

IN REVIEW

When the Price Is Wrong

◆ REVIEW BY GEORGE LEEF

Fight for \$15! That slogan has been reverberating across the United States for the last couple of years, as politicians, union heads, and legions of social justice warriors demand that every worker be paid at least \$15 per hour. To many Americans, that demand is obviously fair because it's hard to live decently on less. To others, it is the worst sort of demagoguery, certain to have harmful economic consequences.

A book that powerfully supports the latter camp and could persuade some who are undecided on the question is *Flaws and Ceilings*, a compilation of essays written and edited by the husband-and-wife team of Christopher Coyne (professor of economics at George Mason University) and Rachel Coyne (a senior research fellow at George Mason's Mercatus Center). Most of the material comes from research done in the United Kingdom, but the universality of the laws of economics makes the lessons every bit as applicable in the United States, European Union, and anywhere else.

Economic distortions / Despite centuries of economic analysis showing that price controls necessarily cause resource misallocation, politicians and activists still press for floors ("flaws" in the title's play on words) and ceilings. The overarching theme of the book is that such price controls are never the solution to a perceived social or economic problem, whether it is low earnings by some workers, the cost of rental housing, the price of energy, "unaffordable" university tuition, transportation costs, or any other. Politicians and activists who sincerely want to improve matters should cross price control measures off their list of policy options.

The Coynes begin by pointing out that the world has had a great deal of experience with price controls. In 301 AD, Roman Emperor Diocletian decreed price ceilings over a wide range of goods and services as

a means of stopping rapid price inflation. Violators could be put to death. But rather than solving the economic problem of rising prices, the price controls compounded them by causing severe shortages of goods. Seventeen centuries later, Venezuela is now wracked by shortages of staple goods for precisely the same reason: the imposition of price controls by an authoritarian ruler.

As the Coynes explain in their chapter on the economic and political consequences of price controls, prices play a crucial role in solving the economic problem of getting the greatest value from the use of limited resources. Whenever government officials dictate that something must sell for less than the price that would clear the market, the result will be a shortage, and whenever they dictate that something must sell for a price that's more, the result will be a surplus. There is no getting around economic reality.

Moreover, the waste and distortion caused by price control is not limited to visible consequences such as lines of unemployed workers and the disappearance of toilet paper from store shelves. They also drive people away from market competition and into political competition. "Efforts are shifted," they write, "from pleasing private consumers to attempting to influence the political process, which ultimately determines how controls are implemented and enforced." Thus, we lose productive jobs and gain lobbyists—a bad tradeoff for society.

Yet another cost of price controls that few people grasp is what economic historian Robert Higgs calls "regime uncertainty." It is hard enough for people in

business to forecast market changes, but once government gets into price setting, the uncertainty is compounded. The cost of planning and investing is increased.

Wages / Probably the chapter with the greatest immediate interest, given our current battle over the minimum wage, is W. Stanley Siebert's on the economics of wage floors. In his analysis, wage floors (in other words, minimum wage laws) are just an easy way for politicians to garner votes by showing their concern without addressing real problems, especially in education. "The low level of skills acquired by children from our many single-parent families is ignored, as is the worklessness among these families," writes Siebert, a professor of labor economics at the University of Birmingham. Moreover, the minimum wage does palpable harm to disabled people who want to work but will never find jobs and also to students who have to settle for volunteer work because low-paying internships are not allowed.

Siebert also examines the effects of the "living wage" movement, which is potent in the UK just as it is here. The proposed living wage for London would require increases for some 25 percent of the labor force, but of course that doesn't shed any light on the actual winners and losers. Siebert writes that if enacted, the measure would wipe out jobs for 300,000 young and unskilled workers, while creating new jobs for around 140,000 more highly skilled workers. He fears the "long-term consequences for those trapped outside the labour market."

Turning to other nations, Siebert finds consistent evidence that raising the minimum wage leads to the destruction of jobs for unskilled workers. Two points he makes are especially interesting.

First, he is aware that U.S. minimum wage advocates have been citing a 1995 study by David Card and Alan Krueger as proof that the conventional economic wisdom that minimum-wage increases lead to job losses is wrong. Siebert rightly dismisses that argument. "The work," he writes, "is sold as a 'powerful new chal-

lenge to the conventional view,' but this is misleading—it is a very specific challenge and a weak one at that.”

Second, there's the pitiable case of South Africa. Under apartheid, the white regimes adhered to what they called their “civilized labour policy,” which meant mandatory high wages to keep black workers from competing with whites. One might have thought that the post-apartheid governments would have done away with this market interference, but that's not the case. Siebert informs readers that the minimum wage policy continues, but with a unionized African labor elite as the new beneficiaries. He sadly concludes, “Thus, we see a policy originally designed to hurt African workers is now being carried forward by African politicians and unions themselves, and still hurting African workers.”

Rent control / Rent control measures remain in force in a number of American cities, most notably New York. So Ryan Bourne's chapter, “The Flaws in Rent Ceilings,” will be of interest here as well as in Europe, where such laws are more common. Just as with minimum wage laws, rent ceilings are supposed to help the poor, but Bourne shows they don't.

The consequence that economists would predict from any law that keeps prices artificially low—shortage—has unquestionably occurred with regard to rent controls. Capital stops flowing into the rental housing industry because returns are depressed by the law. Bourne, who is head of public policy at the UK's Institute for Economic Affairs (IEA), presents some intriguing evidence on this. In Britain, following the introduction of rent control during World War I, private rental housing shrank from three-fourths of the housing stock in 1918 to just 10 percent by the late 1980s. He then cites research on the San Francisco market by Milton Friedman and George Stigler, who

looked at housing advertisements in the *San Francisco Chronicle*. In 1906 there were about three times as many “for rent” ads as “for sale” ads, but by 1946, after the city had adopted rent control, there were 73 times as many “for sale” ads as “for rent” ads.

Bourne also shows that rent controls do in fact lead to other problems that economists have predicted, such as declining quality and misallocation of space. “In the UK,” he writes, “the long-term effect of rent controls was severe disrepair—with 18 percent of rentable accommodation defined as unfit and needing repair” in a 1982 study. Rent control also interferes with the efficient use of space. Bourne cites a 2003 study of rent control in New York that found that 21 percent of interviewed landlords said they offered fewer rooms than they'd rent if there were no rent control.

Among other wasteful consequences of rent control, Bourne points to a deadweight cost that is largely overlooked: “With tenancy rent control inevitably comes an expansion of bureaucracy too—and this will also have a vested interest in more regulation.” Like other kinds of regulation, rent ceilings spawn officials who will seek to enlarge their budgets and scope of authority—a cost to all taxpayers.

Other topics / Rail travel is more prevalent in Britain than the United States, but Richard Wellings' chapter on the regulation of rail fares contains valuable lessons for Americans. Naturally, when government mandates “affordable” fares below market prices, we find overcrowding. Wellings, who is deputy editorial director and a transportation specialist at IEA, refers to “sardine-like conditions and hundreds of passengers left on the platform.”

But a less visible consequence is the rent-seeking by special interest groups. He notes that the rail industry takes advantage

of the inefficiencies caused by fare ceilings to lobby for increased government spending on infrastructure and rolling stock. Wellings argues that the British rail experience strongly supports Mancur Olson's point that government regulation leads to “distributional coalitions” of beneficiaries.

The book also contains excellent chapters on price controls in energy markets, financial markets, and “minimum unit pricing” (a British regulation that public health advocates claim leads to a decrease in excessive drinking). I will finish this review, however, with some comments on an area of personal interest, namely university price controls, ably discussed by Steven Schwartz, vice-chancellor of Brunel University.

In the UK, the government limits tuition at public universities so that they are “affordable” for students. Taxpayers must then make up the considerable difference between revenues and costs, which gives university officials lots of room for dubious expenses. Schwartz writes, “Universities also use their surpluses to provide staff with higher salaries, managers with better perks, and students with more lavish facilities. Just because an institution is not-for-profit does not mean that no one benefits.” The late Henry Manne made precisely that argument for decades.

Even with the tuition ceilings, many students take out college loans. And just as in the United States, Britain now faces a serious repayment problem; presently, about 45 percent of the UK loans have to be written off as uncollectable. The root of the problem is moral hazard: bearing no risk, the universities admit many academically marginal students who don't learn much of value and are unlikely to find employment that pays well enough to cover their loan payments. Schwartz offers good advice on that: make universities bear some of the risk of default. His solution is equally applicable here.

Summing up, the great value of *Flaws and Ceilings* is that it strongly argues against price control measures of all kinds. It would be an excellent choice as an ancillary text in grad school or even upper-level undergraduate classes in economics and public policy.



**Flaws and Ceilings:
Price Controls and the
Damage They Cause**

**Edited by
Christopher Coyne
and Rachel Coyne**
**198 pp.; Institute of
Economic Affairs, 2015**

Can the Fed Safely Pop Bubbles?

◆ REVIEW BY IKE BRANNON

The relatively meager economic growth of the past few years owes to a variety of causes, with declining population growth, moribund productivity gains, and a credit market that has yet to recover fully from the financial crisis being the most probable culprits. However, the notion that insufficiently expansionary monetary

policies hindered what should have been robust post-recession growth has broad currency across the zeitgeist: advancing this idea is almost the *raison d'être* of Paul Krugman. This perception is undoubtedly a reason that the Fed hesitates to end its current zero-interest-rate regime, as if another round of quantitative easing and another year or two with an interest rate of zero could return the economy to full employment.

While printing money may be easier to accomplish than expansionary fiscal policy, economists have long argued that expansive monetary policy isn't costless, and none more eloquently than Elmus Wicker, professor emeritus of economics at Indiana University. He has spent a remarkably fecund lifetime looking at the mistakes of monetary authorities, filling up several books in doing so. The stock market bubbles that arose in the 20th century—both before the Great Depression as well as the Internet bubble of the 1990s, among others—can be laid at the feet of monetary policy.

Wicker's latest book doesn't come to bury the Fed, but to praise it, or at least praise certain federal open market committees throughout the 20th century. He has

tasked himself with determining whether the Federal Reserve has shown the ability to burst speculative bubbles before they wreak havoc with financial markets and the broader economy.

The cost to our economy from these

bubbles, once they've exploded, can be immense: Wicker has pointed out in previous works that there is every reason to believe that the actions of the Federal Reserve not only contributed to the speculative stock market bubble in the late 1920s, but also exacerbated the length and depth of the Great Depression through a series of disastrous decisions. The Fed knew in the 1930s that keeping money tight would hasten bank collapses, but the view held by many at the time—especially in the Chicago Federal Reserve Bank—was that financial markets needed an occasional fire to clear the brush and lay the

groundwork for renewed growth, an inapt metaphor taken entirely too far.

Ubiquitous asset bubbles/ The major question regarding the art of deflating asset market bubbles is whether the Fed can even recognize those bubbles *ex ante* and, if so, whether it has the ability to gently prick such a bubble without hastening any market collapse and ancillary real

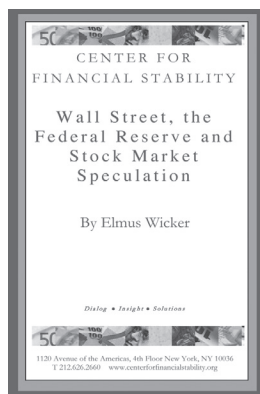
decline. Wicker argues that it has done precisely such a thing in the past, repeatedly and successfully. And on occasions when it has abjured such responsibilities, tears have resulted.

He posits that there have been 11 clear asset bubbles easily identifiable *ex post* since the Fed's inception: three before the Depression (including in 1928–1929) and eight afterward. The Fed successfully popped bubbles in 1919 and 1926, but in 1929 its behavior was inconsistent. Wicker shows that while it may have increased the discount rate in the late summer of 1929, the move was merely a seasonal adjustment that in no way constituted a monetary tightening. He argues that the Fed was unambiguously expansive until the collapse.

In the years after World War II, with the stock market crash still fresh in everyone's memory, the Fed regularly took action in various ways to rein in speculative bubbles and did so without any great damage to the broader economy. There were three such occasions in the 1950s and a couple in every one of the next five decades as well. This was not a task that occurred with extreme regularity, and the Fed had proven itself adept at reacting to them, according to Wicker. It has used a variety of tools at its disposal to effectively puncture them, most notably margin requirements.

It wasn't until Alan Greenspan became Fed chair that the Fed abandoned this task—to great harm, ultimately. Wicker takes apart Greenspan's famous utterance that identifying a bubble is beyond the ken of the monetary authority, and that for the Fed to deliberately inject itself into a market to do so means supplanting the collective decisionmaking of millions of market participants with the judgment of one man—or one bureaucracy. That perspective was shared to some degree by Greenspan's predecessor, Paul Volcker.

This attitude famously led to the so-called "Greenspan put," which is the notion that potentially disastrous market collapses would always be countered by accommodative Fed policies, thereby creating a moral hazard and encouraging risky wagers in financial markets. It's not



Wall Street, the Federal Reserve, and Stock Market Speculation: A Retrospective

By Elmus Wicker
94 pp.; Center for Financial Stability, 2015

at all clear that some variant of a “put” isn’t still in place today.

While anyone who is paying attention can agree that market bubbles can wreak havoc, whether the Fed can recognize them and subsequently deflate them with a minimum of grief is a question that sharply divides the discipline. Wicker has marshaled a wealth of evidence that the Greenspan doctrine is simply wrong: the Fed proved itself capable of discerning lacunae between market and fundamental asset values and deflating bubbles, with a record of success that spans decades as well as a variety of regimes and chairs. Abdicating a job it had done commendably for over 60 years because the evidence suggests it cannot be done is an interesting decision, and one that was not widely challenged at the time—to our everlasting regret, Wicker suggests.

A useful lesson? / Wicker is a remarkably lucky economist. I say that because as arguably the world’s foremost living monetary historian, who cut his teeth studying the causes of the Great Depression under John Hicks, he may be the only one of his ilk who was able to experience both the Great Depression and the financial crisis of 2008 and lived to write about them both.

His research brings forth a positive message: the Fed has indeed proven itself able to recognize asset price bubbles and it has shown itself capable of deflating them with little or no ancillary damage. Abjuring such a responsibility—as it has done for the last three decades—is a prescription for disaster.

Stock market bubbles can impose severe economic costs. Wicker reminds us that the stock market boom in the late 1990s directed billions of dollars of capital to Silicon Valley and the information technology sector that could have been used much more productively elsewhere. And the housing bubble engendered by the loose monetary policy in the early 2000s sent billions into misbegotten housing investments, lit the fuse for the financial crisis that caused trillions of dollars of wealth to evaporate, and triggered a steep recession.

These days it sometimes seems that the Fed has few defenders. Wicker has had a few bones to pick with the institution over the years, but he has identified a skill that it ably exercised for decades, but that many now deny ever existed. While conservatives today go to pains to do what they can to circumscribe its efforts—and not without good reason—we should also recognize what it can do. Finding and ending speculative bubbles before their effects cross over to the real economy would be an incredibly valuable contribution to society. Assigning itself such a task would impose a genuine con-

straint on an otherwise natural tendency for the Fed to accommodate financial markets as long as there are no overt signs of price inflation.

In other words, listening to Wicker’s findings would be akin to asking the Fed to consider a broader price index than just the Consumer Price Index or Personal Consumption Expenditure Index. It would also entail more than merely watching a single number and require it to monitor price trends across markets—a task that it is surely capable of performing.

Failing to do so could be enormously costly. R

Shaky Housing Policy Logic

♦ REVIEWED BY VERN MCKINLEY

The lingering policy issues from the financial crisis can be divided into two major categories: those that Congress has addressed through the Dodd-Frank Act (I believe most of the law’s provisions were unsatisfying, to say the least) and those that were not addressed at all. Fannie Mae and Freddie Mac, the two government-sponsored enterprises (GSEs) that dominate the mortgage industry, fall into the latter category.

In her new book *Shaky Ground*, financial journalist and former Goldman Sachs analyst Bethany McLean tackles that most intractable of policy issues: what should we do with the two GSEs, which the government took control of in September 2008. She makes a commitment in the book’s preface: “What I’ve tried to do in this book is to lay out the facts in a way that I hope will help readers think about the issues and make up their own minds. This is too important to let special interests determine the outcome while we play possum.”

I have closely followed the saga of Fannie and Freddie since I wrote a paper on them for the Cato Institute in 1997 (“The Mounting Case for Privatizing Fannie Mae

and Freddie Mac,” *Policy Analysis* no. 293). I was hopeful based on this initial passage and her history that McLean would bring to the table a balanced, fact-based, and measured analysis of a topic that usually is discussed at a volume “up to 11,” to borrow from Nigel Tufnel.

McLean has developed a reputation as a fair arbiter of financial policy matters. She has two previous financial policy books to her name: *The Smartest Guys in the Room* (Portfolio, 2003; co-authored with Peter Elkind), which tells the tale of the fall of Enron, and *All the Devils Are Here* (Portfolio, 2011; co-authored with Joe Nocera), which traces the history of the mortgage industry in the lead-up to the financial crisis of 2007–2009. The latter does an excellent job of weaving together an interesting history of the industry and the policy push for increased homeownership, although I didn’t always agree with its policy implications. For the most part, McLean and Nocera got the history right.

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Leading the reader / In her preface to the new book, McLean calls Fannie and Freddie “two of the villains” in the run-up to the financial crisis. In one of her introductory chapters, she carefully and rightly lays some blame for the crisis on the pair, albeit not particularly forcefully:

There is truth to the broad argument that government housing policies, of which [Fannie and Freddie] were one instrument, helped cause the crisis. The government did push for weaker lending standards, and Fannie and Freddie certainly helped facilitate that. And there is an argument that Fannie and Freddie helped blow the bubble bigger than it otherwise would have been.

So far so good.

But then she gets sidetracked, dedicating most of her third chapter, titled “The Blame Game,” to an attack on American Enterprise Institute scholar Peter Wallison, who has been criticizing Fannie and Freddie since the 1990s. He was one of the few people back then warning against the increasing influence (political and financial) of the GSEs and the risks they posed to the financial system.

One would think McLean would recognize Wallison as a lonely voice whose early warnings turned out to be prescient, but no. In the early stages of the chapter she recounts a snarky comment from one of his detractors: “Everyone agrees that there is simply no way to make Peter happy.” After that unhelpful quote, she commits the rest of the chapter to deriding what she calls “Wallison’s narrative.” The back-and-forth in this chapter really is unnecessary and her approach of “leading the witness” (readers) to conclusions about Wallison’s theories about the financial crisis gets away from her objective to simply “lay out the facts” and let readers make up their own minds.

In this same chapter McLean further tries to convince the reader that Fannie and Freddie’s purchased loans were not that risky, notwithstanding the fact that she acknowledges that those loans put the pair on the brink of insolvency. She also claims that subprime lending was “never truly about homeownership,” notwithstanding the fact that as subprime lending took hold, the homeownership rate spiked to nearly 70 percent.

Part Two of the book, which recounts the history of the two GSEs from the 1930s

to the early 2000s, really does not add much new information to the public store of knowledge on Fannie and Freddie. Many of the same facts are recounted in *All the Devils Are Here* or in another book that McLean cites throughout *Shaky Ground*, *The Mortgage Wars* (McGraw-Hill, 2013), authored by former Fannie Mae chief financial officer Tim Howard. If a reader has followed the mortgage market and its history over the past decade, this material will simply be a review. This summary approach would be alright in most cases, but

Shaky Ground is a relatively compact book and by this point McLean has burned through nearly two-thirds of its pages without getting into the nitty gritty of the policy update on Fannie and Freddie since the government takeover, reserved for Part Three of the book.

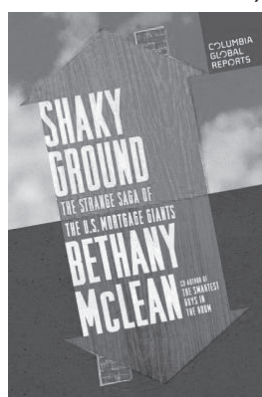
Winding down (or not) / In this final part of the book, labeled “Limbo,” which is how the status of Fannie and Freddie has been described by many observers (myself included), McLean embarks on whirlwind coverage of:

- The contrasting and lurching leadership parade at the Federal Housing Finance Agency, which acts as conservator for Fannie and Freddie. First, Ed DeMarco tried to reduce the pair’s

footprint on the industry and protect taxpayers. Then DeMarco’s successor, Melvin Watt, began moving the GSEs back to the status quo, as explained in a quote in the book by Cato’s Mark Calabria.

- The dysfunctional signals emitted from the political world about what to do with Fannie and Freddie. This is best epitomized by the fact that the major financial reform effort since the crisis, Dodd-Frank, did nothing to resolve the “limbo.” Adding to the mess has been the conflicting signals from the Obama administration that on the one hand indicate the White House wants to “ultimately wind down” the pair, but on the other hand show a desire for maintaining a government role in the housing market to mitigate the next downturn.
- In a chapter notably called “Mr. Hedge Fund Goes to Washington,” McLean explains how hedge funders came to invest in Fannie and Freddie *after* they were placed in government conservatorship, how Treasury ended up “taking” all the underlying value in the pair through a profit sweep, and the litigation that predictably ensued. Trust me, this is the best I can explain this legal morass in a 1,500 word book review.
- Corker-Warner, the legislative plan that “would have killed Fannie and Freddie” once and for all, but because the stakeholders in housing reform are so splintered, it can only boast a plurality of support.

To me there are some hot topics that would have made for even more interesting reading had McLean included them in this third part. Foremost among them is a building controversy over whether Fannie Mae and Freddie Mac were insolvent when they were taken over and placed into conservatorship by the government, and whether the takeover was even justified. Looking into this topic would have required some good investigative reporting combined with a few well-placed Freedom of Information Act requests to try to determine what informa-



Shaky Ground: The Strange Saga of the U.S. Mortgage Giants

By Bethany McLean
159 pp.; Columbia
Global Reports, 2015

tion the government had on the solvency of Fannie and Freddie, and whether it was reasonable to place them in conservatorship based on that information. McLean enters a theoretical discussion of the GSEs' "net worth," but ultimately bypasses the topic of solvency, explaining in a C-SPAN interview with the *Wall Street Journal's* Joe Light that "I tend to cut the government a little slack" on such matters. That's not a particularly satisfying outcome for those readers interested in questioning the whole basis for government intervention in the Fannie and Freddie case.

Conclusion / In the final chapter, McLean begrudgingly throws up her arms and pledges her support for the idea of reanimating Fannie and Freddie: "better the devil you sort of know." According to her logic, this will be done with a Fannie and Freddie with "much higher capital levels, more competent regulation [whatever that means], maybe an explicit guarantee for which they pay the government, and no portfolio business." The only problem with her logic is that it bears a striking resemblance to what we had in the bygone years of Fannie and Freddie, but that busi-

ness model slowly evolved into the "toxic twins" through the political power of the housing industrial complex. Based on that history, the wild hope that this optimistic scenario can ultimately unfold is not intellectually defensible.

In looking at what she perceives as the benefits of Fannie and Freddie, McLean never explains why she believes that government should ensure a wide availability of 30-year mortgages. That is especially troubling given that so much of the benefit of the government backstopping of Fannie and Freddie flows to upper-middle-income and high-income homeowners (myself included). She also does not explain why we should keep in place this duopoly pair of enterprises given the systemic risk this distorted market structure presents.

For readers who have followed the soap opera of Fannie and Freddie since well before the financial crisis, much of this book will be review and largely a disappointment. For those less schooled in the arcane nature of the pair, the middle chapters will be a useful tutorial in how *not* to structure U.S. housing policy going forward. We should not make the same mistakes over and over again. R

are continuously growing richer and the poor poorer."

Fitzhugh (1806–1881) was a Virginia lawyer who mainly earned a living with his pro-slavery books and newspaper articles. His conservatism and opposition to revolutions made him suspicious of secession, but he sided with the Confederacy once the Civil War began. He also accepted the Confederacy's defeat gracefully. He even worked as a court agent in the post-bellum federal Freedmen's Bureau and as an associate judge in the Freedmen's Court. He loved all governments, at least potentially, including the federal government. In fact, his biggest lament was that the federal government wasn't interventionist enough; as he wrote before the war, "The element of force exists probably in too small a degree in our Federal Government."

Fitzhugh's thesis / His first book, *Sociology for the South: Or the Failure of Free Society*, published in 1854, argues that the experiment of free societies has been a disaster for humanity and that a return to slavery is warranted. In this pamphleteer's work, he used the recently coined word "sociology" to mean a theory criticizing free societies. His second book, *Cannibals All! Or, Slaves Without Masters*, published three years later, emphasizes, in what he said was "a more rigidly analytical manner," that competition reduces individuals to economic cannibals, making the weak no better off than slaves—and, in fact, worse off because they lack the protection of a master.

According to Fitzhugh, supposedly free workers are exploited by capitalists. Competition forces them to underbid their fellow workers and accept subsistence wages, which leads them to destitute lives. As a result, crime and vice are rampant in free societies; men beat their wives. It was the general recognition of these problems that fueled socialism. "We are a Socialist," he wrote, using the academic "we." Free trade is the terrible result of liberty: "Admit liberty to be a good, and you leave no room to argue that free trade is an evil—because liberty is free trade."

A Coherent Authoritarian

◆ REVIEWS BY PIERRE LEMIEUX

Western politics in the 21st century is a continuation of old debates. One of these is between paternalism and individual liberty: can society allow individuals to make their own choices, or should political authorities make lifestyle choices on people's behalf and for their own good?

Today's so-called "populist" right and "populist" left want a strong state that is capable of overriding individual choices, whether it be in matters of trade or of domestic allocation of resources.

An interesting predecessor of this orientation was the American George Fitzhugh.

Largely forgotten today, he was an influential 19th century intellectual who was deeply opposed to individual liberty and a strong proponent of slavery. See if this bit of Fitzhugh sounds especially contemporary: "Whether between nations or individuals, the war of free trade is constantly widening the relative abilities of the weak and the strong. It has been justly observed that under this system the rich

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IN REVIEW

Like Aristotle, Fitzhugh starts from the idea that man is a social animal. Property is but a trust that must be exercised “for the good of all society.” And society is prior to the individual:

Man is born a member of society.... He and society are congenital. Society is the being—he one of the members of that being. He has no rights whatever, as opposed to the interests of society.... Whatever rights he has are subordinate to the good of the whole; and he has never ceded rights to it, for he was born a slave, and had no rights to cede.

People need to be governed because, without government, society would collapse into a war of all against all. Everybody needs government, but the weak more than others, Fitzhugh argued. Individuals who are able to control their passions can live under a government of laws; the others need a more personal and arbitrary government to be protected against exploiters and against themselves.

In competition and trade, “the intellectually astute and powerful conquer and subject those who are intellectually feeble,” he claimed. Government cares about its subjects and, therefore, must control them: “It is the duty of society to protect the weak.” But those who require protection and support must also accept being controlled, “for the price of security has ever been, and ever will be, the loss of liberty.”

All government is involuntary, he noted approvingly, and all forms of government are slavery. Family government is slavery, for children and wives obey their fathers and husbands. Submitting to labor associations to avoid or mitigate exploitation also implies slavery. Even more so does civil government. Soldiers are slaves. Everybody is more or less the slave of his government. This is a good thing, he thought, not bad.

When we look at the state of free societies, we realize that we need more, not less government, according to Fitzhugh. Socialists recognize this, but do not yet understand that “slavery is a form, and the very best form, of socialism.” Expound-

ing on an idea that socialists and fascists would repeat endlessly in the future, he argued that “as civilization advances, liberty recedes.”

Fitzhugh, of course, wanted nothing to do with anarchy or “the sovereignty of the individual.” He was against all liberty: “no one ought to be free.” He summarized his political theory with one of his great aphorisms: “Liberty is an evil which government is intended to correct.”

For Fitzhugh, “negroes” need most to be controlled because they are naturally lazy, intemperate, and improvident. “Slavery,” he wrote, “is the only thing in the world that can enforce temperance.” He invited his readers to compare the Southern slave to the recently emancipated slave in the West Indies: the latter “*is really* free, and luxuriates in sloth, ignorance and liberty, as none but a negro can.”

A slave has a master to take care of him during his whole life. Indeed, it is in the master’s interest to take care of his property; “slaves never die of hunger,” he observed. It is because he has an owner that the slave is well taken care of, contrary to the destitute free laborer. In non-slave societies, domestic animals are better cared for than workers.

Slaves realize that they need masters, Fitzhugh claimed, and slaves are happy. A slave owns his master nearly as much as the master owns his slave, Fitzhugh reasoned, because the master owes continuing support to the slave, or else he must sell him. The slave is a member of his master’s family and indirectly partakes in the ownership of the farm; this is why he boasts of “our crops, horses, fields, and castle.”

The master is a socialist power who takes care of and controls his wards, Fitzhugh argued: “A Southern farm is the beau ideal of Communism.” Everybody receives according to his wants. The masters need more, they get more. The slaves need less, but they get everything they need: “The slaves are well fed, well clad, have plenty of fuel, and are happy.”

Slavery, Fitzhugh explains, has always existed. It was approved by the Bible and by the highest philosophical authorities of

antiquity: “The true vindication of slavery must be founded on [Aristotle’s] theory of man’s social nature, as opposed to Locke’s theory of the Social Contract, on which latter Free Society rests for support.”

It’s not only the blacks who need masters: 19 out of every 20 individuals need “guardians, trustees, husbands, or masters,” Fitzhugh explained. The weak need to be protected from the strong:

We do not set children and women free because they are not capable of taking care of themselves, not equal to the constant struggle of society. To set them free would be to give the lamb to the wolf to take care of.

For many, freedom is slavery, and only (total) slavery can liberate them. If the poor and destitute could legally sell themselves into perpetual slavery, many would be happy and wise to do so.

Debatable approach/ What to think about all this? Beyond his racism and his distasteful conclusions, Fitzhugh’s approach and methods are highly debatable (to put it charitably). He entertains an organicist vision of society: “The social body is of itself a thinking, acting, sentient being.” At other times, his approach is more neatly collectivist, as when he argues that, with the respective duties of slaves and masters and the social limitations of private property, “*every man has property in his fellow-man!*” (emphasis is Fitzhugh’s); or that “national wealth” is much greater than the sum of individual wealth. On this last point, he adds, “this is a most interesting subject,” but one that he has “not mastered”—a comment befitting many of the topics he covered.

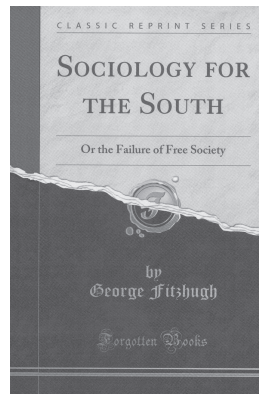
As much as Fitzhugh’s theory looks coherent, it is full of gibberish and logical sleights of hand. He did not believe in organized thinking, preferring what he considered “common sense”: “Philosophy is always wrong and instinct and common sense always right.” “We are no regular-built scholar—have pursued no ‘royal road to mathematics,’ nor to anything else,” he was proud to say; but he claimed to “have,

by observation and desultory reading, picked up our information by the wayside, and endeavored to arrange, generalize, and digest it for ourselves.” In an 1855 private letter, he confessed that “my pseudo-learning is all gathered from Reviews.... Newspapers, novels, Reviews, are the sources of my information.” This rejection of organized knowledge is typical of today’s populists, both of the right and left.

Fitzhugh never attended college, but he was not wholly ignorant of Western ideas and literature, as his numerous quotations from Virgil, Horace, and other ancients show. His culture, however, seems to have been pretty much limited to the ancients, the Bible, and a few modern reactionary writers. He thought that the South’s institutions “combine most that was good in those of Rome and Greece, of Judea, and of Medieval England.”

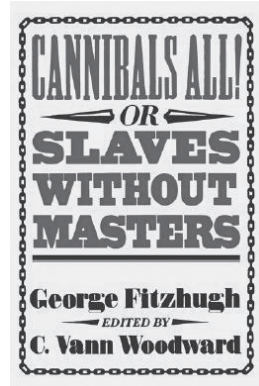
Fitzhugh disliked political economy, which “is the science of free society,” as opposed to socialism, which is “the science of slavery.” He had quite certainly not read Adam Smith or the other economists he attacked, like David Ricardo or Jean-Baptiste Say. He did not understand how an increase in the money supply would lead to a higher price level. He was hopelessly confused between money and wealth. He did not understand comparative advantages. Those are just a few examples of his intellectual shortcomings.

He also gets many of his facts wrong. Fitzhugh spent all his life in Virginia, and had little direct experience of the world, save for a short trip to the North to deliver a speech at the New Haven, Conn., Lyceum. Nonetheless, though he



Sociology for the South: Or the Failure of Free Society

By George Fitzhugh
310 pp.; A. Morris,
1854



Cannibals All! Or Slaves Without Masters

By George Fitzhugh
379 pp.; A. Morris,
1857

could not have known everything we now know about the industrial revolution and the economics of slavery, he could still have avoided his worst mistakes. Economic freedom was already increasing the standard of living for common laborers in the Western world. He observed that advancement in Connecticut but dismissed it as anything but a temporary phenomenon, partly caused by parasitic trade.

Economic historians (see Robert Fogel and Stanley Engerman’s work) confirm that the Southern slave was generally well treated, for the master wanted to protect his capital. An average slave was worth, and could be sold for, about \$1,000 at the time Fitzhugh was writing. (Fitzhugh’s own figure of \$700 was an underestimate.) Assuming 2 percent annual inflation, that equates to \$23,000 in today’s dollars. Over his lifetime, the average slave got back, in shelter, food, fuel, other maintenance expenses, and some cash, 88 percent of what he produced for his master. His calorie intake was higher than even our current standards. But contra Fitzhugh, the South-

ern slaves were not lazy and inefficient; they were hard workers who made the large plantations efficient and profitable businesses.

As for the slave-owner, he was not, as Fitzhugh tried to persuade his readers, the “least selfish of men.” Fogel and Engerman calculate that the return on capital on large plantations was 10 percent, the same as the typical return on capital of the most successful New England textile firms. Southern slave owners were efficient businessmen, not disinterested paternalists. Fitzhugh, who

was not always perfectly consistent, admitted elsewhere that “motives of self-interest” also animated slave owners.

His general thesis is based on peculiar definitions of liberty and slavery. He takes liberty to mean the absence of any constraint, including those generated by voluntary contracts and non-coercive social institutions. He correctly blames socialists and anarchists for defending this licentious and unworkable “liberty,” but he uses their definition of the term. He also adopts a very wide concept of slavery as encompassing any constraint on the exercise of liberty. Since slavery in this very wide sense is defensible, while unconstrained liberty is not, he concludes that slavery in the strict sense—the perpetual appropriation of another person’s body—is also desirable, which is a non sequitur if ever there was one. He chose his fuzzy definitions to make his analysis possible and to lead directly to his conclusions.

Catalog of economic errors/ Fitzhugh had no idea of how free markets work. It is true that competitive workers bid down wages until all can find jobs. But it is also true—and completely ignored by Fitzhugh—that competitive employers bid up wages until exploitation is reduced to zero. It is for this very reason that the standard of living of Connecticut workers in Fitzhugh’s day was high and rising. But he did not build on his observation of the free workers’ standard of living, either because he did not have a theory capable of incorporating it or because he was more a pamphleteer and a propagandist than a scholar.

He apparently had no idea of the normative values that economists naturally entertain when they leave the domain of purely positive analysis. Consider his argument about slaves as well-maintained property. The master who owns his slave’s human capital will of course take better care of that capital than if it were *owned by no one*. But the individual who owns his own human capital also has plenty of incentive to take care of it. He knows what’s good for himself and will use, or invest in, his human capital in a way to

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maximize his own utility given his own preferences. Fitzhugh was able to claim that the free worker's human capital would be neglected only by negating individual preferences and paternalistically assuming that the master knew better than the slave what was good for the latter.

In this viewpoint, Fitzhugh was not unique. Most justifications of power, whether from the left or right, rely on paternalism and the negation of individual preferences. But Fitzhugh was more openly coherent. He also pushed what we would today call cost-benefit analysis to its limit. At the end of *Cannibals All!*, he asked if it would not be better, in case of a surplus of slave labor, to kill the surplus slaves instead of setting them free. The latter solution, he explained, would not only condemn the freedmen to starvation, but would also push down wages for other free workers. In other words, the cost of setting slaves free would be higher than its benefits.

Do capitalists exploit workers? A positive answer implies adopting the labor theory of value: the idea that all value is created by labor. As many 19th-century economists already knew, production also requires capital (tools, machines, buildings, other equipment), which is not totally traceable to labor. The capitalists bring a contribution by forgoing consumption in order to accumulate capital, which has its own productivity. The capitalists' remuneration is thus not stolen from labor. Moreover, labor is not homogeneous: are managers and executives also exploited? Finally, consumer preferences also contribute to creating value.

If we accept that an individual is best positioned to know what brings him the most utility, any act of exchange creates benefits for all parties to the exchange, compared to a situation where exchange had not occurred. Otherwise, at least one of the parties would have declined the exchange. So we know that a worker who accepts a job—who exchanges his labor for a remuneration—benefits. Economists call this the benefits of exchange. The owners of capital also benefit, of course, but they can't expropriate the workers' own

contribution. The same reasoning does not apply to the slave, who is forced to accept whatever his owner pays him and does not benefit from the competition of other employers.

Fitzhugh actually believed in a very naive version of the labor theory of value: that one hour of work should always exchange exactly for another hour of work—whatever the value of the thing produced or the nature of the work. He

In his wishful thinking, masters were not subjected to the human nature he so often invoked when decrying capitalism and economic liberty.

defined any other exchange as exploitation, which condemns virtually all acts of exchange. No surprise that he saw exploitation everywhere, although he had a blind spot for slavery. He should have read Smith and Say.

Fogel and Engerman estimate that "the average income received by a prime [slave] field hand, including benefits in kind, was roughly 15 percent greater than the income he would have received for his labor as a free agricultural worker." Does that mean, as Fitzhugh would have it, that the slave was better compensated than the free worker? Of course not. The slave's freedom was severely restricted, which was a large cost that must be deducted from his real income. Fogel and Engerman find that after the abolition of slavery, large plantations could not survive because they were unable to pay enough to attract free workers. Fitzhugh was not wrong when he claimed that, at least on large plantations, free labor was, *for the plantation owner*, cheaper than slave labor. But the slave—*from the point of view of the slave*—received much less if we include the servitude that came with his pay package. He was paid much less in real income (pecuniary income minus lost utility from enslavement) than a free worker. Free labor would have demanded much

more than the 15 percent premium in return for doing slaves' work on large plantations.

Economic freedom is efficient precisely because it allows every individual to express his own preferences without an outside owner overriding them. All individuals are free to express their preferences in their market transactions and, because competition is free, nobody is normally under the domination of only one buyer or seller. The slave, on the contrary, cannot partake in this efficiency and is necessarily exploited by his monopolistic master. The threat of the whip partly replaces economic incentives. At the time Fitzhugh was writing,

people were poor compared to today, but the efficiency of liberty had already multiplied the incomes of free workers.

Fitzhugh claimed that free individuals are economic cannibals, and that the weaker ones end up being dominated and exploited just like slaves but without the benefit of a protective master. In his wishful thinking, masters were not subjected to the human nature that he so often invoked when decrying capitalism and economic liberty. In reality, masters could cannibalize their slaves much better in the absence of competition from other employers (and in the absence of an easy escape to the North or West). And Fitzhugh did not see that "cannibalism" better characterized the more powerful government he desired.

Conservatism and socialism / Fitzhugh's intellectual construction is very fragile and ultimately rests on the double assumption that free markets don't work in the interest of their participants, and that political government is a master as benevolent as parents toward their children. *Sociology for the South* and *Cannibals All!* brew a strange mixture of socialism and conservatism. "Extremes meet," he notes. Authoritarian power is the common denominator.

That all individuals are slaves to society fits well with a socialist ideol-

ogy stripped of its millenarianist hopes. Fitzhugh concurred with the socialists “that free competition is the bane of modern society,” and “that it is right and necessary to establish in some modified degree, a community of property.” “We agree with them,” he explained, “in the end they propose to attain, and only differ as to the means.”

Fitzhugh was also a conservative. Things must not change. The epigraph of *Sociology for the South* is taken from *Ecclesiastes*: “The thing that has been, it is that which shall be; and that which is done is that which shall be done; and there is no new thing under the sun.”

But what to conserve? Often, conservatives want to conserve what is, but only if it fits precisely what should be. Fitzhugh thought that the South was as it should be, but he was pushing for still more authoritarianism (in the form of protectionism, for example).

Things did change, in the North as well as the South, with the federal power grab that accompanied and followed the Civil War, as shown by Jeffrey Hummel in *Emancipating the Slaves, Enslaving Free Men*. In a sense, Fitzhugh got his wishes:

More of despotic discretion, and less of Law, is what the world wants.... A constitution, strictly construed, is absolutely inconsistent with permanent national existence.

Racists like Fitzhugh were completely defeated by the abolition of slavery. Fogel and Engerman note:

What antislavery critics generally objected to was not the fact that slavery constrained the opportunities open to the blacks, but the form which these constraints took. While physical force was unacceptable, legal restrictions were not. Thus many one-time crusaders against slavery sat idly by, or even collaborated in passing various laws which serve to improve the economic position of whites at the expense of blacks. Licensure laws helped to squeeze blacks out of some crafts. Educational restric-

tions helped to exclude them from others. Meanwhile, taxation and fiscal policies were used to transfer income from blacks to whites, perhaps more effectively, certainly more elegantly, than had been possible under slavery.

One could argue that there is not much to learn in Fitzhugh's books, except for a catalog of economic errors and a testimony in economic and intellectual history. But they offer much of interest in those areas. And nearly every page, especially perhaps in

Sociology for the South, contains an unforgettable aphorism illustrating the absurdity of authoritarianism. All in all, the two books are well worth reading. R

READINGS

- *Ante-Bellum: Writings of George Fitzhugh and Hinton Rowan Helper on Slavery*, edited by Harvey Wish. G. P. Putnam's Sons, 1980.
- *Emancipating Slaves, Enslaving Free Men*, by Jeffrey Rogers Hummel. Open Court, 1996.
- *Time on the Cross: The Economics of Negro Slavery*, Vols. 1 & 2, by Robert William Fogel and Stanley L. Engerman. Little, Brown, 1974.

The Essence of Hayek

◆ REVIEW BY DAVID R. HENDERSON

One of the greatest economics thinkers of the 20th century was the late Austrian economist Friedrich A. Hayek. He was Austrian in both senses of the word: he was from Austria, and he was a leader of the Austrian School of economic thought. In his critiques of central planning, he wrote articles that are still widely read

today, especially his 1945 classic, “The Use of Knowledge in Society.” *The Road to Serfdom*, his 1944 warning that central planning would reduce not just economic freedom but also political freedom and civil liberties, is still in print 70 years later. In the 1970s and 1980s, he also did groundbreaking work on the legal system.

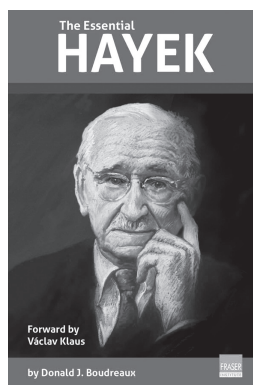
Unfortunately, many people find his work hard to read. Partly because of his Germanic writing style—with long sentences containing many dependent clauses—many people don't have the patience to read him. What has been needed for some time is a book that gives his central insights succinctly in

an easy-to-read format.

George Mason University economist Don Boudreaux has written such a book. Boudreaux, who regards Hayek as his “greatest hero,” covers the high points of Hayek's work. (Disclosure: Boudreaux is also a senior fellow with the Vancouver-based Fraser Institute, where I am a senior fellow.)

Probably Hayek's most important contribution to economics was the aforementioned article, “The Use of Knowledge in Society.” Boudreaux explains Hayek's insights in the article beautifully. Hayek had laid out how

the price system—that is, the free market—coordinates the activities of literally millions of producers and consumers around the world, allowing each to use his or her own special skills. Boudreaux explains the problems that the market solves with a



The Essential Hayek

By Donald J. Boudreaux

85 pp.; Fraser Institute, 2014

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clever analogy: the economy as a jigsaw puzzle with a billion pieces. One person, the analog of a central planner, can't possibly make all the pieces fit. But the price system gives an incentive to each individual to make his own piece fit. Quoting his George Mason colleagues Tyler Cowen and Alex Tabarrok, Boudreaux writes, "A price is a signal wrapped up in an incentive."

Law and legislation / In one brief chapter on the rule of law, Boudreaux nicely lays out how it is like traffic rules. When people understand that they are to stop at a red light, things work much better than when some drivers don't stop at a red. But this means that we should hold all drivers, no matter what their status, to the same rules. He writes,

If some class of drivers (say, red-headed people) were free to ignore traffic lights, then the value of traffic lights to all other drivers would be greatly reduced. A driver approaching an intersection when the light is green would still have to slow down and look to ensure that no red-headed driver is barreling through the intersection. Traffic accidents would increase and the traffic flow would slow down.

Similarly, when

all people, including the highest government officials, are bound by the same general and impartial rules, every individual enjoys the greatest chances of achieving as many as possible of his own chosen ends. True equality reigns.

Boudreaux notes that this is equality before the law, but not equality of outcomes. Refreshingly, but not surprisingly given his generally clear thinking, he does not fall into the trap of advocating equality of opportunity. The Kennedy or Rockefeller or Gates child born into a rich family will always have an advantage, and the only way to neutralize that advantage is to have the government take away most of the rich families' wealth.

One of the distinctions that Boudreaux and Hayek both stress is the one between

law and legislation. Boudreaux illustrates this with three nice examples, two of law and one of legislation. On the law side, he tells a story that anyone who has ever parked at a shopping mall is probably familiar with. You are looking for a parking spot and see a car pulling out, so you turn on your blinker to signal that you are in line for that spot. Another driver, seeing that you are waiting, drives on to find a different parking spot. "In this everyday example," he writes, "you and the other driver are governed by law." You are widely recognized as having established for yourself "a temporary property right to that space." But that right is not written down anywhere and did not come about because of some committee. Rather, it "emerged, unplanned and unintended, in the course of human interactions."

His second example of law is the *lex mercatoria*, or the "Law Merchant." This evolved among merchants as international trade developed. When conflicts arose—usually because of differences in expectations—courts, staffed by merchants themselves, ruled on the conflicts. Moreover, no government enforced the courts' rulings. Concern about one's reputation was the "enforcer."

An example of legislation that Boudreaux gives is a provision in Massachusetts' criminal code that makes it a "criminal offense for two unmarried adults to have consensual sex with each other." Boudreaux writes that no police officer would arrest people who violated this legislation. Moreover, he writes, if some out-of-touch policeman and court did attempt to punish an unmarried couple for this "crime," the public "would regard the police officer and the court—not the couple—as having broken the law."

On his blog, *Café Hayek*, Boudreaux often emphasizes the distinction between law and legislation. The above examples crystallize that distinction well.

Group arrangements / In a chapter titled "The Challenge of Living Successfully in Modern Society," Boudreaux points out, as did Hayek, the two different social

arrangements we all find ourselves in: that of our families and close friends, which he calls "small-group arrangements," and that of millions of strangers, which he calls "large-group arrangements." It's a challenge, he argues, to be able to "function comfortably within *both* types of arrangements." The reason: behaviors that are appropriate in one setting are not necessarily appropriate in the other.

One big difference is that "small-group norms of fairness that work well for determining the distribution of goods and resources within families and among friends are inappropriate for judging the distribution of goods and resources in the larger society." Boudreaux points out that we can know, for example, whether our brother's low income is the result of bad luck or his choices, but we can't know that kind of detail about strangers. Indeed, he writes, "The best available means of gauging the size of each person's contribution to the economy is to measure the monetary earnings he or she amasses in dealing peacefully in the market with customers, suppliers, and competitors."

He does an excellent job of relating Hayek's views on the causes of booms and busts. I do have a problem with those views (though not with Boudreaux's exposition of them): According to Hayek, the central bank, by expanding the money supply, plays a central role in causing a boom. That's good reasoning so far. But the business people who build long-run projects in response to artificially low interest rates overexpand, leading to future problems and a bust. Why do they make this mistake repeatedly? There's an old saying, "Fool me once, shame on you; fool me twice, shame on me." Even animals often learn to stay away from other animals that have attacked members of their herd. Wouldn't human animals be even better at learning that when the central bank increases the money supply substantially, they shouldn't be fooled by artificially low interest rates?

At an Austrian economics conference in Hartford, Conn., in 1975, I asked Hayek if he agreed with me that his theory would

collapse if people had what economists call “rational expectations.” He didn’t address my question directly, but said that he didn’t believe in rational expectations. Yet even if you don’t buy the extreme version of rational expectations, all you need for the Austrian business cycle theory to break down is that it gets harder and harder for the central bank to fool people.

Ideas and government/ In the final chapter, “Ideas Have Consequences,” Boudreaux argues, as did Hayek and John Maynard Keynes before him, that in the long run, people’s ideas affect government policies. He contrasts that view with Karl Marx and George Stigler, who believed that government policies are the result of the interplay of various interests. Boudreaux challenges that latter view in two ways. First, he notes, we live in groups and we are constantly talking and writing. He asks, “And what are talking and writing if not a sharing of ideas?” This reminds me of a statement by Stigler at the Mont Pelerin Society meetings in Hong Kong in 1978. In his presidential address, he had told the assembled members and guests not to kid themselves that they could influence policy because you can’t tell policymakers anything they don’t already know. I asked him if a fair summary of his talk was that there is no point in trying to persuade people of things because they already have all the information they need. “Yes,” he replied. “Ok,” I said, “so why did you give this talk?”

Boudreaux points to other strong evidence against the Marx/Stigler view. He argues that “if government policies are driven only by special-interest groups—and therefore that the ideas that people have about the ‘rightness’ or ‘wrongness’ of policies are irrelevant—then the government wouldn’t bother to portray farm subsidies and the creation of other special-interest-group privileges as being in the public interest.” Politicians’ dishonesty and duplicity, notes Boudreaux, “testify to the power of ideas.”

Fortunately, in *The Essential Hayek*, Boudreaux is spreading largely good ideas. R

The Power of Private Ordering

◆ REVIEW BY THOMAS A. HEMPHILL

When Americans think of economic regulation, they think of government as the regulator, both developing and enforcing rules. Regulation is the result of legislation enacted by national, state, and local governments, then fleshed out and implemented by administrative agencies, all for the purpose of

“correcting” an observed “market failure.”

This focus on government as the solution to market failure problems is misplaced, argues Edward Peter Stringham, the Davis Professor of Economic Organizations and Innovation at Trinity College in Connecticut. Successful private governance solutions presently permeate the marketplace, and more such private arrangements can be used to address problems now considered the responsibility of government.

In his new book, *Private Governance*, Stringham utilizes analytic approaches drawn from economic history, law and economics, finance, and public choice theory to assist in his building a case for private ordering and self-regulation. He provides the reader with detailed historical examples of the development of national stock markets—including private self-regulation efforts—in Great Britain and the United States, as well as private policing efforts in California and North Carolina. In a more modern vein, he discusses the development of private governance mechanisms to combat online fraud in e-commerce (PayPal), commercial dispute resolution, and the importance of under-

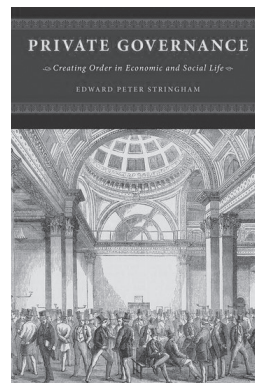
standing risk management in relation to financial derivatives that are responsible for expanding the scope of markets.

Stringham proposes the following hypotheses: Fraud is pervasive in commercial transactions, but so are private

solutions to mitigate it. Private parties have incentive to create nonviolent, socially constructed solutions for unwanted behavior, though these often are underappreciated by policymakers and the general public. And private governance is a common form of social ordering in society, but is rarely noticed by most consumers. By presenting these hypotheses, he explores the use of many private ordering mechanisms, including sorting, reputation, assurance, bonding, and risk management techniques. All of these are offered in contrast to what is referred to as the “legal centralism”

approach to governance in society.

Legal centralism/ In contrast to private governance mechanisms, the advocates of legal centralism believe that, regardless of its many forms, government is the primary source of rules and enforcement efforts. All forms of legal centralism assume that markets would not function successfully without the existence of government’s administrative rules. More-



Private Governance:
Creating Order in Economic and Social Life

By Edward Peter Stringham

296 pp.; Oxford University Press, 2015

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over, legal centralism inherently includes positive assumptions about the efficacy of government. Not surprisingly, legal centralism is widely embraced by lawyers, legislators, and many free-market advocates (including, at least to some extent, Nobel laureate Friedrich Hayek) who believe that the protection and enforcement of contracts through judicial oversight are essential to maintaining a peaceful civil society.

Proponents of the strongest forms of legal centralism consider legal rules and regulations to be costless, and property rights and commercial exchange to be impossible without government enforcement. Weaker forms of legal centralism recognize some costs associated with legal rules or regulations, but still consider them necessary.

Stringham proposes that instead of assuming that government has the ability and interest to solve problems, certain conditions for government intervention should be met. Consequently, he asks that whenever a potential problem exists in society, the following questions should be answered effectively:

- Do regulators, police, and courts have the knowledge and ability to solve the problem in a low cost way?
- Do regulators, police, and courts have proper incentive to solve the problem?

Where the legal centralist assumes that the answer is “yes” to both questions, the private governance researcher considers the possibility that regulators, police, and courts may be lacking in important ways. If the answer to one or both of the questions is “no,” then unmet consumer needs exist, and one should ask:

- Will the private sector have the ability, knowledge, and incentives to solve those unmet needs?

If the answer is “yes,” then private ordering should address the problem. Stringham does acknowledge, however, that in some cases there may be no apparent workable solution to a societal problem. But in other cases, private parties will notice problems both simple and com-

plex, search for solutions, and apply creative private governance mechanisms to solving them.

Clubs and voluntary association / According to Stringham, the amount of governance can be analyzed as a “club” good provided in a variety of forms. A club is an association of persons participating in a common objective who voluntarily agree to make regular payments or purchases in order to secure certain personal advantages. Clubs allow members to voluntarily participate in preferred governance structures to solve problems. They create effective incentives for continued cooperation, while meeting many objectives of creating a civil and free society. Membership in a private club can be formal or informal, long-term or short-term, and can take the forms of belonging to a financial club (Visa and MasterCard), a geographic club (Disney’s Celebration-Florida or Las Vegas’s City Center), an office, apartment complex, or religious organization, among others.

A fundamental difference between governmental clubs and private clubs is that private clubs are voluntary associations that people join contractually and are free to quit, while governmental clubs are involuntary associations where specific behavior is required and ultimately coerced. Private clubs, says Stringham, allow for variation in governance structures, experimentation in leading to what works best, and innovative solutions that meet the challenges presented by emerging problems—all factors missing from most governmental clubs. He further argues that the assumption that only government can create some of the institutions necessary for markets to function is incorrect and believes that government’s structure and enforcement mechanisms are simply a means of extracting revenue for those who control the state.

As mentioned earlier, he offers several case studies of how private governance operates in markets. In his carefully constructed summary of the economic history of how the world’s first stock markets developed in Amsterdam, London, and New York, he found overwhelming evi-

dence of how those exchanges were created and maintained without (and in some cases, in spite of) government regulatory oversight. In the case of the Amsterdam exchange, participants found it more cost effective to rely on reputation mechanisms than on governmental, or even private, courts. The London exchange evolved from coffee house interactions among buyers and sellers. With government enforcement lacking, the exchange clubs developed their own form of assurance against fraud: they only admitted individuals who met their conditions of membership, and removed those who defaulted (“cheated”) on financial arrangements with other members. In New York, the exchange created a transparent operating environment, offering different sets of entry rules (“financial and other governance requirements”) for participants to choose from, with the exchange approving (“accepting as members”) only firms that warrant trading privileges.

In a more modern example of private governance in an anonymous, commercial setting, Stringham evaluates how electronic payment processors such as PayPal have developed ex-ante risk management “fixes” to the problem of online fraud. Traditional methods of ex-post government enforcement against fraud are simply not efficacious. To assuage concerns that its customers might have about using its online service, PayPal has assumed most of the risks associated with fraud by developing and applying risk management technologies that have significantly reduced fraudulent activities, thus ensuring a safer transacting environment for its customers. Stringham concludes that a service like PayPal—if not most electronic commerce—likely would not exist had the market depended on government to enforce contracts transacted over the Internet.

Another example of private governance involves adjudication by contract. He presents a “real world” example of private governance: dispute resolution, which Stringham describes as a system of “market chosen law” that allows parties to evaluate and agree to a set of rules and procedures that they consider best for their

transaction. The author discusses mechanisms that are client-centric and make proceeding faster and fairer, with eBay a useful illustration of how this process works to the customer's advantage. These private arbitration arrangements, which can include arbitration, bracketed-arbitration, final-offer arbitration, private judging, and Med-Arb ("medical arbitration"), allow for a free choice of rules and procedures, and providers of such services have an incentive to offer those that are ex-ante beneficial to all parties. The popularity of private arbitration, both for consumer-to-business and business-to-business transactions, has remained strong, and as noted by Stringham, the more people who can "opt out" of the inefficient government legal system, the less "necessary" that legal system is.

More private governance, less government regulation / Based on the evidence he provides in his book, Stringham concludes that markets preceding government in addressing failures is the correct sequence. Yet, from art certification, to policing, to financial markets, government intervention has often undermined markets for private governance by employing institutional barriers to push out, monopolize, or co-opt private governance efforts. "Private governance always functions to varying degrees, but it functions much less effectively the more it is hobbled by government," says Stringham. He argues that just as competition generates discovery of new knowledge and innovation in the marketplace, it also is responsible for a similar response in governance systems. He allows for choice to be exercised in the development of mutually beneficial rules and regulations that adapt to problems, contexts, and timeliness, and without the threat of coercion embodied in legal centralism. He acknowledges that while "the assumption that the state creates the framework for markets is an unrealistic view of the state, ... one can believe that while still allowing for a very large percentage of governance to be private."

Stringham makes a powerful case for the existence of successful private gover-

nance in the marketplace. He is quite right that private governance mechanisms are invisible until something goes wrong ("a crisis appears") and the knee-jerk reaction is to reach for a public policy "fix" to resolve the problem. His examples of government regulation implementation and nonmarket failure "put the lie" to this assumption. Unlike the many successes of private governance, which often go unnoticed by the citizenry, the failures of nonmarket intervention are noted but often ignored or explained away under the rubric of "good intentions." As my experiences in the business school classroom have revealed, students are rarely exposed to examples of successful private governance, such as the private sector-driven development of operating standards in technology-driven U.S. industries. Furthermore, even in the realm of environmental "sustainability" practices that are being voluntarily instituted by companies and industries, the threat of further government regulation is viewed as the motivator,

rather than factors such as reputation and consumer demands.

Stringham's book is a readable treatise, notwithstanding the sometimes tedious but necessary scholarly economic history of financial markets, and his arguments maintain a consistent internal logic. His use of both historical and modern industry case studies effectively complements his philosophical arguments in favor of private governance. He does, however, occasionally include snarky comments that distract from his effective arguments. And more careful proofreading would have eliminated obvious copy errors.

I am pleased that Stringham wrote this book. While I share much of the author's criticisms on the deleterious effects of non-market intervention, I would not go as far as he does in severely circumscribing the authority of public governance. But he recognizes that one need not fully embrace the merits of private governance in order to recognize the merits of the greater use of private governance. R

Cowboys and Entrepreneurs in the Cattle Kingdom

◆ REVIEW BY PIERRE LEMIEUX

Some 150 years ago, in 1866, an Illinois cattle dealer named Joseph McCoy bought a herd of longhorns that had been "trailed" from Texas, and sold them to slaughterhouses. His entrepreneurial spirit saw this as not just a one-time deal, but as a long-term business opportunity. Other cattlemen would soon be trailing Texas cattle to the

expanding railroad network that was then reaching the Kansas prairie, and the trains would take the animals to urban processors and consumers.

The next year, thanks in part to McCoy's investments, the Chisholm Trail began moving cattle from San Antonio to a new railhead in Abilene, Kan.

The Chisholm Trail is an icon of the

"cattle kingdom." *The Chisholm Trail: High Road of the Cattle Kingdom*, first released 35 years ago, tells much of what there is to know about the trail, the cowboys who worked on it, and the industry they were part of. The author, Don Worcester (1915–2003), was professor of history at Texas Christian University, president of the Western History Association, a prolific author, and lover of Western culture.

Starting in the 1850s, cattlemen and other businessmen discovered that Texas

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cattle could be trailed to California, Missouri, and up to Illinois. From Illinois, they could be shipped by rail to New York City, and still turn a profit if there had been no costly incidents on the 1,500-mile drive. But it was after the Civil War that the enterprise became really profitable.

During the Civil War, when many cowboys served in the Confederate Army, longhorns proliferated and spread wide on the Texas range. Cow hunts were organized to round up cattle. Horse-mounted cowboys caught longhorns with lassos. Specialized cowboys called “brush poppers” pursued them in the treacherous Texas brush country, full of plants with dirk-like thorns—a dangerous job for both horses and men.

Cowboys were simple cowhands on ranches, and the great drives generated much of the mythology and symbolism of cowboy culture. The great cattle drives lasted barely two decades, and less than a decade

on the Chisholm Trail, but they remain central to Western lore. Worcester opens a window on those two decades and shows all the ramifications of the cattle kingdom.

The incentive to ship cattle to northern slaughterhouses was fueled by the high prices that beef commanded in urban centers and by the arrival of the railroad in Kansas. But the animals still needed to be trailed from Texas to the Kansas railheads, and entrepreneurship was needed to build up the trailing industry.

Enter McCoy. He made arrangements with the Union Pacific Railroad, which had reached Abilene. There, he bought land and built stockyards and a 100-room hotel. The first herd reached McCoy’s new market in the summer of 1867, starting half a dozen years of cattle drives along the Chisholm Trail.

The trail / Between San Antonio and Abilene lay some 700 miles of open range—

unoccupied public land or land controlled by Indian tribes in what was then formally called Indian Territory and today is Oklahoma. (The name “Oklahoma” comes from *okla* or “red,” and *humma* or “people,” in the Choctaw language.) The initial Chisholm Trail had been named after Jesse Chisholm, a Cherokee-Scot trader whose wagons carried goods from the future site of Wichita, Kansas, to Indian camps in Indian Territory. Texas cowmen appropriated the name to identify the whole extended trail from San Antonio to Abilene.

“Before ranches were fenced,” notes Worcester, “cattle often strayed a hundred miles or more from their home ranges.” The animals had to be rounded up and branded. At least 5 million longhorns were trailed north. Perhaps a fourth of those used the Chisholm; most of the others took the longer Western Trail, which ran a bit farther west,

through Texas, Indian Territory, Kansas, Nebraska, the Wyoming Territory, and up to the Montana Territory and the Dakota Territory.

A trailed herd typically numbered 2,500 to 3,000 head, but could reach 5,000. On the trail, the animals moved in a narrow file spreading a couple of miles behind the leading steers. A herd traveled a dozen miles a day, so about two months were needed to reach Abilene from San Antonio.

Life on the trail was rough. A dozen cowboys, under the direction of a trail boss, were required for a drive. In the hot prairie climate, a marching herd generated a large cloud of dust, which enveloped the cowboys. “Looking at a herd being driven at a distance, one could only see a great cloud of dust rising to the heavens,” said one observer. Crossing rivers was often risky because of flash floods, quick sands, water moccasins, etc. Indian attacks were possible. Stampedes—when the whole herd

started running out of fear—were frequent, often caused by lightning, and cowboys had to chase the herd, sometimes for tens of miles, reach the lead steers, and make them gradually turn back.

The meals, prepared by the crew cook, were typically made of cornmeal, beans, bacon or sowbelly, molasses, and coffee. At the end of each day, a bedding ground with grazing capabilities had to be found for the cattle. The cowboys slept under the stars, on blankets that they stored in the chuck wagon. They got little sleep as they took turns watching the herd. “If you expect to follow the trail, son,” one trail boss said, “you must learn to do your sleeping in the winter.”

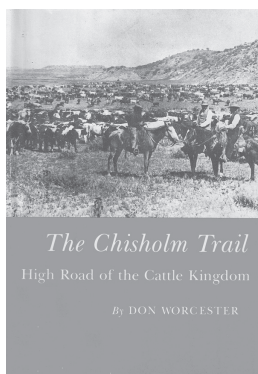
The crew was completed by a wrangler, who was responsible for the horses.

Don Reeves, the curator of the National Cowboy and Western Heritage Museum in Oklahoma City (a must visit), notes that “cattle drives were only a slice of cowboys’ history.” Yet the era of the great cattle drives, which overlaps the conquest of the West, represents the mythological golden age of cowboys. According to Worcester, “there can be little doubt that the cowboy of the trail-driving era captivated Americans as no other folk hero before or since.”

The cowboys were young men, in their teens or early twenties. Between 35,000 and 55,000 cowboys rode the cattle trails. They were armed with revolvers and sometimes Winchester rifles. Although the majority were white Texans, perhaps a fifth were blacks or Latinos. Many were illiterate. It is reported that most participated in no more than one drive.

One literate cowboy in Montana was E. C. Abbott, a.k.a. Teddy Blue, who wrote his memoirs with the help of ghost writer Helena Huntingdon Smith, under the title *We Pointed Them North: Recollection of a Cowpuncher*. He conveyed the cowboys’ sense of pride:

The cowpunchers was a totally different class from these other fellows on the frontier. We was the salt of the earth, anyway in our own estimation, and we had the pride that went with it.



**The Chisholm Trail:
High Road of the
Cattle Kingdom**

By Donald Emmet
Worcester

207 pp.; University of
Nebraska Press, 1980

The trail boss worked for the cattle owner or for a trailing contractor hired by the owner. More rarely, the trail boss was the cattle owner himself, like in the case of the Snyder brothers, who began their career buying cattle on credit and trailing them to Abilene. Then as now, the division of labor was generally profitable.

The second most important man in the crew was the cook. The trail boss and the cook were typically older than the cowboys.

At the end of the Chisholm Trail stood Abilene, which had previously been an agglomeration of a dozen families around a stage coach station. It became a vibrant town after the first herd arrived in the summer of 1867. When a herd was a few miles from Abilene, the cowboys would graze it there until its price had been negotiated with buyers in town. Abilene's cattle fortunes lasted only a few glorious years, until 1873. After Abilene and then Wichita, the major cattle town became Dodge City, along the Western Trail, until 1885–1886.

Vast industry / Cowboys stood at the bottom of a vast industry. They were the burger flippers of the cattle kingdom—albeit, as we saw, proud burger flippers. In 1884, according to Worcester, a cowboy was paid \$30 per month on the trail, which he received at the end of the drive. Assuming an average annual rate of inflation of 2 percent, that translates to \$390 a month in today's dollars. For a two-month drive (from San Antonio to Abilene), he would thus earn \$780 of today's money. For a drive up to Montana, he would receive double, about \$1,560 today.

As a point of comparison, the trail boss earned more than three times the cowboy's monthly salary. Ranch managers earned 50 percent more than cowboys. As another point of comparison, Abilene's first city marshal, appointed in 1870, started at \$150 a month (more than \$2,000 today), plus \$2 (\$27) for each conviction of a suspect he arrested.

Obviously, part of a cowboy's real income, especially on the trail, came from the adventure. The trail was a young man's game.

"Cowmen," Worcester recognizes, "were as owners and managers considerable more important than the cowboys they employed." Management and entrepreneurship were crucial. Entrepreneurship was visible all along the supply chain, and many entrepreneurial stories can be read between the lines in Worcester's book.

New boots and lassos appeared on the market. Winchester developed its famous lever-action rifles. Colt and Remington competed with improved revolvers. Stetson hats and Levi Strauss jeans, crucial parts of cowboys' clothing, were created during this period. These artifacts and more can be seen at the large, privately financed National Cowboy and Western Heritage Museum. Mail-order houses appeared, from which cowboys could order the tools of their trade. Railroads ended up competing for cattle shipments.

Diversified formulas were developed to share the risks of the long trail drives, during which cattle were sometimes lost. When the cattle owner hired his own crew, he shouldered all the risks. His financial risk was maximized when he bought a herd on credit in order to drive it. When he paid a flat fee to a trailing contractor, the risk of cattle loss was transferred to the latter. Some trailing contractors purchased the herds to be trailed, thereby shouldering all the risks—and, of course, capping the cattleman's possible upside. The trail contractor business was huge: Worcester estimates that "at the height of the trailing era, about a dozen major contractors were responsible for three-fourths of the trail herds."

Except for rustlers and other shadowy characters, honesty was a feature of the cattle kingdom. Contracts between cowmen were settled by a handshake: "Often transactions involving many thousands of dollars are made verbally only, and complied with to the letter," McCoy noted. In Texas, writes Worcester, "some vaqueros [cowboys] worked for years without settling their wages, but no wise rancher would cheat them."

When a cowboy arrived in Abilene after a couple of months on the trail, he wanted booze, gambling, and women. Supply met

demand, and Abilene became a sin city. Though its name was piously inspired by the New Testament (*Luke* 3:1 mentions "the tetrarch of Abilene"), the town became more like Sodom and Gomorrah. Saloons with gambling tables, dance halls, and brothels thrived.

Dodge City soon replaced Abilene as the great sin city, on a larger scale. Fort Worth, along the Chisholm Trail, had the same problem—or the same opportunities. Like in Abilene, the authorities' concern was more about public safety than morality: Dodge City's marshal, "Long Hair" Jim Courtright, was explicitly hired "to keep the peace, not clean up the town."

Miles City, a Montana cow town, was apparently even worse. There, Teddy Blue explains, cowboys could "marry a girl for a week, take her to breakfast and dinner and supper, be with her all the time." He continues:

You couldn't do that in other places. ... I suppose those things would shock a lot of respectable people. But we wasn't respectable and we didn't pretend to be, which was the only way we was different from some others.

Violence and property rights / Cowboys were not always peaceful. On the trail, they were monitored by their boss and were very reliable. But in the cow towns, they got drunk, sometimes intimidated citizens, and were involved in gun fights. These were violent times. Yet, wandering criminals were also to blame for the violence.

At any rate, Western violence has often been exaggerated. We cannot use as a representative picture the old saying quoted by Worcester about another cow town: "In Caldwell you're lucky to be alive."

The testimonies we have show that cowboys were not violent toward women. Teddy Blue boasts about "these notions of chivalry toward women, no matter who they were," that is, including prostitutes. About those, he writes, "Well, they were women. We didn't know any others. And any man that would abuse one of them was a son of a gun."

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One reason why violence in the West was not as prevalent as in Hollywood movies is that individuals (all men at any rate, although there was no rule against women being armed) were all equally armed. This imposed a clear risk to anyone initiating violence. The six-shooter was called “Colonel Colt’s Equalizer.” Worcester does not discuss these issues, but other analysts have. Economists Terry Anderson and Peter Hill, who have studied this epoch extensively, write: “In the mining camps and on the open range, the six-gun seldom served as the arbiter of disputes. ... In short, the West was really not so wild.”

If we believe Teddy Blue, the northern towns and ranges were less violent:

In a way the life up north was a whole different from what it was in Texas and on the trail. ... All old-timers who know the West will tell you that they did not have so many killings and shooting scrapes after they got up north as they did in Texas. Matt Winters used to say that the alkali water they drank up here took it out of them, and the winters froze out what was left. Well, Matt ought to know. Old Matt was one of the ones that tamed down after he come to Montana, so he got to be pretty civilized in the end.

On the open range, which was a common pasture, overgrazing became a problem as the cattle industry developed and the land grew scarce. The potential for violent conflict sometimes materialized in range or fence “wars.” But cattlemen soon found a better solution: define property rights. As Anderson and Hill explain, the incentive to do so came from the hope of appropriating the increased production (the “rent”) that would come with well-defined property rights.

Just as miners formed mining districts that established property-right rules, cattlemen formed associations to protect the rights they claimed on the open range. The associations coordinated roundups from which they excluded newcomers. The latter, not wanting to lose cattle regularly, had to move to other parts of the range or

buy informal range rights from an existing owner.

Hence the relative peacefulness of the range. Anderson and Hill argue that the different federal homestead acts inefficiently supplanted the property rights that were spontaneously emerging as an economic response to scarcer land.

Creeping regulation / The cowboy era was a time of rugged individualism, adventure,

Riding in open spaces with no effective authority over him but his employer, the cowboy provided a vivid contrast with regimented European societies.

and liberty, which explains the power that its mythology exerted not only in America but also in Europe and elsewhere in the world. As historian C. L. Sonnichsen said, “The legendary West belongs to the world and not just to us.” Riding in open spaces with no effective authority over him but his temporary employer, the cowboy provided a vivid contrast with regimented European societies.

Although the cowboys’ libertarian mythology broadly conforms to their history, government intervention was not unknown in the last third of the 19th century. Politicians tend to be nearly as entrepreneurial in regulating and controlling as businessmen are in earning profits. In most cases, though, regulation was lighter than it is now.

In cow towns such as Abilene and Dodge City, one could not go armed and a visitor had to check his guns when coming into town. But those were local ordinances, not state or federal laws. Until the recent revival of the Second Amendment, most of today’s America was more restrictive than that.

Another example relates to sanitary regulation. Longhorns carried a tick that did not affect them but could infect other cattle. Against this “Texas fever,” the State of Kansas established a quarantine line east of which Texas cattle could not be trailed

during part of the year. The line was traced slightly west of Abilene, but it was ignored when the business potential for the town became obvious. Things changed over the years as the line was gradually moved west.

There was worse. Kansas imposed alcohol prohibition in 1881 (and it continued to 1948). Following the Civil War, the federal government seemed emboldened by the conscience of its power. In 1885, Congress outlawed enclosures of big

ranches on the public domain, an intervention that stopped the ongoing definition of private property rights. Anderson and Hill note that in 1889 the feds expropriated the Outlet, a large track of grazing land

that cattlemen had leased from the Cherokees. According to the same authors, the federal government also limited land acquisition by foreigners.

Just a few years before, the outlook for private property rights seemed brighter. In the heydays of the cattle kingdom, British investors got deeply involved in what looked like a promising industry. By 1883, according to Worcester, “British companies owned or controlled at least twenty million acres of rangeland.” A populist reaction ensued. Some states such as Texas tried to prevent foreign ownership of land, but the courts declared such bans unconstitutional.

In cowboy times, laws were often disobeyed and governments did not have the resources for stringent enforcement. Quarantine lines were not always respected. After he was elected mayor of Dodge City in 1881, Alonzo Webster did not enforce the new state prohibition of alcohol; indeed, he was himself a saloon owner. Some nostalgia for the lawlessness of the cowboy era can be forgiven.

End of an era / The Chisholm Trail had a short existence: by 1874, it had fallen into disuse. Worcester offers many reasons for its demise. For one, the moving of the Kansas quarantine line to the west

finally displaced the main cattle terminal to Dodge City on the Western Trail. The same demise hit the Western trail a dozen years later, partly caused by the further moving of the quarantine line.

Other factors were at play. Competing railroads made shipping directly from Texas economical. The invention of modern barbed wire allowed ranchers, homesteaders, and crop farmers to erect fences on the open range. Trailing cattle became more difficult if only because the fences restricted water access.

Worcester seems to think that all those factors played a role. He adds some fuzzy reasons like “overstocking, overproduction, and poor management.”

In a *Journal of Economic History* article published a few years before Worcester’s book, Harvard economist David Galenson (now at the University of Chicago) emphasized the development of a northern cattle-raising industry. The northern ranges, stocked via the trails, pushed down cattle prices to the point where importing them from Texas became less profitable.

A political factor also intervened: from 1885 on, northern cattle ranchers protected themselves against Texas competition by extending quarantine laws. It wouldn’t be the last time, nor probably the first time, that sanitary excuses were used to favor special interests and increase state power. The chief of the U.S. Bureau of Statistics at the time, Joseph Nimmo, indignantly wrote in an official report:

That the freedom of commercial intercourse should be invaded or even threatened by indirection, through the exercise of the police powers of a State for sanitary purposes, is repugnant to the cherished love of liberty which has from the beginning characterized the people of this country.

Conclusion / Worcester’s *Chisholm Trail* is a fascinating book that introduces the reader to the cowboys, their lives and times, the cattle kingdom, and the frontier. The book helps us understand why this era had such an effect on popular

culture in America and abroad. It can be complemented by the analysis of economists like Terry Anderson and Peter Hill.

Teddy Blue’s poetic testimony and nostalgia add another layer to our understanding of cowboy times and their place in the American mythos. *We Pointed Them North* closes on these words:

A man has got to be at least seventy-five years old to be a real old cowhand. I started young and I am seventy-eight. Only a few of us are left now, and they are scattered from Texas to Canada. The rest have left the wagon and gone ahead across the big divide, looking for a new

range. I hope they find good water and plenty of grass. But wherever they are is where I want to go. R

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Nailing the Mouse, but Missing the Elephant

◆ REVIEW BY DWIGHT R. LEE

Government regulations have become a strait jacket that is preventing government from performing important functions in a timely and efficient way. This has happened over time, in large part because of the widespread belief that the only way government officials can be trusted is to make them adhere to detailed rules specifying what they are supposed to do and how they are to do it.

This has led to “the rule of nobody,” with no one having the authority to make government work. In a nutshell, this is the problem that Philip Howard elaborates on, and suggests solutions to, in *The Rule of Nobody*. His book can be thought of as a call-to-action for dismantling the dysfunctional regulatory edifice that is destroying responsible political judgements and paralyzing government.

Let me say upfront that I think *The Rule of Nobody* is an interesting book and worth reading. Yet I am troubled by what I believe is its narrow focus. There is no doubt in my mind that the expansion of overly detailed government regulations

is a serious concern. But there are two very different types of problems with that growth. First, there are the problems created when those detailed regulations are imposed on political decisions, which are the ones that primarily concern Howard. Second, there are the problems created when detailed government regulations are imposed on market decisions, which Howard mentions only occasionally, and then largely as byproducts of the first set of problems.

I believe that Howard takes aim at the smallest part of the problem of government regulation—the mouse, if you will—and misses the far larger part of the problem, the elephant. By doing so he overlooks the very real possibility that the benefit of reducing the problem of the mouse will be more than offset by increasing the problem of the elephant.

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IN REVIEW

Attention-getting examples / Throughout the book Howard illustrates how multitudes of mindless government regulations—which no one can know completely, and no one can wholly obey because the rules sometimes conflict with each other—are paralyzing the ability of political authorities to take action, no matter how obvious it is that a particular action is needed.

He begins his preface with an account of a tree falling into a creek, causing a neighborhood to be flooded during a New Jersey storm. As the town officials were about to send a tractor to remove the tree, they were informed that they were dealing with a “class C-1 creek,” which meant approvals had to be obtained from appropriate authorities before the natural condition of the creek could be altered. Consequently, the tree wasn’t removed until after a \$12,000 permit was purchased and the necessary government approvals were obtained, which took 12 days. The first chapter contains an example detailing the government studies, approvals, and permits from multiple agencies that had to be made or acquired before permission was given to raise the height of a bridge, making it possible for larger, more efficient ships to use the port of Newark, N.J. Most of the requirements had little relevance to the risks or problems associated with the project. It took over three years before a “finding of no significant impact” was made, at which point the project manager at the Port Authority commented that the wait for the lawsuits that would further delay raising the bridge could begin.

Howard provides many other bizarre, tragic, and infuriating examples of government dysfunction: public school officials being unable to fire incompetent teachers; firemen not permitted to save a drowning swimmer because they had not recertified

to perform land-based water rescues; the thousands of government job classifications in New York City imposing such restrictions as preventing a clerk inputting numbers to calculate the sum; firing a Florida lifeguard for rescuing a drowning man just outside his designated zone; suspending a seventh-grade girl from school for a week for having momentarily possessed an attention-deficit-disorder pill another student put in her hand; and increasing the number of reimbursement categories in Medicare from 18,000 to 140,000, with 21 different categories for “spacecraft accidents” and another 21 for bathtub injuries.

Were the goods worth delivering? / For Howard these

examples are illustrative of an attempt to create an automatic government that generates predictable outcomes by replacing the judgement of responsible government officials with a proliferation of detailed regulations. He sees this as a problem that has become much worse over the history of the American republic despite being identified from the very beginning. As noted by James Madison

in *Federalist* 62:

It will be of little avail to the people that the laws are made by men of their own choice if the laws are so voluminous that they cannot be read, or so incoherent that they cannot be understood.

Howard cites Madison’s statement early in the book, and several times he credits the Founders for understanding the threat of too much regulation, as well as the U.S. Constitution for keeping that threat from erupting until after the New Deal and World War II.

Interestingly, Howard favorably quotes a 1937 report on government organization indicating that the relative freedom from detailed regulation helped the New Deal

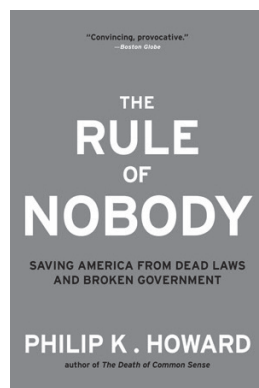
to “deliver the goods.” There is no doubt truth in this view, though whether the goods delivered were a blessing or a curse is certainly debatable.

No less controversial is Howard’s praise for the progressives and the 1960s reformers, although his praise is qualified. As he sees it, “Just as the progressives gave the lie to laissez-faire, so too the 1960s reformers punctured the illusion that America was fair.” Howard’s qualification is his acknowledgement that attempts to be fair to everyone who complained of unfairness contributed to the creation of the administrative state with increasing reliance on detailed rules. Giving flexibility for a government official to use his or her judgement had to be limited. “No official could decide anything without proving why it was fair to whoever complained.”

Of course, the zero-sum feature of so many government decisions invariably meant that “fairness” for some meant “unfairness” for others. This led to an increasing number of lawsuits, followed by judges going beyond their judicial roles and making legislative decisions. This created a backlash against “judicial activism” and distrust of decisionmaking latitude by both government officials and judges. In Howard’s view, this sequence of events helps to explain why “rulemaking took off like a rocket” in the late 1960s as Congress began taking greater advantage of a 1946 legislative act “authorizing agencies to write regulations with the force of law,” with these regulations imposing more and tighter strait jackets on public decisionmakers.

While Howard clearly wants to reduce the suffocating details of government regulations, he is far less concerned—if concerned at all—with the increased range of activities subjected to the control of government regulators. He states, for example:

Law in a democracy ... provides the organizing framework for government, setting public goals and priorities. This role has been transformed by the rise of global markets and institutions, requiring government to ramp up its oversight responsibilities—setting minimum



The Rule of Nobody: Saving America from Dead Laws and Broken Government

By Philip K. Howard
256 pp.; W.W. Norton, 2014

standards for virtually all social activities, in the workplace, schools, markets, factories, hospitals, and playgrounds.

Maybe Howard believes that having government “ramp up its oversight responsibilities” over “virtually all social activities” can be done while avoiding imposing detailed regulations on the private sector. But later he clearly suggests doubts by pointing out that “using detailed rules to minimize discretion” is now popular with almost everyone. Politicians like being able to shift much of their legislative workload and responsibility to bureaucratic agencies by letting them provide the legislative detail. Corporations, particularly large and well-established ones, see detailed regulations as effective entry barriers to competition threatened by new and smaller rivals. The more detailed the rules, the easier it is for public employees to avoid responsibility for unfortunate results because they followed the rules.

Missing the elephant / Unfortunately, by limiting his discussion primarily to the negative effects of an avalanche of detailed regulations on government performance, Howard has greatly limited his ability to consider the far greater cost that excessive government regulation imposes on the private sector. His discussion of regulation’s negative effect on economic performance is scattered in a few pages throughout the book and focuses primarily on nursing homes.

Even there, however, the emphasis is on how *better* regulation could correct the problems. As Howard states, “There’s usually no need for rules telling people how to fulfill their responsibilities if they are accountable when they fail.” But the only accountability he mentions for nursing homes is accountability “to the inspector [presumably with a lot of latitude to enforce general rules], who is accountable to a higher official and, potentially, to a court.” What Howard fails to mention here, or anywhere else in the book, is that government agents, responding to the incentives of the political process, are far less

accountable to the public interest than are private-sector agents responding to the incentives of the market process.

The cost of hampering the performance of government agencies with excessive government regulation is no doubt a problem. But is it a problem we should try to remedy? Howard is unable to make a convincing case that it is because, by focusing on the mouse, he has largely ignored the elephant in the room: the cost of hampering the growth of economic productivity because of excessive government regulation.

Consider some examples that illustrate why the elephant is so big compared to the mouse. Howard says nothing about the Internal Revenue Service. This is not surprising given his primary concern, because there are reasons to believe the IRS is fairly efficient at performing its mission of collecting tax revenue. In the 2014 fiscal year it collected \$2.52 trillion in taxes, on a budget of \$13.5 billion. That is, the average cost of collecting \$100 in tax revenue was about 53 cents. But that cost pales in comparison to the cost of the regulatory quagmire imposed on the private sector by an excessively complicated federal tax code. Just complying with the paperwork demands is estimated to cost around 20 percent of the total revenue raised, with the excess burden resulting from tax-induced distortions surely adding at least another 15 percent per dollar raised (which is less than estimates of the marginal excess burden). So once the cost of tax regulation on the private sector is considered, a reasonable estimate is that \$35 has to be added to the 53 cents it costs for the IRS to collect \$100.

Of course, taxes have to be collected, which necessitates some compliance costs and excess burdens. We can quibble over how much cost reduction is possible from tax reform, and how the tax code should be reformed. But it is clear that serious tax reform could reduce the cost of tax regulations on private-sector performance by several orders of magnitude more than the cost saving from better regulations on the internal operation of the IRS.

The National Labor Relations Board (NLRB) and the Equal Employment Oppor-

tunity Commission (EEOC) are not particularly complicated bureaucratically and few would argue that they are paralyzed with rules. (Indeed, if only they were.) Instead they are very good at imposing rules on employment practices and hiring decisions that substitute one-size-fits-all rules for the local information and incentives communicated through labor markets. Who knows how much the recent NLRB ruling on franchise employees will reduce productivity by complicating management practices and increasing labor strife? Or how much being threatened or charged with disparate-impact discrimination by the EEOC has cost, and continues to cost, countless employers by diverting their otherwise productive efforts and resources into avoiding or fighting ill-advised criminal charges? Surely the private-sector cost of the regulations imposed by these two agencies greatly exceeds the cost of any excessive internal regulations they are burdened with.

Finally, no matter how one assigns the blame for the Great Recession, there can be no doubt that the effect of rules promulgated by Fannie Mae, Freddie Mac, and Ginnie Mae were responsible for hundreds of billions of dollars of lost output. This is hardly an argument for focusing on the problem of internal regulations on these agencies hampering their ability to do their jobs while giving little thought to their contribution to the cost of a major recession.

Constrain government to correct it / The most effective thing we could do to reduce the cost of regulation is not correct government by relaxing the constraints on its actions (which might reduce the cost of the regulatory mouse), but by undoing a large number of things government is currently doing and increasing the constraints on its ability to do them again (which would surely reduce the cost of the regulatory elephant).

For example, the federal government’s lack of fiscal responsibility creates “market failures” that are then used to justify regulations that worsen the “market failures,” etc. Consider transfers and subsidies. By some measures the percentage of the fed-

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eral budget going to transfers and subsidies has increased from about 15 percent in the early 1950s to over 60 percent today. This undeniably reduces market accountability. The availability of subsidies increases business returns from rent seeking for more government advantages relative to the return from serving the interests of consumers. Transfers to consumers, either directly or indirectly (through business subsidies), means the recipients are spending other people's money, which reduces their accountability to the costs their consumption decisions impose on others. In both cases, the problem is compounded by distortions in market prices, which render the prices less able to provide the information and motivation needed to make

productive and accountable decisions.

Having crippled market accountability, government has a justification to impose more of the only accountability it can: the crude and clumsy accountability of central planning—more spending and detailed regulations that are completely innocent of embodying any local knowledge of time and place. Can anyone seriously believe that the growth of government subsidies and transfers in financing medicine and higher education are unrelated to the growth of government regulation that is increasingly bedeviling the supply and consumption of those two important services? If Howard had given this question serious thought, he might have written a different book. R

Egad, Geoengineering!

◆ REVIEW BY DAVID R. HENDERSON

How likely is it that the world will warm not just by 2 degrees Fahrenheit by the end of this century, but by 11 degrees? What would happen to the planet? And, to avoid a much hotter world, what should we do and when should we do it? In *Climate Shock*, Gernot Wagner, the lead senior economist at the Environmental Defense Fund, and Martin L. Weitzman, a professor of economics at Harvard University, address those questions.

They claim that if the concentration of carbon dioxide in the air rises from its current level of 400 parts per million (ppm) to 700 ppm, the probability that the world will warm by more than 11 degrees is 11 percent. If that were to happen, they claim, we would experience serious rises in ocean levels and more and more-violent storms, to name two major consequences. To avoid that, they propose a Pigovian tax of at least \$40 per ton of carbon dioxide emitted and, they say, "We must act now." If we don't substantially reduce our carbon usage soon, at some point we will find

ourselves using "geoengineering" to reduce the earth's temperature by a few degrees. And they fear that geoengineering could get out of control and have unintended consequences. Better, they say, to impose a stiff carbon tax now.

How convincing is their case? Not very. They could be right, but they don't tell us nearly enough to justify their most important claim: an 11 percent probability of a much warmer climate. And, while they often profess relative certainty in the body of the book, they tend to relegate some of the most important doubts and controversies to the footnotes. That's a problem because few people read footnotes. Also, the authors judge competing policy responses to global warming asymmetrically. Specifically, they advocate a stiff carbon tax throughout, always claiming that it's the obviously right thing to do, without ever

considering whether such a tax might have unintended consequences. But when they consider geoengineering solutions—technological methods to alter the climate that they admit would cost a small fraction of the carbon tax—they raise the specter of unspecified unintended consequences and even construct a scenario in which a mysterious foreign government could engage in unchecked geoengineering.

Why a tax? Consider their claim, early in the book, that "the latest research suggests that climate change will lead both to more *and* bigger storms" (italics in original). But turn to the footnotes and you see that they are less certain about those storms than they seem in the text. First, they point to a 2005 study's finding that "hurricanes had intensified over the preceding three decades." Then they write, "The ensuing scientific debate seems to have settled with the conclusion that climate change does indeed lead to more intense hurricanes but that their frequency may not change (or may even go down slightly)." Notice three things: First, they admit that there's a debate among respected climate scientists, something you don't get a hint of unless you read the footnote. Second, Wagner and Weitzman reference only the sources on their side, the main one being Massachusetts Institute of Technology meteorologist Kerry A. Emanuel. Third, one of the consensus views of the scientific debate, that the number of hurricanes will *not* increase, directly contradicts their conclusion in the body of the book. Finally, in that same footnote, they write, "That scientific debate isn't settled, yet the physical signs are sadly clear." How could the physical signs of something that hasn't happened yet be clear, sadly or otherwise?

In their discussion of geoengineering, they point out that the 1991 eruption of the Mount Pinatubo volcano, with its spewing of sulfur into the atmosphere, reduced global temperatures by about 0.5 degrees Celsius (0.9 degrees F) the following year. We could achieve Mount Pinatubo-like results, and in a controlled way,

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by pumping comparable amounts of sulfur dioxide into the air: “About 20 *million* tons of sulfur dioxide managed to wipe out the global warming effects of 585 *billion* tons of carbon dioxide in the atmosphere” (*italics in original*). The authors also point out that such solutions would cost somewhere between \$1 billion and \$10 billion dollars per year. “Those,” they write, “are the engineering costs of getting temperatures back down to preindustrial levels.” That cost, they point out, amounts to just pennies per ton, versus a hefty \$40 carbon tax per ton. So why not go the sulfur route?

Yet Wagner and Weitzman argue against that idea. Even if doing so would reduce temperatures by the same amount everywhere, they argue that “it would still be hard to agree on the ‘right’ temperature.” That’s true, *but that’s also true of any policy to deal with global warming, including their proposed carbon tax*. If they are right about the effects of a carbon tax, the higher the tax, the lower the earth’s temperature will be. Why would it be easier to agree on the temperature one wants to achieve with a carbon tax than on the temperature one wants to achieve with geoengineering? They also argue that to use a geoengineering solution, “we would need strong, global institutions and well-formed governance processes.” But that’s also true of a globally agreed-upon carbon tax.

They reveal the depth of their opposition to geoengineering when they write that “[we] hope we are wrong about the seemingly unstoppable drive toward geoengineering.” Geoengineering technology, they write, “is too cheap and too readily available.” That’s a strange criticism coming from economists. We economists tend to think that, all other things equal, solutions that are cheap and readily available can’t be *too* cheap or available. Their fear, they write, is that a solution would be “geo-

engineered in some ‘rogue’ fashion.” But as noted above, *any* government solution to climate change has problems. A carbon tax could be implemented in a “rogue” fashion also, used to go after politically unpopular industries and firms and to exempt those with political pull.

Wagner and Weitzman do address

other geoengineering solutions, such as carbon capture and storage and ocean fertilization. The latter refers to dumping “iron or other nutrients into surface waters to make them more fertile grounds for natural carbon dioxide uptake.” An advantage of this is that it would encourage the growth of fish. But, they argue, most of these approaches “run head-on into the free-rider problem” because, they assert, these efforts would be so much more expensive than shooting sulfur “into the stratosphere to create an artificial sun shield.” But in fact, the iron solution is actually quite cheap. Besides, although

there *is* a free-rider problem, that is hardly a show stopper; their preferred option of a stiff carbon tax also has large free-rider problems. What happens, for example, if China and India rely on the United States to impose a tax and they don’t impose one?

Wagner and Weitzman write, “Loss of human lives, ecosystems, or food aren’t [sic] compensated so readily by increased consumer electronics.” They *seem* to be saying that global warming will reduce food output, but one of the main effects of increasing carbon dioxide, as climate scientist Craig Idso has pointed out, is greater plant growth, which means more food, not less. One would have expected two economists to examine the benefits of global warming as well as the costs. Only in a footnote do they tell us that some of the effects of carbon “may also decrease” the estimated social cost of carbon. Unfortunately, they don’t tell us which. Do they

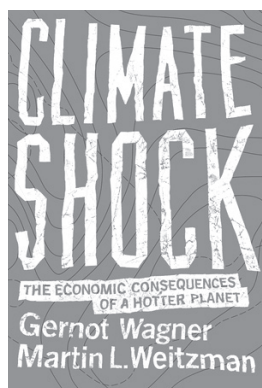
have agriculture in mind? We don’t know. This is another example of their hiding doubts in the footnotes.

11 percent alarmism / Wagner and Weitzman’s strongest and most important claim is that there is an 11 percent chance the earth will warm by 11 degrees or more. How do they achieve this level of specificity? By using as inputs some fairly sketchy probability estimates made by other climate scientists and the Intergovernmental Panel on Climate Change. If you have total trust in those estimates, you can trust the authors’ 11 percent scenario. But there is good reason to not trust the inputs. Judith Curry, a climate scientist at the Georgia Institute of Technology, writes:

More than a dozen other observation-based studies have found climate sensitivity values lower than those determined using global climate models, including recent papers published in *Environmetrics* [sic] (2012), *Nature Geoscience* (2013), and *Earth Systems Dynamics* (2014). These new climate sensitivity estimates add to the growing evidence that climate models are running “too hot.” Moreover, the estimates in these empirical studies are being borne out by the much-discussed “pause” or “hiatus” in global warming—the period since 1998 during which global average surface temperatures have not significantly increased.

Assume for a moment that you were convinced by the authors’ claim that there is an 11 percent chance of an 11 degree (or more) increase in world temperatures, the results of which would be very bad. What would follow? As noted, they want a \$40 per ton carbon tax immediately. They write: “We once had decades to turn the climate ship around. Not anymore.”

Is that because the high temperatures are just around the corner? No. Recall that in their view the 11 percent probability happens if we get to 700 ppm of carbon dioxide in the atmosphere. Unless we change our behavior, they argue, this would happen by 2100. But they seem



Climate Shock: The Economic Consequences of a Hotter Planet

By Gernot Wagner and Martin L. Weitzman
250 pp.; Princeton University Press, 2015

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to waffle substantially on this estimate. They get to 700 ppm by 2100 by counting “other greenhouse gases.” But they give us enough information to calculate that we will hit 700 ppm in 2165 because of an increase of 2 ppm of carbon dioxide per year and a current level of 400 ppm. Finally, they write that we won’t know the precise temperature that results from increased greenhouse gas concentrations until “hundreds of years into the future.”

But whether the amount of time we wait until knowing is 85 years or 200 years, why the urgency? The closest they come to an answer is an analogy with a “civilization-as-we-know-it-altering” asteroid that has a 5 percent chance of hitting Earth in 100 years. They write, “We wouldn’t say that we should be able to solve the problem in at most a decade, so we can sit back and relax for another 90 years.” True. But there are more than a few decades between now and 90 years from now. Or, back to their estimate that we could hit very high temperatures by 2100, there are more than a few decades between now and 2090. Moreover, no one I know on either side of this debate advocates that we do nothing. We all want to know more and develop various technologies—and all of that is happening. Even if we decide that a carbon tax is the right path, we couldn’t wait 10 or even 20 years until we know more?

Schneider strategy / The authors quote the late climatologist Steve Schneider, who lamented at a 2010 conference that he and fellow climatologists felt obligated to attend and discuss solutions because they had not been listened to decades earlier. If Schneider’s name sounds familiar, you may remember him for writing the following:

On the one hand, as scientists we are ethically bound to the scientific method, in effect promising to tell the truth, the whole truth, and nothing but—which means that we must include all the doubts, the caveats, the ifs, ands, and buts. On the other hand, we are not just scientists but human beings as well.

And like most people we’d like to see the world a better place, which in this context translates into our working to reduce the risk of potentially disastrous climatic change. To do that we need to get some broad-based support, to capture the public’s imagination. That, of course, entails getting loads of media coverage. So we have to offer up scary scenarios, make simplified, dramatic statements, and make little mention of any doubts we might have. This “double ethical bind” we frequently find ourselves in cannot be solved by any formula. Each of us has to decide

what the right balance is between being effective and being honest. I hope that means being both.

At book’s end, the authors cast aside all doubts, writing: “We ought to do everything in our power to prevent further climatic changes. It’s not a question of if we should set a price on carbon but how high it should be.” But wait. What happened to the geoengineering solution that could be done for pennies on the dollar or, more accurately, pennies on the \$40? Is this ending the authors’ version of the Schneider strategy? R

The Politician–Public Sector Unionism Complex

♦ REVIEWED BY GEORGE LEEF

In the summer of 2015, the former mayor of San Jose, Calif., Chuck Reed, launched a ballot initiative intended to alter the retirement benefits of future state and local employees. Several California cities have already gone bankrupt and more are teetering on the brink. That prompted Reed to take a step intended to stem the fiscal bleeding

resulting from the state’s excessively generous pension system.

Key provisions in the measure would require local governments to obtain voter approval if they want to continue giving new employees defined-benefit pensions after 2019, and require voter approval for increases in existing pensions. Further, the initiative is designed to prevent the state’s gigantic public employee pension system, CalPERS, from undermining it, something the union has done with other initiatives.

It’s noteworthy that Reed is a Democrat. As mayor, he struggled with the budgetary troubles caused by the tremendous and growing cost of public pensions. It’s also important to note that CalPERS is working behind the scenes to block Reed’s initiative. A union-friendly member of the State Assembly requested a legal opinion

from CalPERS about the effects the initiative would have if it passed. The union duly produced an alarmist “analysis.” The *Wall Street Journal* opined in August that this “appears to be a test-run for the political attacks unions are likely to wage should Reed’s initiative qualify for the ballot.”

California is drowning in red ink, but the public sector unions worked hard to attach themselves like lampreys to the treasury. They will use every bit of their great political power to remain there.

All of that is pertinent to Daniel DiSalvo’s illuminating book *Government Against Itself*. DiSalvo, an assistant professor of political science at the City University of New York, has written a scrupulously fair account of the effects of public unionism nationwide. He comes from a family with deep union roots and is represented by the university’s faculty union—facts that add to his credibility. Having looked at a

GEORGE LEEF is director of research for the John W. Pope Center for Higher Education Policy.

great deal of evidence, he concludes that public unionism results in “government that spends more but does less.”

Symbiotic relationship / DiSalvo reminds us that, for a long time, there was bipartisan consensus against allowing government employees to form unions and bargain collectively. President Franklin D. Roosevelt dismissed the idea of government employees unionizing, as did long-time AFL-CIO president George Meany. Unions, they thought, existed to help workers extract some of the profits earned by capitalists, but in the public sector they would only extract additional dollars from the taxpayers.

Some Democrats, however, presciently sensed political advantage in allowing (and often encouraging) public employees to unionize. In 1959, Wisconsin became the first state to approve of such unions. In January 1962, President Kennedy signed Executive Order 10988, which gave federal workers the right to form unions, although not always to engage in collective bargaining. Ever since then, public sector unionism has been growing apace while private sector unionism has been in steady decline. Today, only four states hold out against public employee unions: Virginia, North and South Carolina, and Utah.

Quickly, a symbiotic relationship developed. Politicians would help the unions get what they wanted—higher wages and benefits, greater job protection, better working conditions—and in turn the unions would give those politicians their full support. Once that relationship started, the unions learned how to exploit it to the utmost, not only squeezing government budgets tighter and tighter, but also taking over policymaking to a large extent.

Among the author’s most memorable examples is the way the California Correc-

tional Peace Officers Association (CCPOA) has become the 800-pound gorilla of Sacramento politics. Not only are the “correctional peace officers” remarkably well compensated (including large pensions) for rather low-skill work, but the union’s lobbying has driven up the demand for prison guards by pushing through the “three-strikes” law that takes away judicial discretion in sentencing and thus leads to a growing number of prisoners. That illustrates one of DiSalvo’s recurring themes, namely how public unionization increasingly leads to policy decisions being made to suit the interests of the union rather than the citizenry at large.

The CCPOA also exemplifies how unionization interferes with standards and discipline. After it was discovered that some of the “correctional peace officers” had organized “Gladiator Days” where they enjoyed the spectacle of fights among the inmates, the union’s stonewalling made it extraordinarily difficult to fire those responsible.

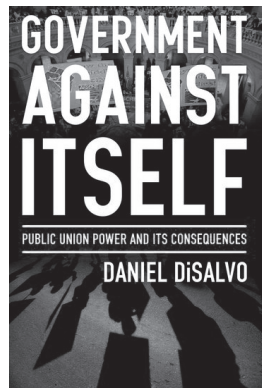
Teacher unions are another powerhouse created by public unionism. DiSalvo writes, “Many features of school organization are designed to protect teachers rather than to deliver the best possible education for students.” For example, collective bargaining contracts usually require that teachers be paid according to a rigid salary schedule based on seniority. That rigidity prevents public school administrators from compensating teachers based on their performance and thus improving incentives. But from the standpoint of the union, improving incentives and performance is not desirable. Its interests are best served by maintaining the sense of solidarity, and competition among its members would erode that sense. Despite all the rhetoric union leaders lavish on their dedication to academic excellence, they readily sacrifice it to their own good.

And, as with the prison guards, teacher unions make it extremely hard to fire a teacher even when there is ample cause. DiSalvo points to statistics showing that doctors and lawyers are more than 10 times as likely to lose their licenses to practice as a teacher covered by a union contract is to be fired for performance-related reasons.

In many other ways, public unions increase the cost of services. One field where that is glaringly obvious is firefighting. Although the number of fires across America has fallen by 40 percent over the last several decades, the number of firefighters has actually increased by 40 percent thanks to the lobbying power of firefighter unions. They have succeeded in keeping their numbers growing by recasting fire departments as “first responders.” In Los Angeles, DiSalvo reports, only 2 percent of the calls to the fire department are now for actual fires, and most of those are for small fires in garbage cans and dumpsters. The majority of calls are requests to transport a sick person.

Political benefits, public costs / Arguably, the most serious effect of public unionism is on pension costs. Politicians tend to think in short-run terms, so a promise of immediate union campaign support in exchange for a politician’s commitment to back pension increases is hard to resist. The future budgetary trouble will likely be someone else’s problem, but even if the politician who takes the deal is still in office, he can count on union help in deflecting the blame. That explains why, in states where public unions are strong, workers can often retire early and make nearly as much as they did when they were working. Sometimes they can even make more by taking advantage of easily gamed rules about claimed job-related disabilities.

In states where the politician/union alliance dominates, the cost of pension generosity is hitting hard. DiSalvo points to the rift that has opened between those Democrats who don’t want pension costs to gobble up many dollars they would rather put toward their priority uses, and those who won’t risk antagonizing their



Government Against Itself: Public Unionism and Its Consequences

By Daniel DiSalvo
289 pp.; Oxford University Press, 2015

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union backers under any circumstances. The battle between San Jose's Reed and union-loyal Democrats in the California legislature is a sign of more internecine warfare to come.

Not only are pensions high in the union-friendly states, but they are also badly underfunded. Why wouldn't union officials pressure their legislative allies to make sure the pension and other retirement funds are kept on a sound financial footing? DiSalvo answers:

"Because union leaders know that benefits are legally—and in some cases constitutionally—guaranteed, they have confidence that the benefits in the future will be paid. Union leaders adopt something of a 'too big to fail' mentality." That is, they calculate that it is a better use of their political capital to push for greater benefits than to use it fighting to divert enough money into the plans to avoid crises. So far, that strategy has worked.

Pushback / Looking at the sweep of history, we have gone from a bad situation in early America where the spoils system

of patronage gave the people high-cost, inefficient public services to the fairly good system of largely nonpartisan civil service, and now back to a new sort of spoils system controlled by the public employee unions. DiSalvo makes a strong case that it is time for the pendulum to swing back—

Efforts to undo the economic and political damage that has been done by public sector unionism will be opposed vigorously at every step.

and that now seems to be happening. He points to several hopeful trends.

First, there is the pushback from liberal Democrats who see how badly city and state budgets are being distorted by the hegemony of the public unions, which consumes public resources those politicians want to devote to other purposes. Second, the unions have been defeated in some pitched battles against reform-minded Republicans (most notably Wisconsin Gov. Scott Walker) where they threw everything they had into protecting the status quo. Third, the legal landscape for

public unions is becoming more hostile. DiSalvo discusses two recent cases, *Knox v. SEIU* and *Harris v. Quinn*, where the U.S. Supreme Court curtailed the power of public unions and suggested a willingness to go further. After the book was written, the Court granted certiorari in *Friedrichs v. California Teachers Association*, which could prevent unions from using dues money to fund political activism.

Maybe the pendulum image is misleading, though. Pendulums swing on their own, but efforts to undo the economic and political damage that has been done by public sector unionism will be opposed vigorously at every step. The nasty tactics employed by the unions in Wisconsin—occupying the capitol building, threatening legislators, having their allies in the legislature leave the state in an effort to prevent a vote—will probably be repeated over and over. DiSalvo is under no illusions about the difficulty of recovering ground that has been lost to the public unions.

Government Against Itself is an excellent analysis of the political economy of public employee unions. It will probably make DiSalvo persona non grata among many of his faculty colleagues, but that is the price of speaking truth to power. R

Working Papers ♦ BY PETER VAN DOREN

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

Air Pollution

"As the Wind Blows: The Effects of Long-Term Exposure to Air Pollution on Mortality," by Michael L. Anderson. September 2015. NBER #21578.

What are the health consequences of exposure to conventional fossil fuel emissions? The U.S. Environmental Protection Agency sets ambient air quality standards using research on mortality rates in different metropolitan areas that have different ambient pollution levels. Such observational studies infer causality between air quality and mortality through statistical controls, and thus are subject to all the doubts that accompany statistical inference.

Just as medicine increasingly has relied on clinical trials rather than observational studies to understand the effects of drugs, diet, and behavior on human health, economists have increasingly published the results of natural experiments in which people are exposed to pollutants in a manner that is plausibly random and health effects are observed. In my Working Papers column in the Winter 2012–2013 issue, I described a paper that examined the summer cap-and-trade system for nitrogen oxide (NOx) emissions in the Eastern and Midwestern United States and its effects on ozone levels and asthma drug expenditures.

This paper compares the mortality rates of people who live upwind and downwind of interstate highways in the Los Angeles metropolitan area where the winds often blow in the same direction. Many studies have measured air quality near major highways. Ultra Fine Particles (UFP) and NOx plumes don't decay to background levels until they get 600 meters downwind, while

Even with the smaller estimated health effect, Anderson finds that reducing the downwind extra exposure to NOx and ultra-fine particles would be cost-effective.

upwind levels decay to background levels within 100 meters. During “carmegeddon” in Los Angeles in July 2011, when Interstate 405 was shut down over a weekend and car emissions fell accordingly, UFP levels were 83 percent lower downwind but there was no change upwind.

Given the persistent wind direction, wouldn’t people avoid downwind houses and thus make exposure non-random? The answer appears to be no. One reason for this is that people cannot perceive UFP and NOx readily with their senses. People can perceive conventional particulate matter and ozone with their senses, but those emissions decay to background levels within 100 meters downwind of highways. Anderson examines housing values and shows no difference in values upwind and downwind of highways, so there is no obvious evidence of non-random sorting of people into upwind and downwind houses. In the data in this paper, the median individual over 75 has lived at his current location for 25 years and 78 percent of them have lived at their current location for over 10 years.

Anderson finds that moving from the upwind to the downwind side of the road (within 600 meters) increases average NOx levels by 43 percent and mortality rates for those above age 75 years by 3.6 to 6.8 percent. This estimate is 60 percent smaller than one of the studies the EPA currently uses as a basis for its standard setting.

But even with the smaller estimated health effect, reducing the downwind extra exposure to zero in dense urban areas like Los Angeles would be cost-effective, according to Anderson. This would add 0.24 years to life expectancy at birth, or 372,000 total life-years in a sample of 1.55 million individuals. That equates to \$37.2 billion in benefits if each life-year is valued at \$100,000. There are 2.9 million cars in the Los Angeles basin. Using federal tax credits to spur replacement of all those cars with zero-emission electric vehicles would cost only \$21.8 billion, passing the cost-benefit test.

CAFE Standards

“Do Consumers Recognize the Value of Fuel Economy? Evidence from Used Car Prices and Gasoline Price Fluctuations,” by James M. Sallee, Sarah West, and Wei Fan. July 2015. NBER #21441.

Do consumers appropriately evaluate future energy costs in their decisions to purchase capital goods? That is, are they willing to pay up to \$1 today for an investment that saves \$1 (present value) in future energy expenses?

Advocates of the Corporate Average Fuel Economy (CAFE) standard, which mandates reduced energy use by automobiles, argue that consumers undervalue future energy savings in their decisions to purchase cars and trucks. Exactly 10 years ago in these pages, Molly Espey argued to the contrary: consumers seemed to value fuel economy appropriately when purchasing 2001 model-year cars (“Do Consumers Value Fuel Economy?” Winter 2005–2006).

This paper examines a large sample of vehicles sold from July 1993 through June 2008. The authors compared the sale prices of identical cars with different odometer readings and thus different total future operating costs. They tracked those prices month-by-month, along with changes in fuel prices, which altered the cars’ future operating costs. The researchers compared the car prices to determine if consumers changed their valuation of otherwise identical cars because of the change in future fuel costs.

Consumers appeared to conduct full valuation of gasoline costs over the remaining lifetime of the vehicle. A \$1 increase in the present discounted value of the fuel cost over the remaining life of the vehicle resulted in a \$1 decrease in the price paid for the vehicle. The policy implication is that no CAFE policy is necessary because consumers are willing to pay the cost of improved fuel economy on their own.

Cigarette Taxes

“Cigarette Taxes and Youth Smoking: Updated Estimates Using YRBS Data,” by Benjamin Hansen, Joseph J. Sabia, and Daniel I. Rees. June 2015. NBER #21311.

In these pages last winter, Kevin Callison and Robert Kaestner presented evidence that cigarette taxes have become so high and smokers are now such a small percentage of the population that current consumption is price inelastic (“Cigarette Taxes and Smoking,” Winter 2014–2015). That is, remaining smokers have such a strong preference for smoking that further cigarette tax increases will not reduce use further and cannot be justified by health benefits.

This paper asks whether the same is true for youth smoking. The standard answer, using 1991–2005 data from the Youth Risk Behavior Survey, was that a \$1 increase in the per-pack tax reduced smoking participation among high school students by 3–6 percentage points and frequent smoking (smoking in 20 of the last 30 days) by 2–4 percentage points. However, data from 2007–2013, when several states increased their cigarette tax, did not find any relationship between higher taxes and further declines in youth smoking or smoking frequency. Also, adding state-specific time trends to the 1991–2013 data eliminated the effect of tax increases on youth smoking. The authors speculate, analogous to the authors of last winter’s article, that the only young smokers left are price inelastic, like their elders. R