

IN REVIEW

The Tech Giants Are Out to Get You

◆ REVIEW BY SAM BATKINS

After reading *The Age of Surveillance Capitalism*, you'll either be convinced that Google, Facebook, Microsoft, et al. are the most diabolical villains in history or you'll laugh off the book as anecdote-driven hysteria. To the credit of the author, Harvard business professor Shoshana Zuboff, the book is an incredibly comprehensive and well-researched review of how the tech giants make money and the tactics they employ to collect and monetize data. But she would be far more persuasive if she reined in the hyperbole.

By her telling, tech firms are “vampires” and tyrannical. Here's just one sample:

Surveillance capitalism's antidemocratic and antiegalitarian juggernaut is best described as a market driven coup from above. It is not a coup d'état in the classic sense but rather a coup de gens: an overthrow of the people concealed as the technological Trojan horse that is Big Other.

And that's one of her tamer passages.

She defines “Big Other” as a ubiquitous, sensate, and networked infrastructure that relies on “instrumentarian” power. She goes to great lengths to invent new words and new terms to describe how the tech giants not only collect our data but control our lives and even dictate our actions. Be afraid. Be very afraid.

If you want to distill the book to central themes, one need only rely on Zuboff's definitions for “instrumentarian” and “surveillance capitalism,” two terms she invented. The former is defined as a means of power that knows and shapes behavior toward Big Others' desired ends. The latter takes literally half a page to define, but broadly it's a “new economic order” that relies on “parasitic” logic and behavioral modification to expropriate critical

human rights. If you thought Mao, Stalin, Lenin, and Hitler were bad, wait until you meet the chief executives of the tech giants. That's not my hyperbole; Zuboff includes those monsters in her book, which seems like a quick way to lose thoughtful readers.

Where's the consumer harm?/

Even the staunchest libertarians acknowledge companies make mistakes. That's the point of competitive markets: allowing other players to take advantage when the market leader stumbles. However, after reading Zuboff's description of the extensive data collection practices of the tech giants, one wonders how, exactly, consumers are harmed. Sure, the concept of Google Glass—the wearable device that looked like eye-

glasses and included a camera and facial recognition technology—scared some people. But if Google were so effectively evil, why didn't Google Glass catch on? The tech giants enter products and services into the market frequently and some fail miserably (e.g., MySpace, Google+).

It never seems to occur to Zuboff that people may generally *like* the goods Google, Microsoft, and Facebook provide. Instead, she posits that we patronize these companies because we're forced to and because they employ behavioral

modification techniques. One example of such modification is when Facebook changes its algorithm on election day to show people that their friends have voted, which tends to boost voting. Thus, Facebook can increase election turnout. Yes, peer pressure works. Advertisements work. The tech giants use a 21st century version of advertisement and modern technology to make our lives easier.

Firms have been collecting information about consumers for generations. What seems to upset Zuboff is that tech firms are increasingly doing this from inside our homes, controlling our thermostats and serving as our personal assistants (e.g., Google Home, Amazon's Echo). For those

fearful that this invades our privacy, there is a simple preventative: don't buy these products. Yet, according to Zuboff, there is little any of us can do to ward off the “totalitarian” impulses of the tech overlords.

Today's privacy debate probably should revolve around the “reasonable expectation of privacy,” which is a term in Fourth Amendment law, but it has relevance to our relationship with the tech giants as well. Most people realize that by using Facebook and Google, they are consenting to those firms' data collection practices. Similarly, traveling in public reduces people's expect-

tation of privacy: government and corporations can use traffic cameras and cell phone geolocation to track people's movement, for instance. For government, people have no option to “turn off location services.” However, consumers fed up with Google and Facebook can choose a non-Android phone, use another search engine, or simply delete their Facebook account. That's not hard, and it's not “mind control” or “Chinese brainwashing” to consent to use their services. If you're curious, the Central Intelligence Agency's MKUltra mind-



The Age of Surveillance Capitalism: The Fight for a Human Future at the New Frontier of Power

By Shoshana Zuboff

704 pp.; Public Affairs, 2019

control program does make an appearance in the book, and readers' eyes will roll after seeing the comparisons Zuboff makes between it and tech company practices.

Just as Google Maps routinely tracks individuals to determine their location to help users get from place to place—a practice that once required either fumbling with maps or owning an expensive GPS—so too do tech-based games like Pokémon Go. This frightens Zuboff and she lists a parade of horrors resulting from the game—which has largely died out in the United States. Back when it *was* popular, perhaps people played it because they enjoyed it and enjoyed competing with their friends. Not according to Zuboff, though; Pokémon Go is an elaborate behavioral modification tool that she deems “exploitation-ware” because it relies on augmented reality to herd collective behavior. Yet, Nintendo's 1985 video game classic Super Mario Brothers also attracted millions of players around the world, but no one compared it to MKUltra. The interactive shooter game Fortnite is certainly herding collective behavior of adolescents everywhere. Are its creators also exploitative—or worse?

Here again, readers should be struck by Zuboff's failure to provide evidence of consumer harm. Sure, the book is filled with anecdotes about how towns and individuals have been inconvenienced by Pokémon Go and Google Maps, but what is the tort? What is the cause of action or corporate practice that warrants her comparisons to mass murder? If there is corporate malfeasance leading to a massive data breach and people's identities are stolen, then they should sue away. But data security and theft aren't Zuboff's primary concern; rather, she opposes the data's very collection.

Perhaps her strongest argument, which she does not exploit at length in the book, relies on antitrust grounds. In concentrated markets where tech giants buy up competitors one-by-one, consumer advocates often appeal to regulators for relief. There is even a handy (if flawed) index the Justice Department uses to measure

market concentration: the Herfindahl-Hirschman Index. Yet, readers will find no mention of the index in her book. They will find plenty of wildly hyperbolic language, though.

How to tame the giants / One might assume that somewhere in the tome's 700 pages there is a comprehensive plan to address these data collection and “behavioral modification” practices. But there is little such discussion, even in the 30-page (!) conclusion.

Instead, there are mentions of how Europe is addressing privacy practices through its General Data Protection Regulation (GDPR). She calls these laws “vital and necessary.” But then, a few pages later, she mentions that Google and Facebook continue to flourish despite antitrust investigations, GDPR, and multi-billion-dollar fines.

Left unstated is how regulation has helped to entrench these firms' market power. According to an early policy analysis of GDPR, which is still in its infancy, the regulation has caused job losses approaching 30,000, double-digit declines in venture capital investments, and billions of dollars in compliance costs. Yet, the tech giants and their armies of lawyers can comply with those regulatory interventions. Judging by the decline in venture capital, many burgeoning companies cannot. Even larger companies like the *LA Times*, which still does not comply with GDPR, are affected.

If regulation and fines won't work, perhaps breaking up the tech giants is the only option. Sen. Elizabeth Warren (D, MA), who has staked her presidential campaign on progressive policy proposals, has called for dismantling Google, Facebook, Apple, and Amazon. In her view, a company is de facto too big if its revenues exceed \$25 billion. Her post on *Medium* unveiling this proposal did not describe the logic or economics behind the \$25 billion figure. BP and ExxonMobil had revenues exceeding \$240 billion in 2018. Remember when their “bigness” incited calls to break up large oil companies? By Zuboff and Warren's thinking, not only is

big bad, but the relatively benign practice of data collection is also cause for increased antitrust scrutiny.

Perhaps the most disappointing aspect of the book is that there is no discussion of the balancing of costs and benefits in tech. Are there costs to having a few large platforms dominate search functions and online advertising? Yes. But there are also benefits from large companies providing goods and services that we largely enjoy, and there would be incalculable costs for breaking up those companies.

Let's not forget the benefits of these companies providing countless jobs, with high wages and employee benefits. Zuboff views these benefits as bugs and not features of the tech giants. She writes, “The huge salaries of the tech firms have lured so many professionals that there is no one left to teach the next generation of students.” So, among the tech companies' other sins, apparently, is compensating their employees well.

Conclusion / Few will complain that Zuboff's book is under-researched. Its endnotes section alone is roughly 130 pages. However, her demonization of the tech giants and name-checking Mao, Stalin, and Hitler will turn off most readers quickly. To her, the tech giants are so evil she has to invent a dozen terms to describe just how abusive their practices are.

She'll be pleased to know that some people—even libertarians—detest the business practices of the tech giants and this will cause declines in their market share. “Delete Facebook” has been a popular search term for the past five years and peaked on March 18, 2018 (thanks, Google Search Trends) during the height of the Cambridge Analytica news. Markets can turn away from the tech giants as quickly as they embraced their new technology if company business practices become objectionable for too many consumers.

What won't help is more regulation that causes barriers-to-entry for potential competitors. Zuboff seems to recognize this but, sadly, spends few words acknowledging this reality. R

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Greenspan's Tale of Capitalism vs. Progressivism

REVIEW BY GEORGE LEEF

These days, many Americans who regard themselves as part of the intelligentsia are talking about socialism. Among the professoriate and the college-educated, socialism is looked upon favorably while capitalism is held in disdain. These people have rarely heard any criticism of the former, nor a defense of the latter.

Crucially, they don't know how capitalism works: how it harnesses human energy and creativity for the production of goods and services most in demand, and thus raises the standard of living for everyone.

If you could get those who think they want socialism and believe that capitalism is horrible to read *Capitalism in America* by Alan Greenspan and Adrian Wooldridge, you'd put a considerable dent in those beliefs. The authors—Greenspan, of course, is the former Federal Reserve board chairman and Wooldridge is the political editor of *The Economist*—have written a mostly excellent, illuminating history of the consequences of America's embrace of capitalism rather than a government-controlled economy. The authors give a historical account of the roots of capitalism in America, its success in enabling people to advance economically, and the reasons why it has been so vilified by statist.

Most importantly, Greenspan and Wooldridge get absolutely right the fact that the original American system—secure property rights, the rule of law (particularly the sanctity of contract), and people's freedom to try producing and exchanging goods with little if any government interference—made it possible for virtually everyone to succeed, although often after some failures. Unlike most of Europe, where traditional privileges restricted opportunity to a few, in America, they write, “it was possible for

people born in obscurity to rise to the top of society and for ordinary people to enjoy goods and services that were once confined to the elites.” Fortunately, the Founders understood that the people would thrive if government refrained from undermining their natural urge to produce and invent. They also knew it was essential that people not be deprived of the fruits of their labor. That didn't change until the imposition of the income tax in 1914.

Freedom and creative destruction / Under capitalism, Americans produced goods and services at a pace unknown in history. U.S. economic expansion in the late 18th and 19th centuries was stupendous. Within a century of the Founding, Americans enjoyed higher incomes than did people in Britain, Germany, France, and Italy.

Alexis de Tocqueville saw clearly why prosperity was rising in America. The authors quote his observation that “the entire society is a factory.” He and many others noticed how extraordinarily busy Americans were—the energy that they put into their farms and trades. Under capitalism, free Americans used their brains and brawn much more effectively than did the taxed and regulated peasants of the Old World. It's that

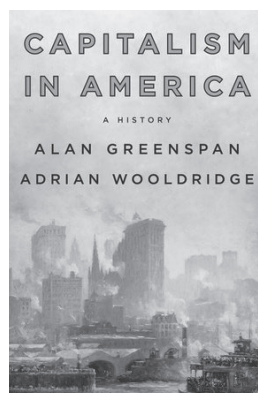
freedom to try without having to get permission from authorities that makes the world of difference between capitalism and socialism.

One of the key concepts of capitalism is what the Austrian economist Joseph Schumpeter called “creative destruction”: the inevitability that free people will come up with new methods and products that displace older, inferior ones. Such progress necessarily wipes out some investments and jobs. The crucial thing about American capitalism is that (at least until fairly recently) we let creative destruction run its course. The authors write:

America has been much better than almost every other country at resisting the temptation to interfere with the logic of creative destruction. In most of the world, politicians have made a successful business out of promising the benefits of creative destruction without the costs.

To say, however, that the United States experienced rapid economic growth because of capitalism in its early decades is to overlook the vast difference between the North, with its free market for labor, and the South, where much of the labor force consisted of slaves. Greenspan and Wooldridge devote a chapter to the gap

between the two regions. Slavery acted as a drag on innovation and the development of industry in the South. One telling point the authors mention is that 93% of all U.S. patents issued up until 1860 went to inventors in the North. The economic gap between the regions kept widening as, they write, “the North invested in more machinery and the South invested in more slaves.” Millions of industrious immigrants went to the free Northern states, but relatively few to the hidebound South. Given the huge disparity in resources, the outcome of the



**Capitalism in America:
A History**

By Alan Greenspan and
Adrian Wooldridge

486 pp.; Penguin Press,
2018

Civil War was almost inevitable.

I only wish that Greenspan and Wooldridge had clearly stated that slavery is incompatible with capitalism, which calls for mutual consent on all contracts. Stealing your workers is just as uncaptalist as stealing your raw materials or threatening customers to compel them to buy. The South was economically backward because it relied so heavily on a coercive, pre-capitalist mode of production.

After the prodigious human and material costs of the Civil War, America began to grow and build again. The postwar decades were marked by strong economic development. Business leaders kept finding ways to produce more with less. Bessemer steel plants, for example, could turn out more steel of better quality with substantially less usage of coke than older hearths could. As a result, the authors write, “Steel put cheap tools in everybody’s hands and cheap utensils on everybody’s tables.” The price of kerosene fell sharply over many years as oil refiners like John D. Rockefeller improved their efficiency. (Cheap, universally available kerosene for lighting, by the way, destroyed the whaling industry; that’s another point I wish Greenspan and Wooldridge had made.) Capitalism’s creative destruction was working wonders.

Standards of life for ordinary people increased steadily. Because of improvements in farming, food processing, and transportation, Americans could enjoy far better, more varied diets than ever before. New kinds of merchandizing, such as the Sears mail-order catalogue, made it possible for people to obtain goods they could have barely imagined in the recent past. Massive waves of immigrants poured into a country where they had boundless opportunity to succeed, unlike in their homelands.

Progressive push-back / However, some dark clouds were forming. One of them was the way a few capitalists—railroad magnates initially—began turning to the government to enhance and protect their profits. This gave state capitalism a foothold, and it has grown into what the authors describe as a grave and debili-

tating problem today. Business success depends more and more on good lobbying than on good products.

The other dark cloud was Progressivism. The Progressives were mostly university-educated intellectuals who were certain that society could be improved by abandoning “chaotic” capitalism in favor of a “scientifically managed” economy. In their vision, enlightened government officials would set “fair” wages and prices, break up businesses that got “too big,” and have government provide for the needy. A leading Progressive, economics professor Richard Ely, declared in 1885 that *laissez-faire* was “unsafe in politics and unsound in morals.”

Progressive tracts and speeches had a big effect. Greenspan and Wooldridge put it this way:

The Progressives’ greatest achievement was to encourage a change in the American attitude to government. Before they got to work, Americans were optimistic about business and cynical about government. A couple of decades later, Progressives had persuaded a significant number of people that the opposite was the case.

With that change in attitude came a clamor for all sorts of government mandates: minimum-wage laws, maximum-hour laws, price controls for businesses “affected with a public interest,” antitrust laws, and more. Progressivism ushered in the pernicious notion that the people secure prosperity and safety through government power rather than through freedom under the rule of law.

At first, Progressivism did little damage. Most Progressive legislation was defeated and that which passed was frequently declared unconstitutional by the courts. But that would change.

One of Greenspan’s favorite topics in his early days as an Ayn Rand follower was gold, and he still gives a strong defense for the gold standard as the foundation for capitalism. He and Wooldridge write:

The fact that the supply of gold was limited meant that gold was one of the

most solid defenses of liberal society against the temptation to debauch the currency, the monetary equivalent of property rights. The universal acceptance of gold as a means of exchange made it easier to trade goods across borders.

Unfortunately, governments could not resist the urge to meddle with the gold standard when it suited their supposed needs. In 1890, for instance, the U.S. government enacted the Sherman Silver Purchase Act, a blatant piece of special interest legislation. (See “Silber on Silver,” p. 57.) Because of a huge silver find in Nevada, the price of silver fell dramatically. Politicians who wanted to raise the price of silver and spark inflation that would benefit debtors passed a bill requiring the federal government to purchase nearly all the silver the mines were producing and turn it into coins.

This law undermined confidence that the United States would continue to adhere to the gold standard, eventually provoking the severe economic contraction known as the Panic of 1893. The Silver Purchase Act was later repealed and the nation returned unequivocally to gold after the election of 1896, despite Democratic candidate William Jennings Bryan’s “Cross of Gold” speech advocating bimetallism and the free coinage of silver. The book’s point is clear: capitalism works best when government protects sound money.

Progressive efforts at undermining capitalism were given a tremendous boost by World War I. President Woodrow Wilson, an outspoken opponent of *laissez-faire* and limited government, entered the war in Europe in 1917 even though he had campaigned for re-election in 1916 on a peace platform. War gave the government the excuse to vastly increase its powers over the economy and even trample upon the First Amendment. Greenspan and Wooldridge sum up the unhappy situation thus:

The America of 1918 was a very different country from the America of the late nineteenth century. It had most of

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the accoutrements of a modern state-dominated society: an income tax, a central bank, and a swelling bureaucracy. And it had a significant group of people who thought that the major problem was that this hadn't gone far enough.

The Depression and WWII / The 1920 election brought to Washington a traditional pro-business administration in Republicans Warren Harding and, upon Harding's death in 1923, Calvin Coolidge. They cut taxes, did away with much of Wilson's bureaucracy, and made the right decision to do nothing when the economy went into a sharp recession in 1921. (The economy recovered and resumed growth in 1922.)

But, the authors note, not all was well. The Republicans returned to their traditional support of high tariffs and instituted the nation's first law to restrict immigration. (See "The War against Chinese Restaurants," Summer 2017.) Even its putative defenders couldn't resist throwing

sand in the gears of capitalism.

When the stock market crashed in late 1929, the White House was occupied by Herbert Hoover, a Republican with strong interventionist instincts. Instead of following Harding's laissez-faire approach from earlier in the decade, Hoover wanted the federal government to play an active role in restoring prosperity. Among his actions was signing the Smoot-Hawley Tariff of 1930, against the advice of most leading economists of the day. Hoover believed that keeping out imports would raise domestic prices and revive the economy. Instead, the result was an international trade war that saw American trade fall by two-thirds from 1929 to 1933, adding drag to the floundering economy. He also pushed for a huge tax increase to cover the rising cost of federal programs—another drag.

Hoover was crushed in the 1932 election by Franklin D. Roosevelt. With unemployment at unprecedented levels, most of the people were willing to hand power over

to a jaunty, upbeat politician who promised to revive the economy. FDR was even more of an interventionist than Hoover and surrounded himself with a "Brain Trust" of intellectuals who admired the greater interventionism of Europe, including fascist and communist regimes. Congress rubber-stamped FDR's waves of New Deal legislation, which tried to end the Depression through heavy government management of business activity and labor. Greenspan and Wooldridge criticize many of these initiatives; perhaps the most awful was the plan to raise the price of pork by ordering the slaughter of millions of baby pigs at a time when many people were going hungry.

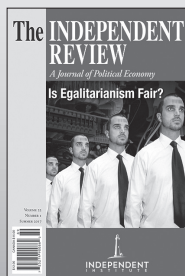
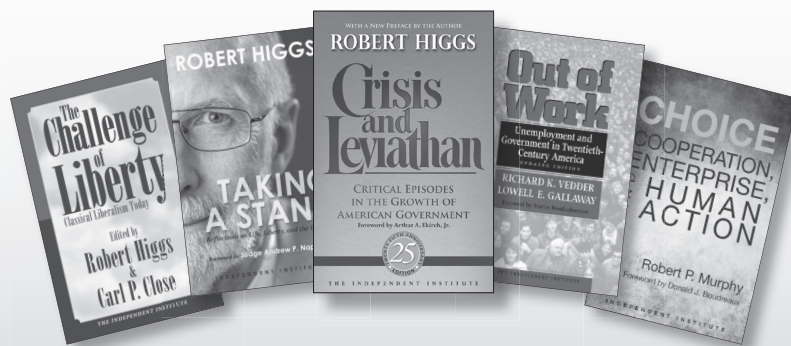
Although the Depression dragged on and on, including the "Recession within the Depression" of 1937–1938, Progressives were delighted with Roosevelt's New Deal. It had, the authors write, "put the federal government at the heart of American society." Capitalism was not gone, but

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the economic liberty it needs had been permanently reduced.

Yet, the New Deal policies failed to provide the stimulus their creators envisioned. Instead, according to Greenspan and Wooldridge, World War II “finally pulled the United States out of the slough of despond.” That’s one of the book’s errors. The United States had basically returned to long-term economic trend before Pearl Harbor, as FDR’s gold policies unwittingly rectified the Federal Reserve’s tight-money policies that had produced the Depression. The war did create enormous employment as millions of men were drafted and huge factories opened to produce war materiel. By 1944 the nation’s GDP was twice what it had been in 1939, but it consisted in large part of military hardware rather than more goods and services for the citizenry. That’s not a healthy economy. It’s disappointing to read Greenspan and Wooldridge fumble this.

Further, the authors declare that the war “forced companies to devise new techniques to boost output.” But under capitalism, as they show throughout the book, people are constantly trying their utmost to improve efficiency.

The last chapters of the book cover the economic slowdown over the last several decades: historically sluggish growth and falling numbers of new business startups. Has capitalism run out of steam, as some commentators (who favor still more government control and redistribution) maintain?

Greenspan and Wooldridge don’t think so. Capitalism, they argue, remains the optimal economic system. Unfortunately, we have undermined it with a host of bad government policies. As the authors write, America “is trapped in an iron cage of its own making: out of control entitlements and ill-considered regulations are forcing it to perform well below its potential.”

What’s the solution? The authors want to open the cage so that capitalism can again work. They’re right. Our future will be much brighter if we can return to the days when people were free and Washington, DC was not the nation’s heart. 

Silber on Silver

REVIEW BY GARY RICHARDSON

If William Silber had appeared before the Warren Commission investigating John F. Kennedy’s assassination, his “power to provoke passion and fury in the American heartland” may have convinced the commission that the assassin’s real motivation was to get even for JFK’s “downgrading the silver subsidy.” Okay, that’s a bit of a

stretch, but the fact that the downgrade *could have* inspired the assassination is just one of the many interesting, provocative stories that Silber, a Stern Business School finance professor, tells in *The Story of Silver*.

Despite its academic publisher and the apparatus of a technical tome (including 64 pages of footnotes and nine pages of bibliography), the book is entertaining and enlightening. It should appeal to a wide audience, including anyone interested in American or financial history or who simply likes a well-written story. Silber is an architect of palatable prose. He grabs readers’ attention and keeps them turning pages with his intriguing anecdotes and amusing asides.

Silver’s story is worth telling. The white metal serves as a store of value and means of payment. It has important uses in electronics, photography, housewares, and jewelry. Silver coins and bullion formed the monetary foundation for many regions of the world for big chunks of history, including Europe from the 15th through 18th centuries and China and the Middle East well into the 20th century. Debates about its monetary use played a large role in the history of the United States, beginning before the Founding and continuing through the Great Depression. Silber’s book focuses on the U.S. experience.

Bimetal standard / The first tenth of the text takes the tale from Alexander Hamilton through William Jennings Bryan. As the first secretary of the treasury, Ham-

ilton oversaw the construction of the U.S. monetary system. He established a bimetallic standard in which gold and silver served as legal tender, with the hope that both metals would circulate. Silver’s abundance would promote economic growth and price stability in an era when scarcity of coins often generated deflation. Increases in the mint price of gold, Gresham’s law (“Bad money drives out good”), the Coinage Act of 1873, and the Gold Standard Act of 1900, however, meant that the yellow metal served as the medium of exchange in America throughout the 19th and 20th centuries.

Bryan was the most famous of the politicians who urged returning to a bimetallic standard. “The Great Commoner” represented the mass of Americans living west of the Mississippi who believed that more circulating currency would bring higher prices for crops, livestock, and farmland, helping them to pay the mortgages on their farms and machinery. Bryan’s “Cross of Gold” speech at the Democratic Convention in 1896 asserted that free coinage of silver would promote prosperity for the common man and free the United States from subservience to the gold-standard nations in Europe.

Silber’s concise coverage of 19th-century American monetary history is fun to read. I plan to assign these chapters to my undergraduates in American monetary history because many of them refuse to read boring books on the topic. Silber’s treatment covers key historical points, clearly explains the forces underlying the monetary system, and rivets readers’ attention. The material is not novel and requires

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some caveats that I will discuss later, but nothing this entertaining has been written on the topic since Frank Baum penned *The Wizard of Oz* as a monetary allegory.

The Depression and WWII / The book's second storyline spans Chapters 4 through 8, or about one-fifth of the volume. It involves China, Japan, and the Franklin D. Roosevelt administration's monetary policies. In this section, Silber offers a novel tale; you will not find it told completely—if at all—in books and articles about this era or in widely used textbooks on American history. His story is important because it illuminates a clear case where political institutions set up long ago profoundly influenced world events in ways that could not have been anticipated at the moment of the institutions' creation.

Roosevelt became president during the depths of the Great Depression. The economy had collapsed because a shortage of money lowered prices, raised interest rates, bankrupted households and firms, and dislocated industry and trade. Roosevelt campaigned on a promise to raise prices back to the level they had been before the onset of the contraction. To fulfill this promise, he needed to resuscitate the banking system and expand the money supply. That, in turn, would raise prices, lower interest rates, encourage consumption, and increase investment. His efforts focused on the financial system, the Federal Reserve, and the gold standard.

In Roosevelt's race to resuscitate the American economy, silver was a sideshow. He signed the Silver Purchase Act, which authorized the Treasury to buy huge quantities of the metal at gradually increasing prices, and then to use the metal to back currency in circulation. These purchases may have marginally increased the money supply, but they were unnecessary; reforming the gold standard and rescuing the banking system accomplished that task. Silver purchases were, however, necessary to convince senators from Western, silver-mining states to support Roosevelt's political program. Those senators had political influence in Washington, where they chaired key

subcommittees and controlled votes needed to pass the New Deal through Congress.

High-school and college history textbooks scarcely mention Roosevelt's silver policies, if at all. The same is true for most scholarship on the subject. Silber shows that this policy played a central role in world affairs and had a huge effect on the lives of one-quarter of humanity. Silver was the foundation of China's monetary system; its currency was backed by silver, not gold as in most of the rest of the world. America's campaign of massive silver purchases raised the metal's price on the world market and deflated China's economy. High silver prices encouraged investors to withdraw silver from Chinese banks and sell it in London. China's money supply fell, as did prices and incomes. Rising silver prices also increased the value of the yuan in foreign exchange markets, which reduced China's exports to the rest of the world, where currency was not based on a silver standard.

The silver shock put China in desperate straits. Its economy could not bear the strain from the silver drain. Its central bank and financial system lacked the skills and knowledge to alleviate the affliction. China's economic depression deepened and civil unrest spread. The central government was already fighting on several fronts: a communist insurrection festered in the hinterland; regional warlords sought to increase their authority at the expense of the national government; and Japanese armies, which already occupied north-eastern China, renewed their advances in coastal, central, and southern China.

The Roosevelt administration was warned that its silver policies, which were put in place to purchase the allegiance of a few senators from silver-mining states and to appeal to Democratic voters who still

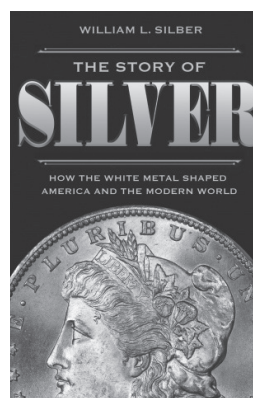
believed in the mythical powers of silver touted by turn-of-the-century populists like Bryan, would weaken China and facilitate Japan's expansion. Domestic politics overrode international concerns. Sure enough, China's weakened condition encouraged Japanese aggression.

To protect China, the Roosevelt administration eventually embargoed shipments of oil and other raw materials destined for Japan. To break the embargo, Japan attacked Pearl Harbor, the Philippines, and U.S. and Allied possessions throughout the Pacific. Japan's offensive brought the United States into World War II and eventually brought the Communist Party to power in China. This important and insightful story is the heart of Silber's book. It should be more widely known and taught. The book convinced me that I should include this information in courses that I

teach on economic history.

The next chapter discusses silver's use during World War II. The metal conducts electricity well, making it an important wartime good. The United States had lots of silver stockpiled at West Point, and the Treasury Department lent much of it to the Manhattan Engineering District to help produce atomic bombs. So, Roosevelt's silver purchase policies, which induced silver to flow from Beijing to New York and London, weakening China and facilitating Japan's expansion in Asia, also helped the United States build Little Boy and Fat Man, the atomic bombs dropped on Hiroshima and Nagasaki, which convinced Japan to withdraw its troops from China and surrender to the Allied coalition.

Post-war / After the war, industrial demand for silver increased, and its utility as a monetary metal declined. Federal Reserve Notes (the typical dollars that you see today) were backed by gold. There was no need for



**The Story of Silver:
How the White Metal
Shaped America and
the Modern World**

By William L. Silber

340 pp.; Princeton
University Press, 2019

paper dollars backed by stockpiles of silver. Coins continued to contain silver, but as industries' demand for silver increased, the silver content of coins declined. There was no sense in minting coins whose silver contents would have greater value as jewelry, or silverware, or computer components. Someone would simply melt down the coins.

There also was no longer a political need to buy off senators from silver-mining states with government-guaranteed purchases of silver at a fixed price. Miners could sell silver for more money to manufacturers and, besides, the senators from silver-mining states could be swayed more cheaply with promises of highway and agriculture funds. The Kennedy administration and Congress recognized the reality of the situation, leading the former to propose and the latter to legislate the repeal of the Silver Purchase Act of 1934.

While the Kennedy-era silver policies seemed sensible and had widespread support, Silber conjectures that they could have been controversial among some small segment of the population. Maybe someone captivated by Bryan's "Cross of Gold" speech considered Kennedy's actions inexcusable. Maybe that irate individual shot Kennedy from a hidden vantage point, getting away with murder because Lee Harvey Oswald happened to shoot at Kennedy's motorcade at the same time. Silber's conjecture seems insensible, maybe even crazy—but, he asks, is it any crazier than the other conspiracy theories about the assassination? Maybe not.

After the Kennedy assassination, the book's tone changes. It stops discussing silver as a means of payment and begins discussing it as a speculative asset. A lot of information is packed in this portion of the text, which spans about 40% of the book. These chapters describe how commodity markets function and the strategies of famous men who speculated in silver. They also provide investment advice.

A focus is the Hunt brothers—Nelson, William, and Lamar—who were some of the richest men in America. In the late 1970s and into 1980, they tried and failed

to get even richer by cornering the market on silver. Another notable character in these pages is the investment sage from Omaha, Warren Buffett. These chapters are entertaining mainly for their gossip about, and character studies of, famous and infamous investors. The stories remind me of *Crazy Rich Asians*, but the cast of characters is a bunch of rich white men with colorful backstories, profligate tastes, and more greed than good sense (with the exception of Buffett, who seems to just have good sense). Another apt pop-culture comparison would be *Real Housewives*, but with a focus on rich husbands, their over-the-top investment antics, and their conspicuous consumption.

Beware playful writing / Overall, the book is entertaining, contains novel insights, and is well researched. I will recommend it to friends and assign portions to my undergraduates. My students may need guidance, however, on how to interpret portions of the text.

The book is filled with metaphors, analogies, funny phrases, wry humor, and outlandish conjectures. Silber writes, for example, that the tension leading to the duel between Aaron Burr and Alexander Hamilton "probably" began because one studied at the College of New Jersey (now Princeton University) and the other studied at King's College (now Columbia University), making them "natural Ivy League rival[s]." When I read this, I understood it was a joke; respected biographies of Burr and Hamilton do not indicate that college rivalries played a role in their animosity. Silber's version of events could not be true, literally, since the Ivy League's existence (and the use of the term) began in the 20th century. An undergraduate with less knowledge of American history, however, might miss the humor, believe the statement, and remember it, because readers tend to remember the provocative over the mundane.

A similar danger lies in the hook that reels readers into the Kennedy chapter. I mentioned it at the beginning of this review. The chapter begins and ends with

the theory. The last two sentences are:

However, murder for the sake of silver dollars seems excessive, a primitive response to a commercial conflict, perhaps understandable in the more violent nineteenth century but inconsistent with the more civilized twentieth. Or not?

Or not what, I wonder. The only places in this universe where the silver-policies-killed-Kennedy conspiracy theory exists are in the 11th chapter of this book and on an array of websites, inspired by Jim Marr's cult conspiracy compendium *Crossfire*, that proffer a similar senseless story. The book cites no historical evidence for the idea. A footnote indicates the Warren Commission did not mention the theory among its catalog of rumors, contentions, claims about, and potential causes of Kennedy's assassination. The purpose of this provocative claim is to raise eyebrows and increase readership. It serves that purpose well because it is not just untrue but absurd.

I worry, however, that readers who do not get the humor might take this claim seriously, particularly given its prominence and repetition in an academic book written by a famous scholar. We live in a world where conspiracy theories flourish. Fiction spreads faster than fact. The book contains numerous claims, like the Kennedy conspiracy theory, that could be misconstrued. As a reviewer (and a professor who will assign part of this text to his students), I want to give readers simple rules that will help them separate fact from fiction. I derive the rules from two observations:

First, the author knows what is true and what is not. He indicates spuriousness with adverbs expressing uncertainty, such as "perhaps," "probably," and "possibly." Readers should be skeptical of all claims in sentences with adverbs like that; these claims are often false.

Second, the author keeps readers' attention by constructing paragraphs with concluding sentences that are intriguing

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and provocative, so readers should also be wary of claims in the last sentences of paragraphs. They are often hyperboles or embellishments open to misinterpretation. Overall, readers should realize that when the last or next-to-last sentence in a paragraph contains an adverb expressing uncertainty, then the conjectures or claims in those sentences have no basis in fact. Ignore those sentences, I will instruct my students; cross them out.

With that minor caution in mind, Silber's book is insightful and enjoyable. It deserves to be read widely, particularly the chapters on Roosevelt's silver policies and their effect on China. These chapters raise questions about the nature of the United States and why our political system at times pursues policies that benefit small groups of our citizens at the expense of not just the rest of our nation but the rest of the world. R

Don't Forget the "Free" in Free Trade

◆ REVIEW BY PIERRE LEMIEUX

One can imagine a "progressive" argument for free trade. Let individuals and private entities import and export as they wish and can, and let the welfare state's security net catch the few big losers. Everybody will be better off, as most people greatly benefit from free trade and the losing minority will be compensated. The poor will gain, both at Walmart and from the increased economic security that a rich-society-cum-welfare-state provides. Scandinavian countries may provide the best examples of this approach.

This idea could be thought of as a loose international version of an argument for economic freedom. As Milton Friedman might have said, let markets work and generate prosperity, and let some minimum guaranteed income (or negative income tax) ensure that nobody loses out, at least to the point of destitution.

It was thus refreshing to see the title of Reed College economist Kimberly Clausing's new book, *Open: The Progressive Case for Free Trade, Immigration, and Global Capital*. Unfortunately, the book doesn't quite deliver on the promise of its title.

An incomplete defense / Clausing does present a standard economic defense of

free trade. She "defends global economic integration, arguing from a perspective that consistently prioritizes the needs of American workers." "The substantial challenges of middle-class economic stagnation and increasing income inequality require bold, serious policy responses. But they don't require a retreat from globalization."

The book shows how free trade generally benefits the poor and middle class. "In the United States," the author writes, "tariffs take a bite out of the aftertax incomes of the poorest 20% of the population three times larger, in percentage terms, than they take from the top 20%." She emphasizes that recent economic disruptions are caused more by technological change than by international trade. She points out that the trade deficit is the consequence of a low domestic savings rate and high budget deficits, which attract foreign capital; net foreign capital inflows are the mirror image of the trade deficit.

Among the many facts marshaled by *Open* is the observation that, with the

development of supply chains spurred by comparative advantage, it's not clear anymore what is a domestic product. "Six out of the ten 'most American' cars (based on the source of their parts) are made by foreign firms," Clausing notes.

Yet, something is not right with her defense of free trade. Perhaps it is her repeated appeals to today's cause-célèbre: fighting income inequality. She writes that the incomes of the lower half of the income distribution have stagnated, a claim that is both exaggerated and based on imperfect and controversial statistics. She also observes that the share of labor income is decreasing relative to capital income. But that doesn't mean that real wages have decreased; it just means that they have not increased as much as profits, interest, and rents.

To the extent that this picture of growing inequality is correct (and there is something true here), the reader would have hoped for an inquiry into the role played by direct government interventions other than protectionism: professional licensure, zoning regulations, stifling regulation in general, crony capitalism, the criminalization of drugs and the carceral state, etc. Clausing does allude to the growing protection of "intellectual property" as another possible factor, but only in regard to pharmaceutical companies.

As she notes, the workers most affected by economic change are the least-skilled and least-educated ones. At least before college, education is financed and provided mainly by governments. And more of gross domestic product goes to education in America than in most of the rest of the world. It's thus hard to be persuaded when she writes that more public education and ("ideally," she writes) free community college would solve American workers' problems.

Like many progressives, Clausing falters when she discusses labor and income distribution. For example, she writes, "When companies earn outsized returns, this squeezes the returns for other factors of production throughout the economy." Of course, there is no fixed quantity of

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wealth to share and the economy is not a zero-sum game. She is especially critical of multinational corporations, which she claims escape their supposedly fair share of taxes. She notes that multinational corporations undertake the vast majority of foreign trade. We might emphasize—and she would agree—that this is ultimately on behalf, and for the benefit, of consumers.

Value of imports / What is missing from this defense of free trade is what's also missing from the conservative (and formerly Republican) defense: recognition of the importance of imports. Clausning defends free trade mainly because of exports. As Princeton economist and *New York Times* columnist Paul Krugman has argued, this amounts to defending free trade largely for the wrong reasons. Essentially, the benefits of trade come from exchanging the fewest exports for the most imports.

I suspect that Clausning would agree with this point, but she doesn't seem to appreciate the implications that follow.

For example, she pays too much attention to free trade agreements, even writing that “the case for trade agreements is akin to the case for government.” By this she means that a free trade agreement represents a sort of international government complementary to the domestic kind, one being as endearing as the other. In fact, the advantage of trade agreements is that they *constrain one's own government* from indulging in protectionism; that they constrain foreign governments too is a means to that end. It's because you don't trust your own government to unilaterally maintain your freedom of trade and resist the pressures of special producer interests that you want it to bind itself with free trade agreements. Clausning hints at this argument but she doesn't fully acknowledge it.

She seems to be deeply fearful of limiting her own Leviathan, for example by letting free trade proceed even when it leads to deregulation. It can lead to deregulation because importers may try to avoid domestic regulation by buying foreign goods that evade costly domestic mandates and prohibitions, or because exporters will

complain about regulations that make them less competitive. Clausning replies that this regulatory competition leads to a “race to the bottom,” a frequent invocation in her book. But if competition were a race to the bottom, Cuba, North Korea, and Venezuela would be at the top of the economic barrel. The real race to the bottom occurs when different Leviathans cartelize in order to better control their subjects, for instance when agreeing on common regulations in “free trade” agreements.

Clausning's case for free trade is buried under a pile of arguments that not only

have nothing to do with free trade, but that make it so regulated and controlled that we may wonder what is left of the “free.” She argues that free trade agreements should, as they have started to do, contain labor and environmental requirements. (Minimum wages imposed on Mexico in the proposed new North American trade pact are one example.) “Trade agreements can and should be about more than trade,” she writes. Fighting “harmful policy competition”—including tax competition—is part of her embrace of globalization. She often seems to believe in all the regulations she proposes more than in *free* trade, which is the freedom of individuals and private entities to trade internationally if others want to trade with them.

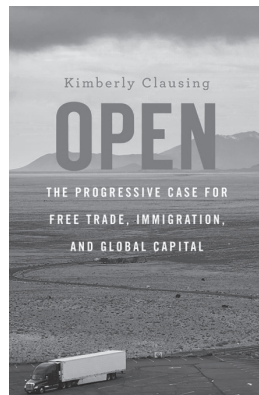
If other national governments encumber their subjects' trade with regulations, that is unfortunate. But it is no reason for our own government to do the same. As economist Joan Robinson once wrote, pro-

tectionist retaliation looks like a decision “to dump rocks into our harbors because other nations have rocky coasts.”

Immigration and progressivism / Clausning's argument for immigration is more coherent. She emphasizes the benefits of immigration for Americans—the importers of immigrants, as it were. American companies started by immigrants include Google, AT&T, Goldman Sachs, Kohl's, DuPont, and Qualcomm. When, in 2016, Bob Dylan won the Nobel Prize for Literature, six scientists from American institutions won other Nobels; all of them were foreign-born. Also foreign-born were two-thirds of the scientists based in American institutions who won Nobels between 1977 and 2015. Less-skilled immigrants also offer to natives more opportunities for mutually beneficial exchange by adding their labor to the U.S. labor pool.

In short, “restricting immigration, trade, and international business is more likely to harm workers than help them,” Clausning notes, and “tighter immigration restrictions are a bad idea.” She argues for more liberal immigration rules, like for foreign students who are often forced to leave the country after obtaining degrees from American universities.

In today's usage, “progressive” seems to mean everything that's good, so Clausning apparently believes there is no need to define the term in her book. Still, it would have been useful if she had explained what the label means to her. The early-20th-century progressive reformists were ambivalent on free trade, although President Woodrow Wilson, himself a progressive, vigorously led the Democratic Party to reduce tariffs. The progressive movement was generally racist, eugenicist, and anti-immigration. (See “Progressivism's Tainted Label,” Spring 2016.) The Democratic Party, which became the standard bearer of progressivism, was also the party most favorable to free trade, including through Franklin D. Roosevelt's administrations. It is these more enlightened Democrats whom Clausning represents.



Open: The Progressive Case for Free Trade, Immigration, and Global Capital

By Kimberly Clausning
360 pp.; Harvard University Press, 2019

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Like modern-day progressives as well as traditional conservatives, she wonders what “we” should do “as a society,” using a common and usefully obscure bit of collective-speak. Illustrating the danger of collective-speak, she calls for “a better partnership between society and the business community,” as if “the business community” was not part of “society.” What about “inclusion,” a mantra that appears two dozen times in the book? Is the business community to be included by force?

To be fair, Clausing is not anti-business like so many other progressives are. And she once uses “common interests,” a concept easier to define. In a diverse society, which she presumably favors, she should realize that few interests are genuinely common to all individuals; individual liberty (with some side bargains, Nobel economist James Buchanan would add) may be the only one. She should investigate this approach.

Romantic politics / What may ultimately explain Clausing’s disappointing defense of free trade and certainly her optimistic view of government intervention is her romantic politics. She seems to ignore the insights of public-choice economics, which, as Buchanan said, is “politics without romance.” For example, she writes about the “vital role” played by “the US Congress (and the president), by avoiding deficits and debt in good times, so that deficit expansion is more feasible when recessions arrive.” This is a strange statement or formulation because she certainly knows that, since 1960, the federal budget has shown an annual surplus only twice, in 1999 and 2000 (six times if we include off-budget transactions like Social Security).

“Unfortunately,” she adds, Trump’s tax cuts “will increase deficits by about \$1.5 trillion over the coming ten-year period.” It would be worth mentioning that the total deficits over a 10-year horizon were already forecasted at \$10 trillion before Trump took power. Trump is just adding to forecasted deficits that were already very high.

Clausing implicitly assumes that government is a naturally benevolent organization

that will raise the minimum amount of taxes to produce essential public services, efficient redistribution, and absolutely necessary regulations. If only multinationals and the rich would pay their “fair share” of taxes, everybody would be happy!

A carbon tax is one of her pet projects. She writes, “By taxing environmental harms ... revenue can be raised to help fund civilized society.” “Government,” she previously affirmed, “must ultimately be responsible for civilization itself.” She wants to impose on “every US resident company” an annual “sunshine tax report” on its global, country-by-country operations, revenues, and taxes (in addition to the information firms currently must provide), plus an annual “sunshine labor report ... on a set of benchmarks on pay structure and labor inclusion.” She claims that the latter would be “only a reporting requirement, not a regulation”!

As she later says about politics, it’s “an area in which economists can be naive.” My friendly and respectful prescription for this naiveté would be an antidote of public-choice economics.

It is not enough to have great ideas about what a virtuous government elected by enlightened voters and run by omniscient bureaucrats should do. Reforms must be achievable with individuals as they are and with feasible institutions. Otherwise, we fall into what economist Harold Demsetz called the “nirvana approach” to public policy.

Clausing has a blind spot for government failures. The budget deficit is one example. Another is what she calls the “insufficient financial market regulation” that “was instrumental in generating the Great Recession of 2008.” This seriously underplays the fact that the crisis originated in government-introduced (by Ginnie May in 1970), government-guaranteed, and government-promoted mortgage-backed securities. Other government regulations also played a major role.

She has only good words for the post-crisis and regulation-heavy Dodd-Frank Act. A few years before the crisis, one of the legislation’s namesakes, Rep. Barney

Frank (D, MA), claimed that the federal government had “probably done too little rather than too much” to meet the goal of “affordable housing”; he wanted “to get Fannie [Mae] and Freddie [Mac] more deeply into helping low-income housing” and “to roll the dice a little bit more” on housing. We know how that turned out.

Thinking outside the box? / I don’t think that Clausing makes a case for free trade that satisfies what I suggested would be a good “progressive” argument. She does propose a sort of minimum income in the form of refundable tax credits (an extension of the current Earned Income Tax Credit), but she does not pair it with a general deregulation of markets. On the contrary, she proposes an expansion of the regulatory state. She does not think outside of the box, or it is a small “progressive” box.

I have focused mainly on the failings of *Open*, but this is not to deny the book’s qualities. It is well documented and much superior to standard progressive-speak (granted, that bar is low). It does teach some basic economic principles and facts about the world. For example, Clausing writes:

It is difficult to find a good economist who does not recognize the merits, and even the magic, of international trade for raising the standard of living and contributing to the felicity of humankind. At root, the case for international trade is not much different from the case for markets; the presence of international borders does not change this basic logic.

As we saw, the thrust of her practical recommendations is not consistent with this orientation. Will her book help progressives understand that protectionism is a betrayal of the individuals they want to defend? Perhaps, but it is not certain. Progressives, just like conservatives, may have their revelation only after a radical realization that primacy must be given to individual choices, not to collective choices. This is the crux of the matter, in free trade as in other policy areas. R

A Love Letter to Tyler Cowen

◆ REVIEW BY DAVID R. HENDERSON

T Tyler Cowen's latest book, *Big Business: A Love Letter to an American Anti-Hero*, is excellent. Cowen, an economics professor at George Mason University, makes a strong evidence-based case that big business in America is an important—probably the most important—contributor to our well-being.

In a heavily footnoted book with references to scores of high-quality articles and books, Cowen argues that:

- Businesses are less deceptive than many other actors in society.
- CEOs are not, in general, paid too much.
- Most people like their jobs and often find them a safer haven than their homes.
- Big business is not particularly monopolistic.
- Big tech companies are not evil.
- Wall Street and finance companies in general are responsible for much of our prosperity.
- Cronyism by big business is not a major factor in government policy.

His case on each is persuasive and, as a bonus, he often has fresh insights and occasionally brings dry humor to his writing. My main criticism is that he is a little too “politically correct” at times.

If I were to lay out all that I learned from the book, I would almost restate it. Instead, I'll note some of the best and most insightful arguments.

Deceptive businesses? / Consider the claim that businesses are deceptive. Henny Youngman, a comedian in the 1950s and 1960s, had a famous routine in which he responded to the question, “How's your

wife?” with the comeback, “Compared to what?” Similarly, Cowen—while not denying that businesses sometimes engage in fraudulent practices—thinks it reasonable to compare their incidence of fraud with that of the rest of us. And many of us don't come out looking good. He quotes an executive headhunter's claim that at least 40% of resumes contain falsehoods. A more formal research study found that number to be 31%, with a whopping 76% embellishing the truth. Another survey found that 53% of people admitted to having lied in their online dating profiles. Writes Cowen, “Personally, I would be hard-pressed to find a big business that lies to me as much as—presumably—my friends, family, and closest associates do.” One sad fact he cites is that the books most likely to be stolen from libraries are books on ethics. And disproportionately represented are those “likely to be read by faculty and advanced students in moral philosophy.”

How do for-profit companies compare to nonprofits on moral behavior? Cowen points out that many charities don't accomplish much, “but rather continue as lost causes with no impact.” He also cites a study of California hospitals that found that when nonprofit hospitals had some market power, they did not supply more charity care than the for-profits did. He cites Ben Goldacre's 2012 book *Bad*

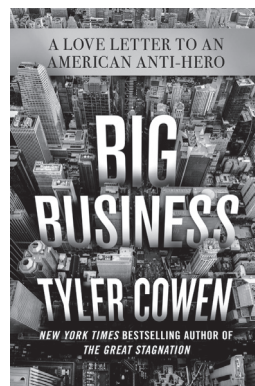
Pharma that, in Cowen's view, makes justified charges against large pharmaceutical companies. The problem with Goldacre's book? There's no balance. Goldacre ignores Columbia University economist Frank Lichtenberg's finding that drug companies cost us only \$12,900 per year of life saved. Cowen speculates that Goldacre titled his book *Bad Pharma* because “his Bad Publishing Company wanted to sell more copies of it and thus needed a catchy title.”

A well-publicized 2016 study found that 4–20% of business leaders were psychopaths compared to about 1% of the population. Until reading Cowen's book, I hadn't known that finding had been retracted. Cowen points out the obvious reason many people had not heard about that: the retraction was not nearly as publicized as the original study.

CEO compensation / Are CEOs paid too much? Surely, \$18.7 million—the median amount paid to CEOs of the 350 largest American corporations—must be too much. Cowen thinks it's not. They are paid to create value, he argues, and the skills required of a modern CEO are extensive.

Market data support him. He notes that a firm's stock price rises when companies announce that they will tie CEO pay to stock prices or other long-term performance indicators. He also points to one study that finds that when a CEO dies suddenly, the firm loses an average of 2.32% of its value over the next three days. If the CEO who dies is a young founder, the firm loses 8.82% of its value on average.

We often hear the charge that CEOs of big businesses are too focused on the short term. My standard response, which I got from University of Rochester finance economist Clifford Smith, is that Merck and other drug companies would earn way



Big Business: A Love Letter to an American Anti-Hero

By Tyler Cowen

259 pp.; St. Martin's Press, 2019

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more in the short term by cutting research and development to zero; the fact that they don't is strong evidence that they think long-term. Cowen has two even better responses. First, high price-to-earnings ratios, like those we're seeing now, conflict with the claim of excess short-termism. Second, he notes, when the future is uncertain, thinking long-term might not be the best option. He points to the U.S. tech companies that expanded into China with the goal of long-term profits and then did badly because of the Chinese government's hostility. They thought long-term—and were wrong.

Work and leisure / For me, the most enjoyable and insightful chapter was the one titled “Is Work Fun?” Cowen's basic argument is that productive work “is one of the most fulfilling sides of our lives.” That's easy for him—and me, who seconds his view—to say because we have (or had) relatively cushy jobs. But he points to a study that measures stress levels by measuring a person's level of cortisol—a hormone that increases blood sugar in response to stress—throughout the day. A majority of the people studied had higher levels of cortisol at home than at work. We're back to Youngman's “Compared to what?”

Cowen also cites a study of “flow,” developed by psychologist Mihaly Csikszentmihalyi. Flow is “an integrated, dynamic feeling resulting from processing stimuli, responding to changes in a developing situation, and solving problems with some measure of success.” Work, notes Cowen, promotes flow. Workers at various levels, including those in clerical jobs, in five large Chicago companies were given devices to report on the quality of their experiences on the job and at leisure. The bottom line is that they were in the “flow” state more while working than while at leisure.

Cowen also points out that work “can be an important vehicle for helping others.” Here, he dramatically understates the case. He gives examples of such jobs as brain surgeon, medical research, firefighting, working with a suicide help line, advis-

ing governments, and being a first-rate U.S. president. Notice what's missing from his list? How about the vast majority of unglamorous private-sector jobs: garbage collector, waiter, bond dealer, mechanic, cab driver, etc.? In all those jobs, people help others.

He also addresses sexual harassment, which can certainly make a job less fun. Cowen points out that the private sector has moved to address the problem much more quickly than government has. He also notes that companies with histories of harassing female employees must pay

Cowen points out that the private sector has moved to address sexual harassment more quickly than government has.

females more than otherwise, adding, “Clearly, that is not enough of an incentive.” He doesn't say why it's not enough. He seems to be judging that the incentive is too weak if any harassment remains. But here he has dropped his economist's judgment and gone “PC.” The cost of rooting out any remaining harassment may well exceed the benefits, and Cowen doesn't even try to explain that it doesn't.

Market power / One controversial issue in the last few years has been about the degree of monopoly and market power in the U.S. economy. Cowen's argument on this is twofold. First, both the amount of market power and the harm it causes are less than many people think. Second, the main harmful monopolies are in health care and schooling, where government regulation is the culprit. He notes that in the last 40 years, Kodak, IBM, Microsoft, Blackberry, Yahoo!, AOL, Digital Equipment Corporation (DEC), General Motors, and Ford were all called monopolists. Kodak is now bankrupt; DEC was bought by Compaq, which later merged with HP; and the others all face stiff competition. Myspace was thought to have

“first-mover” advantage and, of course, has been completely dominated by Facebook. And the web has made many industries more competitive.

The web has also, notes Cowen, facilitated price discrimination, which typically gives low prices to people with low time values. Since time values and income are highly positively correlated, price discrimination “is usually an egalitarian development.”

He warns that much regulation is a fixed cost of doing business, which means that more regulation will hobble competition from smaller firms. That warning is particularly relevant today, as Facebook founding CEO Mark Zuckerberg is advocating government regulation of his industry.

Even cable TV providers, which have local monopolies in most U.S. markets, face more competition as more and more households “cut the cord.” Cowen also points out the obvious fact—but one that's still worth pointing out—that the high subscription prices of cable, adjusted for quality and variety of programming, are much lower than they were previously.

One discordant note in an otherwise excellent chapter is Cowen's statement that the four largest firms in one sector of the economy “controlled” half or more of the market. The reality is that the typical firm, large or small, controls *none* of the market. Unless the firm has long-term contracts with customers, customers are free not to buy anything at all.

Corporate “evils” / In a chapter devoted just to tech companies, Cowen, riffing on the old Google slogan “Don't be evil,” asks “Are the big tech companies evil?” His answer is no. To make his case, he lays out some of the incredible things they do for us. Take Gmail, one of the best email services around, which charges the user a zero price. The possibility of setting up an account for free and using it immediately,

writes Cowen, “would have astonished us as recently as the 1980s.” He understates the case; it would have astonished us as recently as the late 1990s or even the early 2000s.

What about the fake news stories published on Facebook during the 2016 election? Cowen notes how trivial they were as a percentage of user actions and points out that the “more serious” mainstream media sources ran many stories about candidate Hillary Clinton’s email scandal. He quotes a *Columbia Journalism Review* estimate that, over six days during the campaign, the *New York Times* “ran as many front-page stories about Clinton’s emails as it did about all policy issues over the sixty-nine days immediately preceding the election.” As far as I know, President Trump has not thanked the *Times*, but he should.

Moreover, if the electronic media bear most of the blame for the dreck that they publish, how should we think about brick-and-mortar publishers? Cowen notes that for-profit publishers have printed the works of Marx, Mao, Hitler, and Stalin. Those four, indirectly in Marx’s case and directly for the other three, were responsible for over 100 million deaths in the 20th century. Great line: “Facebook hasn’t come anywhere near to doing the damage that the printing press (and radio) did by helping to communicate the ideas of fascism, Marxism, communism, and so on.”

In that same chapter, Cowen reports on a debate he had with writer Nicholas Carr, who argues that Google makes us stupid. The first question that Cowen asked Carr was whether Carr had prepared for the debate by using Google to research him. Writes Cowen, “I thought I had won right then and there.” Presumably Carr had to answer “Yes.” From personal experience, I can say that even if Google hasn’t made me smart, it has certainly made me more informed.

Toward the end of the chapter, Cowen does raise a justified concern that tech will cause us to lose our privacy. It’s hard to know how to counter that loss.

One of the book’s best chapters, which added to my stock of knowledge, is “What

Is Wall Street Good for, Anyway?” It turns out to be a lot. Cowen’s section on the importance of venture capital in the history of many major companies is eye-opening. It’s also heartening to see that 55% of U.S. households own stock, up from 32% in 1989. Cowen also highlights Vanguard’s positive role in bringing down fees paid to mutual fund companies. He reports that people who have invested with Vanguard have saved \$175 billion by not paying the average active fund fee since 1974, when Vanguard began. It has also saved investors about \$140 billion through lower trading costs. I had known that the savings were large, but I had not known that they were that large.

The biggest surprise, though, is that, as one partner in a Swiss law firm put it,

“America is the new Switzerland.” American laws, writes Cowen, have evolved to produce a high level of secrecy for some asset holders in this country. And South Dakota seems to be our own Luxembourg. With only 850,000 people, South Dakota “is home to more than \$226 billion in assets held in trusts.”

I’ve not even mentioned the last two chapters, “Crony Capitalism” and “If Business Is So Good, Why Is It So Disliked?” They’re excellent also.

All in all, Cowen’s love letter is sorely needed, not mainly by America’s big businesses, but by America’s voters. If 30% of the voters understood even 20% of the insights in this book, we would likely have much better policies and Americans, over time, would be much better off. R

Reinhardt’s Last Book

◆ REVIEW BY DAVID R. HENDERSON

Uwe Reinhardt was a well-known health economist at Princeton University who died in 2017. An outspoken advocate of government regulation of health insurance, he helped design the single-payer system adopted by Taiwan’s government.

Reinhardt’s last book is *Priced Out: The Economic and Ethical Costs of American Health Care*. In it, he argues that U.S. health care is too expensive, its administrative costs are too high, the U.S. tax system subsidizes health care for high-income people, and the government should increase the subsidy for health care for low-income people. He also expresses strong skepticism about requiring people to pay more out of pocket for their own health care, claiming it will not push consumers to price-shop for care.

Unfortunately, in the book Reinhardt biases his comparison of drug prices across countries and says nothing about the U.S. Food and Drug Administration’s

role in causing high drug prices. In claiming that people won’t price-shop when their incentives are changed by higher deductibles, he uses one company’s experiment to generalize to the whole country. Yet he himself, with his advocacy of reference pricing, argues that people who have to pay out of pocket *will* price shop. In discussing the tax treatment of employer-provided health insurance, he likens taking advantage of the tax break to feeding at the public trough. An immigrant himself—first from Germany to Canada, and then from Canada to the United States—Reinhardt criticizes the hiring of immigrant doctors. One refreshing proposal, though, is his idea for letting people avoid the Affordable Care Act (ACA) and take responsibility for their own health insurance.

DAVID R. HENDERSON is a research fellow with the Hoover Institution and emeritus professor of economics at the Graduate School of Business and Public Policy at the Naval Postgraduate School in Monterey, CA. He was the senior economist for health policy with President Reagan’s Council of Economic Advisers. He is the editor of *The Concise Encyclopedia of Economics* (Liberty Fund, 2008).

IN REVIEW

Drug prices / Reinhardt's most important factual message is that Americans spend more per capita on health care than people in any other country and that the prices we pay for health care are much higher than prices elsewhere. He is right on both counts.

He uses two figures, though, that bias the comparison for drug prices. One figure shows that the average price for a 30-day supply of Xarelto, used to prevent or treat blood clots, is \$292 in the United States versus \$126 in the United Kingdom and \$48 in South Africa. Another figure shows that the average price for a 30-day supply of Tecfidera, used to treat multiple sclerosis, is \$5,089 in the United States versus \$1,855 in Switzerland and \$663 in the UK. Those comparisons are biased because both drugs are brand-name drugs, yet a large percentage of the drugs Americans take are generics.

According to an October 2017 study by the Commonwealth Fund, 84% of the drugs Americans took in 2014 were generics. The UK percentage was also 84%, but every other country was much lower. The lowest in the Commonwealth Fund study was Switzerland, where only 22% of drugs taken were generics.

Not surprisingly, therefore, the differences in spending on drugs between the United States and these other countries were narrower than the brand-name drug prices would suggest. In 2015, according to the Commonwealth study, per-capita spending on pharmaceuticals in the United States was \$1,011.40 versus \$783.30 in Switzerland and \$497.40 in the UK. One might wonder if that's because the higher prices in America give us an incentive to buy a lower quantity of drugs per person, but the Commonwealth study says that's not so: "Drug utilization appears to be similar in the U.S. and the nine other countries considered."

Disappointingly, in Reinhardt's discussion of drug prices he does not mention one of the culprits responsible. The FDA makes prices higher for some drugs by putting barriers in the way of pharmaceutical companies that make so-called "me-too" drugs. Frequent *Regulation* contribu-

tor Henry Miller of the Pacific Research Institute has defended such drugs on the grounds that no drug is a perfect substitute for another and that, therefore, some patients whom the original drug wouldn't help would benefit from the me-too drug. But there's also a narrow economic argument for these drugs, one that I'll make by analogy with cars: A Chevrolet is a me-too Ford. If a government agency put barriers in the way of Chevrolets, Fords would be more expensive. Putting barriers in the way of me-too drugs gives pharmaceutical companies even more market power.

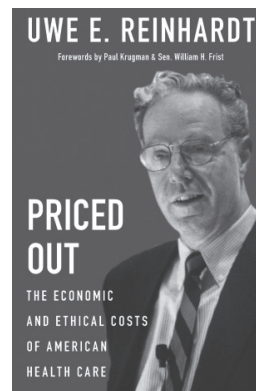
Cost-sharing / Many health economists, including me, have proposed reining in wasteful health care spending in the United States by moving to catastrophic health insurance. Under this, people would pay out of pocket for the first few thousand dollars of each year's health-care spending. That change, many of us have argued, would encourage patients to be more cost conscious, shopping around for cheaper drugs, asking tougher questions of doctors who want to order expensive tests, maybe even choosing hospitals for non-emergency surgery based on costs, and, of course, cutting out less-important care.

We do have evidence of this happening. In the famous RAND health insurance experiment that ran from November 1974 to January 1982, thousands of people were given health insurance with wide variation in co-insurance rates—the percentage of medical bills paid by the participants in the experiment. The co-insurance rate varied from 0% to 95%. The experiment found that patients faced with higher co-insurance rates used less medical care, yet there was little effect on health outcomes. This suggests that people who had to pay more out of their own pockets cut out the least beneficial medical care.

Reinhardt doesn't mention the RAND experiment, but he calls the idea of shopping for cost-effective health care "a cruel hoax." He writes, "Patients typically do not know binding prices and robust data on the quality of care when they approach the health care system." He writes further, "In effect, they enter that market like blindfolded shoppers pushed into a department store." He cites a 2015 National Bureau of Economic Research study that found that a large company that had switched to high deductibles did find health care spending by its employees fell by 11.8–13.8%, which is significant. But, the researchers also found, this reduction was due entirely to a reduction in the quantity of health care purchased; having patients be responsible for more of the cost of their health care did not cause any increase in actual price shopping.

There's an explanation for this finding that confounds Reinhardt's argument. Even the employees of a large company are just a tiny percentage of the market. So, providers, used to figuring out the prices of health care only *after* the care is provided, are not set up to give price information in advance to those who ask. That likely would change if high deductibles became more common.

The best way to see whether higher out-of-pocket costs cause people to price-shop for health care is to examine a market in which a large percentage of patients pay for their own care. One such market is for LASIK eye surgery. A quick Google search finds that prices, though not quoted to the penny, are customarily prominently displayed on LASIK surgeons' websites, which also often offer financing options. Why mention prices if people are not price shopping? Interestingly, after stating, "Most prices for health care in the United States are kept as trade secrets between insurers and providers of care,"



Priced Out: The Economic and Ethical Costs of American Health Care

By Uwe E. Reinhardt
201 pp.; Princeton University Press, 2019

Reinhardt admits the point about LASIK, writing, “The only exceptions are said to occur in the markets for LASIK and cosmetic surgery, where physicians usually do apprise patients of prices ahead of the treatment.” It does seem, therefore, that if a large percentage of Americans had high deductibles, a substantial portion of these consumers would price-shop much more than they do now.

Surprises/ In his discussion of high costs, Reinhardt points out the awful reality that patients often get “surprise” medical bills. They can carefully choose a hospital within their insurer’s network, but learn only too late that various doctors on their case were “out of network.” The result: surprise medical bills that can run into the thousands of dollars. One partial solution for this would be for the government to allow more vertical integration in health care so that all of the providers for a given surgery would be in the same firm and thus part of its insurance network. One barrier to vertical integration is Certificate of Need (CON) regulations that many states have: these laws make it difficult for competitors to start hospitals and surgery centers. Unfortunately, Reinhardt doesn’t mention CON regulations.

While on the subject of surprises, I’ll note one I had in reading the book’s epilogue by Reinhardt’s widow, Tsung-Mei Cheng, a health policy research analyst at Princeton’s Woodrow Wilson School of Public and International Affairs. She quotes Reinhardt’s statement in 2009, before Congress passed the ACA, that America should use “reference pricing.” She also quotes from his lengthy 2009 C-SPAN interview in which he explained the idea. Insurance companies would pay 100% of the price of a low-cost drug or a low-cost hospital visit, which would be the “reference price.” But if some patients want a more expensive drug or hospital, they would have to pay the difference between the price of that care and the reference price. That would give patients good incentives: their health care basics would be covered and they would decide whether the extra quality or luxury

was worthwhile. This seems like a good idea, but it surprised me that Reinhardt embraced it because it sounds awfully close to the notion of price shopping that he rejected in the book.

One policy that would likely move insurance companies closer to reference pricing is to reform the tax treatment of employers’ contributions to their employees’ health insurance. The contribution is a legitimate cost of doing business and, therefore, for tax purposes is deductible from the employers’ revenue. But it’s tax-free income to the employee. That gives employers an incentive to provide more-generous health insurance than otherwise.

Reinhardt highlights this fact, but he calls the tax treatment a “generous public subsidy.” The people taking advantage of it, he writes, have “their paws so squarely in the public trough.” He’s mistaken. It’s true that in its economic effects, the tax-free treatment of employers’ contributions *acts like* a subsidy. But it’s not a subsidy; it’s a way for employees to reduce their tax bill. While the tax treatment does create bad incentives, it is no more a subsidy than a tax rate cut would be. Reinhardt’s implicit assumption is that the government owns the employees’ income.

His language on another issue, immigration of doctors, is also disturbing. In the aforementioned C-SPAN interview, he stated that when doctors who have trained in other countries move to the United States, we are “robbing them of their physicians.” We’re not. When Reinhardt and I moved to the United States from Canada, the United States did not “rob” Canada of budding economists; we immigrated. The case with doctors is no different.

In her epilogue, Cheng points out that when Reinhardt was a child in Germany, he and his siblings had health care through the “social insurance” system that Chancellor Otto von Bismarck established back in 1883. She comments, “Germans may not always have had enough food in those years, but all had the health care they needed.” That comment is telling. There are tradeoffs. Would you rather spend a dollar on health care or on food,

and who should get to choose? Cheng’s comment implies, and presumably her husband would have agreed, that it should be the government’s choice and the government should choose health care over food. Why that’s so is unclear. Elsewhere in the book, Reinhardt notes that health care contributes “no more than 10 percent to 20 percent of observed cross-country variations” in health status measures. For some people, especially poor people, food could easily be more important than health care.

Community rating proposal/ I’ll end with a Reinhardt policy idea I like, about how government should deal with a perverse incentive that the ACA creates. The ACA requires insurers that sell individual health insurance policies to practice community rating. “Community rating” means that insurance companies charge the same premium to healthy people that they charge to unhealthy people. The result, he notes, is that a high percentage of healthy people will game the system, refraining from buying insurance until they are sick.

The usual solution for this that health policy analysts advocate is to require the uninsured to wait months or years before they can buy community-rated insurance. Reinhardt takes this idea a step further. He would require all American residents, at age 26, to buy community-rated insurance. If they refuse, they would not be allowed to buy community-rated insurance at any time in the future. They would instead go uninsured or buy insurance priced according to risk.

As long as government would not regulate the items that individual insurance would cover, this strikes me as a good proposal. I could imagine young people saving a few thousand dollars a year and then, when they get sick at, say, age 50, having tens of thousands of dollars to spend on health care. I could also imagine them doing what my daughter did before the ACA prohibited it: buy risk-priced health insurance with guaranteed renewability. That would be a large improvement on the current system. R

IN REVIEW

Doing Damage to the Deference Doctrine

REVIEW BY VERN MCKINLEY

Those of us who engage in contemporary policy debates need to be reminded more often of the ongoing expansion of the administrative state. These federal agencies regularly push the limits on their authority and act with limited oversight from the chief executive or from the judicial and legislative branches. In a real

sense, they have become a de facto fourth branch of government, competing for power with the three branches explicitly enumerated in the Constitution.

Daily policy debates about the operations of the administrative state tend to bog down in the technical details of regulation of the individual sectors, whether financial services, health care, environmental policy, or something else. Matters that fall under *Chevron* deference—the Supreme Court doctrine that administrative agencies are entitled to a presumption of expertise and courts should defer to the interpretations of federal law adopted by those agencies—are resolved in favor of an ever-expanding administrative state. Precious little time is dedicated to assessing the resulting expanded breadth of the entire administrative state.

Peter Wallison gives us a well-timed reminder of all this in the form of a history and assessment of the vast administrative state. The book allows us to step back and look at the longer-term trends in administration beyond industry-driven anecdotes. Wallison has been a senior fellow at the American Enterprise Institute since 1999. I reviewed his last book, *Hidden in Plain Sight* (see “Peter Wallison Dissents Again, With Feeling,” Spring 2015), which offers his narrative of last decade’s financial crisis. The title of his newest book gives a hint of his preferred solution for applying judicial review in reversing the trend of expanding

agency authority.

Defenders of the status quo argue that the courts have to allow administrative agencies to grow because the economy and society have become so complex that we are “compelled to hand more and more authority to the agencies of the administrative state.” This makes the book especially timely; recent changes in the makeup of the Supreme Court have yielded a majority block of justices (Chief Justice John Roberts Jr. and Associate Justices Clarence Thomas, Samuel Alito Jr., Neil Gorsuch, and Brett Kavanaugh) who seem poised to reassess the efficacy of the *Chevron* doctrine. (See “From *Chevron* to ‘Consent of the Governed,’” Winter 2018–2019.) Wallison calls the doctrine “the Supreme Court decision that is most responsible for the growth of the administrative state.”

The genesis of the administrative state / Wallison’s historical summary traces back the administrative state to the early days of the Progressive Era, driven by what he calls “ideas about government that gave rise to a very different view of the Constitution than had prevailed in the past.” Twinned with this new view was a romantic idea of how the world should work, an “extravagant faith in administration,” as explained

by Princeton research scholar Thomas C. Leonard. Leonard speaks of “the visible hand of administrative government, guided by disinterested experts who were university trained and credentialed, [that] would diagnose, treat and even cure low wages, long hours, unemployment, labor conflict, industrial accidents, financial crises, unfair labor practices, deflation, and other ailments of industrial capitalism.”

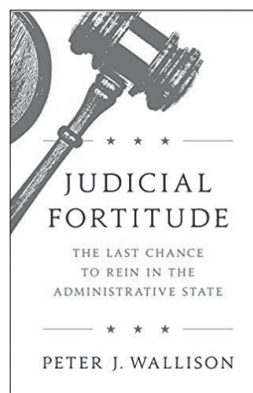
Not surprisingly, President Woodrow Wilson was an early adherent of the administrative state. One of his articles as a newly minted Bryn Mawr College professor, “Study of Administration,” elevated the “success of the government’s postal service” as an exemplary case that could be replicated again and again. Under this

emerging progressive view of an all-encompassing administrative governing style, not only were these administrators to take on the full range of industry tasks, but they were also to take on the role of the courts in setting the parameters of their own administration. As Wallison explains, “The idea [was] that administrators, as disinterested experts, rather than the courts, should interpret the scope of their authority.”

The administrative state would not stop there under Wilson’s vision, as the agencies were also to supplant Congress and the executive branch by discerning and

carrying out the will of the public. Again, as summarized by Leonard, “For Wilson, administrative agencies were not simply acting on the instructions of Congress or even the President; they were to be the government itself in the sense that they were to understand in some way what the public wanted and carry it out.”

The Republican administrations of the 1920s brought a normalizing of the federal workforce back to pre-wartime levels of about 500,000. President Franklin D. Roosevelt would then bring the next big



Judicial Fortitude: The Last Chance to Rein in the Administrative State

By Peter J. Wallison
216 pp.; Encounter Books, 2018

VERN MCKINLEY is the coauthor, with James Freeman, of *Borrowed Time: Two Centuries of Booms, Busts and Bailouts at Citi* (HarperCollins, 2018).

expansion in the administrative state. “The New Deal was just like the Progressive Era, only bigger,” writes Wallison. This time the courts were complicit in the initial inklings of deference, falling in line with the progressive approach. Wallison quotes an opinion by Justice Stanley Reed on a tax case, *Gray v. Powell* (1941), that was a “precursor of *Chevron*”:

Congress, which could have legislated specifically as to individual exemptions [from the tax], found it more efficient to delegate that function to those whose experience in a particular field gave promise of a better informed, more equitable adjustment of the conflicting interests of price stabilization, upon the one hand, and producer consumption upon the other.... Where, as here, a determination has been left to the administrative body, this delegation will be respected, and the administrative conclusion left untouched.

Administrative abuses / Fast-forward to the present and the result has been an administrative state that has become a law unto itself. Wallison chronicles many examples of abuse, too numerous to recount in this review.

One that he references multiple times throughout the book is Operation Choke Point, a case study from the financial industry that has been the focus of Wallison’s recent research. As he explains, the initiative was a particularly egregious exercise of administrative power. The Obama Justice Department and the Federal Deposit Insurance Corporation developed a policy out of whole cloth, conspiring on “a plan designed to choke off the operation of disfavored businesses by using bank regulation to deprive them of operating funds and other financial services.... The bank regulatory agencies directed banks to cease making loans or, in some cases, cease to provide any banking services.” Obama administration regulators went forward with this plan, notwithstanding the fact that “there was nothing in the laws they were purporting to enforce that gave them the authority to drive otherwise lawful

activities out of business.” Mind you, all of these targets were legal businesses that ran afoul of the administration: “sellers of firearms and ammunition, coin dealers, sellers of lottery tickets, money transfer

One of the dangers of allowing agencies to decide the extent of their statutory authorities is the arrogance that comes from not having to answer to the courts.

networks and payday lenders.”

Payday lenders were a particular target of the DOJ and FDIC. After three long years under this abusive program, a number of these lenders initiated litigation against the FDIC, other banking regulators, and the DOJ. The D.C. Federal District Court affirmed that the services were wrongly denied, one of the few bright spots for the courts, in contrast to the “frequent failure of the courts to discipline the agencies of the administrative state.” As Wallison summarizes the lessons of Operation Choke Point, “One of the dangers of allowing agencies to decide the extent of their statutory authorities is the arrogance that comes from not having to answer to anyone, least of all the courts.”

Reform / Such abuse is driven by lawmakers’ incentives to avoid hard decisions. Wallison explains:

Congress delegates power to the executive because that is the most politically convenient way to achieve its objectives. Delegation of standard-less discretion allows Congress to pretend to address problems—even when it has no clue—and then, as a bonus, to complain if the executive’s solution turns out to pinch important constituent (or donor) groups.

He argues that this approach “is the logical consequence of the way the Supreme Court has structured Congress’s incentives.”

The approach of the D.C. Federal District Court in the Operation Choke Point case was a positive step, but Wallison further

calls for the application by the courts of the non-delegation doctrine. Congress holds all legislative power and he advocates the view that it is “a violation of the Constitution for Congress to transfer (or delegate) any of

its legislative authority to administrative agencies or others.” *Judicial Fortitude* begins with the following quote from Justice Thomas’s concurrence in *Department of Transportation v. Association of American Railroads* (2015):

We have too long abrogated our duty to enforce the separation of powers required by our Constitution. We have overseen and sanctioned the growth of an administrative system that concentrates the power to make laws and the power to enforce them in the hands of a vast and unaccountable administrative apparatus that finds no comfortable home in our constitutional structure.

For Wallison this means it is primarily the job of the judiciary to rein in the administrative state.

He reserves the final chapter for an assessment of *Chevron v. Natural Resources Defense Council*, the unanimous 1984 ruling penned by Justice John Paul Stevens that established *Chevron* deference. Stevens writes that in cases where

the statute is silent or ambiguous..., the question for the court is whether the agency’s answer is based on a permissible construction of the statute....

A court may not substitute its own construction of a statutory provision for a reasonable interpretation made by the administrator of the agency.

In 2013, the Court began a to-be-fully-determined “split” on upholding the *Chevron* doctrine, with Roberts, Kennedy, and Alito dissenting in a case interpreting the authority of the Federal Communications Commission. As Wallison writes in this final chapter, “We must imbue the judiciary with the fortitude that the Framers expected from independent judges.” R

Markets and Morality

REVIEW BY GEORGE LEEF

We find rising prosperity and social peace in places that generally accept free markets, and we find poverty and strife in places that reject free markets—with Venezuela as the current prime example. Despite that, we hear much debate today over the morality of markets. When people are at liberty to engage in, as

Robert Nozick put it, “capitalistic acts between consenting adults,” the consequences of those acts make some people unhappy. Those people complain about income inequality, worker exploitation, “commodification” of certain goods, and the undermining of key societal values.

The renewal of these complaints in recent years makes Michigan State political scientists Arthur Melzer and Steven Kautz’s *Are Markets Moral?* especially timely. The book is a compendium of 11 essays from authors with diverse views. Melzer and Kautz write in their introduction, “Is it somehow the case that the essential principles of the capitalist system are at odds with morality, or, less drastically, do the practical workings of the system eventually but inevitably weaken or overthrow moral practices and outcomes?” They want to know why some thinkers believe free market capitalism to be unobjectionable while others regard it as morally suspect.

In his own chapter, Melzer gives readers an overview of “the moral resistance to capitalism.” He focuses on the profit motive and points out that there are both right-wing and left-wing arguments that it does considerable harm. Right-wing critics contend that free markets lead people to a constant pursuit of wealth at the expense of higher, more intrinsically satisfying ends in life. The culture becomes overly materialistic, in this view. Left-wing critics complain about a different set of harms: markets make people unjust and exploitative. The rich use their gains to grow steadily richer while the

poor grow poorer. Even if the poor don’t actually become worse off, the widening gap makes them feel worse off.

Defenses / Brown University political theorist John Tomasi kicks off the debate with a sharp essay, “Economic Liberties and Human Rights.” His central claim is that “all people, everywhere, have powerful rights to engage in private economic activity.”

He discusses the counter-arguments that have been made by such thinkers as Mill, Keynes, and Rawls that economic liberty leads to undesirable conditions that the state must correct by restricting the right to engage in economic activity. To them, Tomasi replies,

Though eminent scholars have sometimes looked down their noses at the familiar work-a-day virtues associated with economic liberties, many ordinary working people see the development and exercise of these virtues, in support of one’s own dreams and the dreams of those one loves, as the very *core* of a free life.

Critics of the free market, he says, ought to pay some attention to the complaints of ordinary people who have lost economic liberty.

New York University law professor Richard Epstein follows Tomasi with an essay arguing for “smart consequentialism.” He, too, defends the morality of capitalism, but argues that the best way to do this is to show the benefits of capitalism rather than appealing to notions of universal rights and especially the moral absolutism of Kant.

After considering numerous legal and moral problems, Epstein writes:

I cannot understand why a set of legal rules that seeks at every point to advance human welfare would be dismissed as immoral. On the other hand, I see every sign of danger in legal rules that block the road to success with ill-conceived regulatory and taxing initiatives.

Ill-conceived regulatory and taxing initiatives are, of course, inevitable consequences of efforts to reform or “humanize” capitalism.

Challenges / In the book’s first chapter that questions the morality of markets, New York University sociologist Steven Lukes surveys the arguments of critics on the right and left. English poet William Wordsworth lamented that as the market expands, we “lay waste our powers” and “have given our hearts away.” Another romantic, Thomas Carlyle (coiner of the epithet “dismal science” to refer to the field of economics and its embrace of free markets), saw capitalism as the destroyer of “communal bonds.” Lukes correctly observes that markets upset hierarchies and some people regard that as too high a cost to bear.

On the left, Lukes notes that Marx complained not only about the immiseration of the proletariat, but also that capitalism converted previously honored professionals such as lawyers, priests, poets, and scientists into mere paid laborers. Among contemporary enemies of the free market, Harvard political philosopher Michael Sandel bemoans the way “commodification” tends to degrade commercial goods and Stanford philosopher Debra Satz maintains that markets are noxious when they jeopardize equality. She opposes, *inter alia*, markets for human organs.

Lukes is quite taken with Keynes’ idea that capitalism will eventually deliver such abundance that material concerns will no longer be of issue and humanity’s remaining problem will be for everyone “to live wisely and agreeably and well”—which evidently doesn’t require much economic liberty. He closes with the rather defeatist cry, “I doubt whether the advocates of thick economic liberty and the virtues of

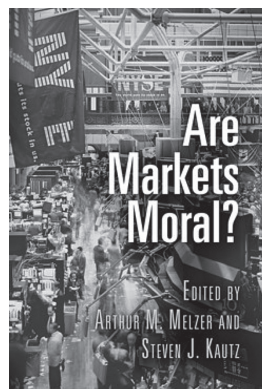
the market can be brought to see what I have called illusions as illusions.”

Princeton legal scholar Robert George is not nearly so hostile to market liberty as Lukes. Instead, he advances a conservative criticism of business, which he thinks too often forgets that it has a stake in the health of social institutions. “The long and short of it,” he writes, “is that if we want limited government and a level of taxation that is not unduly burdensome, we need healthy institutions of civil society, beginning with a flourishing marriage culture supporting family formation and preservation.” George isn’t blaming free markets for the decline of the family, but others argue that drugs, gambling, pornography, video games, and so on are capitalist products that are to blame. George simply says that businesses should refrain from undermining the family and instead try to strengthen it.

But the enormous good capitalism has done must not be forgotten. George points especially to education. There is much hostility toward business in academia, he notes. The critics overlook the support that businesses give to education, both directly and indirectly via taxes. The taxes needed for public support of education, he reminds the academic critics, are mostly possible only because of market activity.

In the same vein is an essay by the late Peter Lawler, professor of government at Berry College. His “Higher Education and American Capitalism Today” explores the effect of capitalism on colleges and universities. More and more, when Americans go to college, they are there simply to learn a technical or vocational competency, not to read and think about the best works of humankind. Our mania for trying to put as many people through college as possible is a failure. Lawler writes, “Lots of students leave college with big debts and no prospects of becoming prosperous enough to make the monthly payments. Our colleges

are charging students ridiculous rates not to prepare them effectively to be free beings who work.” Were more of us truly educated, Lawler believes, we would be better able to “resist the reductionist excesses of both capitalism and communism.” Like Wordsworth, Lawler thinks that capitalism is leading us astray.



Are Markets Moral?

Edited by Arthur M. Melzer and Steven J. Kautz
247 pp.; University of Pennsylvania Press, 2018

Cultural views / Gurcharan Das, an Indian businessman, contributes a chapter on a concept vital to his culture: dharma. It doesn’t translate easily into English, but it implies a personal obligation to act honorably in all public and private dealings. It’s the “invisible glue” that, according to Das, made Indian society work. Under dharma, the pursuit of business success was perfectly fine, but subject to moral constraints. Those who violated dharma were subject not to legal punishment, but punishment by other market participants through the loss of reputation.

India’s trouble, Das says, is that for many decades it was dominated by statist thinking that came from British intellectuals. Jawaharlal Nehru, India’s prime minister from the modern nation’s founding in 1947 to his death in 1964, was responsible for fastening “a dirigiste, socialist state.” He notes, “Ironically, socialism was out of character with the historical temper of the country.”

Fortunately, India made an about-face in 1991 when new political leadership embraced free markets. The result has been tremendous economic growth. During the decade from 2003 through 2012, the nation averaged 8% annual growth, allowing millions of Indians to escape from grinding poverty.

Next, University of Illinois at Chicago economist and historian Deirdre McCloskey explains what she calls “The Great Enrichment.” For nearly all of human history, people lived precariously—the Hobbesian “short, nasty, brutish” life. What allowed humanity to start to become

rich, she argues, was more than anything else a change in the way people thought about market activity. “What changed,” she writes, “was not the security of property, but the rhetoric of trade and production and improvement—that is, the way influential people talked about earning a living.”

That change led to “the Bourgeois Deal”—namely, if the bourgeoisie were allowed to produce, trade, and prosper, eventually everyone would be better off. Without the protective shield of that change in thinking, McCloskey argues, government would have stepped in and blocked capitalistic improvements in order to protect vested interests. Who mostly benefits from free markets? McCloskey answers, “The wretched of the earth.” Without it, the great majority of humans would still lead lives of “utter, terrified misery.”

Following McCloskey comes University of California, San Diego political scientist Fonna Forman. I expected her to present a strong counter-attack against the market advocates when she opened her essay with the story of her great-grandfather, who left Poland for the United States, choosing to settle in Milwaukee because the city had elected a socialist mayor. But Forman instead argues that we should rethink what most people take to be Adam Smith’s message that society functions best with a strictly individualistic capitalism. She offers several case studies involving improvements in Latin American cities that came about without capitalism.

She explores the “tradition of public thinking about urban life that has been steadily retreating in Europe and the United States, in favor of more overtly private agendas.” She does that in a series of case studies involving local politics in Latin American cities. In Bogota, Colombia, for example, the mayor succeeded in improving social norms through “behavioral intervention,” such as persuading people to be more conscientious drivers and to use less water when showering. While those stories are interesting, it’s hard to see any indictment of the morality of free markets in them. Neither Smith nor any other market proponent ever said that there aren’t non-

IN REVIEW

profit means of addressing civic problems.

Conclusion / The book's final section consists of two essays dealing with Smith, Locke, and Montesquieu. Utah State political theorist Peter McNamara contrasts Smith and Locke, concluding that while Smith was quite certain that commerce has a beneficial moral effect on people, Locke was far less certain. Utah Valley University

political scientist Andrew Bibby brings the volume to a close with an essay on the French liberal Montesquieu's thoughts on the relationship between commerce and morality. He regarded it as beneficial, tending to "cure destructive prejudices."

Naturally, the debate over the morality of markets will continue. Anyone who wants to enter the fray will find this book full of valuable insights. **R**

Rather than being communities of disinterested truth-seekers as in the intellectual ideal, universities are like any large bureaucratic organization. They are filled with empire-builders, schemers, and Machiavellian maneuverers seeking to acquire resources for themselves, their departments, and the causes they find important.

In this respect I think Brennan and Magness (and probably the rest of the public choice tradition generally) could strengthen their argument. A lot of academics will be turned off by their assertion that in many cases "moral language disguises self-interest." *Surely*, the offended reader says, *this describes those scoundrels over in the business school but it doesn't describe me.*

The reader puts the book down, never to pick it up again, and perhaps to tweet about Brennan and Magness's crazy conspiracy theory. And perhaps the reader will think that even if there are cases where self-interest is a problem, it has an easy enough fix: turn the power over to those who are not self-interested. Simple.

Brennan and Magness can offer a stronger argument to this, though: Their conclusions follow even if academic actors *aren't* self-interested. I've devoted myself to what I consider the most important work there is: the study of economics.

Assume I've done so out of absolutely no material interest whatsoever and out of truly altruistic intentions. Still, I'm faced with the problem of scarcity: I need food, shelter, and other goods to do this work. That means I must be "self-interested" in the weakest of senses. Public choice still works *even if we keep the altruistic romance* in politics and academia.

Incentives in the University

REVIEW BY ART CARDEN

It's no secret that higher education is broken. A steady stream of books confirms everyone's suspicions about the troubling rise of the "neoliberal" "corporate" university, the "devaluation" of the humanities, the "stealth plan for America," why Johnny *still* can't read, and how liberal professors are destroying young people's minds.

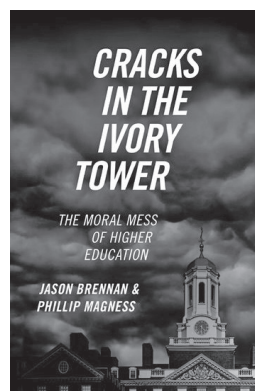
Recent years have seen a serious improvement in this genre, first with Bryan Caplan's *The Case Against Education* (Princeton University Press, 2018) and then Greg Lukianoff and Jonathan Haidt's *The Coddling of the American Mind* (Penguin Books, 2018). Now, the incredibly prolific Georgetown political philosopher Jason Brennan has teamed up with the equally prolific economic historian Phil Magness to explore a surprisingly under-researched area: the business ethics of higher education. Or more accurately, the lack thereof.

They offer 11 tightly argued chapters of about 25 or 30 pages each. The prose is clear and they do a very good job specifying what evidence would be sufficient to convince them that (for example) student evaluations are valid indicators of teaching quality. They conclude that a lot of the usual stories about what is ailing higher education—neoliberalism, corporatization, etc.—are basically ghost stories about "gremlins" or "poltergeists"—appeals to effectively supernatural explanations. These phenomena have a more mundane explanation: higher education is a moral

mess because the incentives in higher education are a mess.

Public choice in education / In arguing this, they draw from James M. Buchanan and Nicholas Devotoglu's 1970 book *Academia in Anarchy* (Basic Books), written during Buchanan's brief stop at UCLA. Buchanan and Devotoglu point out an oddity in the structure of higher education: the consumers don't pay, the producers aren't accountable to their customers, and the payers don't consume. It's a prescription for anarchy, according to Buchanan and Devotoglu—or a moral mess, according to Brennan and Magness.

The authors clearly and self-consciously follow the public choice tradition of "politics without romance," using the tools of public choice theory (rational choice, behavioral symmetry, methodological individualism) to develop an explanation of academia without romance.



Cracks in the Ivory Tower: The Moral Mess of Higher Education

By Jason Brennan and Phillip Magness

336 pp.; Oxford University Press, 2019

Imagined improvement / The moral mess, Brennan and Magness argue, is a result of pathological incentives in higher education. Shortly after they identify stories you might read in the *Chronicle of*

Higher Education or *Inside Higher Ed* about effectively supernatural forces taking over campuses, they explain that the “treatment effects” of higher ed is not what a lot of people think. Hence, they argue that “most academic advertising is immoral bull—.”

They distinguish between the selection effects and the treatment effects of higher education. Evidence suggests that smart kids go to college (selection effect), rather than that college makes kids smarter (treatment effect). A lot of colleges’ claims about transformative experiences are simply not grounded in convincing evidence. There are stories and a lot of wishful thinking, but the best and most systematic evidence about the treatment effect of schooling shows that people don’t acquire the skills and dispositions we want them to have by going to school per se. Academic advertising about the value of higher education is, therefore, immoral not because it is purposely deceptive, but because it is negligent: schools make claims about transformative experiences that aren’t evidence-based. The advertisers and recruiters might believe in their hearts that State U really changes people and are acting out of the best of motives. However, they are basing this conviction not on careful evaluation but on a combination of anecdotes and wishful thinking.

This leads to the heart of the book. A lot of public policy is made not on the basis of the world as it actually is, but on the basis of the worlds we can imagine. Higher education policy is no different and advocates for greater subsidies usually build their cases on sandy aspirational foundations of what we imagine higher education is and can be. One of the best examples of this is the common curricular mistake that a lot of institutions make: asserting that students should know something and then concluding the students will learn that thing if they are forced to take a course in it. Students should know how to write, so they should be required to take composition courses. Students should be numerate, so they should be required to take math classes. Students should understand the economic way thinking, so they should be required to take econom-

ics classes. Knowing a second language and being familiar with other cultures is advantageous, so students should be required to take two semesters of a foreign language.

It does not follow, however, that people will be more knowledgeable about a subject if they are required to take coursework in it. The treatment effect of courses is pretty dismal. The Collegiate Learning Assessment featured in Richard Arum and Josipa Roksa’s book *Academically Adrift* (University of Chicago Press, 2011) shows that students don’t really improve their writing skills in composition courses. Brennan and Magness don’t discuss this, but the economist and leader in economic education, Robert Frank, author of *The Economic Naturalist* (Perseus Books, 2007), has argued that the treatment effect of a traditional introductory course on economic understanding is effectively zero. When we are making curriculum decisions, we should be doing so in light of these realities and not in light of what we can imagine.

Reform? / To the extent that there are solutions to this moral mess, we would do well to look carefully at the incentives at play in higher education and ask about the costs and benefits of rigorous evaluation of student learning. Brennan and Magness devote a chapter to student evaluations and another chapter to grades, arguing in both cases that the mathematical averaging that gives us composite teaching evaluations and grade point averages is largely arbitrary and not terribly informative.

The problem, they point out, is that more rigorous and informative evaluation is very costly and no one really has an incentive to do it. This conclusion appears again in their chapter on cheating. It is easy, they argue, to cut way down on cheating by giving many low-stakes assessments rather than just one or two big tests. This, however, is costly for the faculty member and rarely rewarded. It is far easier, they note, to give and grade one or two very large assignments than to give and grade many smaller assignments when, ultimately, the money and prestige professors desire result from research they could be

conducting in the time they are devoting to teaching and assessment.

Conclusion / Throughout, the book offers a useful mix of ethical reasoning and hard-headed empirical analysis. It presents important correctives to some of the popular-but-wrong stories that make regular appearances in the higher ed press. The academy, for example, is not being “adjunctified”; if anything, the tenure-track footprints of the supposedly-most-beleaguered humanities disciplines are growing on campus. There hasn’t been a “neoliberal” turn in higher education administration. Faculties have moved politically leftward and, if anything, a lot of administrators running student development programs and assorted student service offices are even further left than the faculty. And so on. If higher education is going to develop a respectable ethos, we need to dispense with some of the popular-but-wrong stories people tell.

If I were to summarize the entire book in a single sentence, it would be, “People respond to incentives, even in the academy.” In a lot of cases, we can peek behind grand rhetoric and find naked self-interest underlying curricular proposals, the development of the general education requirements, and the continued persistence and proliferation of doctoral programs that should probably be shuttered. Importantly, Brennan and Magness’s explanation works if we interpret “self-interest” in the broadest sense to include sincere altruism and say that educational altruists are just trying to do what they think is best in a world of scarce resources and differences of opinion as to what makes for a flourishing life. We will see conflicts between an altruist-filled English department and an altruist-filled economics department as long as resources are scarce and each department sincerely believes that the marginal dollar spent on its program has a higher social benefit than the next-best alternative.

Cracks in the Ivory Tower is an important contribution that, if we are lucky, will make those of us in higher education do some serious ethical reckoning. If nothing else, the taxpayers who are subsidizing our lifestyles deserve it. R

Working Papers ⇄ BY PETER VAN DOREN

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

Freight Railroad Regulation

“Economic Foundations for 21st Century Freight Rail Rate Regulation,” by John W. Mayo and Robert D. Willig. November 2018. SSRN #3286211.

When *Regulation* first appeared in 1977, the term “regulation” mainly referred to price and entry controls enacted with the intention of mitigating expected consumer harm in markets whose firms have large economies of scale and scope. The poster child for this was railroad regulation. Accordingly, when this type of regulation was shown to often harm consumer interests, railroads became one of the first candidates for deregulation.

The Staggers Act of 1980 largely, but not completely, deregulated the pricing of freight rail services. On the 30th anniversary of the Staggers Act, *Regulation* published two articles on how the industry flourished following deregulation and what issues remained. (See “The Staggers Act, 30 Years Later,” and “Railroad Performance Under the Staggers Act,” Winter 2010–2011.)

We are now nearing the 40th anniversary of the Staggers Act. This paper reminds us of the fundamental economics of industries with economies of scale and scope and how that economics informs the residual rate regulation that remains for freight railroads.

The authors of this paper state the fundamental economic problem clearly:

It is impossible to allocate, in any nonarbitrary way, a share of fixed and common costs to any one of a railroad’s many activities. There is simply no way to subdivide those costs in a mechanical fashion that is unique and has any foundation in economic logic. The significance of this problem is much magnified by the fact that a substantial share of total railroad costs is fixed and common. In addition, if the regulator attempts to force rates to equal marginal costs, overall revenues will endemically fall short of overall costs. For rail systems that are characterized by scale and scope economies, rates must generally lie above the costs economically attributable to individual services if the firm’s revenues are to cover its total costs.

...Compensatory rates cannot be determined by the regulator on the basis of cost data alone since the financial viability of any price depends also on the quantity of rail services customers are willing to buy at that price. Rational determination of prices must be based on both cost and demand conditions.

The authors go on to demonstrate the folly of two “mechanical” methods of allocating fixed costs among consumers: equal

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division (dividing total fixed costs by the number of shipments) or constant percentage markup above marginal costs. Both methods would drive away users that value the service at more than the marginal costs they impose but less than their share of fixed costs under the “mechanical” sharing rules and increase costs on the remaining customers. No one benefits from this type of pricing.

The Staggers Act retains federal rate-setting authority for so-called captive customers (those who have no shipping choices other than one railroad) who pay more than 80% above variable cost. The authors argue that the appropriate regulatory fallback for the captive shipper is stand-alone cost pricing, i.e., the long-run costs of the shared common portion of the railroad plus the long-run costs of the shipper-specific line.

Health Policy

“The Effect of Health Insurance on Mortality: Power Analysis and What We Can Learn from the Affordable Care Act Coverage Expansions,” by Bernard Black, Alex Hollingsworth, Leticia Nunes, and Kosali Simon. February 2019. NBER #25568.

How should we evaluate health insurance policy initiatives? One obvious metric is whether increases in the population covered by health insurance reduce mortality. Studies of important policy initiatives like the introduction of Medicare and the Oregon Medicaid expansion as well as the RAND Health Insurance experiment found no statistically significant effects on mortality. Those who oppose government-funded health insurance expansions cite such evidence in their criticism.

This paper evaluates the expansion of health insurance under the Affordable Care Act (ACA) and comes to similar no-effect conclusions. But the authors argue that the problem is not the real effect of the policy but the inability of any plausible research design to distinguish any mortality effect from no effect. To be able to detect an effect on mortality, the affected population must be reasonably large relative to the already insured population and the reduction in mortality also must be reasonably large. Neither is likely to be true.

Suppose first that out of 100,000 individuals aged 55–64 (those most likely to die and thus benefit from ACA coverage), half became newly insured because of ACA subsidies. The annual mortality rate in this group is around 600 per 100,000. If insurance were to reduce the probability of death by 25% among the newly insured, then insuring 50,000 individuals among 100,000 individuals would reduce the expected number of annual deaths by 75 ($0.5 \times 0.25 \times 600$) to 525. If mortality events are independent, the expected standard deviation of mortality per 100,000 persons would be around 24 and the expected *t*-statistic would be 3.07. Such a decrease in mortality would be easily discernible in the

data with 95% confidence, which requires a t -statistic of only 1.96.

But the average increase in health insurance coverage attributable to Medicaid expansion over 2014–2016 was only around 1.1% for persons aged 50–64, and only around 4% for low-educated populations. Further, a 25% mortality reduction, as in the example above, would be extraordinary. The introduction of sulfa antibiotic drugs in the 1930s, by comparison, reduced maternal mortality by 24–36%.

If the increase in the insured population is only 5% (much greater than the actual 1.1%), and the mortality reduction for the newly insured is 10% instead of 25%, the expected population average treatment effect would be a reduction in the mortality rate of 3 ($0.05 \times 0.1 \times 600$) to 597. The standard deviation in the number of expected deaths would remain the same, so the expected t -statistic would be 0.11. According to the authors, to increase the t -statistic by a factor of 20 to 2.2, one would need a sample 400 times as large: 40 million people.

Such a study is not feasible, so the use of decreases in mortality to evaluate the effects of policies to increase the number of those with health insurance is also not feasible. Thus, the rationale for increasing the use of health insurance through public subsidies cannot be because such a policy saves lives. We never could tell whether the policy saved lives.

Bank Regulation

“The Impact of the Durbin Amendment on Banks, Merchants, and Consumers,” by Vladimir Mukharlyamov and Natasha Sarin. February 2019. SSRN #3328579.

“How Do Capital Requirements Affect Loan Rates? Evidence from High Volatility Commercial Real Estate,” by David Glancy and Robert Kurtzman. November 2018. SSRN #3289453.

The Durbin Amendment, a late addition to the Senate version of the 2010 Dodd–Frank financial reform legislation, passed without hearings or debate in May 2010 and became part of the final legislation. It directs the Federal Reserve to promulgate a rule to ensure that fees for debit transactions be “reasonable and proportional” to the actual cost incurred by the bank. The final Fed rule on this provision capped debit card fees (charged to merchants by banks with assets above \$10 billion) at 22¢ plus 0.05% of the transaction amount. For banks above the asset threshold, debit card fees on an average transaction of \$38 fell from 43¢ to 24¢ (exactly the maximum Durbin allows: $22¢ + 0.05\% \times \$38$). Fees for banks below the \$10 billion threshold went unchanged—still 43¢. The result is a decrease of \$6.5 billion in revenue annually for the affected banks (25% of their total debit card fee revenue).

In the first of these two working papers, the authors conclude that large banks affected by the debit-fee rule totally offset their \$6.5 billion loss by charging higher checking account fees. Monthly maintenance fees on checking accounts doubled, decreasing the share of consumers with free checking accounts from 60% to 20%.

Did consumers at least benefit from merchants passing on the debit card fee reductions? The authors examined gasoline sales data from 65,000 stations in 10 states for the six months prior to and after the implementation of the debit-fee limit. Gas stations saved an average 0.76¢ per gallon. The paper compares retail gasoline profit margins in those ZIP codes with a large reduction (top decile) in debit card fees (34%) with identical ZIP codes (in terms of income, population density, and gas station density) with a low reduction (bottom decile) in fees (3.6%). The comparison found no difference in retail margins. The same comparison was performed on top-quarter and bottom-quarter and above- and below-median debit-fee reduction ZIP codes. Again, no difference in retail margins was found. So, in general, gasoline stations did not pass on their cost savings to consumers.

But gas stations did have lower margins in certain specific circumstances: in ZIP codes in which debit card usage relative to combined debit and credit card use was above the median. And in those high-debit-card-use ZIP codes, the pass-through to consumers was larger in ZIP codes with more competition (above the median number of gas stations per capita).

So, in general, merchants gained from the rule. Banks offset their losses with increased checking account fee revenue. Consumers, particularly low-income consumers, lost out through increased checking account fees and a decrease in free checking accounts after balance requirements increased dramatically, which led some lower-income consumers to become unbanked.

The second of these two working papers concerns shareholder equity in banks. The failure of financial firms during the Great Recession of 2008–2009 led many academics to recommend more equity and less debt in the capital structure of banks. In times of reduced loan repayment, equity owners of banks would lose their money, but as long as equity exceeds loan losses, the bank survives.

Previously in these pages, I described the work of Anat Admati (“Working Papers: Bank Capital Requirements,” Winter 2010–2011), who argues that regulatory mandates for more shareholder equity would allow banks to survive bad times. According to Admati, “Increasing equity requirements would reduce the cost to society of having a fragile and inefficient financial system where banks and other financial institutions borrow excessively, and thus it would be highly beneficial.”

The authors of this paper studied the increase in commercial real estate construction loan capital requirements from 8% to 12% in 2015. They found an increase in loan rates of 38 basis points (0.38%) relative to a baseline median interest rate of 3%, a 13% increase. The increase is not observed in construction loans not affected by the regulatory change. This increase is not the result of a change in the risk composition of borrowers, but rather an overall decline in construction loan risk-taking. This, in turn, keeps some construction projects from happening.

Increased capital requirements increase bank stability, but this benefit is not free. R