

Unchecked and Unbalanced: How the Discrepancy between Knowledge and Power Caused the Financial Crisis and Threatens Democracy

Arnold Kling

Lanham, Md.: Rowman & Littlefield, 2009, 136 pp.

Arnold Kling's *Unchecked and Unbalanced* is a novel and insightful take on both the financial crisis and broader trends in the provision of government services. Its central point is best summarized by its subtitle, "How the discrepancy between knowledge and power caused the financial crisis and threatens democracy." This is a brief, very readable book for two distinct audiences, those interested in further understanding the financial crisis and those interested in improving the accountability and efficiency of services provided by government.

The first of the book's three chapters provides Kling's insights into the financial crisis, which also serves as his case study for the broader, more generalized chapters that follow. Readers interested in only the general framework can move directly to chapters two and three. However, in doing so, the reader will miss the benefits of Kling's experiences as an economist at both Freddie Mac and the Federal Reserve, two institutions at the heart of the financial crisis.

While providing a concise overview of federal housing and mortgage policy, and its role in the crisis, the original contribution of Kling's work is his theory of "suits vs. geeks." A large portion of chapter 1 focuses on various permutations of suits vs. geeks, in both causing and responding to the financial crisis.

In the context of Fannie Mae and Freddie Mac, the geeks built and used sophisticated statistical models of the housing and mortgage market, and generally understood the limitations of those models. Unfortunately, in Kling's story, the geeks are not the ones making the calls. That's the job of the suits. Kling argues that the geeks often "saw lower values and higher risks in the securities than the suits, but the suits were in charge of setting corporate portfolio policy." Not mentioned by Kling, but supportive of his analysis, are the many examples at companies like Bear Stearns and Fannie Mae where not only were the geeks ignored, they were often fired for raising concerns about the companies' risk-taking.

Although Kling takes the reader through the many other causes of the financial crisis, most of these other causes have been debated and

discussed elsewhere. The suits vs. geeks divide serves as the foundation of the remaining chapters.

The second chapter expands and generalizes the suits vs. geeks divide to cover the discrepancy between knowledge and power found in government. The role of knowledge and its communication up the corporate and governmental hierarchy is a little understood, but critical part, of understanding the crisis. For that reason alone, this slender book is worth reading.

The general thesis of chapter 2, and the heart of the book, is that “knowledge is becoming more specialized and more dispersed, while government power is becoming more concentrated. This discrepancy creates the potential for government to become increasingly erratic and unaccountable and, as a result, less satisfying to individuals.”

Much of chapter 2 is devoted to demonstrating that knowledge is becoming more specialized and that government is becoming less responsive, or “unchecked.” In lieu of being able to directly subject increasing knowledge specialization to empirical testing, Kling provides a variety of examples, such as the growth in medical specialties and sub-specialties or the massive expansion in detailed classifications in jobs, library systems, and innovation, to prove his case. While I find the many examples persuasive, this may be the result of already having much sympathy for the view that knowledge is becoming more specialized. Non-economists, or those not steeped in F. A. Hayek, may need more evidence than is presented by Kling.

The argument that government is becoming more concentrated and less responsive may also seem obvious. Kling provides a variety of measures to illustrate this trend. His measures fall along two dimensions: scale and scope. In relation to the scale of government, Kling argues that both the substantial increase in spending per legislator, at both the federal and local level, along with the massive increase in number of citizens per representative, has led to an expansion of scale of responsibility and power on the part of politicians. He presents these trends in a variety of ways, offering a qualitative test of robustness. Also offered are interesting comparisons with the private sector. For instance, Kling shows that “only 83 people in the world . . . have as much wealth at their disposal as a member of the Montgomery County [Maryland] Council.” Inherent in

this increase in responsibility and power per politician is a reduction in the ability of any one politician to fully grasp how exactly those funds are being spent and the impact of that spending.

Adding to the complexity of government that results from larger scale is the complexity that results from a greater scope, which is having government involved in more and more distinct activities. Kling extends the economic literature on product bundling to the provision of public services, arguing that many of the same incentives found in private sector bundling, such as price discrimination, are also found in government.

Kling goes on to demonstrate why some of the instances of efficient bundling in the private sector do not apply to the government, arguing that most government bundling is inefficient and used to capture more “consumer surplus” for government. In addition to the consumer welfare effects of bundling government services are the information impacts on politicians. As politicians tend to be specialized in getting elected, they will likely lack the requisite skills for understanding the provision of ever increasing services provided by government, including the service of financial market regulation.

The final chapter offers several mechanisms for decentralizing government power. To some degree the question of whether a particular service should be provided by government or not is put aside; the discussion is on how such services should be provided. Much of the discussion will be familiar to urban economists working in the tradition of Charles Tiebout or political science following Albert Hirschman’s framework of exit and voice. Kling connects this literature with both the writings on private neighborhoods and the libertarian literature on the private provision of public goods, illustrating how these various mechanisms could result in government services being provided more competitively, while reducing the disconnect between knowledge and power that increasingly characterizes government.

Unchecked and Unbalanced covers considerable ground in just over 100 pages. It also does so in a manner accessible to economists and non-economists alike. If there is a fault to be found with the book, it would be the combination of considerable scope with modest scale. Kling’s unique insights into the financial crisis make *Unchecked and Unbalanced* required reading on the financial crisis,

yet its brief coverage of many of the core issues in the crisis make it only one of several pieces of required reading.

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The Making of Americans: Democracy and Our Schools

E. D. Hirsch Jr.

New Haven, Conn.: Yale University Press, 2009, 261 pp.

Historian David Tyack breaks educational progressives into two types: pedagogical and administrative (Tyack 1974). The former are champions of “child-centered” instruction in the classroom, while the latter want centralized, government control of the schools.

The last century has been good to anyone who embraces both types of progressivism. But for E. D. Hirsch Jr.—who reveres government schooling but hates progressive pedagogy—it has been deeply frustrating. And as his new book, *The Making of Americans: Democracy and Our Schools* makes clear, that frustration is likely to continue. For politically progressive reasons, Hirsch won’t break with the system that has given progressive pedagogy a stranglehold.

Literature-turned-education professor Hirsch is probably best known for his “cultural literacy” crusade. His 1987 book *Cultural Literacy: What Every American Needs to Know* resided on the *New York Times* bestseller list for 26 weeks and was a major flashpoint in the culture wars of the 1980s. At about the same time the book came out, Hirsch founded the Core Knowledge Foundation and assembled curricula based on his theories.

What does it mean to be “culturally literate,” according to Hirsch? Ultimately, to possess the shared knowledge necessary to fully interact with other members of one’s society; to have all the historical, literary, and other knowledge that constitutes a community’s culture. Because culture changes slowly, and is, naturally, based largely on what was prominent in the past, this corpus of knowledge consists of much that is often considered dead-white-male stuff in America.

There is an important side benefit to cultural literacy: actual literacy. Research cited by Hirsch demonstrates that effective reading requires not just the ability to decode letter sounds, but also previous knowledge of much of what is being read. You need to start off