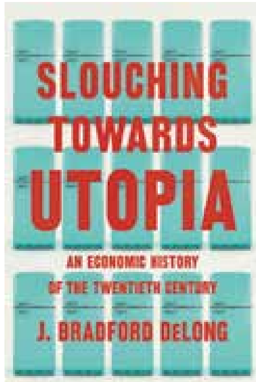
ated by the creation. Poverty is imposed by the destruction." How does he square that contention with data showing the increasingly capitalistic world's poverty is declining? The reader can't tell because, annoyingly, the book is not footnoted.



Slouching Towards Utopia: An Economic History of the Twentieth Century

By J. Bradford DeLong

624 pp.; Basic Books, 2022

To be fair, DeLong is right to criticize those who either ignore public goods and economic fairness, or who claim—with little or no evidence—that any and all "interventions" in the market harm growth. But he goes much further in fundamentally rejecting market economics and growth. Reading *Slouching* makes one wonder how he lasted two years as an economic official in the centrist Clinton administration. The answer, of course, is that over the last two decades many once-center-left economists have lurched far leftward as they have abandoned growth in favor of redistribution and become anti-business.

DeLong rejects growth because he has concluded it has failed to provide the promised utopia. He writes:

> Suppose we could go back in time to 1980 and tell people how rich, relative to them, humanity would become by 2010.... They would surely think the world of 2010 would be a paradise, a utopia.... What went wrong?

For him, a nearly ninefold increase in world per-capita income is not really progress, but "a slouch. At best." Moreover, the "market economy solved the problems it set itself, but then society did not want those solutions—it wanted solutions to other problems, problems the market economy did not set for itself."

Perhaps, but the market did solve arguably the most pressing problem of human existence: how to improve living standards. Describe for typical middle-class Americans what life was like for their great-grandparents' generation in the 1880s, then ask if they are more satisfied with what they have today, and most would laugh at the mere thought of going backward.

DeLong seems not to appreciate that humanity's material wants are pretty vast, and it takes *a lot* to satisfy them. Even an economy that has grown 8.8 times larger in the last 130 years is still not big enough. We might reach economic utopia when everyone has a hot tub, a personal trainer, a really nice car, takes nice vacations, and has kids in private school. But we need a lot more than 8.8 times economic growth to get that. How about 50 times more output? So rather than reject market-based growth because most Americans still would love to consume much more, DeLong should be asking how to reignite economic growth rates that have become anemic.

We get to the crux when DeLong writes that the "market economy was more problem than solution" and "material wealth is of limited use in building utopia." Once you have discredited growth as a goal and the market as a means of achieving it, abandoning markets and rejecting entrepreneurs and corporations is easy.

Permanent stagnation? / What does all this have to do with a 624-page economic history? It's hard to say because *Slouching* mashes together a long book and a short essay. The short essay is about why capitalism and growth are bad and why growth is over. The long and largely unrelated book is an attempt to present an economic history of the 20th century. But while DeLong's long and wide-ranging history—sweeping in everything from late 1800s industrial development to the world wars, the rise of the Soviet Union, the period of post-war growth, and more—is interesting, it is disconnected from any real thesis. What does a long narrative of the Korean War have to do with economic growth and its demise? The reader is left to wonder. It's just 605 pages of economic history that is sometimes interesting, often repetitive, and frankly not very convincing in its explanation of why growth accelerated.

DeLong does argue that growth picked up around 1870 and ended in 2010, and that this period was transformative. But the reader doesn't need 605 pages to learn that. More troublingly, DeLong provides neither evidence nor logic to explain why he claims growth is over. He simply observes that productivity growth rates have fallen since 2010 and asserts that this is permanent. Someone writing in 1938 or 1978 could have written a very similar book, having surveyed the economic malaise around them at those times and concluded that growth was then over for good. In fact, many wrote such books in those periods, and they all turned out to be wrong. The onus is on DeLong to explain why this time is different and the slow growth that immediately followed the Great Recession should be deemed permanent. Yet, he fails to do this.

Perhaps the biggest disappointment in a book that purports to explain economic growth over the last 140 years is the lack of analysis of technological change. Indeed, DeLong admits that "I have not written much in this book about precisely how new technologies have advanced human collective powers.... I have simply written about their rate of growth." A better appreciation of these technologies would make one less pessimistic. Artificial intelligence, robotics, autonomous systems, quantum computing, and biotechnology all have the ability, once they mature, to rev the world's growth engine, just as the industrial, electric, and computer ages did before.

It is unwise to bet against markets and entrepreneurs' ability to produce growth and innovation. As Schumpeter once wrote, "The possibilities of technology are an uncharted sea." Sadly, DeLong and many left-leaning economists seem to prefer staying hunkered down in a sheltered harbor where markets and businesses are held fast, no one is rich, and nothing changes. R

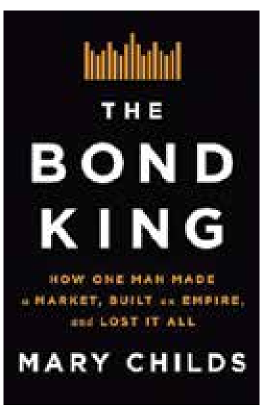
Tales of PIMCO

REVIEW BY VERN MCKINLEY

Megabanks and other large financial institutions in the United States and the people who lead them all have their own stories and monikers. Goldman Sachs has a reputation for providing a steady stream of treasury secretaries through the revolving door between New York and Washington, earning it the nickname "Government Sachs." Steven Mnuchin, Henry Paulson, and Robert Rubin all made the transition from Goldman to treasury secretary in the past few decades. Many books have chronicled the history of Goldman Sachs, whose founding dates back to the 1860s.

In her new book *The Bond King*, Mary Childs chronicles PIMCO, a large financial institution in its own right that was founded during the 1970s. She has plenty of material to relate, notwithstanding the firm's relatively short history. Childs is cohost of National Public Radio's *Planet Money* podcast and previously worked at *Barron's* and the *Financial Times. The Bond King* is her first book.

My previous knowledge of PIMCO came from my familiarity with the "Big Three" public financial figures who worked there. Bill Gross, who is the central figure of Childs's book, was tagged with the moniker "the bond king" by *Fortune* in 2002. He is familiar to the public because of his many appearances on Bloomberg, CNBC, and other financial networks. Economist Mohamed El-Erian has also been active on the business TV circuit, was under consideration for vice chairman of the Federal Reserve during the Trump years, and is more recently known as a harsh critic of the Federal Reserve's handling of monetary policy in the wake of the pandemic. Neel Kashkari is familiar thanks to his stint as the bailout czar under Paulson during the Great Recession. I never followed closely their work at PIMCO, but Childs does a good job of weaving a compelling narrative to fill that void.



The Bond King: How One Man Made a Market, Built an Empire and Lost It All

By Mary Childs

322 pp.; Flat Iron Books, 2022

Gross / Gross's founding and building of PIMCO is the major narrative of the book. PIMCO is not a bank and does not primarily focus on trading stocks; rather, its focus is on trading in the bond (or fixed income) market. As Childs explains:

> Normal people don't like to talk about "bonds." … We like to talk about stocks, which are also claims on a company but are riskier, more whimsical. People think stocks are more fun.… [In contrast, bonds] are mostly bought by sophisticated, institutional investors—big kids.

It all started during the early 1970s at Pacific Life Insurance, where Gross landed his first job after graduating from business school. His initial focus was on actuarial science, assuring that Pacific's bond portfolio was of the proper size and duration to pay off life insurance claims when they came due.

Within a few years, a more appealing possibility came into view: not only to sit on those bonds until the proceeds were needed, but also to trade the bonds. Toward that end, Gross's boss "gave him $5 million to play with." The platform for that trading became Pacific Investment Management Company (PIMCO). Eventually, Gross and his colleagues not only managed bonds for Pacific Life, but also for clients of their own, including AT&T and RJ Reynolds Tobacco.

The inflation of the 1970s was a good time to start such an operation, as older bonds were eroding in value because of their woefully low, pre-inflation coupon rates. Gross and his team focused on "making money buying the better bonds and selling the worse ones." As the 1970s came to an end, the ups and downs of the early 1980s, with a double-dip recession and taming of inflation, "kicked off a multi-decade bond rally."

Gross built a team and Childs traces their personalities and quirks in the early chapters of *The Bond King*. Before there was CNBC and Bloomberg, there was Louis Rukeyser and public television's *Wall Street Week*. Gross was Rukeyser's go-to guest when he wanted to talk about the bond market, making Gross an industry celebrity. When cable exploded, he seamlessly transitioned to the new medium and can still be seen today, weighing in on the bond and broader market issues of the day.

Childs's narrative for Gross reveals two personalities. First of all, there is the swashbuckling capitalist of the bond market who takes risks, bets big money on contrarian trades, and wins. There was no bigger contrarian trade than his bets during 2006 that the mortgage market would falter. For Gross, the evidence of weakness in the mortgage market began to emerge in 2005 with talk that the market was "frothy" and that a "housing bubble" was building. He dispatched members of his team to initiate boots-on-the-ground analysis of individual housing markets. They were told of the heavy reliance on interest-only, adjustable rate, and "affordability" products that helped drive the increase in prices. By May 2006, PIMCO's official newsletter explained that housing was "slowing under its own weight." Talk of an "end of the housing boom" and the housing market being a "disaster-in-waiting" increased in volume and PIMCO began to shift its portfolio accordingly.

The market broke during late 2007 and early 2008, and Gross the capitalist morphed into Gross the interventionist. On a CNBC appearance with anchor Erin Burnett early in 2008, he was already "urging the government to inject money into the system." While the major fund that he managed (the Total Return fund) had 60% of its holdings in Fannie Mae, Freddie Mac, and other government-sponsored enterprise bonds, he urged that what to that point had been an implicit government guarantee to back these securities become an explicit guarantee.

He relied on the Chicken Little language so typical of that era to emphasize his point: "Unchecked, … [this could] turn a campfire into a forest fire, a mild asset bear market into a destructive financial tsunami." Gross admitted, "You can say that I'm talking my book"—that is, he had a conflict of interest in urging a policy that would benefit him financially. Paulson's Treasury Department ultimately put together a plan to bail out Fannie and Freddie, as Childs explains: "The government was doing exactly what Bill Gross had wanted, had asked for. His gamble would pay off." Notwithstanding Gross's love of government intervention, he fancied PIMCO as a company that "efficiently allocate[s] capital around the U.S. and the world. We are in the business of capitalism."

El-Erian and Kashkari / El-Erian's "first stint at PIMCO" started in 1999 when he was brought on to manage the emerging markets team. The fund he managed generated returns of nearly 30 percent, in large measure because he eased out of Argentina investments just as they were on the verge of default in 2001. He departed PIMCO in 2006 to manage Harvard's massive endowment fund, but he was lured back to PIMCO by September 2007 to a role with Gross as co–chief executive officer and co–chief investment officer, making him the heir apparent if Gross were to retire. El-Erian's remit was simple: "Find where PIMCO could expand."

El-Erian's personal lawyer played an important behind-the-scenes role in the development of *The Bond King*. Childs takes several breaks from her tale to clarify the lawyer's position on statements in the book. For example, she explains that "according to people familiar with the conversations, El-Erian had demanded co–CEO, too" when he returned to PIMCO. However, El-Erian's lawyer states "that it was Gross's idea, as part of a succession plan." That makes me wonder, were Childs and her publisher under threat of a lawsuit if they did not give El-Erian's side of the story on every matter of controversy she raises in *The Bond King*?

To me, Kashkari always seemed way over his head as a newbie policy guy at the Treasury Department. He "cold-called" Paulson to come onboard as the financial crisis was beginning because "he wanted to learn how government worked." He presented a bailout plan (TARP) to Paulson involving asset purchases, but when it became obvious that would not work, the program turned on a dime and became a capital injection program.

Childs explains that Kashkari was similarly over his head at PIMCO:

> If Kashkari's time at Treasury had seemed to some a step beyond his abilities or experience, this new role was another step farther. He had never worked at an asset manager. He would lead building a new equities business without ever having managed an equities business or been an investor at all.

But that did not matter because, for some reason, "Gross had been impressed by [Kashkari]" and the hire reinforced a desired "cozy relationship with the government." Kashkari did not fit the PIMCO mold and lasted all of three years before departing to "explore returning to public service." A failed run for governor of California and ultimately a position as president of the Federal Reserve Bank of Minneapolis ensued.

Losing it all / Gross certainly received the accolades of his industry. He was a three-time winner of the Morningstar Fixed Income manager of the year award based on best performance for clients and was later named the fixed income manager of the decade in 2010. PIMCO's assets under management closed in on the $2 trillion mark. In the post–financial crisis era of tightened regulation through the Dodd–Frank Act, PIMCO dodged a bullet when it avoided designation as a systemically important financial institution. Heavy lobbying by PIMCO helped.

But as the subtitle of the book indicates, Gross's empire began to erode. His management style of scrutinizing his employees created a pressure cooker environment—what Childs describes as "miserable," a "scorching office climate.… The pitch-black early mornings, the politicking, the disrespect, the never-ending emails from Gross and El-Erian and on down the line." Some employees stayed for the "fatter paychecks," but many headed for the exits.

By 2013, the relationship between Gross and El-Erian

> was deteriorating. Things were getting increasingly tense.… It felt now like Gross and El-Erian no longer saw eye to eye on the firm's direction, or over trades and strategy, or whom to hire, or what new products to push…, all against the backdrop of clients pulling their money.

Possibly worst of all, Gross "was acting erratically, and it was threatening to hurt the firm." Early in 2014, El-Erian informed the PIMCO executive committee that he was leaving. The *Wall Street Journal* had a front page spread on the exit. Childs succinctly summarized the contents of the article: "Bill Gross was a terrible asshole." This was a shock to the financial industry given that they had only seen "Gross's folksy TV persona."

Gross then seemingly became paranoid that others at PIMCO were trying to sabotage him. His attempt at a "media tour" to salvage his reputation failed miserably. The saga moved quickly after that, with Gross and PIMCO's executive committee each trying to gain the upper hand.

Gross proposed a way to step back from his leadership role and eventually exit after lingering in a "sidecar" role, contingent on the departure of his perceived adversaries. The committee pushed back, saying his departure time frame was too long and he had lost the trust of his colleagues. The focus turned to firing him outright. Three members of the senior management team threatened to resign. Gross started to reach out to other trading firms. The executive committee proposed a short fuse on a "retirement," with no long period for him to linger. Gross ended the suspense with a surprise announcement that he would depart for Janus Capital Group on September 26, 2014.

The Bond King is an engaging read. A few sections drag given the technical discussion involved, but given the topic that is unavoidable. I hope to see more historical chronicles on major financial institutions from Childs in the future, given her demonstrated ability to tell a story and to mix in humor at an opportune time (like the ongoing commentary from El-Erian's lawyer). *R*

Do You Trust the Climate Change Experts?

REVIEW BY ANDREW N. KLEIT

University of Virginia law and economics professor Jason Scott Johnston's recent book *Climate Rationality* offers an extensive critique of climate change science, built upon his broad research in the area. This is a worthy task, as the climate change literature is increasingly important in directing public policy. In doing this, Johnston attempts to thoroughly evaluate a broad collection of academic articles. The result is a dense tome deeply critical of climate science and its applications, with a reference list of over 550 academic articles. While this work is needed, not all parts of the book are equally compelling.

Some literature and its applications / The academic literature Johnston examines is far too vast to review in depth here. Instead, I focus on his views of three aspects of climate science: how changes in temperature and other relevant factors are measured, how changes in climate are forecasted, and how the economic effects of climate change are estimated.

Climate science relies on climate data. Johnston points out several weaknesses in how these data are measured.

Because the methods of calculating maximum temperatures on land have changed, as have the physical areas around many or most temperature reporting sites, the raw temperature data from land-based weather stations are subject to a great deal of adjustment before being used in analysis. Of course, the more adjustment that occurs, even with the best of intentions, the more error is likely to occur. Johnston claims that this process is subject to "upward" bias, inaccurately increasing temperature recordings. Determining the accuracy of Johnston's claim is very difficult.

He also suggests that using the relatively cool 1950s as base years rather than the relatively hot 1930s serves to bias the estimates of temperature change upward. Essentially, the base year does matter. Today's temperatures may be higher than they were in the 1950s, but perhaps not higher than in the 1930s. This, in turn, may change our viewpoints on the threat of climate change.

Theory predicts that climate change will have larger effects in the troposphere (the lowest part of the earth's atmosphere) and the upper reaches of the ocean than it will on land. The temperature measurements from these places are in large part taken from satellites. These readings have both the advantage of not needing as much adjustment as land-based measurements and the disadvantage of a shorter period of data measurement. Johnston tells us these studies show far less warming than the studies based on temperatures from land-based monitors. The inference is that, in these circumstances, the land-based readings are less trustworthy.

Similarly, reported increases in hurricanes in general and intense hurricanes in particular can be attributed to the rise of satellite reporting, which today observes essentially all hurricanes, rather than pre-space-age ship-based reports. Similar challenges exist for measurements of sea level. Even with satellite-based data on sea level, the magnitude of needed corrections and potential errors in these corrections swamp the magnitude of the measured sea level change.

Global climate models (GCMs) are used to forecast how much the climate in the future will change because of carbon emissions. These models are highly complex and, again, subject to error. An unfortunate feature of GCMs is that, for almost everyone, the models are "black boxes" whose internal characteristics are not well understood. Of course, the quality of any model is unlikely to be better than the quality of the assumptions going into it. The limited amount reported on these models indicates that they are dependent in large part on assumptions about the feedback on climate from both clouds and aerosols. Unfortunately, as Johnston ably explains, the values of these variables are essentially unknown. These models also generally omit the warming effects of black carbon (what the EPA calls "soot"). A further problem with GCM models is that they do not appear to forecast the past ("backcast") very accurately, at least without what researchers call "tuning."

The social cost of carbon (SCC) is an important regulatory instrument in cost–benefit analysis used by the federal government. Any cost–benefit analysis of a

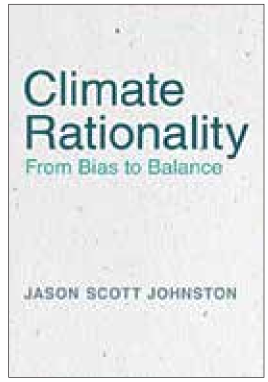
IN REVIEW

climate-based regulation will use this number. But there are three problems with the SCC. First, as Johnston ably outlines, the damage function that is derived from the GCM model is not estimated econometrically. Rather, it is derived in an opaque and perhaps arbitrary fashion as a projection of results in the academic literature. Again, such a process is subject to subjective decisions.

Second, as Johnston discusses (albeit too briefly), because most of the effects of climate change are far in the future, small changes in the discount (interest) rate applied make big difference in the SCC. For example, if the discount rate used is 1%, the value of a dollar used 50 years from now is about 61¢ today. If the discount rate is 3%, the value of that dollar is 22¢ today. Thus, the lower the interest rate used, the more important it is to take action today, rather than to wait.

Unfortunately, neither Johnston nor the field of economics offers substantial guidance on what interest rate to use. Let me present a little intuition: do you think people in the 2020s should reduce their consumption so that people in the 2070s will be wealthier? (Or perhaps the questions should be, do you think people in the 1970s should have reduced their consumption so that people in the 2020s would be wealthier?) If you think the answer is yes, you probably would support a relatively low interest rate for climate change analysis (because you are more likely to think that society should save for the future), but if you think the answer is no, then you probably would support a relatively high interest rate and less action on the climate today. Put another way, the question may come down to whether you think people in the 2070s will be substantially richer than people today. If they will be richer, there is less point in reducing consumption and carbon emissions today.

Third, Johnston unfortunately does not address the issue of "standing" in cost–benefit analysis. This is a question of who "counts" in the calculus. Generally, when governments engage in cost–benefit analysis, who counts is that government's own citizens, but no one else. Indeed, federal law expressly prohibits non-Americans from having standing for the purposes of climate change. Despite this, and in contrast to the Trump administration, the Biden administration's SCC takes into account the effects of climate change on people around the globe. This has the effect of essentially raising the SCC from $7 to $51 per ton.



Climate Rationality: From Bias to Balance

By Jason Scott Johnston

280 pp.; Cambridge University Press, 2021

From an economic point of view, global standing for U.S. government cost–benefit analysis may only make sense if U.S. carbon reduction induces all (or most) other countries to reduce their own emissions by a similar amount. There seems, however, to be no real reason to believe that will occur. Unfortunately, Johnston does not address this problem.

A strength of the book is its review of the costs of decarbonizing the electricity grid and the rest of the economy. Despite what some advocates have claimed, decarbonization will be no easy task. (See "The Limits to Green Energy," p. 40.) Modern economies depend on a reliable supply of electricity, so increasingly relying on intermittent wind and solar sources of electricity will require two things:

- a much broader set of transmission lines, so that if intermittent power is not available in one region, it can be sent from another; and
- electricity demand response, so that consumers of electricity will pay higher prices for electricity when it is scarce, reducing their demand during those times compared to the average prices that are typically paid today.

There is tremendous opposition in almost all populated regions to building new transmission lines in the United States. (See "Promoting Cost-Effective Grid Modernization," p. 34.) Further, after over two decades of attempts to encourage demand response, it is very clear that, despite the best efforts of economists, many or most consumers do not want it. (See "Confessions of an Energy Economist," p. 30.) People prefer to have constant prices for electricity, perhaps in part because they do not desire additional worries in their lives.

The book includes an examination of the environmental costs of renewable technologies. Some of these I cannot take too seriously. Wind towers may kill hundreds of thousands of birds per year but, as Johnston points out, cats kill billions. We are not going to run out of birds, though some individual species may be threatened. Wind towers do take up a great deal of land. Johnston estimates they might eventually take up land equal to the size of Nebraska. I am, however, not sure this is so important, perhaps because I spend a good deal of my time driving empty roads in central Pennsylvania. There is a lot of land in this country. Other environmental problems are more serious. As Johnston notes, one challenge that we have not been forced to deal with yet is disposing of various parts of wind turbines and solar generators once their usefulness has expired.

Another issue that Johnston does not address is that wind and solar generators require substantial amounts of rare earth minerals, which currently come in large part from Inner Mongolia in China. Extracting and processing these materials can be quite harmful to the environment. If you think renewable energy is "clean," do an internet search for some pictures of mines in that area. A further problem is the limited supply of these materials. Rare earths are not as rare as the name suggests, but they are hard to find in marketable quantities. If we truly decarbonize, the cost of extracting these materials and the resulting price are likely to soar as demand for them rises. Finally, relying on China for these materials creates national security issues.

In his final substantive chapters, Johnston points out a key flaw in the economic models of climate change. Climate change will change relative prices. For example, it will make some areas less viable for agriculture. His well-argued thesis is that human ingenuity, aided by appropriate institutions in the industrial era, has shown itself to be responsive to the needs of society. Johnston illustrates this with a short but compelling chapter discussing economic advancement in the Sahel region of Africa. In this sense, projections of the effects of climate change on the economy without assuming adaptation can be seen as worst-case scenarios. Entrepreneurial humans motivated by profit, at least in countries with strong property rights, will do better. Of course, the effects of future adaption are hard to estimate for many of the same reasons that future harms from climate change are difficult to forecast.

Science and advocacy / Johnston takes on the idea of climate science as an objective, unbiased field of research. There is an ideal of how science is "supposed" to progress: Dedicated scientists do replicable work in laboratories and offices, attempting to find "truth" in an unbiased fashion. Their work is reviewed by dispassionate peers and accepted for publication if it is worthy. Their motivation is to find truth and nothing else.

Of course, that is not how the world works. Climate science is not replicable, and scientists are human beings. In particular, climate scientists need research funding to conduct their research. Much of the funding for climate science in the United States comes from three government agencies: the Environmental Protection Agency, NASA, and the National Oceanic and Atmospheric Administration. Public choice analysis suggests that all three have strong bureaucratic reasons to prefer research that shows climate change is a looming threat. Scientists would be less than human if this did not influence them.

As Johnston points out, many climate scientists are also climate advocates, arguing for swift action to reduce climate change. It is hard to be both a truth seeker and an advocate. Scientists are supposed to be unbiased; advocates are not. Given that there are so many obscure assumptions in climate change analysis, it is natural to suspect that scientist-advocates would be more likely to make assumptions implying increased harm from changes in the environment.

Unfortunately, climate scientists take actions in response to criticism that certainly make it look like they have something to hide. An example of this is their dismissing criticism by proclaiming that "the science is settled." Of course, science is never settled. Perhaps what is meant by this is that there is a consensus that human-caused climate change is occurring. But this leaves plenty of room for investigation. In particular, if the climate is changing, then we need further analysis on how much it is changing, and what (if anything) we should do about it today.

Further, there is an unfortunate tendency in climate science to respond to critiques by engaging in ad hominem attacks, calling skeptics "deniers" and ostracizing them. Such attacks both increase the cost of defying the existing consensus and lead outsiders to believe that climate scientists fear open debate. My impression is that at least some climate researchers understand the implications of this behavior and regret it. Of course, climate change skeptics have been known to make their own ad hominem attacks on climate scientists.

The administrative state / Attempts to pass explicit climate change legislation through the U.S. Congress over the last 30 years have been largely unsuccessful. Given this, administrative agencies such as the EPA have attempted to expand environmental regulations under existing laws, and therefore their bureaucratic missions, to cover the emissions of carbon, often under less than obvious legal justifications.

Johnston criticizes the federal judiciary for allowing this to occur and failing to rein in the encroachment of the regulatory state into areas not (at least directly) authorized by underlying legislation. Johnston focuses on the legal infirmities in the EPA's Clean Power Plan, which in his view attempted to expand the agency's purview well beyond what Congress had intended. Perhaps some of what he was referring to was heard by the Supreme Court before its recent decision in *West Virginia v. EPA*, which ruled that the EPA does not have authority to implement the Obama-era Clean Power Plan.

Much of Johnston's critique of federal courts (in particular the landmark 2007 decision in *Massachusetts vs. EPA*) is centered around those courts' acceptance of the Intergovernmental Panel on Climate Change (IPCC) as a neutral, objective authority on the science of climate change. The EPA and lower courts also commonly cite the IPCC as an unbiased authority. Johnston examines the IPCC and argues that it is, at its core, a political body. As such, like all other advocates, its positions must be considered warily.

The IPCC is essentially an arm of the United Nations, created in 1988 to summarize research on climate change. Scientists are a large part of the IPCC process. But in the end, it is government representatives, not scientists, who make the decisions on the positions the IPCC takes.

Johnston's crucial point here is that the process by which the IPCC produces reports does not resemble how articles are produced for academic journals. The chapters in IPCC reports do have academics as lead authors, and these academics write the initial drafts. The reports, however, are then subject to a review process involving various government officials and entities. They do not undergo an independent peer review process. In the end, decisions about what goes into the IPCC's final reports are made by government officials, who can and do reject the views of the experts. This is not a neutral, scientifically based approach.

Writing / The book has its weaknesses. It is long and requires substantial effort from the reader. Johnston is comprehensive in his review of the literature, and this is the strength of the book. Judicious editing, however, could have made for a shorter but not less detailed volume, while prodding the author to cover important omitted topics and excise unimportant ones. For example, Chapter 5 highlights at some length the Obama administration's "war" on the coal industry. Whatever one thinks of that policy, it is unclear why it is included in this book. On the other hand, as mentioned above, the issues of cost–benefit standing and the supply of rare earth elements should have received more scrutiny. A brief discussion of non–North American perspectives on climate change would also have been helpful.

The ordering of the book creates difficulties. Critiques of climate change science and economics should come first, rather than an examination of how the administrative state deals with climate change. For example, the first substantive chapter of the book reviews the legal meaning of "endangerment" and how a slim 5–4 Supreme Court majority in *Massachusetts v. EPA* used that definition to support efforts to reduce carbon emissions under the Clean Air Act. The first time I read the chapter, I was confused because so many of the concepts described had not been previously introduced. The second time I read it, after reading the entire book, the chapter made much more sense. This is a difficult burden to place on the reader.

Johnston uses as a theme for his book the idea that climate policy is driven by the precautionary principle, rather than economically based cost–benefit analysis. This theme is not carried throughout the book. For example, much of the discussion in Johnston's work, and in the broader community, focuses on measuring and using the appropriate SCC. Using the SCC is an explicit method of cost–benefit analysis. Johnston contends that the SCC is determined through a lens of the precautionary principle, but he does not really support that argument.

Conclusion / I do not have any distinct views on the nature and threat of climate change. It is simply not my expertise; I am an energy and natural resources economist. But the sheer complexity of climate models, the potential for bias in these models, and the public choice implications of the incentives facing both the government agencies that deal with climate change and the researchers they fund give me pause.

A further concern is the seeming unwillingness of climate change scholars to address many of the critiques of their work. If there was ever a field that needed vigorous debate, it is climate science. The stakes are large and the models opaque. Too often, however, the field of climate science seems to turn into the field of climate advocacy

I do feel confident in saying that decarbonizing the economy would be a painful and expensive task. Modern society depends on reliable and inexpensive energy. Further, it is unclear if it really would be worth doing for the United States if other major carbon emitters such as India and China do not join in carbon reduction.

In the end, the many questions Johnston raises come down to a simple query: do you trust the experts? As readers of *Regulation* know, there are plenty of reasons to be skeptical. R

How Much Lending Discrimination Exists?

REVIEW BY VERN MCKINLEY

The topic of fair lending in the United States covers a cluster of federal legislation originally signed into law during the 1960s and 1970s, including the Fair Housing Act (FHA), Equal Credit Opportunity Act (ECOA), Home Mortgage Disclosure Act (HMDA), and the Community Reinvestment Act (CRA). The enforcement of these laws often follows the political cycle, as enforcement and the amendment of the underlying regulations are decidedly a higher priority during Democratic presidential administrations than Republican.

For example, during Bill Clinton's presidency, then–attorney general Janet Reno and comptroller of the currency Eugene Ludwig led an effort to amend the underlying regulations and increase enforcement measures under the CRA. (See "Community Reinvestment Act: Ensuring Credit Adequacy or Enforcing Credit Allocation?" Winter 1994.) Candidate Clinton had campaigned on the issue, which was highlighted in his "Putting People First" campaign document. The Biden administration is now considering the state of fair lending legislation in the wake of a decreased emphasis during the Trump administration.

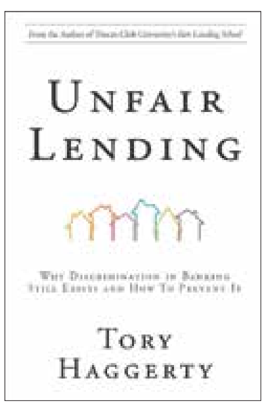
Tory Haggerty gives his take on the state of the fair lending laws in his new, self-published book *Unfair Lending*, the title of which implies that there is still a long way to go on the issue. Haggerty is a former bank examiner for the Federal Deposit Insurance Corporation (FDIC) who worked on nearly 100 fair lending compliance examinations. He now owns his own consulting business that focuses on providing advice regarding fair lending. *Unfair Lending* is his first book.

Types of bank examiners and fair lending / Haggerty gives some indication throughout the book of the type of work he did as a bank examiner, but he does not clearly explain the various types of bank examiners. There are so-called safety-and-soundness examiners, who "crunch the numbers" to assess the financial solvency and liquidity, asset portfolio quality, and earnings of banks, as well as the quality and judgment of bank management (so-called safety-and-soundness analysis). In contrast, the type of examiner that Haggerty was and the type most relevant to *Unfair Lending* is a compliance bank examiner. Compliance experts need to understand the relevant fair-lending laws and underlying regulations, as well as have some knowledge of statistical analysis and sampling, which is used to look at historical lending patterns to determine a bank's compliance with the fair lending laws.

Haggerty begins the book with his own definition of fair lending: "the process of making consistent loan decisions based on someone's creditworthiness and not on their personal characteristics."

He then dedicates a chapter to summarizing the FHA, ECOA, HMDA, and CRA. There is some overlap in the enforcement realm of the FHA and ECOA, as both set forth a list of prohibited bases, such as race, color, religion, sex and national origin, among others. Lenders that fall under the scope of these laws cannot use a prohibited basis when making a loan decision. The FHA focuses on home loans while the ECOA has a broader scope. HMDA requires the collection of data on home loans, and bank examiners use the data to test fair-lending compliance. Finally, the CRA requires banks to reinvest the funds collected in the communities where they operate.

These laws were drafted in response to "redlining," the discriminatory practice by which bank managers (with government support, at least until the civil rights era) would literally draw a red line on a map around certain neighborhoods or other geographic areas with a high concentration of minority residents and inform their loan officers to avoid lending in those areas. Haggerty dedicates a chapter late in the book to this practice. The FHA and ECOA address redlining directly. The HMDA requires collection of lending data to, in part, test for redlining or similar practices. The CRA is intended to prevent a bank from drawing deposits from a redlined geographic area and extracting those deposits to fund lending in areas outside that geographic area.



Unfair Lending: Why Discrimination in Banking Still Exists and How to Prevent It

By Tory Haggerty

156 pp.; self-published, 2022

Fair lending risk and the current level of discrimination / Most of the rest of the book is broken down by chapter based on Haggerty's seven stages of the loan lifecycle, as he walks through the different types of "redlining risk." This focuses on the sequential process of lending and the accompanying risks of running afoul of the fair lending laws at each of its stages: the collecting of information on a prospective borrower for the application process, the steering of customers to the appropriate product for their needs, underwriting the loan by making a determination on the financial standing of the borrower, determining the pricing of the loan, making exceptions to the lending procedures, determining whether to deny a loan, and the marketing of lending products.

A few of these chapters (those on underwriting and pricing) raise issues concerning the automation of some of these processes based on algorithms. (See "Algorithms: The Life Blood of the FANGs" Fall 2020.) Automation can potentially reduce the risk of fair lending violations if applied properly.

The chapters on the loan lifecycle have a common format of introducing the topic, including some background information on the credit process. This is followed by a case study of the specific type of risk based on Haggerty's experience as a bank examiner and consultant. Each of these sections concludes with some detailed advice on avoiding fair-lending pitfalls.

Criticisms / There is a lot of useful information on fair lending and the book is a good refresher for those who have worked with the topic in the past but have not done so recently. There are also weaknesses with the book, and I think some of them may be attributable to its being self-published. *Unfair Lending* did not have the typically more intensive third-party review that accompanies a title that comes out of a publisher.

There is a lot of useful information on fair lending and the book is a good refresher for those who have not worked with the topic recently.

More importantly, I was disappointed that the book did not have more of a policy orientation. Its promotional material, in particular its subtitle, gives the impression that *Unfair Lending* analyzes and does some form of statistical analysis of the current extent of discriminatory lending in the industry. There was an oft-cited Federal Reserve Bank of Boston study that justified many of the Reno–Ludwig fair-lending interventions of the 1990s. David Horne, an economist with the FDIC, uncovered many flaws with that study and there was an intensive discussion in the industry at that time about the extent of discrimination. I thought Haggerty would pull together more recent analysis of lending discrimination in that same vein. It is not enough to provide a few references to policy topics and some anecdotal examples from his own personal experience to prove the extent that such discrimination "still exists."

There are no footnotes or endnotes in the book at all, even when conclusions of a policy nature are declared. For example, early in the book Haggerty makes the claim, "People can't get funding to start a business or go to college because of their race." In fact, there are stories in the business press about the opposite problem regarding funding for college loans, as students of all races are overburdened with student debt that they struggle to repay and they were not properly informed of the risks they were taking on when they agreed to the debt. It would have been very useful to have some citations to the most up-to-date research to support the contention of lingering discrimination on both business and student loans.

In summary, I would describe *Unfair Lending* as a practitioner's guide. The book's promotional information that might draw potential policy readers, even if unintended, is a little misleading. Online samples of a half-dozen pages of *Unfair Lending* are available, but they are not enough for a prospective reader to understand the breadth of the book's coverage. This reflects a flaw with today's world of online book purchases, as prospective readers (in most cases) cannot thumb through the full book for content to see that it meets expectations set in the title or promotional material. R

Mistaking the Virtue of Self Interest

REVIEW BY ART CARDEN

Appraisals of market economics by lawyers and businessmen are common. Appraisals by lawyers and businessmen who have also studied theology are considerably rarer. *Better Capitalism* is written by business attorney Paul Knowlton and former CEO Aaron Hedges, both of whom hold master's degrees in divinity, and their book evaluates capitalism from the perspective of Christian ethics.

The book has a lot to recommend it. It brings the "real Adam Smith"—the moral philosopher and economist for whom *The Theory of Moral Sentiments* and *The Wealth of Nations* were part of a unified inquiry—into the conversation on faith, economics, and business ethics. Their discussion of Ayn Rand is striking, and I agree with them that, despite her atheism, she had a profound understanding of what it means for people to be created in God's image. They encourage readers to dig into what thinkers like Smith, Rand, and Milton Friedman actually said and wrote as opposed to what is attributed to them. The authors invite their readers into a conversation, proposing action steps at the end of each chapter and asking readers to email them if they have better ideas. *Better Capitalism* is a sincere search for a better world.

It is also a frustrating book, as the authors seem to misunderstand some important economic ideas and arguments. For instance, I disagree with their reading of Friedman's classic essay, "The Social Responsibility of Business Is to Increase Its Profits." They attribute to him a view that he repudiates explicitly, claiming that his reliance on society's institutions and norms to serve as ethical guardrails is weak sauce. Their warning that he overlooks firms' inclination to increase their profits by working to rig government policy in their favor ignores Friedman's repeated excoriations of people who do most of their "business" in Washington or state capitals. I'm not familiar with anywhere in Friedman's work where he holds up *Atlas Shrugged* villain Orren Boyle, who grew fat on subsidies and special privileges, as a model businessperson. As Friedman pointed out repeatedly, everyone in business believes in unrestricted free trade and competition in every industry but their own, which must be regulated, protected, and supervised as a matter of national security or whatever.

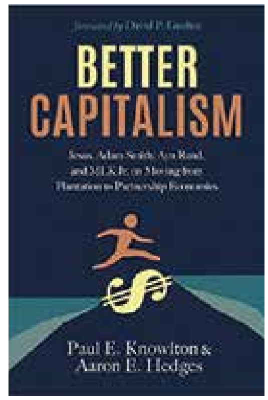
Muddled thinking / This book, and the broader discussion to which it contributes, would be better if it paid more attention to societies' institutions and the incentives they create. I get the impression from *Better Capitalism* that its authors believe fools and knaves occupy government offices and corporate suites, and the way to more ethical capitalism is to replace them with non-fools and non-knaves. That might be true, but if economics teaches us anything, it's that good intentions do not necessarily translate into good outcomes.

The authors refer to and dismiss "blind faith" in the market. To paraphrase Thomas Sowell, we don't have "blind faith" in the market; we have evidence of its efficacy, mountains of it. Since Friedman is one of their subjects, it's helpful to note that what Andrei Shleifer called "The Age of Milton Friedman" has been good for the least of us. With enemies like these, the poor may not need "friends" with blind faith in grand social visions that have failed repeatedly (but only because the wrong people were in charge).

The authors give the impression that government is oriented toward the public good and will achieve it unless sinister interests corrupt it. They write, "We don't errantly expect corporate entities to govern themselves and broader economics in the best interests of the overall public without any public oversight, so we necessarily have to deal with public policy via government." They *do* errantly expect government entities to govern themselves, corporate entities, and broader economics in the overall public's best interests despite incentives to do the opposite. States were born in blood and conquest; a *state*, as Douglass C. North defined it, is an organization with a comparative advantage in *violence*. The problems the authors identify are features of such organizations, not bugs. When they write something like "Professionals don't need to be leashed with price controls or wage caps," I have to wonder if they understand that price controls and wage caps have negative unintended consequences.

Problems like these are sprinkled

throughout the book. I'm not sure the authors understand what economists mean when talking about externalities. For example, they write, "To shift part of the cost of doing business to others without their agreement and even to their detriment was a valid business decision offered by economists (if and for however long you could pull it off, of course)." I don't know any economists who have actually "offered" this as a "valid business decision." While reading the book, I reached for a few classic (or notorious) texts on price theory, like Armen Alchian and Willam Allen's *University Economics* and Deirdre McCloskey's *The Applied Theory of Price*, to see how they treated externalities. McCloskey discussed how private roads would eliminate externalities, but I suspect the authors would object that roads shouldn't be provided by the marketplace and driving shouldn't be priced.



Better Capitalism: Jesus, Adam Smith, Ayn Rand, and MLK Jr. on Moving from Plantation to Partnership Economics

By Paul E. Knowlton and Aaron E. Hedges

278 pp.; Cascade Books, 2021

Smaller and more human? / They also join the left in breathless anger about the size and scope of tech giants like Google, Amazon, and Facebook. I'm not sure what they think constitutes "monopoly" or "market power." Are we supposed to dislike Google, Amazon, and Facebook just because they're *big*? If Google's cash position is "egregious" and there are better uses for those resources, wouldn't shareholders or profit-obsessed investors know it? How would Amazon founder Jeff Bezos become the world's first trillionaire without making Amazon's service a benefit of consumers worldwide? Should we join the authors' unspoken lament? If William Nordhaus is right and almost *all* the value of innovation accrues to consumers, what does Bezos owe to the world? And this doesn't even get into Knowlton and Hedges's conflation of "meaning well" with "doing good." Are they prepared to accept that the best thing Bezos might be able to do for the poor is to continue investing in retail innovation and space exploration?

For a book that seeks to re-humanize the economy, I'm a little mystified by their dehumanization of shareholders and investors. They quote Max De Pree, the late founder of furniture seller Herman Miller, seemingly approvingly when he said the firm's employees are not "the hired guns of distant, mysterious stockholders." The stockholders, however, are neither distant nor mysterious. They are people like you, me, and (I assume) the authors, who have money socked away for retirement in the kinds of well-diversified mutual funds with which Vanguard's John Bogle has blessed us. They are firefighters, police officers, and teachers, drawing from our counting on public employee pensions. True, the people at Herman Miller are not the grist of a corporate mill or hired guns, but they help many people indirectly and non-obviously. Their shareholders are only "distant" and "mysterious" when they're willfully cast as dehumanized abstractions.

Maybe it's inappropriate to think of "markets as the primary means for achieving the public good." You're looking in the wrong place if you're in the snack food aisle at Walmart hoping tortilla chips or Wheat Thins will give you spiritual rest or existential fulfillment. Markets make it a lot easier to achieve the public good by generating the wealth we need to feed, clothe, shelter, educate, and heal people. They provide outlets for meaningful, productive work—and tortilla chips and Wheat Thins make it a little easier, at least, to seek existential fulfillment around someone's kitchen table while discussing the *Book of Proverbs.*

Self interest, mutual benefit / The authors propose replacing "plantation economics"—the economics of exploitation—with "partnership economics." I'm not sure "partnership economics," based on principles of "mutuality and mutual benefit," is that different from regular economics, which is fundamentally about the institutions of exchange for mutual benefit. Admittedly, economists, for our part, have failed miserably in explaining how "the market" brings people together for mutual benefit. Indeed, I suspect many people think Smith's emphasis on "self-love" is another way of saying, "It's fine if people are wretched and selfish because they'll produce more stuff that way." But that wasn't Smith's message, and it wasn't Friedman's.

Economics helps us see how we're driven to "mutuality and mutual benefit" even if we're not motivated by a desire to make our trading partners better off. "Mutuality and mutual benefit" need not be articulated. When I buy gas, I'm not doing so to help Shell shareholders and people up and down the gas supply chain. I'm buying gas to drive my car to work, where I earn the money I need to take care of my family. Even though I'm motivated by "self-love"—the desire to take care of the people and causes that are important to me—free markets bring me into a relationship of "mutuality and mutual benefit" with people I'll never see who have their own families and causes demanding their attention.

The authors are right to emphasize frictional costs and the fact that effecting transfers from one group to another consumes resources without producing any actual benefits. I'm alarmed, though, when I read passages like this: "Simply trading around existing value not only fails to grow the pie—it shrinks the pie because of frictional costs." They quote Bogle's phrase "out-trading other money movers" and write that we should "incentivize work that creates value more than 'work' that merely trades already-created value."

I'm willing to acknowledge that there's some debate about whether some kinds of financial operations, like high-frequency

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trading, improve resource allocation. However, Knowlton and Hedges's critical assessment of trading "already-existing value" suffers two problems: First, it seems to be a version of the Materialist Fallacy: the false belief that only making things creates value, while moving those things around does not. Second, "value" is subjective; it is not inherent to a good or service; rather, it is a measure of people's constantly changing appraisals of those goods and services. When I taught MBA students, I used a textbook that defined the "art of business" as "identifying assets in lower-value uses and profitably devising ways to move them into higher-value uses." Moving assets from lower-value to higher-value uses doesn't shuffle around "already-exiting value"; it creates value.

Conclusion / I share the authors' moral commitments, and I think their discussion of Rand is a unique, overdue, and valuable contribution. They reconcile two seemingly disparate worldviews admirably (Christianity and objectivism). I embrace their effort to bring the "real Adam Smith" back into the conversation. They are also frank and open about how *Better Capitalism* is an effort to start a dialogue, not end it. At the same time, they make some very heroic assumptions about what governments do and can do. A lot of their criticisms of firms like Google and Pacific Gas & Electric imply that there are practically unlimited fortunes to be made if only the enlightened would buy stock in the poorly performing enterprises and make them perform better.

Better Capitalism has its problems, but it is worth reading. It emphasizes action steps, many of which I have glossed over here. I'll close with one: economists need to do a better job helping people understand exactly what our beloved dismal science implies. The world is full of sincere people who mean very, very well and who genuinely want to make the world a better place. We need to do a better job explaining how that happens economically and how meaning well so rarely translates into doing good. R

Standing Up for Trade

REVIEW BY E. FRANK STEPHENSON

U.S. policy in recent years has not been favorable to free trade. Former president Donald Trump boasted that he was a "tariff man" while imposing tariffs on steel, aluminum, and finished goods such as washing machines. Trump also decided against having the United States join the Trans-Pacific Partnership and demanded that the North American Free Trade Agreement (NAFTA) be renegotiated, though the ultimate revisions were relatively minor. (See "Is NAFTA 2.0 Better than Nothing?" Winter 2018–2019.) While President Biden has scaled back some of Trump's tariffs, he has kept and even extended others. Free trade could use a friend right about now.

Into that role steps Fred Hochberg with *Trade Is Not a Four-Letter Word*. As a young man, Hochberg was an executive of family company Lillian Vernon, a direct marketing firm with suppliers in many countries, including China. Later, he headed the Export–Import Bank (EXIM) for eight years during the Obama administration, so he has both private sector and governmental international trade experience. Hochberg's noble goal in *Trade Is Not a Four-Letter Word* is "to puncture the myths, unpack the arguments, and connect all the dots so [readers] can see the full picture of what trade really is."

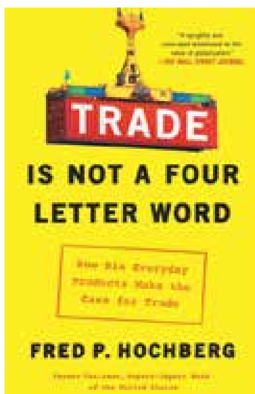
Before discussing the book, it is worth noting two things that it is *not*. First, it is not solely a response to the Trump administration's protectionist policies. To be sure, Hochberg criticizes those policies, but there is much more to the book than rehashing Trump's awful trade agenda. Second, it is not merely an advertisement for EXIM. The book plays up EXIM in several places—including a thinly veiled response to critics who deride it as the "Bank of Boeing"—but overall EXIM is a fairly small part of the book.

The book is organized in three parts: the first consists of three chapters on trade history and myths about trade; the second is six chapters about six products that Hochberg argues make the case for trade; and the third consists of two chapters ostensibly devoted to (unpleasant) realities about trade and remedies to them. Rather than discussing the book along the lines of its organization, I think it is more useful to discuss how it treats important trade concepts such as imports, tariffs, and trade deficits because they are discussed across multiple chapters.

Virtue of imports / Hochberg defines trade as "the exchange of goods and services for mutual benefit." He also bemoans "victims of U.S. trade policy." Based on his definition of trade, one might expect these are people who have been prevented from engaging in mutually beneficial exchange by some sort of trade barrier. However, that's not what he means; rather, he's referring to people who may have lost jobs to import competition after the U.S. government *reduced* tariffs or other trade barriers. For this reason, he includes "trade is win–win" among his myths.

Hochberg nicely explains several ways Americans benefit from imports. Consumers can "eat mangoes in December [and] choose between dozens of cheeses." He points out that supermarkets in 2008 stocked 47,000 items, a five-fold increase since 1975 (though much of the increased variety is domestically produced). Consumers benefit from lower prices: "An America that makes everything at home would be a land of $10 bananas [and] $100 shirts." Many of our popular entertainment options such as *The Masked Singer* and *Veep* are derived from programming in other countries, while ostensibly American-created shows such as *Game of Thrones* feature international casts and are shot in overseas locations.

Many seemingly American-made products contain key inputs obtained abroad. Hochberg makes this point by reminding readers about the harm Trump's steel and aluminum tariffs imposed on the U.S. beer and automobile industries. To emphasize the importance of imports, he includes the notion that "the less we import, the better off we are" as one of the myths about trade.



Trade Is Not a Four-Letter Word

By Fred P. Hochberg

336 pp.; Avid Reader Press (Simon & Schuster), 2021

Having realized the virtues of imports, it is unfortunate that he is less clear about exports. Instead of realizing that exports are the price we pay for imports—and that fewer exports would mean imports are being obtained more cheaply (assuming, for now, no trade deficits or surpluses)—Hochberg cheers on larger amounts of exports. For example, he applauds EXIM's role in financing exports (never addressing the obvious question of why the world's sophisticated financial markets could not perform the same task), writing that one of the benefits of NAFTA is that all three signatories "thrived as exporting heavyweights," and that the United States should want to be an export powerhouse. Conversely, he frets that in the early 2000s China "pass[ed] us and Germany to become the number one exporter in the world." However, there's no prize for being the country with the largest volume of exports; moreover, these rankings may be largely attributable to population size because the United States ranks 50th in exports per capita while China ranks 83rd (tiny Liechtenstein is first).

Debunking myths / Because politicians often impose trade barriers to curry favor with constituents, Hochberg also discusses this important dimension to trade. He points out that non-tariff barriers may be more significant impediments than tariff barriers. Also, pushing back against one of Trump's flawed perspectives on trade, he includes "tariffs are paid by foreigners" among his list of trade myths. However, in saying tariffs "get paid by U.S. citizens to the U.S. government," he overlooks the difference between statutory tax incidence (who remits the payment to the government) and effective tax incidence (how the tax's burden is split after prices adjust, a split that depends on the elasticities of supply and demand). That he points out just a few pages later that China's retaliatory tariffs caused U.S. soybean producers to receive lower prices for their crops reinforces the fact that statutory incidence and effective incidence are not the same.

Regarding trade deficits, Hochberg includes "bilateral trade deficits matter" among the myths about trade. He correctly points out that trade deficits are not akin to debts that must be repaid and notes that knowing someone has a trade deficit with his grocery store tells us nothing about the person's financial position. However, Hochberg could have added that countries have many trading partners and could have an overall trade balance while running deficits with some countries and surpluses with others.

His discussion, or lack thereof, about multilateral balance of payments is one of the weakest parts of the book. He writes that an "overall trade deficit *can* have economic consequences if it gets too far out of hand" (emphasis in original). However, he is silent about what those consequences might be or what constitutes getting "too far out of hand." Nowhere does he explain that trade deficits and capital flows are related. (Countries running deficits have net capital inflows and vice versa.) Because Hochberg quotes Harvard economist Larry Summers as saying "the trade deficit is a terrible metric for judging economic policy," it is disappointing that the book's "Remedies" chapter did not recommend having government statistical bureaus stop calculating and reporting trade deficits. Instead, his proposed remedies include various tweaks to the social safety net and job training programs, as well as including labor and environmental interests in trade negotiations.

While balance of payments issues may be the weakest treatment in the book, Hochberg's excellent explanation of how trade expands the possibilities of what we can obtain from human cooperation is one of the book's strongest points. Apple's iPhone is one of the six products that he argues make the case for trade. He writes of the iPhone: "Building a product this sophisticated would never be possible within the confines of California—or anywhere else for that matter." He then explains that more than 700 suppliers located in dozens of countries play a role in producing iPhones and proceeds to walk readers through examples ranging from China to Switzerland to Rwanda to upstate New York. The iPhone chapter includes an appropriately stinging description of Wisconsin's Foxconn debacle, and it concludes with perhaps the best sentence of the book: "If we Americans were ever left to our own devices, we'd be left without very many devices of our own." (His chapter on the most American car on the road—it's the Honda Odyssey according to how these things are calculated, while the Chevrolet Spark has the lowest percentage of U.S.-produced parts—is also a good discussion of how trade facilitates human cooperation.)

Hochberg's explanation of international trade is somewhat uneven, but he clearly understands both the role that it plays in human flourishing and how the current political environment would benefit from pro-trade voices. While I cannot give his book an unqualified endorsement, I commend Hochberg for standing up for such an important and underappreciated facet of our lives.