IN REVIEW

The *Journal* through Time

REVIEW BY DAVID R. HENDERSON

The most widely read and probably the most influential editorial page in the United States is that of the *Wall Street Journal*. How did that come about? Who have been the major editors over the many decades that the page has been important? What policies have the editors favored, and have their favored policies been good on net for the United States and the world, or bad? Finally, how sound has the *Journal* editors' reasoning about economic issues been?

For people who are interested in answers to those questions, I have two suggestions: read *Free People, Free Markets* by retired *Wall Street Journal* editor George Melloan, and read this review.

Melloan's breezy history of the *Journal* and its various controversies over the years is entertaining and informative. Starting in the early 1970s, he followed closely and often wrote about major developments and events, including supply-side economics and tax cuts, the fall of the Soviet Union, the various wars that the U.S. government got into, and last decade's financial crisis. His thoughts are sometimes insightful and it's heartening to see how he and the *Journal* editors have held firm, for good reasons, on free trade and immigration. Also, he tells how he disagreed with his one-time boss, the late *Journal* editorial page editor Bob Bartley, about the war on drugs. At times, however, I was surprised by Melloan's apparent ignorance of basic economics; that ignorance does, though, explain why the *Journal*'s editorial page has had somewhat of a tin ear on issues such as the causes of oil price increases and the reasons for low interest rates.

Supply-side economics / Although Melloan tells the whole history of the editorial page (now pages), what I found most interesting was the parts of the book that he devoted to the early 1970s. I started reading the *Journal* in 1972 at the suggestion of Benjamin Klein, one of my UCLA economics professors, and haven't stopped. As it happens, one of the biggest changes in the page took place in 1972: 34-year-old Bartley was chosen as editorial page editor. That was not an unalloyed positive.

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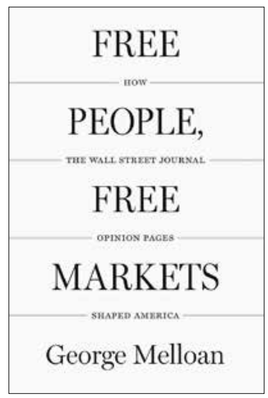
We can thank Bartley for making supply-side economics understandable, popular, and influential. Supply-side economics, as he and other *Journal* writers describe it, is the idea that high marginal tax rates discourage work, saving, and investment. It still shocks me how little emphasis academic economists placed on that insight before Bartley came along. Remember that the top marginal tax rate on individual income in the 1970s was a whopping 70%, so the idea that marginal tax rates matter should not have been so controversial.



Free People, Free Markets: How the *Wall Street Journal* Opinion Pages Shaped America

By George Melloan

368 pp.; Encounter Books, 2017

The *Journal*'s persistent call for lower marginal tax rates helped strengthen President Ronald Reagan's hand. From 1981 to 1987, Reagan and Congress cut the tax rate paid by the highest-income people from 70% to 28%. For that, those of us who believe in giving people incentives to produce and those of us who believe that people should keep more of their income should thank the *Journal*.

But there was a downside to this advocacy. First, many of the *Journal*'s unsigned editorials (under the heading "Review and Outlook") and guest op-eds during the Bartley era suggested that the economic growth sparked by tax cuts would result in higher federal tax revenues than if tax rates weren't cut. Reasonable back-of-the-envelope calculations showed that this was highly unlikely. As economist Lawrence Lindsey demonstrated with a careful examination of the data, more taxes were paid by the highest-income people, whose marginal tax rates were cut in the early 1980s from 70% to 50%. But it was not true for taxpayers overall.

Second, because the *Journal*'s editors did not worry much about the revenue effects of large cuts in tax rates, they didn't put much emphasis on proposals for reining in federal government spending. Imagine, for example, that the editors had advocated in 1972 that federal spending rise by 0.5 percentage points less per year than it actually did. In 1972, federal government spending was \$244.3 billion. In 2016, it was \$3,852.6 billion. That's a compounded annual growth rate of 6.5%. If our imaginary editors had gotten their way and federal spending had instead risen by "only" 6% annually, it would have been \$3,172.4 billion in 2016. The result, with taxes the same as they are, would have been a federal budget surplus of \$95.6 billion rather than the actual budget deficit of \$584.7 billion.

Immigration, trade, and foreign policy / Two issues on which the *Journal*'s editors have been steadfastly in favor of free markets are international trade and immigration. The *Journal* was a very prominent supporter of the North American Free Trade Agreement and, whatever level of restrictions on immigration we have, the editors have always wanted less. Indeed, Bartley once proposed the following constitutional amendment as an immigration policy: "There shall be open borders." A quick look at the country's immigration policy shows that we started moving away from liberalized immigration even before President Trump. By contrast, over the four decades since Bartley became editor, the United States has moved, on net, closer to free trade.

Melloan is at his best when he analyzes the microeconomic details of an economy. Reporting on a late 1980s trip through the Midwest, for example, he tells of big steel companies "moaning over their losses and demanding that Congress protect them from imports." But he then discovered "that smaller steelmakers using electric furnaces were competitive with foreign producers and were making money." When exploring the changes in the railroad industry, he found entrepreneurs "picking up abandoned trackage and running short lines to serve local needs."

Some of my colleagues who read the *Journal*'s frequent neoconservative foreign policy op-eds and attacks on Ron Paul's noninterventionist views refer to it as the "War Street Journal." But one pleasant surprise, to me at least, was Melloan's documentation of the *Journal*'s earlier opposition to—or at least criticism of—war. He quotes a prescient 1912 editorial by William Peter Hamilton that was critical of what he worried would be a major war in Europe:

> War is a waste. One country cannot dissipate its savings in gunpowder smoke without hurting all the rest of us. In modern conditions of easy communications and international exchange, the misfortune of one is the misfortune of all.

Even much later, the *Journal* remained critical of war. Melloan points out that it "opposed JFK's plan to send American advisers to aid the South [Vietnamese]." In October 1961, he notes, the editors wrote: "Perhaps we should all realize that there are certain things that the U.S., for all its military power, cannot do. One is to reshape the nature of people's radical values." Even today, Melloan—expressing his own views but probably also those of his former colleagues—opposes American politicians "setting up China as a bogeyman for their fear tactics designed to win votes." It would be "dangerous and possibly damaging to world trade," he writes "to put China back on the enemies list."

Unfortunately, that same sense doesn't seem to carry over to the Middle East. The editors were cheerleaders for both recent wars against Iraq. In late January 1991, during the Gulf War, Melloan advocated "a military occupation of Iraq by the United States, Britain and France, with sufficient power to intimidate Syria and, if necessary, Iran." And looking back on their support of President George W. Bush's invasion of Iraq, Melloan writes, "I see very little to regret."

Melloan—and probably his former colleagues—opposes American politicians "setting up China as a bogeyman for their fear tactics designed to win votes."

He argues that destroying Saddam Hussein and his government "gave the United States a position in an Arab country from which to rally other Arab states against yet another U.S. enemy with ambitions for weapons of mass destruction, Iran." Yet the obvious counterweight to Iran in the Middle East was Hussein. Melloan writes earlier in the book about the horror of the Iran–Iraq War during the first eight years of the 1980s, but he doesn't seem to see the connection.

On one war, though, Melloan is on the side of the angels: the drug war. He notes that as early as 1972 he agreed with Milton Friedman that drug prohibition should be ended: "I took a Libertarian view." Bartley, on the other hand, "believed that it is important to the health of a democracy to have a set of agreed-upon standards that covered human behavior." A ban on drugs, claimed Bartley, was such a standard. The obvious counter, which unfortunately Melloan doesn't give, is that threatening people with prison for using, producing, or selling drugs has nothing to do with "agreed-upon standards." Those who go to prison did not, I am certain, agree with those standards. To his credit, though, Melloan points out fellow editor Mary O'Grady's argument that U.S. intervention to suppress coca growing in Bolivia helped elect Evo Morales, a Fidel Castro admirer, as president. Melloan also points out the huge cost of the drug war to Mexico.

He notes that the young Bartley was chosen as editorial page editor over the more senior and more economically literate editor Lindley H. Clark Jr. Of course, we can't know what would have happened if Clark had become the editor. One likely difference, though, is in the choice of junior personnel. Clark likely would have picked deputies who were more economically literate than many of Bartley's picks.

Flubs / An issue on which *Journal* editors have exaggerated for decades is the link between monetary policy and exchange rates on the one hand and oil prices on the other. It's clear that, with everything else held constant, printing more money will cause the value of the U.S. dollar to fall and the price of oil in dollars to rise. But Melloan continues the *Journal* tradition of writing as if the *chief* driver of higher oil prices is loose monetary policy and the resulting fall in the value of the dollar.

"The price of oil soared" after 2001, he writes, because of the dollar's loss of purchasing power in international markets. That's partly true. But there's an easy way to see just how much, and it appears that editors who write in this vein have never done it: compare the increase in the price of oil in dollar terms and the increase in the dollar value of foreign currency over that same period. From 2001 to 2008, the price of crude oil rose from \$23.12 to \$94.10—an increase of 307%. Over those same years, the price of the euro, the world's other main currency, rose from 90¢ to \$1.47, an increase of 63%. Clearly, other factors were more important to oil's rise than exchange rates. In oil markets as in other markets, the likely main causes of price increases, as energy economists know, are increases in demand or decreases in supply.

Another important example of lack of numeracy is on economic growth rates. Melloan writes that the 1970s were somewhat of a lost decade for the United States, in part because of slow growth. Like many observers, he probably is not aware that the average annual growth in real GDP in the 1970s was a healthy 3.2%, which is exactly what it was in the 1980s.

Also, Melloan attributes the low interest rates of last decade to the Federal Reserve's monetary policy. But the real cause of the low interest rates—as former Federal Reserve chairman Ben Bernanke recognized and as Jeffrey Hummel and I described in "Greenspan's Monetary Policy in Retrospect" (*Cato Policy Report*, November 2008)—was a surge of saving coming from Asian countries and elsewhere, resulting in more money available for lending and investment.

Despite these weaknesses, *Free People, Free Markets* is a valuable resource for those who want a better understanding of the world as the *Journal* editors saw it and an account of the *Journal*'s role in changing that world.

Considering the UBI

REVIEW BY GREG KAZA

The idea of a universal basic income (UBI)—a government subsidy of at least a subsistence income for all citizens regardless of need—has long found support on the edges of the political left. But in recent years it has begun to receive mainstream interest. Hillary Clinton, the Democratic Party's 2016 presidential nominee, noted in her campaign memoir *What Happened* (Simon & Schuster, 2017) that she seriously considered embracing the UBI during her campaign. Some financial and business leaders are now advancing the issue. For instance, bond manager Bill Gross has argued, "If income goes to technological robots whatever the form, instead of human beings, our culture will change and, if so, policies must adapt to those changes." Entrepreneur Elon Musk also cites the prospect of major future job losses from automation as a reason for adopting a UBI, while Facebook CEO Mark Zuckerberg promoted the idea to Harvard University's 2017 graduating class, saying, "Now it's time for our generation to define a new social contract."

Interest in the UBI is not limited to the center-left. Republican Richard Nixon proposed a quasi-UBI Family Assistance Plan in 1969 that also had a non-UBI work requirement. The idea went dormant after Democrat George McGovern proposed a $1,000 per-person UBI as part of his disastrous 1972 presidential campaign, but Republican Alaska Gov. Jay Hammond played a key role in that state's 1976 creation of its Permanent Fund, an oil-rights-subsidized UBI. More recently, the American Enterprise Institute's Charles Murray has proposed replacing U.S. welfare programs with a UBI.

In this new book intended to garner support for the UBI from beyond the political left, authors Philippe Van Parijs and Yannick Vanderborght invoke an even more impressive would-be supporter: Friedrich Hayek. Hayek called for a minimum income while rejecting other welfare state components. "Like the business leaders who have come out in favor of basic income," Van Parijs and Vanderborght write, "many [classical liberals] are attracted to basic income because of its simple, non-bureaucratic, trap-free, market-friendly operation, which helps make generous transfers more efficient and sustainable."

They further write:

> Anyone doubting the power of utopian thinking would be well advised to listen to one of the main intellectual fathers of the "neoliberalism" that has been declared triumphant these days by its friends and even more by its foes.... The lesson Hayek learned from the socialists, we must now learn from him.... The free-society utopia we need today ... must be a utopia of real freedom for all that frees us from the dictatorship of the market and thereby helps save our planet.

Parijs and Vanderborght concede that "sympathy and support" for a UBI is "most generously and most consistently" held by political Greens. Their book uses Green ideology at times. For instance, in Chapter 1 they write, "The conjunction of growing inequality ... automation, and a more acute awareness of the ecological limits to growth [has] made [the UBI] the object of unprecedented interest throughout the world."

They cast support for UBI in terms of "hope in the future of our societies" and "the future of the world." At times, such rhetoric detracts from the work's scholarly aim, especially such sentences as: "In addition to visionaries, activists are needed ass-kickers, *indignados*, people who are outraged by the status quo or by new reforms or plans that target the poor more narrowly, watch them more closely, and further reduce the real freedom of those with least of it."

Explaining the UBI / The authors are more precise defining the UBI: "paid in cash rather than in kind; *individual* entitlement, as opposed to ... [a] household situation; *universal*, as opposed to ... an income or means test; [and] *obligation free*, as opposed to [a tie] to an obligation to work or prove willingness to work." In short, the UBI is "individual, universal, and obligation-free."

The book provides a good overview of the topic, discussing traditional alternatives to the UBI such as public assistance

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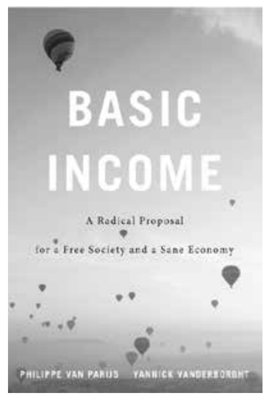
and social insurance. They describe the UBI as "a radically distinct" third model, offer a moral case for it, and tackle such issues as funding and affordability and the idea's political prospects. They also make some surprising claims along the way, including their assertion that "the rich are entitled to [a UBI subsidy] just as much as the poor."

The UBI's intellectual history is traced to the late 18th century. Thomas Paine's 1797 pamphlet *Agrarian Justice* proposed to "create a national fund, out of which there shall be paid to every person, when arrived at the age of twenty-one years, the sum of fifteen pounds sterling, as a compensation in part, for the loss of his or her inheritance, by the introduction of the system of landed property." In sharp contrast to John Locke, Paine asserted of the UBI, "It is not charity but a right, not bounty but justice, that I am pleading for." French social thinker Charles Fourier (1772–1837) was a proponent of a government-guaranteed basic income subsidy "targeting the poor: obligation-free but not universal." More proponents emerged in the 20th century. Bertrand Russell's "'vagabond's wage' was sufficient for "existence but not for luxury." British social activist Major C.H. Douglas (1879–1952) argued that "social credit mechanisms" could pay all households a monthly "national dividend." Infamous Louisiana populist Huey Long advocated a "Share Our Wealth" program that would have operated like a UBI. More recently, economist Robert Theobold (1929–1999) advocated a "guaranteed income" because automation is making workers "redundant."

The welfare state may diminish the UBI's political appeal, making it appear to be just another government handout. The authors argue means-tested welfare state components like Social Security and unemployment insurance are "a safety net that fails to catch a great many people it should catch, and in which others get trapped." In contrast, the UBI "provides a floor on which they all can safely stand."

Today, the UBI competes with other welfare ideas: a one-time basic endowment payment, a negative income tax for low- and non-earners, an earned income tax credit for only low earners, wage subsidies, guaranteed employment, and work reduction. The authors criticize these competing ideas:

- "The basic endowment is about equalizing opportunities at the start of adult life, while basic income is about providing economic security throughout life."
- Because of "the need to switch back and forth between different administrative statuses of claimant or worker, a negative-income-tax scheme presents the same intrinsic defect as standard means-tested schemes."
- The EITC "has the obvious disadvantage of doing nothing for the jobless."
- "If busyness is all that matters, wage subsidies are definitely superior to an unconditional basic income. For those committed to freedom for all, however, the opposite is clearly the case."



Basic Income: A Radical Proposal for a Free Society and a Sane Economy

By Philippe Van Parijs and Yannick Vanderborght

400 pp.; Harvard University Press, 2017

Justifying the UBI / Pro-UBI arguments include "people can take jobs or create their own jobs with less fear;" "earnings ... increase net incomes," and women would benefit because they "currently participate to a lesser extent in the labor market and their average hourly wage is below that of men." The UBI should not be "misunderstood as aiming to equalize outcomes or achievements. Rather, it aims to make less unequal, and distribute more fairly, real freedom, possibilities, and opportunities."

Drawing on utilitarianism, they argue the UBI is "conducive to greater happiness." Unfortunately, they follow this with a bout of unsatisfying rhetoric, claiming the UBI "does not operate at the margin of society but affects power relations at its very core. Its point is not to soothe misery but to liberate us all."

The authors present a moral case for the UBI on the basis of distributive justice, which they define as "the just distribution of entitlements to resources among the members of a society." They answer objections, including concerns that a UBI would encourage idleness by removing the work incentive of basic survival, but struggle to convincingly rebut objections raised by philosophers John Rawls and Ronald Dworkin. Rawls used the stereotype of the slacker Malibu surfer who would rather spend the day on his surfboard than laboring for money, arguing that such folks "must find a way to support themselves and would not be entitled to public funds." Dworkin similarly dismissed such idle people as "scroungers." If Rawls and Dworkin had such concerns, Van Parijs and Vanderborght are unlikely to gain support from people whose political thinking is more inclined to the views of Robert Nozick, who would have criticized the UBI as an illegitimate state acquisition of property. The authors also fail to explain how their abstract theory can achieve a critical mass of support among citizens—many of whom would have the same "idleness" concern—or the public officials needed to enact a UBI.

The authors concede the negative income tax (NIT) has political advantages over the UBI. Milton Friedman wanted an NIT, but wanted it set "low enough" so that taxpayers would be willing to pay the bill and give individuals harmed by the welfare state "a substantial and consistent incentive to earn their way out of the program." Elsewhere, they acknowledge "skepticism about the potential political support" for a UBI. They cite NIT experiments in New Jersey and Pennsylvania (1968–1972); Iowa and North Carolina (1970–1972); Gary, IN (1971–1974); Seattle and Denver (1970–80); and Manitoba

(1970s), observing, "There are now over fifty countries with sovereign wealth funds similar to the Alaska Permanent Fund. Yet, despite various proposals, Alaska's dividend scheme remains unique so far." But they don't consider the possibility governments put their own self-interest ahead of individual citizens. The landslide defeat (76.9% – 23.1%) of a proposed Swiss UBI in a 2016 referendum suggests politics are not on the side of the UBI, at least for now.

As for the size of UBI payments, the authors suggest "picking an amount on the order of one fourth of (a country's) current GDP per capita," though, "there is nothing sacrosanct about 25 percent." Their proposal would equal $1,163 per month in the United States (as opposed to $130 in India and $16 in Congo).

Proponents would fund the UBI through taxation, though no major political party in the industrialized world has embraced this radical idea—at least not transparently. However, some UBI programs have been attempted with nonprofit or private funding. Pierre Omidyar, e-Bay co-founder, is donating nearly $500,000 for a Kenyan UBI experiment. The authors discuss initiatives such as a UBI operated by *MeinGrundeinkommen*, a German nonprofit; and a German United Evangelical Mission monthly UBI project in Otjivero, Namibia.

Conclusion / The UBI is gaining interest in the American political discussion, but on a very superficial political level. In my opinion, Van Parijs and Vanderborght's book does not make a convincing argument that government UBI programs are needed. It also does not devote enough attention to privately funded experiments. These are the more important development in the UBI and they should be closely followed. R

Becoming More Sympathetic with 'Black Lives Matter'

REVIEW BY DWIGHT R. LEE

In this book, James Forman Jr., a Yale law professor, distills his experiences as a public defender in Washington, DC and a co-founder of a D.C. public charter school, as well as his knowledge of politics, the drug war, and the criminal justice system, to tell a sad story. It is a story with few heroes, many victims, and nuances that don't fit well into competing political narratives.

Forman begins by telling the story of a black juvenile he represented who was convicted on relatively minor gun and drug charges. He had no previous arrests, yet he was sentenced to six months in a detention facility that "everybody knew … was a dungeon," instead of receiving probation and the chance to remain in school. Forman couldn't help noticing that everyone in the courtroom was black, including the judge, the prosecutor, and court reporter, as well as the arresting officer. For that matter, so were the police chief, mayor, and the majority of the city council that wrote the gun and drug laws that his client was convicted of violating.

Forman recognizes the progress blacks have made since the 1950s, but "progress wasn't the whole story." In 1954, about one-third of the nations' prisoners were black. The number was approaching 50% by 1994. The increase occurred as the political influence of blacks increased, especially after the passage of the Voters Rights Act of 1965. Forman is not surprised by this because a 2014 survey of Americans found that 64% of blacks thought the courts don't deal "harshly enough with criminals." (The comparable portion for whites was 73%.)

He also recognizes that the consequences he regrets are the result of policies made by people trying to save communities that "seemed to be crumbling before their eyes." There was a dynamic in play that "drove elected officials toward a tough-on-crime stance in some predicable ways." Yet, nobody has a sense of responsibility for the consequences "because nobody is responsible." So, "even reluctant or conflicted crime warriors … become part of the machinery of mass incarceration [that] … continues to churn even to this day, when its human toll has become increasingly apparent."

Forman does an impressive job explaining reasons why the tough-on-crime political responses led to tragic human costs in black communities that continue today. He makes a case for his views that I found deeply convincing and often very touching. I do have some disagreements with a couple of his points, but they are peripheral to his arguments. I applaud him for writing a book that has increased my understanding of a serious problem and made me more sympathetic with the problems so many in the black community must deal with, including many of the black males sentenced to prison.

Forman's story unfolds primarily in D.C., with relevant highlights from other major cities with large black populations.

Appeal of prohibition / As in other large cities, blacks in D.C. are no more likely to use illegal drugs than whites living in middle-class neighborhoods. But blacks' incarceration rates for marijuana possession are far higher than whites, with the gap not explained by more blacks being engaged in street-level distribution.

Because of this gap, David Clarke, one of two white members of D.C.'s first city council, saw an opportunity in 1975 to

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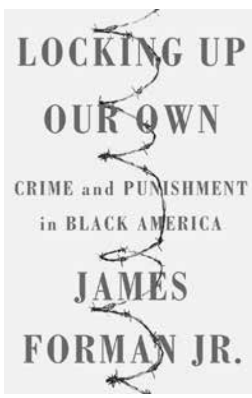
promote civil rights and racial justice by greatly reducing the fine and eliminating prison sentences for possession of less than 2 oz. of marijuana. There was resistance, but passage looked likely except for the city's long and troubled history with heroin. From the early 1960s to 1969, the percentage of new inmates in D.C.'s corrections system who were addicted to heroin increased from less than 3% to 45%, and they were overwhelmingly young black men.

One response was to provide "methadone maintenance" for addicts. This was opposed, however, by those who objected to "masses of black citizens strung out—and completely dependent—on government narcotics." Many black activists in D.C. "believed that whites *wanted* blacks to be addicted to narcotics, because it made them passive; … [and] methadone maintenance was a thinly veiled attempt to keep black people oppressed" (Forman's emphasis).



Locking Up Our Own: Crime and Punishment in Black America

By James Forman Jr.

320 pp.; Farrar, Straus, and Giroux, 2017

Despite the opposition of local black pastors and others who "insisted that [marijuana] was a gateway to harder drugs," Clarke's proposal passed on the first vote. It required a second majority, however, to become law. It was at this point that the clergymen "turned up the heat." They rallied, 150 strong, at the District Building, targeting Council Chairman Sterling Tucker, who needed their support to stay in office, and Mayor Walter Washington, who could veto the bill even if it passed the council. It worked. Tucker tabled Clarke's bill right before the second vote was scheduled, effectively killing it.

Paralleling the D.C. debate over penalties for marijuana possession was a debate over gun control laws. Black-on-black violence was imposing a horrifying cost on the black community in D.C. and other American cities in the mid-1970s. Nationwide, the homicide rate was seven to 11 times greater for blacks than for whites. Some 85% of the victims killed by guns in D.C. were black.

D.C. politicians favored prohibition backed up with harsh penalties "even when the punitive measures … did not achieve the desired results."

Empathy for the victims' families was accompanied by outrage against the murderers and criticism of judges who handed down light sentences for violating gun laws. Harsh prison sentences were demanded for possessing or selling a gun, or committing a crime in possession of one, without the possibility of plea-bargaining. D.C. advocates of these longer sentences knew they would be served mostly by blacks. But they felt this would prevent the small minority of criminals from terrorizing the majority of law-abiding black citizens.

Yet, many blacks had an opposing view. Doug Moore, an influential member of the D.C. council who opposed reducing penalties on marijuana possession, also opposed gun restrictions. His opposition was based on black history. Moore argued that blacks need guns not just for individual protection, but also as "a tool of collective self-defense against violent whites." Coleman Young, Detroit's first black mayor, agreed. He proclaimed, "I'll be damned if I'll let them collect guns in the city of Detroit while we are surrounded by hostile suburbs and the whole rest of the state … where you have vigilantes practicing in the wilderness with automatic weapons."

Forman writes that to "modern ears [those] claims may sound outlandish. But they shouldn't." They were rooted in the history of Jim Crow violence and were strengthened by such outrages as the assassination of Martin Luther King and other civil right leaders. But the hope that gun control in D.C. would reduce black-on-black killing resulted in a 12–1 city council vote for strengthening restrictions on guns in 1976. Tougher penalties for violating those restrictions were postponed until 1979 because of a temporary moratorium on the city council's ability to change the city's criminal law.

In the debate over both marijuana and gun control, D.C. politicians favored prohibition backed up with harsh penalties "even when the punitive measures adopted in D.C. and elsewhere did not achieve the desired results." In both cases, "the majority of those punished have been low-income, poorly educated black men." And the result was a failure "to prevent marijuana use [or] protect the community from gun violence."

Black police are still police / Obviously, not all killing in black communities were blacks shooting blacks. While fewer in number, blacks were being killed by the police, who until the 1960s were almost entirely white. Many of those killings were clearly unjustified (e.g., the victim was jaywalking) and created the same resentment against police that they do today.

In response, blacks made three arguments for hiring black police officers. First, they would be more trusted in black communities and more likely to protect blacks. Second, they would be more respectful and less likely to use unnecessary force. Third, training and trusting blacks to use the police power would send a vital message to both blacks and whites. Forman takes us through the history of the gradual increase in the number of black officers, featuring Burtell Jefferson, who became D.C.'s first black police chief in 1978, and Atlanta's hiring of eight black police officers in 1948, with Martin

Luther King Sr. playing a key role.

Black police were hired, but they were subjected to much the same discrimination as other blacks at the time. Forman tells us about separate and poorly equipped police stations for black officers, of them being required to enter though the back door of integrated stations, being assigned to foot patrols rather than allowed to use police cars, being forbidden to arrest white suspects, being denied promotions based on "suitability interviews" even when they scored well on written exams, etc. Over time, such blatantly discriminatory treatment of black policemen slowly eroded. But so did the hope that black policemen would act differently than white policemen. "A surprising number of black officers simply didn't like other black people—at least not the poor blacks they tended to police," Forman writes. Even those who considered themselves "concerned about protecting black neighborhoods … freely admitted to being markedly more aggressive about responding to such low-level infractions as drunkenness and loitering." Black officers often expressed being embarrassed by the behavior of black offenders. In part, according to Forman, this conduct of black officers "reflected class divisions within the black community."

He writes of his experience as a cofounder of a D.C. public charter school attended by many students who "had lost parents, friends, and siblings to violence, addiction, and prison." The students (all black) "were routinely subjected to verbal abuse, stopped and searched for drugs or weapons, or even punched, choked, or shoved" by police officers (mostly black) without any rationale that Forman could see. He saw these abuses as "part of a larger pattern" reflecting that the police "had been trained to act like warriors."

Predictable responses / As part of that description, he powerfully writes of what happened in "the late 1980s, when a terrifying new drug—crack cocaine—invaded Americas ghettos." According to Forman, crack

> spawned violent drug markets the likes of which American cities had never seen. In their fight for territory, heavily armed gangs turned urban neighborhoods into killing fields. … The menace crack presented in turn provoked a set of responses that helped produce the harsh and bloated criminal justice system we have today … enshrining the notion that police must be warriors, aggressive and armored, working ghetto corners as an army might patrol enemy territory.

Blacks were disproportionally homicide victims when the crack carnage began, but the new drug made things much worse. According to the U.S. Justice Department, by the mid-1990s there was a 1:35 lifetime probability of a black American male being murdered, compared to a 1:251 probability for a white American male. The demands for something to be done "seemed to come from everywhere," but nowhere more vociferously than from "once-vibrant [black] communities [that] had been devastated."

The responses of black politicians and leaders were predictable. Despite overcrowded jails, D.C.'s mayor Marion Barry vowed, "We will find space to put those gun thugs and drug thugs who get convicted of carrying guns and selling drugs." Atlanta's mayor Maynard Jackson warned, "[If] a drug or gun sale resulted in a death, the seller deserves to roast or fry." While serving as U.S. attorney for D.C., Eric Holder's answer for reducing gun violence was, "Stop cars, search calls, seize guns," and he initiated Operation Ceasefire to do exactly that. Knowing better than to inconvenience the politically influential, he exempted from the operation D.C.'s second district, where most of the city's movers and shakers lived.

Unfortunate consequences and root causes / Black leaders knew that the worst consequences of the war on drugs in D.C. and many other large cities were imposed primarily on the poorest people in black communities. Obviously, this was true of the killings and crime, but Forman is also deeply troubled by the lives that were destroyed or almost destroyed by the harshness of D.C.'s criminal justice system on blacks who violated laws that were commonly violated with impunity by people in middle- and upper-class neighborhoods. This was also recognized by black leaders. Holder was acknowledging the obvious when he said of Operation Ceasefire that the "people who will be stopped [and arrested] will be young black males, overwhelmingly."

Forman ends his book with mild optimism by mentioning the recently declining crime and murder rates, more lenient drugs laws, and the increased concern over the disproportionate attention the criminal justice system gives to poor black males. He comments throughout the book on the importance of measures to reduce the root causes of crime, such as poverty, joblessness, and poor education.

Unfortunately, he devotes little attention to how best to address these root causes beyond occasional expressions of support for such policies as more federal spending on welfare programs and a "Marshall Plan" for cities to promote urban revitalization. There is no suggestion that these programs might be worsening the root causes, if not outright creating some to them. He recognizes the lack of jobs in ghettos and points out that "a young black man without a high school diploma is more likely to be in prison or jail than to be employed in the paid labor force." Yet he ignores the negative effect of occupational licensing and minimum wage laws on job opportunities for young people from deprived backgrounds, He also does not mention the advantages of school choice in improving the educational opportunities for young people—a surprising omission for someone who co-founded a charter school in D.C.

I am fully prepared to forgive Forman for those omissions, however, because they are likely the result of his experiences and understandings being different than mine. It is because of those differences that I admire *Locking Up Our Own* and I learned so much from reading it. I recommend it with enthusiasm. R

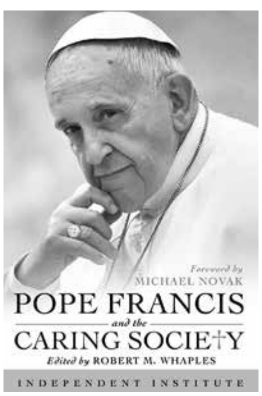
The Pope and the Markets

REVIEW BY GEORGE LEEF

Suppose that you hear someone declare that capitalism produces "an economy of exclusion and inequality" and that "such an economy kills." You might well decide that there's no point in arguing with someone who so embodies Mises' "anti-capitalist mindset." The world is full of such people and they seldom show any openness to counterarguments.

The speaker in question, however, is Pope Francis, whose pronouncements on a wide range of issues command attention simply because of his position as leader of the world's one billion Roman Catholics. His writings, especially the encyclical *Laudato si*, put him far into the "progressive" camp, and those who seek to further expand the state's control over economic life find his views to be useful.

Still, the pontiff has called for dialogue on the issues of poverty, consumerism, environmentalism, business, the family, and so on. Taking him at his word, the Independent Institute has produced a book that responds to his call and his beliefs. Edited by Wake Forest University economist Robert Whaples, *Pope Francis and the Caring Society* offers seven fine essays by scholars who share the pope's Christian convictions but disagree with his ideas on how best to advance them.



Pope Francis and the Caring Society

Edited by Robert M. Whaples

234 pp.; Independent Institute, 2017

Bergoglio's story / If those of us who favor a minimalist state want the pope to understand us, it's important that we understand him. His ideas may be mistaken, but he holds them for a reason. His background has a great deal to do with that.

Born Jorge Bergoglio in Argentina in 1936, Pope Francis's views were shaped by that nation's unhappy experience under Peronist rule. In his foreword to the book, the late Michael Novak observes:

> As the twentieth century began, Argentina was ranked among the top fifteen industrial nations, and more of its wealth was springing from modern inventions rather than farmland. Then a destructive form of political economy, just then spreading like a disease from Europe—a populist fascism with tight government control over the economy—dramatically slowed Argentina's economic and political progress. Instability in the rule of law undermined economic creativity. Inflation blew to impossible heights.

Rather than grasping the connection between economic suffering and the *dirigiste* policies of the governing regime, most Church leaders looked at places like Argentina and condemned what was left of laissez faire. Collectivism was in the ascendancy in the first half of the twentieth century and the Catholic Church was seduced by it. Three years before Peron seized power in Argentina, Pope Pius XI wrote in his 1931 encyclical *Quadragesimo anno*, "The right ordering of economic life cannot be left to a free competition of forces. From this source, as from a poisoned spring, have originated and spread all the errors of individualist economic teaching." That assault on economic liberalism was the foundation for the Church's social teaching for decades until Pope John Paul II had some good words for market competition and the pursuit of profit in the 1980s.

The future Pope Francis thus grew up believing that capitalism was the big problem. It causes a huge gap between the few rich and the many poor and it leads people astray with the "consumerist" impulse. In 1998, he compiled a book following the visit of John Paul II to Cuba in which he declared, "No one can accept the precepts of neoliberalism and consider themselves Christian."

Upon becoming pope in 2013, Francis did not retreat in the least from his longstanding opposition to economic liberalism. As Pepperdine University economist Andrew Yuengert writes in his chapter, "Francis' account of markets is entirely negative: a healthy social order must put markets in their place, reducing their outsized influence on consumer choices, government policy, and labor markets."

Francis has, Yuengert notes, injected a previously unknown cynicism into the debate over the free market by questioning the motives of market proponents. He casts arguments for competition as "mere cover for exploitation." The people who argue for laissez faire cannot be trusted because they have been warped by greed. One must wonder how serious the pope really is about engaging in dialogue with those who disagree with him when he impugns their motives.

In his essay, Acton Institute scholar Samuel Gregg writes that Pope Francis reflects the "us versus them" politics of Peronism and adds that Argentina's miserable attempts at economic liberalization in the 1990s no doubt further soured him on pro-market thinking. While the pope repeatedly attacks laissez faire concepts, he apparently finds nothing to reproach in progressivism. Gregg writes, "In the numerous addresses, press conferences, and interviews Francis has given since becoming pope, it is difficult to find any criticism of left-populist policies that comes close to matching his impassioned denouncements of market economies."

Gregg is disturbed by the pontiff's deep hostility toward people who argue that what

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the poor need is less government help, not more. Business interests and market advocates, in Francis's eyes, "are dishonest and offer only sham arguments and slanted analysis." How, Gregg asks, can he expect to have true dialogue with those whose integrity he has repeatedly and publicly attacked? Moreover, by demonizing business, the pope increases the likelihood that revolutions such as we have seen in Bolivia and Ecuador will completely shut out market competition and saddle the people with thoroughly dictatorial regimes.

Poverty and capitalism / Business and economics professor Gabriel Martinez of Ave Maria University quotes from Francis' encyclical *Evangelii gaudium* to show that he knows the political terminology and can use it as well as any leftist politician:

> Some still defend theories of "trickle down" which suppose that all economic growth, favored by market freedom, manages to provoke by its own power greater equity and social inclusion in the world. This opinion, which has never been confirmed by the facts, expresses an artless and naïve trust in those who hold economic power and in the sacralized mechanisms of the ruling economic system.

Martinez contends, however, that this passage should not be read as showing the pope's implacable hostility to economic freedom, but rather that he opposes the use of market theory "to justify indifference"—the view that "eventually the poor will be alright if we leave then alone; the market will take care of them."

Martinez argues that Francis is concerned that if markets are not kept under control, the result will be control by "the winners," which is to say that the masses will be kept under the heels of economic oligarchs. (In that, he sounds much like Franklin Roosevelt.) What the pope evidently doesn't understand, and unfortunately Martinez fails to stress, is that the solution to the problem of domination by business oligarchy is not a powerful state, but a state where the laws and the people guard against the abuse of governmental power for private ends.

In their chapter "Pope Francis, Capitalism, and Private Charitable Giving," Independent Institute senior fellow Lawrence McQuillen and Victims of Communism Memorial Foundation research associate Hayeon Carol Park push back strongly against the pontiff's belief that a strong state is necessary for the poor to advance. Infinitely better than a redistributive state, they argue, is a state that gets out of the way of wealth creation and private redistribution. Further, voluntary charity is morally worthy conduct, which cannot be said of coercive welfare systems. They write:

The solution to business oligarchy is not a powerful state but a state where the laws guard against the abuse of governmental power for private ends.

> Voluntary giving is not the charitable "giving" the pope often speaks of. The pope instead emphasizes governmental redistribution and a large role for international organizations in facilitating transfers. Unfortunately, the approach he advocates generally results in more human suffering, not less, thus undercutting his call for help for the poor.

McQuillen and Park go further in criticizing the pope's stance in favor of redistribution by noting that he never identifies actual programs that succeed in bringing about social justice. Francis is guilty, they maintain, "of the vice of vagueness, which is no substitute for knowledge and leaves the pope espousing nothing but what he sees as good intentions." They point the pontiff to scholars such as Peter Bauer and Dambisa Moyo who have made strong cases against reliance on government and international aid programs.

Property and the environment / Pope Francis has also had much to say about the environment. Emeritus economics professor A.M.C. Waterman of the University of Manitoba examines the pontiff's "green" positions.

Francis blames pollution on a "throwaway culture" and advocates reliance on renewable energy sources and recycling. He also rails against "disproportionate" growth of cities. To ease pressure on the environment, the pope wants people to adopt a new lifestyle; once we are free from "the obsession of consumption," we will supposedly enjoy cleaner and happier lives.

Waterman examines various claims the pope has made where he undermines his arguments with hyperbolic rhetoric. For example, Francis complains that many of the world's poor suffer from the lack of clean water (which is true), but blames "the deified market" for it. Waterman responds, "Economists know that it is not 'despite its scarcity' but precisely *because of that scarcity* that water should be 'subject to the laws of the market.'" He asks the pope to consider that capitalism is capable of providing the infrastructure for water that the poor in Africa, Asia, and South America so desperately need.

Philip Booth of the Institute of Economic Affairs argues that Pope Francis misses the importance of property rights in alleviating poverty and solving conservation problems. He wants the pontiff to learn more about the benefits of laissez faire, writing:

> Economies broadly based on the principles of economic freedom and private property are more likely to prosper. And as countries become more prosperous, they tend not only to adopt technologies that are less resource intensive per unit of gross domestic product, but also to value environmental goods more.

Booth also suggests that Francis familiarize himself with the work of the late Nobel laureate Elinor Ostrom, who argued that communities are well able to create systems from the "bottom up" to deal with social and environmental problems.

Conclusion / The book's final chapter, by Allan Carlson of the International Organization for the Family, examines the pope's declarations about the economics of the family. Again we find that Francis can't resist attacking capitalism, stating that the social degeneration of the family begins "when human beings tyrannize nature, selfishly and even brutally ravaging it." Carlson writes, "Francis despairs over consumerist cultures that pressure young people 'not to start a family' by simultaneously denying them stable economic 'possibilities for the future' while presenting them with too many options."

Carlson takes the pope to task for paying no attention to the need for property rights if families are to enjoy security and well-being. That's right, but I think Carlson ought to have devoted a few paragraphs to the harm that government welfare programs have done to the family.

Will this book have any effect on the renewed leftward drift of the Roman Catholic Church? Efforts at getting Church leaders off the belief that statism is necessary for a good, fair society have been ongoing for decades with little apparent success. Still, because Pope Francis has said he wants dialogue, we perhaps have a unique teachable moment. Congratulations to the Independent Institute for an admirable effort to take advantage of this moment. *R*

Defending the Free Market from Laissez-Faire?

REVIEW BY PHIL R. MURRAY

In his new book, Bryant University economist Joseph Shaanan explains that free-market advocates laud "a market or decentralized economic system where market forces determine prices and quantities for products and services. All this is done without coercion and without barriers to entry." But, he adds, disagreement exists over the nature of coercion and competition in free markets.

He then describes "market fundamentalism" as a collection of "unsubstantiated beliefs associated with laissez faire such as the idea that markets (or the invisible hand of the market) can handle all economic issues without government's help." In this, he reveals his thesis: "The purpose of the book is to debunk extreme and unfounded assertions attempting to equate the free market ideal and its beneficial properties with actual markets and the economy." His gripe is with what he calls "contemporary laissez faire," which to him is different from a free market.

Market power / Shaanan begins each chapter by presenting a myth that is often professed by laissez-faire enthusiasts. Take "Myth 1: America Has Free Markets." That is a myth because of market failures and "giant corporations," he explains. And on this point he is right; market power is one type of market failure. It is undeniable that many firms in the real world have the ability to restrict output and set price above the marginal cost of production. This is undesirable in the sense that the level of output on the market will be below the efficient level where consumers' marginal value of another unit equals the marginal cost of production. To Shaanan, that is not a free market.

Likewise, the presence of big business renders a market unfree. He decries "powerful bureaucratic centers engaged in economic planning"—meaning corporations that "are hardly the epitome of a free market."

Shaannan emphasizes the ability of big business to undermine consumer sovereignty. Marketing departments influence consumer behavior through conventional advertising and a new ploy of "muddying or blurring the difference between branding and other aspects of life." Corporations also weaken a consumer's judgment from the supply side. "Quite often," for example, "food choices are skillfully manipulated through careful applications of precisely calculated doses of salt and sugar, at times, intended to addict; somewhat at odds with the spirit of consumer sovereignty."

He documents myriad ways in which corporate practice proves that "we do not have free markets of the Adam Smith variety." This reviewer is not an Adam Smith scholar; however, I suspect that the founder of economics railed against merchants in general and the East India Company in particular not so much because they were big businesses but because they benefited from "preference" or "restraint" granted by government.

Darwinian jungle / It is conventional to think of laissez faire and the free market as complementary. If laissez faire is a government policy whereby government officials refrain from interfering with the plans of market participants, then—the standard thinking goes—markets will be free.

However, Shaanan argues, such thinking can harm truly free markets. Consider his "Myth 10: Free Market and Laissez Faire Are the Same."

He writes, "Laissez faire economists usually oppose government antitrust intervention even when used to stop anticompetitive practices and strengthen markets and competition." It is reasonable for Shaanan to characterize free-market economists as critical of antitrust policy. He is aware of Joseph Schumpeter's point that monopolists who innovate should not be discouraged, and Richard Lipsey and Kelvin Lancaster's theory of the second best, though those contributions are relegated to an endnote.

In the body of the text, he claims that

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IN REVIEW

free-market economists "justify their opposition to antitrust laws with the argument that such government actions violate the requirement that no coercion be involved in a free market." That statement underrates the aforementioned critiques of antitrust policy and makes one wonder what's wrong with opposing coercion. Shaanan writes, "It is not coercion that bothers them but government, or more likely, democratically elected government." The real agenda of free-market economists, he alleges, is to achieve corporate hegemony.

America's Free Market Myths: Debunking Market Fundamentalism

By Joseph Shaanan

303 pp.; Palgrave MacMillan, 2017

Misrepresenting market supporters / Shaanan generally does offer an accurate portrayal of free-market principles, but there are troubling occasions when he caricatures and neglects to cite what free-market economists actually write. Consider "Myth 4: Deregulation Always Improves the Economy." I claim that's a caricature because the economic way of thinking recommends deregulation when the benefits exceed the costs, which is not always. In his exposition of this supposed myth, Shaanan cites *New York Times* columnist Thomas Friedman, who is an accomplished writer but not a free-market economist.

Shaanan's notions and observations of regulatory affairs are debatable. Ponder these ideas:

> Those who enjoy freedom from want often object to extending that freedom through government to many others. They describe such attempts to improve the lives of the many, whether it is a minimum wage law, an antiusury law and bans on financial predation, as restricting their freedom.

The author acknowledges that freedom means different things to different people. "To some," he explains, "it represents freedom of opportunity and choice; to others it represents freedom from want and having the bare necessities such as food, shelter and health care." The former meaning appeals to free-market economists; the latter to Shaanan.

He does a service by presenting different viewpoints. But it is unhelpful for him to misrepresent the motivation of critics of regulation by saying that they already have their stuff and don't want other people to have theirs. One reason economists criticize the minimum wage law is that it denies the least productive workers the freedom to work at a wage below the minimum. Having the freedom to work for a low wage does not make one rich, but opting for a low wage is better than being unemployed. The argument against legal maximum interest rates is that they will reduce lending, which harms borrowers. Likewise, it is possible to evaluate "bans on financial predation" by focusing on, say, the difficulty of defining predation, without concern for anyone's freedom to prey. (By the way, the block quote above footnotes Karl Polanyi's *The Great Transformation* as a source, not the work of a free-market economist.)

Shaanan recognizes problems with regulation, such as "regulatory capture," whereby industry executives co-opt regulators who erect barriers to enter the industry and rubber-stamp price increases. "It is not clear," he adds, "that regulators have the necessary information to set reasonable prices." He also admits that deregulation was successful "in some industries." Nevertheless, he devotes much more space to what he considers problems with deregulation.

"In the airline industry," he observes, "prices initially declined and new airlines were established; however, several airlines disappeared, at times, because of anticompetitive practices." Yet, thanks in part to those lower prices, monthly U.S. air carrier passenger travel is up from about 48 million in January 2000 to 60 million last September. Shaanan attributes airline bankruptcies to "anticompetitive practices," but competitive behavior (price and nonprice) will also reduce the number of firms in an industry. I make these points to dispute the author's implication that deregulation of the airline industry did not lead to "the expected competitive outcomes," which is not to suggest that there is no room for improvement in the airline industry.

Housing bubble / There is much to debate over the role of deregulation in the financial crisis of 2008. Shaanan writes extensively about it in "Myth 12: The Government Caused the Crash of 2007–08." The gist of his characterization of the free-market perspective is this:

> The guilty parties within government, although not exclusively, are Fannie Mae and Freddie Mac—the quasi-government mortgage agencies that practically gave away money to people who knew or should have known would not be able to pay their mortgage. The Community Reinvestment Act, created to promote home ownership in defiance of fundamental market principles, played a key role in bringing about this state of affairs.

The author cites several authors to deflect blame from Fannie and Freddie for the economic turmoil. "Perhaps most importantly," he argues, "[Fannie and Freddie] were not involved in subprime lending—a major factor in the crash—until late in the game (2005), at which point they were followers rather than leaders." Yet economist Russell Roberts of the Hoover Institution has argued that Fannie was in the game early. He quotes Fannie's CEO, who said, "Fannie Mae was at the forefront of the mortgage industry expansion into low–down payment lending and created the first 3-percent-down mortgage." ("Gambling with Other People's Money," Mercatus Center, April 28, 2010.) Moreover, getting in the game late does not preclude making a difference. "Between 2004 and 2006," Roberts reports, "[Fannie and Freddie] still purchased almost a million home loans each year made to borrowers with incomes below the median."

Shaanan deemphasizes any damage done by the Community Reinvestment Act (CRA) because "it was private mortgage companies and other financial firms not subject to CRA rules that sold large quantities of subprime mortgages throughout the nation." I don't doubt that, but as Charles Calomiris and Stephen Haber have noted, "Community Reinvestment Act loans by banks, as well as the mandates imposed on Fannie and Freddie that effectively forced them to purchase those loans, set in motion a process by which America arrived at debased lending standards for *everyone*." ("Strange Bedfellows at the Bank," *National Review*, Feb. 4, 2014.) Economists who criticize government policies aim not to exonerate all private-sector actors and lay all the blame on government officials; they indict the two as co-conspirators.

Rent-seeking / Shaanan's condemnation of cronyism is commendable. He declares:

> A major weakness of the economic system is that it encourages rent seeking behavior. This means that some of America's most talented people devote their energies to requisitioning existing wealth, rather than creating new wealth.

He expounds on this in "Myth 2: A Great Wall Separates Politics and the Economy." The favors that businesses seek from government officials include subsidies, tax breaks, and bailouts. Here are a few examples:

> For many years, oil, gas, ethanol producers and sugar growers have received large government subsidies. Oil and gas companies and mining companies have also received resources at below market prices. Television stations do not have to pay for use of the spectrum. The 2003 Medicare law banned government from bargaining with pharmaceutical companies over prices paid for medicine purchased.

Of course, free-market economists are sharp critics of rent seeking. This journal, for instance, often seems like a quarterly exposé of such shenanigans. Yet Shaanan implies that free-market economists shill for corporations. He alleges, "While Milton Friedman and his followers link laissez faire with the defense of individual freedom, in actuality, it is large corporations' right to profit that is being defended." The charge is uncharitable if not unfair. Friedman supported free enterprise, not business, and pointed out that losses were essential to the process.

Readers of *America's Free Market Myths* who prefer increased government intervention in the economy will find the book comforting confirmation that corporations exert undue influence, the middle class is stagnating, and greed caused the Great Recession. They might also learn that government officials are not the faithful servants of progressive conceptions of the public interest. Readers who prefer limited government and a larger role for markets, on the other hand, will be challenged to defend the free market against Shaanan's accusations. Readers of all sorts will learn that cronyism is a real problem and economists of all sorts would do well to battle it. *R*

Against Tribal Instincts

BY PIERRE LEMIEUX

This year marks the 30th anniversary of the publication of F.A. Hayek's last book, *The Fatal Conceit: The Errors of Socialism*. Hayek, of course, was one of the major classical-liberal theorists of the 20th century. Many would call him a libertarian, others would deny him the honor—or curse—of that label. He was a polymath who contributed to many fields of inquiry, including economics, political theory, psychology, and philosophy. In 1974 he shared the Nobel Prize in Economic Sciences with Gunnar Myrdal, a socialist economist who may be remembered for nothing other than that.

In the entry on Hayek in the *New Palgrave Dictionary of Economics*, Bruce Caldwell notes, "If Hayek was in the right place at the right time, it was usually with the wrong ideas, at least from the perspective of most of his contemporaries." Hayek was a deep, original, and controversial thinker, as *The Fatal Conceit* illustrates.

Economics of knowledge / The main error of socialism, he argues, lies in its rationalist goal of social engineering. Socialists do not see the limitations of reason. They do not understand that between natural and artificial phenomena, "between instinct and reason," there is a third category that contains social institutions such as language, morals, and law. Such evolved institutions, which include private property and markets, allow us "to adapt to problems and circumstances far exceeding our rational capacities," even if we cannot rationally explain their complex benefits. Attempting to remodel society on a rational basis could spell the end of civilization and "destroy much of present humankind and impoverish much of the rest."

The ideas in *The Fatal Conceit* build on Hayek's economics of knowledge, developed in the 1930s and 1940s. Consider, say, tin, as he proposed in his 1945 article, "The Use of Knowledge in Society" (*American Economic Review* 35[4]: 519–530). If the metal becomes scarcer, its price will increase, transmitting to consumers the signal to economize on tin-made goods

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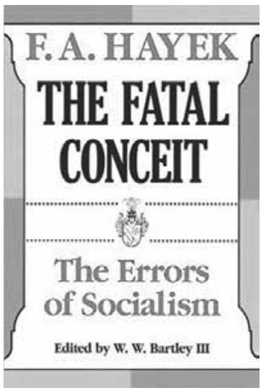
and to producers the signal to produce more tin. It does not matter whether the cause is that the supply of tin has decreased or its demand has increased, and nobody needs to understand that. Through trade, the price signal will be transmitted to consumers and producers far away.

Market-determined prices incorporate the producers' local knowledge, the traders' information, and the users' preferences. All information is thus taken into account by all. In this way, more knowledge is used in society than any individual separately possesses and any planner could ever marshal. Through markets, more is produced of what consumers want than any other economic system could achieve.



The Fatal Conceit: The Errors of Socialism

By F.A. Hayek

194 pp.; University of Chicago Press, 1988

More generally, evolved social institutions use information efficiently. They represent the results of the interaction of millions of individuals over time, and they incorporate all the underlying knowledge, even unconscious knowledge (as most of our knowledge is, from Hayek's viewpoint). In this way, "cultural evolution, and the civilization it created, brought differentiation, individualization, increasing wealth, and great expansion of mankind." Hayek reminds us that the evolutionary approach was pioneered in social studies by Adam Smith and Adam Ferguson in the 18th century, before Darwin used it in biology.

Extended order vs. the tribe / This efficient use of information allows an "extended order" of cooperation among individuals, "beyond the limits of human awareness." "Every individual becomes a link in many chains of transmission through which he receives signal enabling him to adapt his plans to circumstances he does not know," Hayek writes. Society is a "complex system"—he used that expression before it became so omnipresent in science—produced by the independent actions of its individual elements. In comparison, a government bureaucracy is a very simple and ignorant system. "So far as we know," he hypothesizes, "the extended order is probably the most complex structure in the universe."

Trade—especially international trade—provides the paradigmatic case of an extended order. Trade fuels specialization and the division of labor. Trade caused "a substantial disruption of the early tribes," which contributed to new knowledge, the advance of civilization, and economic prosperity.

The extended order is based on abstract rules, like those of private property and the rule of law, which do not impose common goals but allow each individual to pursue his own personal ends. At the polar opposite, the tribe is made of individuals who know each other and are obliged to conform to concrete morals based on primitive instincts and the requirements of collective goals. As Hayek says, the process of the extended order of civilization has been to replace "common concrete ends" with "general, end-independent abstract rules of conduct." The moral rules of an extended order contradict the stifling traditions of the tribe, but they also restrain primitive urges, which is why so many people resist them.

Hayek presents 18th-century French philosopher Jean-Jacques Rousseau as the modern representative of tribal morals. By forcing individuals to obey concrete orders from the state, socialism undermines the extended order in favor of a Rousseauvian conception of the good savage in a tight and ecological society. Contrary to what Rousseau thought, notes Hayek, "the primitive is not solitary, and his instinct is collectivist." Let me add that the vision of society or "the country" as a team evokes the tribal order that Hayek finds behind the socialist agenda.

Hayek sees the process of social evolution as analogous to, but different from, biological evolution. He criticizes sociobiology for focusing on genetic transmission instead of imitation and learning in the formation of the rules we follow. He writes:

> The gradual replacement of innate responses by learnt rules increasingly distinguished man from other animals, although the propensity to instinctive mass action remains one of several beastly characteristics that man has retained. … The decisive change from animal to man was due to such culturally determined restraints on innate responses.

In Chapter 7 of *The Fatal Conceit*, titled "Our Poisoned Language," Hayek brings to our attention the fact that our usual language is often biased toward primitive ways of looking at the world, toward small-group morals. Consider, for instance, the routine personification of society and the glorification of everything "social." In reality, he reminds us, collective utility "exists as little as collective mind."

Ode to diversity / Contrary to the homogeneous tribe, the extended order is based on diversity—real diversity. A few pages of *The Fatal Conceit* sing an ode to diversity. For example:

> Civilization is so complex—and trade so productive—because the subjective worlds of the individuals living in the civilized world differ so much. Apparently paradoxically, diversity of individual purposes leads to a greater power to satisfy needs generally than does homogeneity, unanimity and control—and also paradoxically, this is so because diversity enables men to master and dispose of more information.

Hayek emphatically rejected the "conservative" label. The postscript of his *Constitution of Liberty* (1960) was titled "Why I Am Not a Conservative." In *The Fatal Conceit*, he suggests that sexual mores should naturally change when the purpose of previous social taboos no longer exists:

> I believe that that new factual knowledge has in some measure deprived traditional rules of sexual morality of some of their foundation, and that it seems likely that in this area substantial changes are bound to occur.
> … I am entirely in favor of experimentation—indeed for very much more freedom than conservative governments tend to allow.

He adds that "the development of variety is an important part of cultural evolution, and a great part of an individual's value to others is due to his differences from them." Hayek has always been as ahead of his time as he has been controversial.

He is also far from being a progressive. An important implication of accepting the spontaneous social order is that "social justice" is meaningless. There can be no social justice or injustice in an order that develops spontaneously. Evolution cannot be just or unjust. Only an individual can be just or unjust.

Too conservative? / In some ways, *The Fatal Conceit* appears to be Hayek's most conservative book. Speaking about philosopher W.W. Bartley III, who helped an ailing Hayek finish the book (and provided a complete edition of Hayek's work), Caldwell mentions that "questions have been raised about how much of the book should be attributed to Bartley and how much to Hayek." Yet, *The Fatal Conceit* seems in line with Hayek's three-volume *Law, Legislation and Liberty* (1973–1979). But the earlier *Constitution of Liberty* arguably represents a younger Hayek who was more classical-liberal.

Already visible in *Law, Legislation and Liberty*, a sort of absolutist traditionalism colors *The Fatal Conceit*. Hayek goes so far as to say that "man became intelligent because there was *tradition* … for him to learn" (his emphasis).

Everything is fine as long as tradition generates a liberal extended order. But it does not always. What if tradition veers toward the tribal model? As Hayek seems to admit, this happened in Sparta, and ultimately in Egypt, Athens, the Roman Empire, and China. If, as he also admits, "the expansion of capitalism—and European civilization—owes its origins and *raison d'être* to political anarchy," should statist traditions be obeyed? Should we just wait and see, and embrace whatever comes out of the system? At a certain point, traditions become stifling. Traditions should be revered, but only up to a point.

A related concern is raised by Chapter 8, titled "The Extended Order and Population Growth." Societies that adopted the morality of the extended order have prevailed over primitive societies, Hayek argues, in large part because their traditional rules have allowed for the creation of more wealth and thus a more numerous population. Against environmentalists and Malthusian types, he claims that population growth fuels diversity, the division of labor, and productivity.

There can be no social justice or injustice in an order that develops spontaneously. Evolution cannot be just or unjust. Only an individual can be just or unjust.

But are the results of group selection by cultural evolution necessarily good? Hayek says he does not make that claim, but a simpler one that a return to tribal morals would "doom a large part of mankind to poverty and death." So far so good, and we might forget libertarian concerns for primitive tribes displaced by the advance of civilization—provided the displacement respects certain humanitarian constraints. But the author of *The Fatal Conceit* goes a bit further: "There is in fact no reason to expect that the selection by evolution of habitual practices should produce happiness." Is this morality sufficient? Aren't we back to a simplified utilitarianism where individuals can be sacrificed to the existing order?

Appendix D of the book also suggests tensions between the individual and the spontaneous order of evolved institutions. Hayek claims that "not even all existing lives have a moral claim to preservation." He understands the Eskimo practice of abandoning senile members to die before the tribe's seasonal migration because it may have allowed them to save their offspring. He admits the "individual's right voluntarily to withdraw from civilization," but questions any "entitlements" to those who do that. "Rights derive from systems of relations of which the claimant has become a part through helping to maintain them," he explains. The entitlement point is close to the libertarian argument that individuals should not be forced to subsidize others, but one can easily imagine tyrannical drifts and exclusions—whereby, for example, rednecks and other "deplorables" would be excluded from society.

Conclusion / In *The Fatal Conceit*, Hayek defends the extended order of the market as well as the traditional institutions that produced and maintained it (in some parts of the world, at some time in history). But he does not really consider what to do when a conflict appears between evolved traditions and individual liberty. Has he gone too far in his reverence for tradition? Have we lost meaningful individual consent in the process?

Whatever the answer, the broad points made in *The Fatal Conceit* remain valid and provide a welcome antidote to the deification of lawmakers. The fact that people only venerate ideal lawmakers, not those they actually observe, should help deflate the state's aura. Unfortunately, most people believe that the big problem is that the Red team is in power instead of the Blue, or vice versa. Hayek shows that traditional rules embedded in the extended order of a free-market society provide a better way of coordinating individual actions than commands from lawmakers and other political authorities.

Traditions, of course, must remain open to criticism, but this does not mean they should be actively challenged by a social-engineering state. R

IN REVIEW

How We Dodged a Bullet

REVIEW BY DAVID R. HENDERSON

Rarely do I enjoy a book by an author with whom I fundamentally disagree on the book's topic. But Brian Steensland, a sociology professor at Indiana University–Purdue University Indianapolis, has written such a book.

The Failed Welfare Revolution was first published in 2008, but it has now been reissued as a paperback, probably because of renewed interest in a guaranteed annual income (GAI) program. In the book, Steensland traces the development, in the U.S. context, of the idea of a GAI or a negative income tax (NIT) from the 1940s to President Richard Nixon's serious attempt to implement a version during his first term in office, to later discussions of the idea within Jimmy Carter's administration.

Steensland would probably dislike the title of this review. He sees the defeat in the U.S. Senate of Nixon's proposed Family Assistance Plan, which the House of Representatives passed in 1970 by a vote of 243–155, not as dodging a bullet but, on the contrary, as a huge lost opportunity. But one doesn't have to agree with his perspective to learn from his book.

Steensland gives a detailed account of the various proposals for some version of a GAI, starting with Lyndon Johnson's administration, through the Nixon, Gerald Ford (briefly, given his two years in office), and Carter administrations. Although Steensland is a sociologist, he exhibits a basic understanding of the effects of economic incentives on work and family dissolution. And refreshingly, his book is relatively free of cheap shots at those with whom he disagrees. He tries hard to understand their views rather than merely dismissing them as unworthy. That makes it relatively easy to judge the arguments of the various players and come to conclusions different from Steensand's. In particular, I found the arguments against Nixon's proposal by some of Nixon's own staff much more convincing than Steensland did.

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Early efforts / Most people who know the history of the negative income tax, which is a form of GAI, associate it with the University of Chicago's Milton Friedman, who proposed such a scheme in his famous 1962 book *Capitalism and Freedom*. The idea was to have the U.S. Treasury make a payment to people whose incomes were, for whatever reason, below some low level—thus the term "negative income tax." Then, if their income from sources other than the U.S. Treasury increased, their payment from the Treasury would fall by 50¢ for every additional dollar of income. Steensland gives Friedman due credit but also points out that in 1946 George Stigler, later to be Friedman's colleague at Chicago, had proposed such a plan as an alternative to the minimum wage, which, as Stigler noted, destroyed jobs for the unskilled.

Nothing much happened on the NIT front for more than a decade after Stigler's 1946 proposal. But Michael Harrington's 1962 book about poverty in America, *The Other America*, helped bring attention to it. In that book, notes Steensland, Harrington "argued that it was worse to be poor in an affluent society than in one in which most of the populace was poor." Steensland doesn't comment on that claim but I will. If envy of those around you eats at you then, yes, Harrington probably is right. But if you are poor and can see that many people around you are relatively wealthy, that can spur you to take initiative; if poverty is defined by real income, I would rather be poor in the United States than in, say, Colombia.

In the early 1960s, some liberal/left economists and others started pushing for an NIT or GAI. Among them were economists Robert Theobald and James Tobin. Theobald proposed a flat income grant that would go to every U.S. (presumably adult) citizen. How left-wing was Theobald? Steensland notes that he described left-wing economist John Kenneth Galbraith's *The Affluent Society* as "extraordinarily conservative."

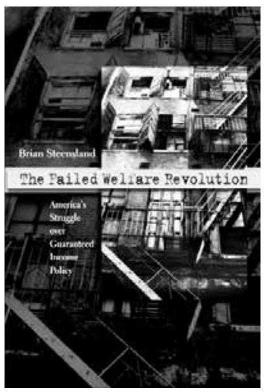
Around the same time, many people's view of the GAI changed, partly because of an influential 1964 article in the *Yale Law Journal* by legal scholar Charles Reich. Friedman and others had argued that government should give money to the poor because that is a way for taxpayers to help them. But Friedman was always clear that the poor didn't have a right to an income provided by government. Reich, however, "argued that welfare benefits were a statutory right once a recipient had established eligibility."

During Johnson's presidency, his newly formed Office of Economic Opportunity (OEO) considered various versions of a GAI or NIT. In 1967, the OEO started a huge, expensive social science experiment to estimate the effect of an NIT on work. The group chosen for the experiment consisted of low-income families with an "employable man" between ages 18 and 58. The reason for the experiment, notes Steensland, is that the OEO and others were concerned about how much an NIT would discourage work effort, especially by men. The experiment ran for many years—the results finally came out in 1978—and yet the people proposing various versions of an NIT did not want to wait for the conclusions.

Partly because of the race riots of the mid-1960s, many advocates—including representatives from big businesses—pushed for some version of a GAI. However, the high budgetary cost of the Vietnam War in the last few years of Johnson's time in office helped put a halt to such a program.

Steensland notes that a proposed NIT would have added $5 billion to the federal government's budget, while a program of family allowances (a payment for every child in every family) would have added $6–14 billion.

Steensland doesn't point out just how high a number this was, so I will. Total federal spending in fiscal year 1967 was $158 billion; that means the cheaper program, the NIT, would have increased government spending by over 3%, and the most expensive version of the family allowance would have increased it by 9%.



The Failed Welfare Revolution: America's Struggle over Guaranteed Income Policy

By Brian Steensland

304 pp.; Princeton University Press, 2018

Steensland claims that the escalating cost of the war caused domestic spending to contract sharply, but that's not true: domestic federal spending increased even as the war's cost rose. He mistakenly uses the fact that Johnson proposed a surtax on corporate and individual taxes as evidence of a shrinking budget for domestic spending: taxes are on the revenue side of the federal budget, not the spending side.

Nixon's FAP / From the outset, Nixon wanted some kind of major overhaul of what he called "the welfare mess." He was worried about poverty but also about more racial unrest. He couldn't know then that the worst of the racial unrest was over.

Within days of being elected in November 1968, Nixon had appointed political scientist Richard Nathan, a researcher at the Brookings Institution, to run a task force to make recommendations about welfare. In its December 1968 report, the task force suggested incremental changes to the existing system. Once Nixon took office, a number of players within the administration, including holdovers from Johnson's administration, weighed in on the various issues. Steensland does a great job of laying out each major faction's concerns, viewpoint, and proposed policies.

At least four big issues divided the various advocates. The first was their view about why people were poor. Some believed that poverty was an inevitable result of being unable to find work in an increasingly technological workplace that required more skills. A 1964 report titled "The Triple Revolution" predicted that in the near future, 6 to 8 million jobs would disappear. When the report was published, 69 million Americans were employed in civilian jobs; by 1970 the number was up to 79 million. Oops. Others thought that the labor market would give work to anyone who wanted it, but that even some of those who got jobs would still be poor.

A second issue that divided them was their view of the deserving and undeserving poor. Some of the advocates didn't think in those terms: if people were poor, whatever the cause, that was justification enough for the federal government to help them. Others saw a strong distinction: the deserving poor were the sick and infirm; the undeserving poor were those able-bodied people who weren't working.

The third issue concerned rationality and paternalism. Some thought that the poor were capable of making good decisions for themselves; others thought that if the government gave them money, many would make bad decisions on how to spend it and on whether to work.

The fourth issue was dependence. Some advocates worried that an NIT or a GAI would create dependence, while others didn't worry about that.

You can take one side or the other on each of the above issues. But as one of Nixon's main advisers on welfare, Daniel Patrick Moynihan, became famous for saying, "Everyone is entitled to his own opinion, but not to his own facts." I repeat the quote because Moynihan, in pushing for one version of a plan, told Nixon a whopper. In an April 1969 letter to Nixon, Moynihan wrote, "For two weeks' growth in the Gross National Product you can all but eliminate family poverty in America." Um, no. The typical annual growth rate in those days was just above 3%, so two weeks of growth was about 0.12% of GNP. Even the cheapest plan would have cost well over half a percent of GNP, which is more than four times Moynihan's estimate.

One of the most interesting parts of Steensland's narrative is his discussion of the role of White House staffers Arthur Burns (later chairman of the Federal Reserve Board) and Martin Anderson, a young economist who was instrumental in getting rid of military conscription. They disliked the idea of a GAI and an NIT on the grounds that the programs would lead to the view that welfare is a right. Burns also argued that it would reduce low-skilled workers' incentive to work. On this issue I found Steensland to be particularly fair. He dismisses the idea that their arguments were "rhetoric cloaking economic interests." He writes that they "had no contact with business elites" and did not "have any reason to dissemble."

After listening to the various players, Nixon put together his Family Assistance Plan (FAP) his first summer in office and did a full-court press to get it into law. It was an NIT in which the loss of subsidy for every dollar of income beyond some level was 50¢, an implicit marginal tax rate of 50%. Families of four with earnings up to $3,920 would have been eligible for a government subsidy. The plan was set to begin in 1970 or 1971, when the median family income was just shy of $10,000.

Although Nixon's proposed law passed overwhelmingly in the House, it died in the Senate Finance Committee, which voted it down 10–6. One reason was that conservative Democrats joined some conservative Republicans in voting against it. Another reason was that the National Welfare Rights Organization, a group supported by people on welfare, saw—correctly—that most of the benefits would go to the working poor, not to those who, like them, were already on welfare. They wanted more for themselves, plain and simple. As a result, three liberal senators voted against it.

In 1972 Nixon, running against George McGovern, wanted to distinguish himself from McGovern on the issue of welfare. McGovern had proposed a "demogrant" of $1,000 per person. It was, in essence, a GAI. Not everyone would get a check: the phaseout of the $1,000 would be complete when a family of four had a total income of $12,000. McGovern's proposal met with so much flak that he backed down. But Nixon, seeing a chance to distinguish himself from his opponent, attacked the "'welfare ethic' that could cause the American character to weaken." Steensland notes the irony: "It was Nixon's proposal that would expand the provision of benefits to thirteen million additional people, while McGovern's new plan [in place of the demogrant] would maintain the existing number of people on the rolls."

Even though the FAP was dropped, it did leave a policy legacy. Nixon introduced Supplemental Security Income (SSI), a special welfare program for people who were elderly, blind, or disabled. And in 1975, President Ford and Congress started the Earned Income Tax Credit (EITC), a kind of negative income tax for people who are employed. The optics on both of these were very different from those on the FAP. SSI was viewed as giving help to some of the most deserving poor. The EITC was viewed as an incentive for people to work more, not less, even though past some income level the EITC would phase out, reducing the incentive to work.

Later efforts / When Carter became president in 1977, he pursued welfare reform. His marching orders to Joseph Califano, his secretary of health, education, and welfare, were to give options for comprehensive reform that would cost no more than the current system. Califano, responding to that directive, counted spending on a number of other government programs as part of his baseline so that he could give himself more running room to propose increased benefits or to extend benefits to a larger group.

With the tax revolt that began with the overwhelming passage of California's Proposition 13 in June 1978, though, moves toward anything like a GAI or an NIT were dead. But the EITC was expanded in 1978 with little opposition. With the election of Ronald Reagan, the GAI and NIT were both dead.

In 1978, notes Steensland, the results of the NIT experiment came out and showed that the NIT reduced work by employed men by 5–10%, which was less than many people had feared. But the reduction for married mothers was 20–25%. Steensland claims that welfare critic Charles Murray used the results of the NIT experiment "in exaggerated ways," but he doesn't say how.

One striking result of the experiment was that marital breakups for participants receiving NIT benefits were 60% higher than for those in the control group. Interestingly, Steensland—who advocates a GAI or an NIT—expresses no concern about this. He devotes not a single word to the effects of marital breakup on children.

Because there is a renewed push today for some form of GAI—even some libertarians advocate it—there's a lesson to be learned from Steensland's book. Some libertarians claim that we could have a reasonable GAI by cutting all other means-tested benefits. This turns out to be false, as I showed in "A Philosophical Economist's Case Against a Government-Guaranteed Basic Income" (*Independent Review* 19[4], 2015). But even if it were true, the Nixon proposal was for a major expansion of welfare spending with no offsetting cuts in means-tested programs such as housing aid and food stamps. The lesson: libertarians who push for a GAI will end up being in an alliance whose main constituents want more government spending. And that's what they'll probably get. R

Were Federal Prosecutors Really Chicken?

REVIEW BY VERN MCKINLEY

There was plenty of outrage to go around after last decade's financial crisis. Advocates for limited government were livid at the use of public financial commitments to save institutions that should have been allowed to fail. Progressives agreed with that sentiment, but they were also angry about the lack of prosecutions of financial executives. Jesse Eisinger, a Pulitzer Prize–winning journalist for *ProPublica*, is in the latter camp. In his new book, *The Chickenshit Club*, he takes on the Justice Department bureaucracy that decided against those prosecutions.

The book's provocative title comes from a story Eisinger tells in the introduction. James Comey, who would later make plenty of headlines as head of the Federal Bureau of Investigation, was speaking to a collection of federal prosecutors shortly after his appointment as the U.S. attorney for the Southern District of Manhattan, the epicenter of Wall Street prosecutions. He asked his audience: "Who here has never had an acquittal or a hung jury? Please raise your hand." A number of prosecutors, proud of their perfect records, thrust their hands into the air. "Me and my friends have a name for you guys," Comey continued. "You are members of what we like to call the Chickenshit Club." The point of embarrassing the hand-raisers was that acquittals and hung juries indicate the prosecutor is unafraid to try cases that aren't clear-cut—or in the words of Eisinger as he summarizes Comey's philosophy, "to be bold, to reach and to aspire to great cases, no matter their difficulty."

VERN MCKINLEY is a visiting scholar at George Washington University Law School and author, with James Freeman, of *Borrowed Time: Two Centuries of Booms, Busts and Bailouts at Citi*, forthcoming from HarperCollins.

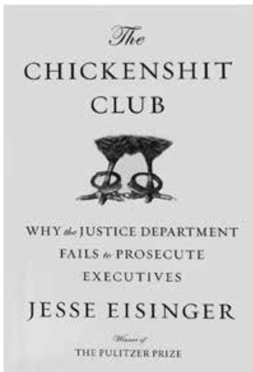
A strong hand / I am particularly interested in this topic of prosecutions because early in my career I worked for the Federal Deposit Insurance Corporation and Resolution Trust Corporation as they cleaned up broke banks and savings and loans during the 1980s and 1990s. As part of that cleanup, there were thousands of convictions of individuals for major financial institution crimes—mostly directors and officers of institutions, as well as attorneys, accountants, and other professionals. All indications were that these were bad actors who abused their positions solely to enrich themselves.

Consistent with that view, Eisinger runs through an encapsulated history of what he calls the "Boom, Bust, and Crackdown" cycle. After the 1929 stock market crash, Congress created the Securities and Exchange Commission, a permanent platform for pursuing those committing financial malfeasance. After the stock market run-up of the 1960s, government cracked down on professionals involved in corporate fraud. After the banking and savings-and-loan failures and the junk-bond blow-up of the 1980s and 1990s, the Department of Justice prosecuted many top executives at failed institutions, and Michael Milken went to jail. Finally, after the tech bubble popped at the start of this century, top officers of Enron, WorldCom, and others also did time.

But something then changed, according to Eisinger:

> By contrast, after the 2008 financial crisis, the government failed. In response to the worst calamity to hit capital markets and the global economy since the Great Depression, the government did not charge any top bankers.

Case studies / This book is quite a bit different than I had expected when I ordered it. I thought that it would have some historical background on the evolution of prosecutions from the takedown of Enron and WorldCom during the early 2000s to the hands-off approach of the late 2000s. I believed that Eisinger would commit most of the book to case studies of the most highly publicized financial institution failures during 2008 and 2009 and the relevant key executives, and try to make an argument for why and under what charges the DOJ should have pursued them.



The Chickenshit Club: Why the Justice Department Fails to Prosecute Executives

By Jesse Eisinger

400 pp.; Simon and Schuster, 2017

However, an all-in case study approach is not the path he chose. A quick review of just a few examples from the book's index bears this out. Angelo Mozilo of Countrywide, who settled with the SEC and avoided a civil trial and criminal prosecution, receives all of two pages of discussion. Dick Fuld, Ian Lowitt, and Erin Callan of Lehman Brothers, who collectively deployed some very questionable accounting practices, likewise receive two pages each. Eisinger does go through case studies of John Paulson, who put together the Abacus 2007 mortgage deal for Goldman Sachs, and Joseph Cassano, who headed up AIG's Financial Products Group. But my expectation was that the bulk of the book would be these types of case studies, rather than just a few isolated instances.

The builders / Instead, Eisinger makes it through nearly half the book before he reaches 2009, when "the Obama people came in to the Department of Justice." He spends that first part of the book tracing through the heyday of the development of enforcement and prosecutions, and then showing how the regime slowly unraveled during the 2000s. Stanley Sporkin spent two decades at the SEC from the early 1960s to the early 1980s, building the capacity of its enforcement division as its director. "By the end of his run at the SEC in 1981, Sporkin had become a hero regulator feared by Corporate America," Eisinger writes. "He would come to be known as the 'Father of Enforcement.'"

Eisinger then connects Sporkin to a kindred spirit:

> To prosecute crimes, [Sporkin] needed allies at the Department of Justice. The Southern District had an effective monopoly on white-collar enforcement at the time. Main Justice and other offices around the country played little role. So Sporkin looked north and discovered friends in the Southern District of New York. He found one prosecutor particularly excited about his brand of justice, a brilliant, young, and aggressive lawyer eager to attack corporate and securities scofflaws: Jed Rakoff.

Rakoff spent much of his early career as a prosecutor in the Southern District of New York and was ultimately appointed to that district's bench by President Bill Clinton. In an interesting twist of the weaving storyline, Rakoff would later become more widely known for criticizing a proposed settlement offered by the SEC in a case involving Citigroup in 2010, arguing, "The court has not been provided with any proven or admitted facts upon which to exercise even a modest degree of independent judgement."

The last gasps of a tough DOJ enforcement regime can be traced to January 2003 and a memo by George W. Bush administration deputy attorney general Larry Thompson in the wake of the Arthur Andersen collapse. The memo set out a tough critique of how firms were complicit in protecting bad actors: "Companies … purport to cooperate while impeding exposure of the full account of a company's wrongdoing." Eisinger summarized Thompson's philosophy: "Pervasive bad behavior, a lack of contrition, a phony compliance program—his Department of Justice would treat these transgressions sternly. Members of the white-collar bar howled in outrage."

A different direction / One of the strands of the countervailing movement against prosecuting individuals was initiated by Mary Jo White during her tour of duty as U.S. attorney for the Southern District of New York. Deferred prosecution agreements (DPAs) allowed the DOJ to make relatively quick work of their investigations. These involve a nice quid pro quo for both sides: the DOJ extracts a large fine and the targeted institution avoids a long, expensive, and public fight. DPAs also have obvious downsides, as Eisinger explains:

> Since these settlements lacked transparency, the public didn't receive basic information about why the agreement had been reached, what the scale of the wrongdoing was, and which cases prosecutors never took up. How could the public know how tough they were, really?

Also helping along the movement away from prosecutions was the development of the revolving door of lawyers moving from the DOJ "farm team" to the big defense law firms, and sometimes back to the DOJ again. No firm better characterized this trend than Covington & Burling and its alum, Eric Holder.

After graduating from Columbia Law School, Holder began his career on the DOJ staff. After a stint as a judge, Clinton first appointed him as a U.S. attorney and then deputy attorney general. Holder then went to Covington & Burling during the George W. Bush administration, only to return to Justice as the attorney general during the Obama years.

Although progressives may have had high hopes that the Obama administration would seek "Old Testament vengeance" against executives in the financial industry, Eisinger makes it clear that this was unlikely to happen.

> In its first year, the department was cautious and overwhelmed by political infighting. One former top official at Justice likened it to a soccer game with 6-year-olds, where everyone clusters around the ball, and it never advances.

A Financial Fraud Enforcement Task Force, announced with great fanfare in late 2009, made little progress. After being called on the carpet for his lack of progress in 2013, Holder resorted to Chicken Little warnings, words that would be ridiculed as the "Too Big to Jail" problem: "I am concerned that the size of some of these institutions becomes so large that it does become difficult for us to prosecute them when we are hit with indications that if you do prosecute—if you do bring a criminal charge—it will have a negative impact on the national economy, perhaps even the world economy." Holder, who later recanted the comment, was the most high-profile of the spinners of the revolving door, but by no means the only one. He is now back at Covington.

If you are interested in the procedural changes and capture of Justice, you will find the *Chickenshit Club* a good read. But if, like me, you were hoping for a little less procedural history and a lot more case studies of whether the DOJ did indeed act cowardly, then you will be a little disappointed. *R*

Imagine What Future Generations Will Think of Us

REVIEW BY DWIGHT R. LEE

Except for being more creative than most, Peter Leeson, the Duncan Black Professor of Economics and Law at George Mason University, is a perfectly normal economist. Because he is an economist, however, he is not a normal human being, as many readers will realize as they read this book. Leeson expects this realization and welcomes it, as he explains early on when discussing his title, *WTF: An Economic Tour of the Weird.*

Consider some examples of things that are obvious to economists but bewildering to most people. Economists believe that a country can increase the incomes of its workers by importing products that they can produce with less effort and fewer resources than workers anywhere else in the world, a belief that is dismissed as bizarre by most normal people. When economists argue that there is an optimal amount of traffic fatalities, or environmental damage from pollution, or sexual harassment, or child abuse, most people are too appalled to appreciate the logic behind those arguments. Despite the powerful case economists make that the cost of goods increases when government subsidizes the goods' purchase, politicians continue to win elections by providing consumer subsidies. And it is easy to predict the reaction to economists when they propose reducing the threat to endangered species by making it legal for people to own some of them and profit by letting trophy hunters shoot them. There are many other examples of economists seeing as sensible things that most people see as weird (or worse).

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Leeson is not primarily concerned, however, with defending the "weird" views of economists. His book instead explains why several historical practices that many readers will consider outrageous were actually quite sensible given the understandings and incentives that prevailed at the time. His explanations are based on the highly commendable way economists consider the practices of others.

When we see or hear of others doing things that make no sense to us, it is easy to dismiss them as irrational if not downright stupid. Economists try to avoid this "stupidity" assumption because it often obscures reasonable, albeit sometimes difficult to understand, explanations. The powerful understandings economists have gained over the years were made possible by assuming that people pursue their interests—both narrow and noble—in rational ways given the constraints and incentives they face.

In order to develop these understandings, Leeson makes a serious effort to find out the legal details, social norms, and institutional incentives that constrained the choices people faced in bygone times. He then applies economic theory creatively to understand why people facing those constraints benefited from the seemingly weird and outrageous practices.

His narrative finds him conducting a sort of museum tour with seven exhibits. He begins with some introductory comments on the importance of curiosity and being open to the possibility that if a practice survives for a few generations, it may have been socially sensible no matter how weird it seems today. I cover only four of his exhibits in this review, with overview discussions of his detailed but very accessible analysis.

WTF: An Economic Tour of the Weird

By Peter T. Leeson

264 pp.; Stanford University Press, 2017

Hot water / The first exhibit, titled "Burn, Baby, Burn" (Chapter 2), examines the practice of "trial by ordeal" that was common in Europe in the 9th–13th centuries CE. The ordeals could involve heat or cold. In one example, the defendant would "'plunge his hand into ... boiling water' and pluck it out.'" If the defendant was innocent, his hand would be "safe and unharmed," people believed, but if guilty his hand would "show burn injuries on inspection three days later." Trial by ordeal could also find the accused carrying a "burning hot iron nine paces." The accused would be judged innocent if his hands were not damaged and guilty if they were.

Trial by ordeal was held in reserve for those being tried for the most serious crimes, and then only when the evidence was considered too ambiguous for earthly judgement. The rationale for trials by ordeal was to "let doubtful cases be settled by the judgement of God." The accused wasn't required to accept a trial by ordeal, but refusing the offer would suggest guilt. The astonishing thing is, as Leeson explains, "it seems that ordeals actually *exonerated* the majority of people who underwent them" (his emphasis).

He finishes with a compelling argument that, given the prevailing beliefs and primitive technology of the day, trials by ordeal were sensible ways to reach decisions on guilt or innocence in tough cases. Furthermore, he argues that practices similar to "medieval-style ordeals" are used today to help determine criminal innocence or guilt, such as lie detector tests (which depend on the stress that test takers feel about lying when being monitored) and swearing an oath on the Bible.

Honoring and obeying until sold / Even trained economists may initially be appalled by Leeson defending the practice of letting men sell their wives to the highest bidder at public auctions. Yet, this is what men could do in 18th–19th century England. He explains in Chapter 3 that the practice benefited both men and women, but particularly women.

Private sales were allowed, but they typically took place in public auctions because husbands expected open competition to yield the highest price. Not surprisingly, husbands generally claimed the "merchandise" possessed fine attributes, but some were "shockingly honest" in acknowledging flaws. For example, one husband's pre-auction description said his wife was a "tormentor, a domestic curse, a night invasion, and a daily devil."

Most sales were final, though one husband "allowed his wife's purchaser to try her out for three days, after which, if the buyer was unhappy, he could bring her back for 50 percent of her purchase price." Also, some purchasers bought wives with the intention of improving and flipping them.

The bid for a wife was not always in cash. "Alcohol was a popular supplement to cash compensation." Other cases included "lottery tickets, dinners, and a donkey" being used for payment.

It is easy to be outraged today at the thought of a woman having to endure the humiliation of her husband trading her for a donkey. But Leeson's argument recognizes that few of us today have enough knowledge of the 18th century English legal system to judge how an Englishwoman might have felt about being publicly auctioned off. Even with knowledge of that legal system we might still, under the influence of today's norms, express outrage at the restrictions it imposed on the choices of Englishwomen almost 300 years ago. But our norms are irrelevant to understanding what was sensible in England, or anywhere else, long ago.

That fact counsels our being open to Leeson's argument that the woman we assumed was humiliated was more likely overjoyed because of recent improvements in the English common law. Auctioning off a wife was one those improvements because, by allowing her husband to get an ass in exchange, it made it possible for her to get rid of one.

Admittedly, the improvements in English common law that increased the options available to women were painfully slow. But Leeson's argument moves us closer to understanding why the legal status of women improved faster in England, and countries influenced by the English common law, than anywhere else in the world.

Can lawyers put exterminators out of business? / In large parts of Europe in the 15th–17th centuries, insects, rodents, and other vermin could be taken to ecclesiastic courts for being too aggressive. As Leeson explains in Chapter 7, these trials were apparently conducted with the utmost seriousness, with "distinguished judges ordering crickets to follow legal instructions, dignified jurists negotiating a settlement between farmers and beetles, and a decorous court granting a hoard of rat defendants a continuance on the grounds that some cats prevented them from attending their trials."

Defendants were summoned to appear in court by reading the summonses where the defendants were generally found. If they failed to appear after three summonses, the court could convict them. Occasionally, however, some representatives of the charged species were brought to court for trial, and then released into their natural habitat to communicate the verdict to their fellow criminals after it was reached. Convicted pests were also notified that the penalty for refusing to turn themselves in was excommunication from the Holy Church.

How to explain bringing legal action against pests for behaving naturally? Part of Leeson's attempt is found in Chapter 5, where he explains the social benefits from medieval clerics' curses on those with whom they disagreed. He points out that a guilty verdict on destructive pests was an ecclesiastic curse widely considered to be as effective as those imposed on sinful humans. Furthermore, he argues that these judicial curses were perceived to reduce the damage from pests. This allowed the clergy to hold onto their legitimacy where it was being threatened by critics of the Church. The legitimacy allowed the clergy to continue generating general benefits with comforting promises to their flocks of a pleasant afterlife and less aggravation from pests during this life. With even more confidence, it allowed the clergy to continue capturing financial benefits with "thinly veiled threat[s] of continued plague if citizens continue to evade their tithes."

More entertaining than a title search / In 12th–13th century England, good records on land ownership didn't exist. For this and other reasons related to the feudal social structure, allocating land though markets was plagued with high transactions costs, resulting in regular disputes over land ownership. Courts attempting to resolve these disputes often turned to heavenly help by arranging combat between representatives of the two disputants—the assumption being that God would favor the rightful owner.

As Leeson explains in Chapter 8, these representatives, referred to as champions, were chosen for their physical prowess. Indeed, some disputants tried to corner the market on brutes to limit their availability to opposing disputants. They believed in God, but they had also heard that God helps those who help themselves, even in underhanded ways.

These practices are second-best solutions. When people in the past were subject to a weird belief or practice, it's possible they were made better off.

From an economic perspective, however, the problem was not just allocating land to rightful owners, but to owners who would make the most valuable use of it. Leeson discusses an interesting parallel between combat competition for God's favor in land disputes and rent-seeking today for politicians' favor in the competition for government largess, even though he considers the former to be more productive than the latter. He points out that "trial by battle enabled judges faced with [poor property rights] to do what the Coase theorem could not: get the land into the hands of the person who valued it more." He also points out that after King Henry II introduced reforms that "marked the birth of English common law and the beginning of feudalism's end in England," there was a marked decline in the cost of trading land in markets—and a disappearance of trial by battle.

Of course, progress always comes at a cost. Leeson does say that the battles between champions were usually not very dangerous for the combatants. They also attracted large crowds when land disputes were on the court's docket. Commonly, before the battle started, the disputants decided to settle. When that happened, the battle often took place anyway to avoid disappointing the crowd.

Second best / A generic explanation for people's initial negative reaction to these old practices is grounded in the economic "theory of the second best." The theory holds that efforts to eliminate a market inefficiency can sometimes make the market less efficient. Therefore, it is theoretically possible that *adding* a specific market inefficiency—a second-best solution—will improve market efficiency generally.

A plausible case can be made that claimed "second-bests" often are *not* more efficient on net. It depends on the existence of particular conditions, and creating a steady stream of market inefficiencies is an unlikely way to improve economic performance.

In essence, the practices Leeson highlights and explains are second-best solutions. He recognizes that his variation of the theory applies only under suitable conditions that have varied over time and place. But when those conditions are right, what I see as Leeson's "theory of the weird second best" supports his conclusions. This theory can be stated as follows: When people in the past were subject to a belief or practice that we consider weird today, it is possible that they were made better off by the addition of another belief or practice that we consider even weirder. As Leeson states: "Seeming senselessness on top of seeming senselessness = pretty damn sensible."

No reason to be smug / In this Twitter/flame-war age, feeling superior to others has become a global pastime. Feeling superior to those who lived long ago has the additional advantage that our predecessors cannot now defend themselves. But Leeson gives them a champion. They would applaud with enthusiasm when he questions whether some of our modern-day practices are any more sensible than some of the historical practices we now dismiss as weird (or worse).

We can only guess what future generations will think about some of our practices, which are often supported by large numbers of highly educated, overtly compassionate, and consistently smug voters. For example, governments try to reduce poverty with government programs that penalize those who reduce their own poverty through productive activity. Politicians proclaim the importance of education and employment to poverty reduction, but protect school systems and pedagogies that render disadvantaged populations poorly educated. Worse, the same politicians often defend—and tighten—minimum-wage laws and occupational licensing laws that leave these same people unemployed and vocationally untrained. Government tries to reduce monopoly power by restricting mergers while reducing competition by restricting imports, creating regulations making it more difficult for small firms to grow or survive, and favoring the largest firms with bailouts and tax breaks.

Any good public choice economist could list more examples of political practices that future generations will consider every bit as weird as the practices Leeson discusses. Maybe several hundred years from now a future Leeson will try to explain how our political weirdness made even a modicum of sense in the 20th and 21st centuries. *R*

Above All, Try Something—Anything

REVIEW BY PIERRE LEMIEUX

A reader can find interesting ideas in *Straight Talk on Trade* by Dani Rodrik, an economist who teaches at Harvard's John F. Kennedy School of Government. But that reader will also find much that is puzzling.

Rodrik claims that he is looking for "a better balance" in trade debates. He defines his own "trilemma": "It is impossible," he writes, "to have hyperglobalization, democracy, and national sovereignty all at once; we can have at most two out of three." In his mind, democracy and national sovereignty forestall hyperglobalization. Democracy and hyperglobalization prevent national sovereignty. And hyperglobalization and national sovereignty—well, those two are simply antithetical. So the trilemma is not perfect—but he did write "at most," and you get the message.

Where he uses the prefix "hyper" is revealing. He also could have claimed that it's impossible to have globalization, hyperdemocracy, and national sovereignty; or globalization, democracy, and hyper-national-sovereignty. But globalization is his focus—and his villain.

For Rodrik, free trade requires political integration among trading partners. But this is not true. It is perfectly possible for two citizens of two sovereign nations to trade freely with one another provided only that they are not forbidden to do so by their respective governments. As Paul Krugman has argued persuasively, each national government can still regulate as it wishes, tweaking comparative advantages but not killing free trade. In fact, it suffices that your government allows you to trade freely (that is, unilateral free trade) for your side of free trade to work. No political integration or world governance is required for that, nor is it necessarily desirable.

It is true, though, that the more free trade there is, the more difficult it is for a national government to have broad control of the nation's economy. That is a feature, not a bug. But as we will see, broad government control is what Rodrik wants.

Strange arguments / The author of *Straight Talk on Trade* does not see the difference between freedom and coercion. One of his memorable sentences is, "Globalization's rules should not force Americans or Europeans to consume goods that are produced in ways that most citizens in those countries find unacceptable." The sentence seems to mean that international trade rules should not *allow* some Americans (say) to consume goods from other countries with different labor and environmental regulations if many other Americans oppose that. In Rodrik's mind, *allowing* individual Americans to do so is the same as *forcing* them to do so.

He often seems to fumble basic economic concepts. For instance, in wondering if developing countries will have anything to export as they become innovative and rich, he forgets that comparative advantage depends on the ratio of *domestic* costs, and that as long as these ratios are not the same, international exchange is beneficial for all sides. In speaking about the big winners from trade, he ignores the consumers. He often sees the mote of market failures, but not the beam of government failures. To be fair to him, he sometimes recognizes the latter—but as we'll see, he overlooks them when their existence proves inconvenient.

Rodrik does discuss public choice analysis, which he refers to as "rational-choice political economy." But he also claims that politics "aggregates a society's risk preferences." He thus ignores that the aggregation of preferences is a major problem that requires either incoherent or imposed preferences, as Kenneth Arrow demonstrated in 1951. He also ignores that a voter acts rationally when he votes his ideology instead of his interests, because

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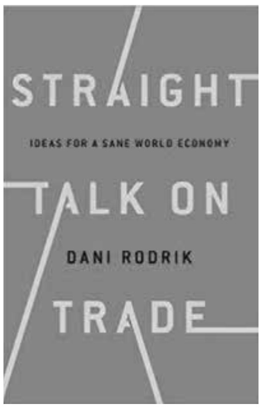
his single vote will not change the results of the election and therefore will do nothing for his interests.

He is obsessed with manufacturing and public investment, as government planners were six decades ago. He thinks like these planners, calculating productivity and constructing future growth paths. Rodrik advocates a "green industrial policy" and "institutional engineering." In passing, he gives a little hat tip to Bolivian president Evo Morales, who infamously argued that he had a human right to run for a third presidential term despite what the Bolivian constitution declared and what a referendum confirmed. The fact that development of poor countries did not take off until their governments released their grip does not persuade Rodrik.



Straight Talk on Trade: Ideas for a Sane World Economy

By Dani Rodrik

336 pp.; Princeton University Press, 2017

Sometimes his logic is fragile or his rhetoric fuzzy. He criticizes current "free-trade agreements" (he himself puts the term into quotation marks) as containing too little free trade, but proposes to make them even less free-trade. He seems to blame businesses for "taking advantage of government subsidies abroad," but accepts domestic subsidies—as if stealing from fellow citizens is morally superior to accepting gifts from foreign taxpayers.

His memory is sometimes selective. Discussing the role of the state in the Great Recession, he sees only a savior. He forgets that mortgage-backed securities—the financial instrument at the center of the crisis—had been introduced by Ginnie Mae, a federal agency created by Congress for this purpose in 1968. Rodrick sees malignant deregulation everywhere, even though interventionist regulation has been growing nearly non-stop since 1960 at least. (See "A Slow-Motion Collapse," Winter 2014–2015.) Does he ignore that before last decade's recession, the New York Fed had hundreds of regulating bureaucrats working onsite at large banks?

In a few astonishing pages of Chapter 5, he seems to argue in favor of 18th century mercantilism over free trade. He recognizes that mercantilism takes the side of the producer against the consumer and that it "offers a corporatist vision." Yet, he seems to view mercantilism-corporatism as preferable to "the liberal approach"—here taking "liberal" in its classical liberal sense, contrary to what he usually does.

Strange ideology / How can we explain all these quirks, inconsistencies, and errors from an intelligent economist?

I see only one satisfactory explanation. Since the heydays of welfare economics, economists have known that public policy recommendations and evaluations—which are Rodrik's bread and butter—require that ethical judgments be superimposed on economic analysis. Ideally, these normative values should be clearly identified and should not interfere with the economic analysis proper. This is not always easy to do, and Rodrik proves it.

So what are his normative values? They are very different from the ones that inspire free-trade economists, which are based on consumer sovereignty and economic freedom. He accuses economists of being influenced by their moral values when defending free-trade, but he commits the same transgression in his criticisms of free trade.

What are Rodrik's values? He usefully distinguishes between mere "majority rule" and "liberal democracy." However, this "liberal" is not the classical liberal label. It seems to mean anything that conforms to his own preferences as a "progressive" who believes in "social justice," "social inclusion," "social purpose," and "societal welfare" (whatever "societal" means as opposed to the standard term "social"). "Climate change" is another of his concerns. No wonder that he had his social and inclusive feathers ruffled by Donald Trump's democratic election.

In reality, Rodrik is not so different from Trump or Bernie Sanders. All three oppose "market fundamentalism" and favor "fair trade." "What makes a populist like Donald Trump dangerous," he writes, "is not his specific proposals on trade. It is the nativist, illiberal platform on which he seems to govern." That is, the problem is Trump's motivation, not his intended results.

Returning to Rodrik's concerns that some Americans will import foreign goods that challenge his values, he refers to such imports pejoratively as "social dumping." He idealizes democracy and "democratic deliberation," apparently unaware of voters' rational ignorance and the irrationality of their decisions. "Democratic politics is messy and does not always get it 'right,'" he admits. "But when we have to trade off different values and interests, there is nothing else on which to rely." Nothing else? Has he ever heard about private property and the market as a means to reconcile "different values and interests"?

"Markets," he says, "require other social institutions." Of course. And other institutions require other institutions. But the question is, do these institutions include Leviathan? He thinks so. Leviathan incarnates collectivist shibboleths like the "national interest," "social goals," "societal demands," and so forth.

For Rodrik, everything is political and must be decided by the collective—that is, a progressive majority that thinks like he does. To be fair, he does recognize that majoritarian democracy must be restrained, but what is to be restrained is not so much political power as its capacity to produce results that he doesn't like.

He writes of capital controls (regulating how a state's own citizens may use their money abroad) that they "may need to be blunt and comprehensive rather than surgical and targeted." And he compares them to gun control: they must cover all citizens as opposed to only controlling "problematic behavior." Who will doubt that the author of *Straight Talk on Trade* is a good, card-carrying progressive?

Member of the failed establishment / It seems that Rodrik only thinks of problems in terms of intervention by some authority. In his mind, the only alternative is between two sorts of authoritarianism: a good one run by leftists and a bad one run by the right. The libertarian notion that authoritarianism should be avoided never seems to cross his mind.

Although he portrays himself as a dissenter against "the establishment," "the elites," and "the reigning market fundamentalist ideology," Rodrik is a good representative of the privileged few who have ruled America and most Western countries since the 1960s: half-capitalist and half-socialist, half-populist and half-elitist, half-democratic and half-authoritarian, half-free-trade and half-fair-trade, half-postmodern and half-moralizing, half-bourgeois and half-punk. Such folks have spent more than a half-century burdening people with a dense network of regulation and surveillance, continually bossing ordinary people around, and pragmatically building a half-police-state. How was that different from the "case-by-case, hard-headed pragmatism" that Rodrik advocates?

Contrary to what he claims, it is not free-traders who have provoked the populist reaction, but the privileged class of which he is himself a member. It is because of people like him that populist and protectionist Trump was elected.

Political wonderland / To be a progressive whose heart bleeds both for inequality at home and poverty in the world must be stressful. Rodrik invents a political wonderland where both problems disappear through the magic of protectionism and dirigisme. But, of course, the correct side must rule:

> A crucial difference between the right and the left is that the right thrives on deepening divisions in society—"us" versus "them"—while the left, when successful, overcomes these cleavages through reforms that bridge them.

He is right about the danger from the right, but he is totally blind to the symmetric danger from the left. Both sides are inclusive, it's just that they don't include the same people. The Harvard professor defends the nation-state because, at the international level, "we do not agree" on values and tradeoffs. He does not seem to realize that "we" don't agree at the national level either; witness the outcome of the last presidential election. He does not understand that "live and let live" is the only peaceful solution.

Rodrik also wants voters to be "globally aware and environmentally conscious," and the state to be perfect, and he has a bridge to sell you in New Jersey.

What does all that mean for international trade? His argument against free trade is basically the following: The democracy I like is incompatible with hyperglobalization, so let's have less free trade. He defends the old nation-state because that's where the Leviathan he wants can dwell. The state should be free to impose on its subjects what the majority has decided. Imports and capital flows can interfere with this, so let's limit those. Less freedom of trade would give all governments more "policy space"—which, Rodrik strangely claims, would fight poverty, inequality, and exclusion.

The state must be free to intervene. Approvingly quoted by Rodrik, Franklin D. Roosevelt said, "Above all, try something." Just don't do that individually.

Besides all the problems I have mentioned, *Straight Talk on Trade* is a loose patchwork of stuff already published elsewhere. Many statements lend themselves to different interpretations, on a spectrum that goes from the soft establishment up to the near-chavismo. Of course, there is always something to learn anywhere. With some books, though, the cost is higher than the benefit. *R*

Working Papers ➻ BY PETER VAN DOREN

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

Mortgage Regulation

"Regulating Household Leverage," by Anthony A. DeFusco, Stephanie Johnson, and John Mondragon. October 2017. SSRN #3046564.

The Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010 mandated that lenders evaluate a borrower's "ability to repay" (ATR) when originating a mortgage. However, Congress created a class of mortgages called "qualified mortgages" (QM) that are automatically deemed to satisfy the ATR rule. This designation includes all mortgages eligible for Fannie Mae and Freddie Mac guarantees. Thus, in practice, the ATR rule only affects loans with principals above $453,100 in 2018—so-called "jumbo" loans. The ATR rule as implemented by the Consumer Financial Protection Bureau (CFPB) required non-QM recipients to have a debt-to-income ratio (DTI) no greater than 43%.

How did lenders respond to the rule? This paper compares the interest rates on jumbo loans before and after the QM rule. Rates increased by 0.10 to 0.15 percentage points per year for DTI above 43%, or 2.5%–3% relative to rates before the rule. In addition, the quantity of high–DTI jumbos was reduced by 15% (2% of all jumbo loans). So lenders increased prices and rationed credit.

Had this rule been in place before the housing bust, would it have decreased the number of defaults? The authors estimated

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the relationship between DTI and default probability in a sample of loans originated between 2005 and 2008. While higher DTIs are generally associated with increased default probabilities, there was no difference in probability of default for those jumbo loans in the regions just above and below the 43% cutoff. This suggests that the policy would not have improved mortgage performance had it been in effect during 2005–2008.

CAFE Standards

"Environmental Protectionism: The Case of CAFE," by Arik Levinson. Working paper, Georgetown University. August 2017.

A recurring theme in economists' evaluations of regulation is that incumbent firms use regulation to raise the costs of their competitors. This paper searches for that phenomenon in 2007's tightening of the Corporate Average Fuel Economy (CAFE) vehicle fuel efficiency standard on automobiles.

Historically the standard was uniform: a sales-weighted average of 27.5 miles per gallon for all cars. The revised standard, effective with the 2011 model year, varied by the "footprint" of the vehicle. The largest cars needed to get 28 mpg while the smallest cars needed 36 mpg in 2012.

The author of this paper, Arik Levinson, notes that domestic cars are larger than imports, thus a CAFE standard that grants larger vehicles less stringent fuel economy requirements benefits U.S. manufacturers. "The switch to footprint-based standards in 2012 granted the average U.S.-assembled vehicle an extra 0.62 mpg, and cost the average imported vehicle 0.68 mpg, for an overall difference of 1.3 mpg," he writes. Given the fine of $55 per vehicle per mpg, the effective tax on imports is $71.50 per vehicle.

Antitrust in Europe

"Is EU Merger Control Used for Protectionism? An Empirical Analysis," by Ann Bradford, Robert J. Jackson Jr., and Jonathon Zytnick. July 2017. SSRN #3003955.

Another policy arena in which regulation is alleged to increase rivals' costs is antitrust. Anecdotes suggest that the European Union uses its antitrust regulation to advantage European producers over U.S. firms seeking greater economies of scale through merger. For instance, in 2001 the EU blocked General Electric's acquisition of Honeywell even though the U. S. Justice Department had approved the acquisition. The EU also stopped proposed mergers by Boeing, Time Warner, and UPS.

To see if the anecdotes do indeed reflect a larger pattern by the EU, the authors of this paper examine the universe of proposed mergers from 1990 through 2014 (5,000 cases). After controlling for the usual explanations of antitrust concerns, the authors found no effect on the incidence or intensity of merger challenges by the EU if the acquiring firm was non-EU. For that time period at least, the EU wasn't using antitrust as a form of protectionism.

Economics of Energy Booms

"Who Wins in an Energy Boom? Evidence from Wages, Rates, and Housing," by Grant D. Jacobsen. May 2017. SSRN #2972681.

How has the increase in oil and gas production from hydraulic fracturing changed the economic fortunes of people living in the rural areas where that extraction takes place? In this paper Grant Jacobsen offers some estimates of these effects.

He defines an energy boom area as a non-metropolitan area (NMA) in which annual gas and oil revenues were at least $500 million greater in 2011 than in 2006. Under this definition, 10% of NMAs were energy boom areas. Forty percent of NMAs had some energy production and 50 percent had none.

Jacobsen compares various outcomes in boom and non-boom areas. In boom areas, population increased by 5.7%, wage rates by 7%, house values by 12.5%, and rents by 5%. Wages went up across occupations—even those not related to oil and gas—because the labor supply proved less elastic than demand. And he found "no evidence that the boom increased the cost of rent when measured as a percentage of household income."

Jacobsen concludes: "The results indicate that there are many monetary 'winners' from energy development in local communities and very few losers. An implication of the results is that bans on drilling have negative monetary consequences for a large share of local residents."

Nudges and Electricity Pricing

"Default Effects and Follow-On Behavior: Evidence From an Electricity Pricing Program," by Meredith Fowlie, Catherine Wolfram, C. Anna Spurlock, Annika Todd, Patrick Baylis, and Peter Cappers. June 2017. NBER #23553.

An important distinction between behavioral and traditional neoclassical economic analysis is the former's emphasis on "default effects," the tendency of people to remain in their original state of affairs. The most famous real-world example of this is the tendency of individuals to save more in employer-sponsored 401k retirement-savings plans if they are enrolled automatically in the plans but have the option to opt out, relative to saving when employees are automatically not enrolled in a plan but have the option to opt in.

Traditionally, electricity prices faced by consumers have not varied over time even though the marginal cost of production is higher on a summer afternoon than during a spring or fall night. Even though the installation of "smart" electric meters now allows consumer electricity prices to vary by time, 95% of U.S. residential customers pay time-invariant electricity prices.

Regulation has published the results of how electricity consumers react to dynamic pricing from some pilot programs. (See “Moving Forward with Electricity Tariff Reform,” Fall 2017.) But how would consumers respond under different scenarios in which consumers have the option to opt in or opt out of different price-variant regimes? That is what this paper explores.

It examines a Sacramento, CA electricity pricing experiment over the years 2011–2013 in which 174,000 households were randomly assigned to five groups:

- A control group that paid a traditional time-invariant price, in this case 9.38¢ per kilowatt hour for their first 700 kWh of consumption and 17.65¢ per kWh afterward.
- A second group that could opt into time-of-use (TOU) pricing. That pricing was 27¢ per kWh on weekdays 4–7 p.m., and 8.46¢ per kWh for the first 700 kWh of off-peak consumption and 16.6¢ per kWh for off-peak consumption above 700 kWh.
- A third group that was assigned to the same TOU pricing but participants could opt out.
- A fourth group that could opt into critical peak pricing (CPP) of 75¢ per kWh 4–7 p.m. on 12 critical days between June 1 and September 30, with prices at other times the same as the TOU groups.
- A fifth group that was assigned to a CPP/TOU scheme like the fourth group, but participants could opt out.

The authors’ findings reflect behavioral economists’ discovery that initial assignment matters. Only 20% of the consumers assigned to the two groups that required opt-in to the TOU or CPP/TOU plans actually opted in. Yet over 90% of those who were assigned to TOU or CPP/TOU stayed in those programs and did not opt out.

The effects of higher prices on consumption did vary by whether the customers were assigned or volunteered. Complacent consumers who were assigned to TOU or CPP/TOU but did not opt out decreased their consumption by about 10% given the higher prices, while those who actively opted in decreased their consumption by about 25%.

However, the complacent customers assigned to TOU or CPP/TOU had an aggregate reduction in electricity consumption that was twice as large in TOU and three times larger in CPP/TOU as compared to consumers in the opt-in groups. Such savings made the programs cost-effective overall. In contrast, in the opt-in CPP/TOU program, costs equaled benefits, while the opt-in TOU program was not cost effective.