
In Review

Grow Your Pie and Eat It Too

REVIEWED BY IKE BRANNON

**The Politics of Abundance:
How Technology Can Fix the Budget,
Revive the American Dream,
and Establish Obama's Legacy**

By Reed Hundt and Blair Levin

101 pages; Odyssey Editions, 2012

A golden rule of politics is to never solve a problem until the voters are aware of it or else no one will get any credit. The \$64 question is whether the majority of voters realize that the lack of U.S. economic growth is a problem we need our politicians to address.

I'm not sure we're there yet. People know only that the current lack of jobs is a problem—or at least those without one know it. As a result, the politicians and pundits have been touting any number of ostensible job creation plans, most of which involve government spending (or “investing”) in various favored industries or in “infrastructure.” The quotation marks indicate the dubious nature of such plans, as well as the very notion that government spending can goose an economy like our own.

Throwing more government money into the economy is not a growth plan; it's a short-term fiscal stimulus that won't do much to boost aggregate demand and will do even less to make the economy more productive. And productivity is what economists mean when they talk about growth.

The arrival of a book by two prominent, rock-ribbed liberal Democrats insisting that the lack of economic growth is a problem suggests that the tepid economic

IKE BRANNON is director of research at the R Street Institute.

gains we've seen in the last four years are beginning to be noticed. Since the advent of the George W. Bush administration, liberals have been ambivalent to the notion that economic growth should be a top priority of government policy, insisting that the benefits of growth mainly accrue to the wealthy, that standards of living for the middle class have scarcely budged over the top few decades, and as a result focusing more attention to policies that redistribute wealth rather than create it. The notion that life hasn't materially improved for the middle class over the past three or four decades—which a number of reputable economic papers purport to show—is absurd, as anyone who can harken back to the days of Country Squire station wagons and AM radio can readily attest. Still, this meme has been a talking point for a goodly portion of Democratic politicians and liberal pundits for some time.

Reed Hundt and Blair Levin are not exactly politicians, but they have toiled in the upper regions of Democratic policy circles for the past two decades, so people pay attention to what they have to say. Hundt was a Federal Communications Commission member in the first Clinton term and helped to engineer a major reform of telecommunications law to nurture the Internet. Levin was his chief of staff at the FCC; more recently he helped author a major FCC study that laid out a broad framework for the next telecom reform—a paper that was well-received by wonks on both sides of the aisle, making it a rather remarkable

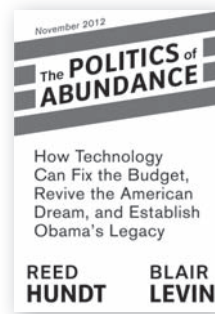
threading of the political needle. However, the apparatchiks of the Democratic Party found portions of the study repellant, especially the section that suggested the heretical view that a small fraction of American households without access to broadband simply cannot be connected in anything approaching a cost-effective way and, therefore, the government shouldn't spend tens of billions of dollars to subsidize them.

It's a heresy that represents a hurdle to Levin becoming the next chair of the FCC, a spot for which he is eminently qualified and would be far better than the alternatives being bandied about. So one way to read this book is as an attempt to remind the Democrats in the White House (and Senate) that Levin played an important

role in ushering in the telecom revolution, which worked out well for the country (and the Clinton administration to boot, as well as every politician who's passed the hat in Silicon Valley looking for campaign contributions).

Of course, the parties have changed since the 1990s, and being a Clintonista—just like being an alum of the George H.W. Bush administration—risks tarring a person as being too centrist to be politically viable. So a cynic might see this book as a way for Levin to re-establish his liberal bona fides.

Investment problem | The book generally has the right diagnosis of what ails our economy: growth is low because investment is low; our tax system is inane; and we need to encourage more investment, especially in the energy and tech arenas. The U.S. tax code treats investment (and investment income) unduly harshly, especially compared to European countries. It does the same for income earned by U.S. firms with foreign operations, which covers all of our major tech-



nology and manufacturing firms.

The authors tend to gloss over the tax problem, which is fine—they're tech guys. Instead, they approach the investment shortfall from another angle, which invariably involves government "investments" of one sort or another. Some of them I like; for instance, I too am a fan of using prizes to incentivize private activities with potential public benefits. However, using it to encourage communities to raise "complementary private investment" to create a broadband service faster than what they currently have is not terribly compelling. Why would this work better than competition between the cable carrier and the phone carrier? It's not clear.

Hundt and Levin do make proposals involving minor government costs that do make a lot of sense. They suggest the federal government make sure there are no barriers that prevent doing telemedicine across state lines, for instance, and that the digitization of medical records be accompanied with a collection of anonymous data in the "medical cloud" that would be made available to any researcher who requests it, which ought to accelerate the ability of scientists to discern the efficacy and safety of various drugs. But for the most part, their book contains a laundry list of "investments" that the federal government needs to make. At the risk of sounding like a generic libertarian, anyone who believes that the government can do a better job than the private sector in borrowing billions of dollars and hastening renewable energy or improving broadband has a faith in government that is far superior to mine.

There's also a tendency for the authors to lapse into cliché. They invoke the "race to the moon" analogy in a couple of different places, and inform us that government must be "of the people and by the people"—boldly challenging readers who yearn for absolute dictatorship, I suppose. Elsewhere, they claim that building the "knowledge and power platform" is one of the most potentially important events in our history, stating gravely that "only Franklin Roosevelt, Abraham Lincoln, and George Washington ever had a chance to lead the country in such a noble task." To equate it with existential threats seems

a bit much to me, but maybe they'll be proven right in another century.

There's more hyperbole. At one point they explain that new technology to capture carbon is important and worth public investment because if our atmosphere were to reach total global carbon emissions above 565 gigatons, we would reach a point of "irreversible calamity." They support that claim with a confusing explanation in a reference to an International Energy Agency publication that didn't appear to contain anything nearly that hyperbolic.

Quibbles aside, *The Politics of Abundance* matters because it represents an attempt by two reputable people on the political left to engage in a dialogue on how to return to the robust economic growth we saw in the 1990s and part of the 2000s, and to talk about it without merely rehashing Keynesian economics. In other words, they are actually thinking about supply-side issues and not demand-side stimulus.

They're also spot-on in identifying where our economy seems to be lagging in investment and productivity, namely the technology and energy sectors, which tend to be capital-intensive industries. And they do make a case that's hard to dispute for why improving our national grid should be a priority, and that it will be tough to accomplish without government involvement of some sort.

At times, conservatives can be maddeningly vague and off-the-mark in their discussions of economic growth (just like their liberal opponents). For instance, much of what's been written on "tax reform" blithely assumes that investment incentives are just as evil as any other tax expenditure. Now that someone on the left is willing to get specific on what might constitute a Democratic plan to boost productivity, maybe the right can begin to debate amongst themselves—and then with Hundt and Levin—about how to accomplish that. **R**

The State and the Wheelbarrow

REVIEWED BY PIERRE LEMIEUX

.....

The Clash of Economic Ideas: The Great Policy Debates and Experiments of the Last Hundred Years

By Lawrence H. White

428 pages; Cambridge University Press,
2012

.....

Larry White's latest book, *The Clash of Economic Ideas*, is two books in one: it reviews important economic events of the past hundred years (with a focus on the United States and the United Kingdom), and chronicles the development of related economic ideas from Adam Smith to our times. It aims to "trace the connections running from historical events to debates among economists, and from economic

.....

PIERRE LEMIEUX is an economist affiliated with the Department of Management Sciences of the Université du Québec en Outaouais. He is the author of *The Public Debt Problem: A Comprehensive Guide* (Palgrave Macmillan, 2013).

ideas to major policy experiments." An ambitious project, to say the least!

White, a professor of economics at George Mason University, shows how the world turned away from the laissez-faire experiment after World War I, and how the New Deal put another nail in the coffin of capitalism. For a long time we have been living in societies not remotely identifiable as laissez-faire. Friedrich Hayek, a future Nobel economics prizewinner (1974), observed in 1935 that "[w]e are certainly as far from capitalism in its pure form as we are from any system of central planning." "The world today," he added, "is just interventionist chaos."

End of laissez-faire | Many will be surprised to discover how, by the time of the New Deal and even before World War I, mainstream economists had come to embrace heavy state intervention in the

economy. In the late 19th century, classical economist John Stuart Mill and economist-philosopher Henry Sidgwick “came to regard an increasing number of activities as exceptions to *laissez-faire*.” Jeremy Bentham had already provided them with good utilitarian tools for that purpose. Alfred Marshall, founder of the neoclassical school of economics and probably the most important economist of his time, wrote in 1907 that “[e]conomists generally desire increased intensity of State activities for social amelioration,” even if “they are opposed to that vast extension of State activities which is desired by Collectivists.”

The Clash of Economic Ideas is full of telling quotes and stories. The American Economic Association was founded in 1885 by anti-*laissez-faire* economists inspired by German socialists. Their leader, Johns Hopkins University’s Richard Ely, argued that “[a]ll the great instruments of production, like telegraphs, telephones, railways, forests, arable lands, and large manufacturing plants, must become collective property.” However, he added reassuringly, “socialism does not imply that it is necessary to restrict individuals in the acquisition of the instruments of production on a small scale—for example, a wheelbarrow or a cart.” As the reader will discover later in White’s book, state planning is not really more sophisticated than a wheelbarrow.

Another famous economist of the early 20th century, Yale University’s Irving Fisher, wrote in 1907 an article titled “Why Has the Doctrine of *Laissez Faire* Been Abandoned?” A defender of eugenics and an advocate of Prohibition, Fisher hailed “the change from extreme *laissez faire* doctrines of the classical economists to the modern doctrines of governmental regulation and social control.”

We tend to forget how statist American intellectuals were during the Progressive Era. By 1921, philosopher and economist Thorstein Veblen, author of the well-known *The Theory of the Leisure Class* (1899), was arguing that the economy would be more efficient if run by a “Soviet of Engineers.”

By the time of the Great Depression, *laissez-faire* had been abandoned by both theorists and policymakers. “[L]aissez-faire

is dead,” wrote in 1939 Rexford Guy Tugwell, a Columbia University professor who had joined the Roosevelt administration. In a 1932 article, “The Principle of Planning and the Institution of *Laissez Faire*,” Tugwell had already argued that “order and reason”—that is, planning—“are superior to adventurous competition.”

When, in 1936, John Maynard Keynes published *The General Theory of Employment, Interest, and Money*, he was sowing an already fertilized soil. Keynes argued that government intervention had to boost consumption to correct and prevent crises of overproduction such as (he claimed) the Great Depression. White shows instead how the Great Depression was a result of government failure, not of market failure, and how the New Deal accumulated government failure after government failure. But Keynes’s influential book provided an a-posteriori rationalization for the New Deal and a justification for the economic fine-tuning that was to characterize fiscal and monetary policy for several decades afterward.

Although he was not a communist, Keynes believed, as White puts it, that “[a]n enlightened government should take control.” In 1926, Keynes had published a monograph titled *The End of Laissez-Faire*. By the time the *General Theory* appeared, many leading economists, including free-market economists at the University of Chicago, had proposed government spending and public works programs to counter the Great Depression. In other words, Keynes only represented the spirit of the times, though perhaps with a vengeance.

World War II marked another big step in government intervention: as Randolph Bourne said, war is the health of the state. After the war, and even though most wartime controls were finally abolished, it was now generally believed that dirigisme was good. This was especially obvious in the UK and other European countries, but the trend was also glaring in America.

Heydays of planning | Oh, how hubristic were the times from the 1950s to the 1970s! Economic planning was seen as

simply the use of reason in human affairs. An academic in good standing had to be more or less socialist. A non-socialist intellectual was nearly an oxymoron. Many academics and intellectuals supported Soviet communism, often even after Stalinist violence had been revealed.

Although they tended to be more critical, economists generally believed in their enlightened capacity to plan the whole economy, to put society on its production possibility frontier as shown in textbook graphs. The zeitgeist is captured by White’s prose nearly as intimately as with a smart-phone camera. Supporters of central planning assumed, as White puts it, “that the production functions can be found in an engineering manual available to the central administrators.”

Ragnar Frisch, a Norwegian econometrician and a darling of the times who was to share the first Nobel Prize in economics, thought that the Soviet Union was overtaking the West. Paul Samuelson, winner of the second Nobel Prize in economics, wrote in his famous introductory textbook *Economics* as late as 1989, “The Soviet economy is proof that, contrary to what many skeptics had earlier believed, a socialist command economy can function and even thrive.”

Perhaps nowhere more than in the field of development economics did the infatuation with planning wreak havoc. John Kenneth Galbraith, the Harvard professor and popular economist, wrote in 1962 that in the developing countries, “the word planning has ceased to be controversial.” “The country which does not have goals, and a program for reaching these goals, is commonly assumed to be going nowhere,” the learned professor pontificated. “This may well be so,” he nodded. In the 1950s, Galbraith brought the gospel of planning to India. After three decades of this regime, White notes, India’s real personal incomes had fallen from three-fifths of South Korea’s to less than one fifth.

Planning advocates realized that much regulation would be required. Tugwell wrote that “[n]ew industries will not just happen as the automobile industry did; they



will have to be foreseen, to be argued for ... before they can be entered upon.” Imagine Steve Jobs arguing for personal computers before the Central Planning Bureau, or Mark Zuckerberg pitching social networks to a congressional committee!

The planning elite would naturally substitute their own preferences to the Plebs’. Maurice Dobb, a famous Marxian economist at Cambridge University, later declared: “Few, surely, could seriously maintain that the amount and sort of music to be played by the BBC should be decided by a market mechanism.”

Challenges to orthodoxy | As Leviathan was growing uncontrollably, several currents of economic thought played contrarian. The Austrian school of economics, born in late 19th century Vienna, started early. From the 1920s on, it was represented by economists Ludwig von Mises and Friedrich Hayek. After World War II, neoclassical economists also became more critical of the accepted statist wisdom, often returning to the insights of Adam Smith and other classical economists. White brilliantly reviews the development of these countercurrents.

As early as the 1920s and 1930s, Mises and Hayek argued that efficient planning is impossible. Planning an economy requires a quantity of information that the planners cannot possess. The problem is not mainly one of computation, but lies in the dispersion, across individual minds, of local knowledge about preferences and costs. This practical knowledge is inaccessible to planners. Only a freely functioning price system can incorporate such information in price signals so that inputs are used efficiently to serve consumer demand. It took much time for mainstream economists to become persuaded of this.

The most enlightened socialists later confessed that Mises and Hayek had won what came to be known as the socialist calculation debate: “It turns out, of course, that Mises was right,” graciously admitted economist Robert Heilbroner after the collapse of the Soviet Union.

Peter Bauer was among the first economists to challenge statist models of development. Today, more economists have

realized, in the spirit of Adam Smith, that economic growth depends on suitable institutions that protect private property and foster enterprise.

When Richard Nixon declared in 1973, “I am now a Keynesian in economics,” he was riding the last wave of Keynes’s macroeconomics tsunami. During that very decade, Keynesianism was battered by the unexplainable coexistence of inflation and unemployment while budget deficits soared. The Austrian theory of the business cycle provided an alternative explanation, but never really caught on. It was left to monetarism to successfully challenge the reigning monetary and fiscal orthodoxy.

At the forefront of this challenge was Milton Friedman, who reformulated and improved the quantity theory of money. He won the 1976 Nobel Prize in economics for his work in monetary economics and related advances in economic theory. Friedman showed that monetary policy was mainly effective in creating inflation, while being incapable of solving unemployment problems. Although he opposed discretionary monetary policy, he did not believe in the fixed exchange rates implied by a gold standard.

White provides masterful explanations of the differences between Keynesianism, the Austrian school, and monetarism. He also discusses more recent debates and macroeconomic theories. He is especially strong in his field of specialty: monetary theory and history. If you want a crash course in monetary economics, this is the book to read.

As White shows, much is wrong with the conventional wisdom that assumes the necessity of a central bank. In fact, private issuance of money could work, and did work in a few historical instances. White explains how a system based on metallic money is a self-regulating order, and how fiat money has historically led to higher inflation. He also shows how, even within the Austrian school of economics (of which he is one of the main contemporary theorists), different and often conflicting theories coexist—on the role of gold, for example.

One chapter of *The Clash of Economic Ideas* is devoted to public goods and Public Choice. Launched by James Buchanan

(winner of the economics Nobel Prize in 1986) and Gordon Tullock, Public Choice theory was the latest (and perhaps the most devastating) attack on the economic orthodoxy that reigned during most of the 20th century. Public Choice economics shows how government is intrinsically incapable of solving the problem of public goods, if only because the very nature of these goods makes the revelation of individual preferences as opaque to government as to the market. More generally, it is not in the interest of politicians and bureaucrats to promote Pareto optimality. All these concepts are beautifully explained by White.

Role of the state | *The Clash of Economic Ideas* reviews many other economic issues: how the market is a continual bidding process; how trade protectionism is like dumping rocks in your own harbors in order to counter some other government doing so in its own country’s harbors; how goods take their values not from the labor expended in making them, but from the preferences of consumers; what is dead-weight loss; what is Ricardo’s rent; what is the land tax proposed by Henry George; how bimetallism cannot work; how deficit spending is not a free lunch; what Ricardian equivalence means; and so on.

White is an excellent storyteller, whether he relates the “Roaring Twenties” and the following crash, the 1944 Bretton Woods accords, or any of the numerous historical episodes that run through *The Clash of Economic Ideas*. The book is full of interesting factoids: how the abolition of price controls in occupied Germany led to an almost overnight disappearance of queues; how the annual *Federal Register* grew from 2,060 pages in 1936 to more than 80,000 pages in 2010; and so forth.

Economic humor is finely distilled. For example, White recalls how, in an episode of the libertarian-tinged animated series *South Park*, a family bought on credit a \$200 Margaritaville blender it could not afford. This imprudence, he points out, is nothing compared to the 400 Margaritaville blenders that the federal debt represents for each American household.

Have economists learned anything? Do they agree on anything? Yes, suggests White,

if we consider our positive understanding of the social world. But disagreement over policy issues remains intense, partly because they involve normative issues.

The major normative issues in both economics and political philosophy relate to the role of the state. White illustrates again and again how “[t]he key insight of economics ... is that, under the right conditions, an economic order arises without central design that effectively serves the ends of its participants.” The implication that the role of the state should be maintained at a minimum is very convincing, but ultimately rests on values that lie outside the scope of science. Yet, economics can help by tracing the likely consequences of state intervention. If you really want smartphones instead of wheelbarrows, don’t ask a state committee to plan their production.

White approaches all these issues with an inquiring and open mind, which is not always the most striking feature of libertarian theorizing. (In writing this, I am not

casting a stone at anybody, since I have myself sinned earlier in my career.)

What is the relative impact of debates over ideas as opposed to competing interests? Sometimes, White seems to argue, ideas shape events as Keynes suggested; in other cases, as economist Vilfredo Pareto would have it, interests rule and ideas just follow. It is fascinating to watch the entanglement of economic events and ideas as described by White. *The Clash of Ideas* certainly brilliantly fulfills its promise to trace these connections.

For the reader with an elementary background in economics (like an undergraduate course in microeconomics and one in macroeconomics), this book provides an entry into the next stage: the fascinating intellectual adventure that justifies learning elementary economics in the first place. The more seasoned economist will find *The Clash of Economic Ideas* an exciting reminder of what he has learned, or should have learned better. R

ideas and their political applications, from the interwar years to the late 1990s, and even the Great Recession of 2008–2009. Jones’s command of political and intellectual history in both the United States and the United Kingdom (his double focus) appears impressive.

Mises’s ideas are the furthest to the “left” of this libertarian spectrum that Jones will entertain, even if he does mention a few more radical thinkers. Some links are missing in his story, but the reader might be satisfied that he chronicles “mainstream” libertarianism, the variety that has had political influence. The book is well-written, the historical details are entertaining, and the reader is ready to forgive many of the author’s venial sins.

Development of neoliberalism | The book traces the origins of neoliberalism and its label to a 1938 Paris meeting attended by Hayek, Mises, and a mix of Europeans that included German “ordoliberals” and French classical liberals. According to Jones, the participants were keen to avoid laissez-faire and wanted instead to “reformulate liberalism to address the concerns of the 1930s.” This group would later evolve into the Mont Pelerin Society, officially founded by Hayek in 1947. Over the following decades, the neoliberals would both drop their original label and become radicalized under the influence of the new, more radical Chicago school of economics, and of a more radical Hayek.

During this second phase of neoliberalism (from 1950 to around 1980), a transatlantic network of think tanks spread libertarian ideas, as Hayek had called for in his 1949 *University of Chicago Law Review* article “The Intellectuals and Socialism.” Jones emphasizes the importance of ideas and

the crucial role that think tanks played in disseminating them.

However, he argues, libertarian ideas gained political currency only because a series of disruptive economic events prompted political leaders and the public to look for new ideas: the oil crises of the 1970s, mounting inflation and unem-

Digging Hard for the Public Sphere

REVIEWED BY PIERRE LEMIEUX

Masters of the Universe: Hayek, Friedman, and the Birth of Neoliberal Politics

By Daniel Stedman Jones

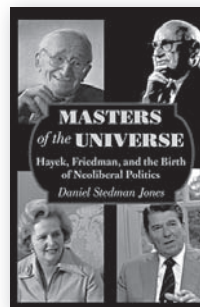
418 pages; Princeton University Press, 2012

“Neoliberalism transformed British, American, and global politics,” argues Daniel Stedman Jones in *Masters of the Universe*. “At the dawn of the twenty-first century, the triumph of the free market was almost universally accepted by mainstream politicians, public officials, and civil servants.” The pictures of Friedrich Hayek, Milton Friedman, Margaret

Thatcher, and Ronald Reagan adorn the book jacket.

But what is “neoliberalism”? Jones tells us it is a “free market ideology based on individual liberty and limited government,” a “radical form of individualism,” a “boundless belief in markets and deregulation.” Besides Hayek and Friedman, we are soon introduced to Ludwig von Mises, George Stigler, James Buchanan, Gordon Tullock, and others. “Neoliberalism” is nothing but what Americans call libertarianism.

Never mind the hint of sarcasm you might imagine in the “boundless belief,” for *Masters of the Universe* is meant to be an academic book, authored by an Oxford Ph.D. in history who is now a London barrister. The reader will start reading this book as a fascinating history of



PIERRE LEMIEUX is an economist affiliated with the Department of Management Sciences of the Université du Québec en Outaouais. He is the author of *The Public Debt Problem: A Comprehensive Guide* (Palgrave Macmillan, 2013).

ployment, and the observed impotence of Keynesian fine-tuning. Both the Democratic Party in the United States and the Labour Party in the UK had started moving toward Friedman's monetarism and the necessity of reining in regulation and trade union power (following the criticisms of the Chicago and Public Choice schools). The world had become ready to welcome Thatcher and Reagan.

Triumph of neoliberalism? | By the time Thatcher and Reagan were elected (1979 and 1980 respectively), Jones tells us, neoliberalism had become generally accepted, had already started influencing politics, and was ready to achieve its more radical goals. In fact, the movement was so strong that it would continue to exert influence after the two political leaders left office.

As the book unfolds, doubts about the author's interpretation of events grow. Is it true that neoliberalism was generally accepted by the early 1980s and that "it reigned supreme" by 1984? (Remember that neoliberalism is libertarianism, even if only the more "establishment" version of it.) Is it true that it ended up influencing even Bill Clinton and Barack Obama? Most libertarians would express serious doubts, even if the elections of Reagan and Thatcher did raise hopes.

It is striking how little Thatcher and Reagan actually accomplished in moving their respective countries toward more libertarian policies. I once read a British libertarian who perceptively noted that Thatcher had succeeded in turning a semi-bankrupt mixed economy into an efficient police state. Neither Thatcher nor Reagan took seriously the individual-liberty component of the libertarian philosophy. When Jones claims that the "neoliberals" (including Hayek before the 1950s) wanted a "limited but strong government," he must not be talking about libertarians anymore.

Both in the United States and the UK, the regulation of business and everyday life continued to advance, even if its growth may have experienced a short pause in certain limited areas. Jones's statement that, after Jimmy Carter, the "ripple of deregulation would turn into a tidal wave that washed away controls from large segments

of the economy"—"relentless deregulation," he describes it—is not far from the exact opposite of the truth. As for fiscal policy under Reagan, total *non-defense* federal spending increased by 61 percent (and defense spending increased 93 percent) during his administration, most of which went to entitlements and social programs. Jones is not very loquacious about this, prudishly mentioning only that "government spending proved tenacious over the entire postwar period." He also notes that the neoliberal policy experiments "had decidedly mixed short-term results even on neoliberal terms," though many of the policies he contemplates are decidedly non-libertarian.

Puzzles | Jones's most baffling claims appear in Chapter 7, the final chapter before the concluding one. Its title seems to ask a question: "Neoliberalism Applied?"—but it deals only with housing and urban policy. (Interestingly, the running title in the chapter drops the question mark.) The double thesis of Chapter 7 is that, in both the United States and the UK, successive governments, starting even before Reagan and Thatcher, and continuing after them, subsidized housing for the middle class and the rich, while simultaneously restricting their support for housing of the poor.

How did government subsidize housing for the middle class and the rich? The deduction of mortgage interest from the federal income tax is duly noted by Jones. Many libertarians would argue that a tax deduction is not exactly the same as a subsidy, but Jones ignores this distinction. The author of *Masters of the Universe*, however, is hunting for other ways, however indirect, in which government subsidized the "wrong" people. He finds them in strange places. The subsidized freeway system, we are told, opened the suburbs to white middle-class workers, who were thus able to leave minorities to the decaying and crime-ridden city centers. Jones also echoes historian Margaret O'Mara in arguing that federal cold war policies favored suburbanization, notably through the localization of research facilities. Perhaps. But does one have to dig so hard to find distorting housing policies?

As for restricting support of housing

for the poor, Jones argues that governments did it in two main ways. First, the thrust of public policy switched from building public housing to subsidizing private housing through the sale of council houses to their renters in the UK and through rent subsidies and rental vouchers in the United States. Secondly, local zoning regulations pushed up house and apartment prices, keeping out the people that the white middle class considered undesirable neighbors. On this second point, Jones is obviously right: zoning has been a catastrophe for access to housing. Not content with this, he throws in the "downward spiral and support for proper public transport systems."

Except for the un-politically correct neglect of public transport and the sale of public housing to the poor in the UK, these policies have little to do with libertarianism. It is true, even if Jones does not agree, that housing subsidies are better than the ghettoization of the poor in public housing projects. Yet, most libertarians would disapprove of any government subsidization of a specific consumption good. As for zoning regulations, they are opposed by virtually all libertarians. So it seems odd that Jones blames "neoliberals" for policies that they loathe.

Chapter 7 is remarkable for another reason. It broadly ignores the long-term, organized effort by the federal government to support home buying by people who could not otherwise afford it, from the New Deal's legislation to the Community Reinvestment Act in 1977 and the policies that pushed the poor to buy mortgages they could not afford. Surely, this is at least as important for housing policy as freeways and cold-war research.

Obsession with the market | If the penultimate chapter of Jones's book is puzzling, its concluding one is astonishing. It is a concentrate of all the problems of the book. All the invisible threads are pulled together with the visible ones. All biases are laid bare, and all lingering questions are answered. The big problem, argues Jones, is that neoliberalism has won, even within the Democratic Party and the Labour Party. The "beguiling belief in markets"

has destroyed the “belief in the efficacy and moral superiority of government and collective action.” The “obsession with the market” has destroyed “the public sphere.”

Seriously? For Jones, not only did neoliberalism generate the 2008–2009 economic crisis, but it is now so encrusted in common sense that it also presided over the public policies adopted to deal with the crisis. From their “fantasy world,” neoliberal economists and “Tea Party nihilists” created a crisis and adopted similarly flawed policies meant to try and fix their mess. Or so says the author of *Masters of the Universe*.

Jones sees in financial deregulation the immediate cause of the Great Recession. Like most others who have argued this point before, he is unable to give specific examples except for the abolition of the Glass Steagall Act of 1933 that prohibited universal (commercial and investment) banking. (How that contributed to the Great Recession, Jones does not explain cogently.) He is blind to the growing regulation that strangled financial institutions from the Great Depression to the Great Recession. No word on the 11-fold increase in the real-dollar budgets of the main federal financial regulatory agencies between 1960 and 2007. Before the 2007–2009 crisis, for example, the New York Fed had hundreds of regulating bureaucrats actually working on the premises of large banks. (On the Great Recession, see my *Somebody in Charge: A Solution to Recessions*, Palgrave Macmillan, 2011.)

To be fair, Jones does devote one whole paragraph (finally, in the conclusion of the book!) to the fueling of risky mortgages by U.S. federal policies, which included coercing banks into lending to risky clients through the Community Reinvestment Act (Jones gets the act’s date wrong). He is prudent, though, using weasel words like “it is alleged” and “it was suggested.” He glosses over the fact that the main public institutions in the failed mortgage policies were old-timers that date back to the New Deal. He obviously ignores that Ginnie Mae, a federal housing agency created in 1968, was itself at the origin of mortgage-backed securities. The agency still boasts about it on its website: “Ginnie Mae ... revolutionized the American housing indus-

try in 1970 by pioneering the issuance of mortgage-backed securities.”

On what planet does the author of *Masters of the Universe* live? Does he know much about Sen. Chris Dodd and Rep. Barney Frank, who figured among the artisans of anti-libertarian housing policies? In 2004, Dodd defended Fannie Mae and Freddie Mac as “one of the great success stories of our time.” In 2003, Frank said that he wanted “to roll the dice a little bit more ... towards subsidizing housing.” Obviously, Jones could not have fit these facts with the same two politicians intensifying financial regulation still more with their 2010 Dodd-Frank Act. Anyway, since all this occurred in the “public sphere,” it must be good.

Jones is right to claim that blind “faith” and biases are dangerous. He has a point when he suggests that many libertarians didn’t, and don’t, guard themselves enough against that danger. But he is totally blind to the facts that contradict his own thesis. He sees “market failure” everywhere, but is rather discreet about government failure.

Masters of the Universe is a very disappointing book. It completely misses a crucial development of the past half century, which is the continuous growth of Leviathan. Jones attributes to libertarian ideas the responsibility for what Leviathan actually did against them. Perhaps he is just trying to re-establish the “moral superiority of government”? R

Encouraging Joblessness

REVIEWED BY DAVID R. HENDERSON

The Redistribution Recession: How Labor Market Distortions Contracted the Economy

By Casey Mulligan

368 pages; Oxford University Press, 2012

Casey Mulligan’s cleverly titled book *The Redistribution Recession* could have been one of the most important economics books of 2012. It makes the case that a major reason U.S. employment has been so low in the last few years is that, during the recent recession, the welfare state became so large. Specifically, Presidents George W. Bush and Barack Obama expanded the food stamp, unemployment insurance, and other programs that made it less worthwhile for people—especially lower-income people—to work. If you were on such programs and started working, you lost benefits—some, such as unemployment insurance, in total, and others, such as food stamps, in part. The result was

.....
DAVID R. HENDERSON is a research fellow with the Hoover Institution and an associate professor of economics at the Graduate School of Business and Public Policy at the Naval Postgraduate School in Monterey, Calif. He is the editor of *The Concise Encyclopedia of Economics* (Liberty Fund, 2008). He blogs at www.econlog.econlib.org.

what economists call “high implicit marginal tax rates.” For every dollar earned, you not only paid payroll taxes, but also lost a fraction of the dollar in reduced government benefits. That, argues Mulligan, is a strong disincentive to work.

But a caveat to the reader: I say that the book “could have been” one of the most important economics books because, although Mulligan occasionally writes well and clearly, much of the book is too technical and hard to follow. Ph.D. economists who are up to speed on highly technical issues *might* be able to zip through the book; however, even though I’m a Ph.D. economist, I found it hard slogging. There are parts of the book that appear to be important, but the way it is written obscures—rather than reveals—Mulligan’s meaning. Typical readers of *Regulation* are probably better off reading my review of Mulligan’s book than reading the book itself.

So, first, I’ll tell his story and some of his important conclusions, and then I’ll discuss how he deals with some Keynesian criticisms of his conclusions.

Expanded welfare state | Consider the food stamp program, which is now called the Supplemental Nutrition Assistance

Program (SNAP). Between 2007 and 2010, notes Mulligan, the number of families with income below 125 percent of the federal poverty guideline increased by about 16 percent. But during that time, he writes, “the number of households receiving SNAP benefits increased 58 percent.” Why? Because the program was changed to allow more people to qualify for it. With the Farm Bill of 2008, which President Bush signed, the government increased the maximum benefit and relaxed the asset and income tests that determine who qualifies for benefits. President Obama’s 2009 American Reinvestment and Recovery Act (ARRA) granted state governments relief from the work requirement that had previously existed in the program and also increased the maximum benefit.

Another major expansion of the welfare state was the legislated increases in unemployment insurance (UI). In the regular state-funded UI system, people who are unemployed can get benefits for up to 26 weeks, and there is an automatic benefit trigger that adds 13 weeks of eligibility for federally financed extended benefits when the unemployment rate in a state goes above a certain level. In 2008, Congress and Bush added an automatic 13 weeks to states that qualified for extended benefits. That meant that an unemployed person in one of those states could get UI benefits for 52 weeks. Later in 2008, still under Bush, the Unemployment Compensation Extension Act added 20 weeks of eligibility. With various extensions and additions, unemployed people in some states could get benefits for up to 99 weeks. That’s positively French!

In a related development for unemployed people, Obama’s ARRA paid 65 percent of the health insurance premium for people who were laid off and who wanted to keep their employer’s health plan. Previously, under a law called COBRA, laid-off employees could keep the employer’s plan, but the employer could charge them up to 102 percent of the premium that would have been charged for their policy had they stayed employed. A 65 percent cut in this premium was a big discount.



Mulligan goes through, in detail, four of the six “safety net” programs: food stamps, UI, Medicaid, and the COBRA subsidy. (The other two are a break on federal income taxes and a break on payroll taxes.) Then, for people in various income and family categories, Mulligan

derives the disincentives to work that the expansions of these programs have caused and are causing. Among six hypothetical households chosen to represent the most common households affected, Mulligan finds that the “policy impact” on a household “with an unemployed primary earner” ranged from \$227 to as much as \$2,190 per month in added disposable income for not working. He notes that these are the amounts by which the change in rules, alone, added to the disposable income of various unemployed people. Those numbers at the bottom end are substantial and at the top end are huge.

Mulligan devotes a large part of the book to estimating the portion of the drop in hours worked by U.S. workers since 2007, when the recession began, that is due to these expansions of the safety net. He writes, “I conclude that at least half, and probably more, of the drop in aggregate hours worked since 2007 would not have occurred, or at worst would have been short-lived, if the safety net had been constant.” He spends much of the book making that case, and this is where, frankly, he lost me in the technical weeds. So it is hard for me to fully evaluate his case.

Is there demand? | Mulligan realizes, though, that he must contend with an alternate claim that other economists, primarily Keynesians, have made: that the problem during the recession and subsequent weak recovery was not that people became less willing to work, but rather that employers became less eager to hire because of weak demand for their goods. Mulligan counters this claim with three sets of evidence, all of which confirm his view that labor supply is key and cast doubt on the Keynesian view that the key constraint has been the demand for labor.

First, Mulligan notes that, to the extent

that the safety net changes are responsible for the drop in hours worked, the following would result:

- Labor hours for the elderly would increase because they were not much affected by the specific safety net increases.
- Labor hours would decrease for single people more than for married people because many of the changes made it easier for single people to get government aid.
- Labor hours would decrease less in regions that had more-stable housing prices because one government program gave people who had suffered a drop in housing price an incentive to cut their income.
- Labor hours would decrease less for high-income people because they got virtually none of the added government benefits.

Mulligan presents evidence that affirms all four expectations. The Keynesian model has no such implications.

Second, notes Mulligan, if the driver of the decline in work hours was a decline in aggregate demand, one would expect a similar decrease in the use of other factors of production. But, Mulligan writes, “Output declined sufficiently less than work hours to make it appear that other production inputs (aside from work hours) tended to *increase* during the recession” (emphasis his).

Third, Mulligan looks at data on summer employment. If, as Keynesians claim, the demand for labor was the constraint, then the seasonal increase in the number of hours worked by young people in 2009, a recession year, should not have been as high as it was in normal years. But Mulligan shows that the seasonal pattern in 2009 was similar to that in prior years.

Mulligan also shows that after housing investment collapsed in 2007, investment in non-residential structures increased. This is evidence that factors of production, including labor, left one sector and went to the other. I’m not sure why he presents this evidence, though. It demonstrates labor mobility, but he seems to see it as something more—specifically, as evidence against the

Keynesian view. But most Keynesians don't seem to deny that even in a recession, labor can move between sectors. That could happen even if the Keynesians are right that wages are inflexible.

Of course, the most inflexible wage is the minimum wage because it is set by law. Mulligan points out that the minimum wage increased from \$5.15 to \$5.85 in July 2007, to \$6.55 in July 2008, and finally to \$7.25 in July 2009—a 41-percent increase. Bush had signed that phased increase into law. Because the inflation rate for those two years was very low, the real increase in the minimum wage was a whopping 36 percent over those two years. Mulligan estimates that this increase destroyed over one million jobs.

Conclusion | The good news is that some of the changes in the welfare laws were temporary; unfortunately, others were permanent. In the food stamp program, for example, the relaxation of income and asset tests under Bush is permanent, as is the increase in the maximum benefit. The easing of work requirements under Obama's ARRA, by contrast, was temporary, expiring in October 2010, and the further increase in the maximum benefit expires in November 2013. In UI, the added 13 weeks of eligibility for extended benefits that Bush and Congress passed is permanent. The Obama-granted 65 percent cut in COBRA noted above was temporary, lasting only from April 2009 to May 2010. Although Mulligan never comes out and says it—because his is not a partisan book—it appears to me that Bush's actions in this area will cause more long-run damage to employment than Obama's.

I have one remaining gnawing problem with the book's argument, though. If the decrease in work hours is due mainly to the drop in labor supply caused by an expansion of the welfare state that discourages work effort, why do so many people show up when jobs are advertised, even at Walmart? It's hard for me to believe that Mulligan's is the whole story. He has persuaded me, though, that his labor supply explanation is a significant, and largely unreported, part of the story. R

Progressivism's War on Science

REVIEWED BY GEORGE LEEF

Science Left Behind: Feel-Good Fallacies and the Rise of the Anti-Scientific Left

By Alex B. Berezow and Hank Campbell
303 pages; Public Affairs, 2012

One of the more familiar tropes of American politics is that the Left embraces science while the Right is at best ignorant about science or even hostile to it. Reporters hungry for a “gotcha” moment like to badger Republicans with questions on science, hoping for an easy story, as when, following the 2012 election, one asked Sen. Marco Rubio (R, Fla.) how old he thought the earth was. (Rubio dodged.)

In *Science Left Behind*, authors Alex Berezow (holder of a doctorate in microbiology and editor of the website RealClearScience) and Hank Campbell (founder and editor of Science 2.0, an independent science communication community) take a hard look at that trope and argue that the Left—especially its green and “progressive” elements—is even more ignorant of or hostile to science than the Right is. Because those powerful elements of the leftist coalition are so prone to anti-scientific notions, they often push for and get laws and regulations that do a great deal of harm.

To support their thesis, the authors contend that the “progressive” Left (and it's getting hard to find leftists who dare to dissent from that part of their clan) has adopted four myths:

- Everything natural is good.
- Everything unnatural is bad.
- Unchecked science and progress will destroy us.
- Scientific knowledge is merely relative—just another opinion or worldview.

Throughout the book, Berezow and Campbell show repeatedly that those

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

beliefs drive leftists to take positions for or against ideas without regard to clear scientific evidence that they will make many people worse off.

Food phobia | Food is one area where the progressive opposition to science (and actual progress) has been the most pronounced. They are infatuated with “organic” food (and pay more for it) even though it is no healthier and may be less safe than ordinary produce. That is only a costly personal choice driven by the “everything natural is good” myth, but the authors note that because organic farming is less efficient, it requires more cultivated acreage to get the same yield. Going “organic” isn't saving the planet.

Far more damaging, though, is the effect of the second myth on food issues. Opposition to anything these progressives perceive as “unnatural” leads them to obstruct scientific advances such as irradiation (which does a much better job of killing harmful pathogens in food than the most careful washing) and genetically modified (GM) crops. Progressives have blocked irradiation on the baseless ground that radiation is always bad for people, never mind that once the pests have been zapped, there is no effect on human consumers. They do their utmost to block or delay the use of GM crops with silly slogans such as, “We'll create Frankenfoods!” Berezow and Campbell show how absurd those fears are. Increasingly precise genetic modification, which has been used on a hit-or-miss basis for thousands of years as farmers have tried to breed better plants, could lead to greatly improved crops, such as “golden rice” that has the Vitamin A needed by many poor people around the globe. The progressives have used their political clout to put up regulatory obstacles to GM crops.

Energy anxiety | When it comes to energy, progressive anti-science ideas are

equally harmful. They have thrown up one ill-conceived roadblock after another in opposing nuclear power (it's not "natural" to make energy by splitting atoms), to hydroelectric power (dams are inconvenient for fish), drilling for oil (can't touch the "pristine" Arctic National Wildlife Refuge even though no one goes to that desolate littoral and hardly anything lives there), natural gas (progressives have pushed dubious horror stories about "fracking"), and even wind power (which kills birds). On the other hand, progressives (allied with agricultural interests and a few big businesses) foisted ethanol on the nation—an inefficient fuel that requires steady subsidization, drives up food prices, and even does environmental damage. A few progressives have finally admitted that ethanol is a bad idea.

The authors sum up the mindset of the progressives with regard to energy as follows: "No energy source is perfect and every energy source either poses a risk or some sort of environmental disturbance.... (P)rogressives seem to be holding out for a miracle solution—an unlimited, completely renewable, environmentally sound energy with no downsides whatsoever." Unfortunately, that childish utopianism gets in the way of energy production we need now.

Obstructing medicine | Speaking of risk, the progressives have managed to enshrine the "Precautionary Principle" into law, although much more so in Europe than the United States. This self-contradicting principle amounts to the demand that any new product or process must be proven safe before the government approves its sale or use. What's wrong with proving safety? Berezow and Campbell answer that proving anything to be completely safe "isn't just difficult—it verges on the impossible, since science can't account for every single possible exigency." That being the case, progressives who fear something new can always say, "We haven't done enough testing to be certain it's safe."

Among other examples, the precautionary mindset is responsible for prevent-

ing the introduction of new medicines that could save many lives and relieve much suffering, on the grounds that testing has not yet proven beyond all doubt that the drugs will never have any harmful effects. The Precautionary Principle fits in perfectly with the anti-science mindset of the progressives because it ignores the inevitable tradeoffs between the known risks of the status quo and the speculative risks of innovations.

Medicine has also been badly affected (maybe we should say "infected") by the anti-science mindset of the progressives. The most vociferous opponents of childhood vaccinations are found not among religious conservatives, but among left-wing elitists who have been taken in by the anti-vaccine hysteria peddled by a number of media stars. We also learn that the federal government is squandering money on an agency called the National Center for Complementary and Alternative Medicine, the legislative baby of Sen. Tom Harkin (D, Iowa). The focus of this bureaucracy is homeopathy, the

key concept of which is that "like cures like." Thus, symptoms of a disease should be treated with diluted chemicals that, if undiluted, would cause the same symptoms. The authors call it quackery and note some of the goofy research the center has funded. Progressives may not like *your* ideas about science, but they don't mind forcing you to help pay for *theirs*.

Education and journalism | Worrisome as all of that is, perhaps the most frightening topic the authors examine is the way progressivism is worming its way into our education system. In the world of higher education, progressives have sown a minefield in numerous topics, making research into them or even discussion hazardous. Science, of course, assumes that questions are always open, so it isn't surprising that the anti-science progressives reject free inquiry into matters central to their belief systems.

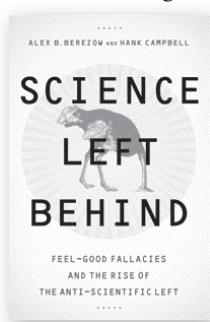
One of those matters is gender. Many ardent feminists are progressives and they have decided that the sole acceptable expla-

nation for labor market differences between men and women is discrimination. In 2005, Harvard University's then-president Larry Summers made the fatal mistake of delicately suggesting at a conference on women in science that one reason why we find more men than women in science departments might be because of the different choices men and women tend to make. For his perfectly reasonable speculation, Summers was relentlessly attacked by feminist progressives, who were later joined by a majority of the Harvard faculty in voting "no confidence" in Summers over his remark. He had stepped on a mine and was dragged off the field, a bloody mess.

Unfortunately, progressive hostility to inquiry is widespread. Berezow and Campbell write, "This problem has become so bad that some scientists are afraid to talk about their research for fear of being labeled sexist—just for pursuing certain hot-button topics." Gender is one of those topics. So is race. So is climate, unless you toe the correct alarmist line. Science is being politicized in those and other fields as progressives, who now largely control hiring and funding at universities, increasingly place boundaries around the freedom to pursue research.

Another malign impact of progressivism is on science journalism. The authors despair that Americans are losing out on what used to be a reliable, objective source of information about science as older reporters retire and are replaced by young ones who have mostly been steeped in the progressive thought-world. Those reporters are often content to write stories that do little more than repeat the press releases of the many Luddite organizations intent on pushing the "Science will destroy us!" line. Rarely do they ask any probing questions. Increasingly, when Americans read stories about science, they're reading advocacy journalism without realizing it.

Science and politics | But wait; didn't President Obama promise in his 2009 Inaugural Address that his administration would "restore science to its rightful place"? Indeed he did, but all he has accomplished, write the authors, is to replace Bush's conservative anti-science policies with progressive anti-science



policies. They offer plenty of evidence to back up that assertion.

Science Left Behind concludes with a chapter devoted to a dozen science issues the authors would like to see the country address in the future. Some of the changes they advocate will appeal to *Regulation* readers, such as managing resources efficiently, which to the authors largely entails throwing off the obstructionist policies that progressives employ. Other advocated policies are not so appealing, such as deciding on America's future in space, where the authors seem to suggest that the government needs to remain active.

The trouble with the chapter is that it is hard to see how we can make progress on any of those ideas until we somehow

negate the power of anti-science forces to throw monkey wrenches into the gears of genuine progress. The depressing takeaway from this survey is that momentum is strongly with the enemies of progress.

Above all else, the book is a plea to stop politicizing science. I couldn't agree more. Not just the United States, but the whole world is losing out on goods we could have produced, energy we could have used, innovations that would have helped people (especially poor people), and knowledge we might have acquired—all because so-called progressives keep obstructing science. Berezow and Campbell have done the world a gigantic service by demolishing the myth that the Left is pro-science. It emphatically is not. **R**

and so the economic institutions tend to work for most groups. And what are these institutions? The ones that a fan of Adam Smith might expect: respect for private property, the relative absence of government-granted privilege, and the rule of law.

You might wonder, given that their message is similar to Smith's, why Acemoglu and Robinson's book has made such a big splash. The main reason is that they give so much evidence—evidence that Smith did not have access to. Also, whereas Smith did not explain *why* some economies are extractive and some inclusive (Smith never used those terms, but he was clearly discussing the concepts), Acemoglu and Robinson try to. In the process, they teach us a lot about countries from Peru to the United States and Canada, from Uzbekistan to China to Africa.

Consider the tragic case of Peru. "Extractive" institutions there began early, even before the 16th century conquest by the Spanish government, but Spanish colonial official Francisco de Toledo "perfected" it in the 16th century. As the authors put it, "Spanish conquistadors found a centralized, extractive state in Peru they could take over and a large population they could [forcibly] put to work in mines and plantations." Building on an Incan tradition of forced labor, de Toledo "defined a huge catchment area, running from the middle of modern-day Peru and encompassing most of modern Bolivia." In this area, he required one-seventh of all males to work in the mines. That lasted for 250 years, until it was finally abolished in 1825. So Peruvians went for well over two centuries without a free market in labor. That put them far behind their counterparts in what were to become the United States and Canada.

Why did the United States and Canada turn out to be so much richer? After all, they had fewer natural resources than South America and a much harsher climate, so one might have expected they would do much worse. Although Acemoglu and Robinson don't cite Smith on this, he provided the answer in 1776 in *The Wealth of Nations*. He argued that it was the difference in economic freedom. The economic institutions that the Spanish government established in Latin America

The Wealth—and Poverty—of Nations

REVIEWED BY DAVID R. HENDERSON

Why Nations Fail: The Origins of Power, Prosperity, and Poverty

By Daron Acemoglu and James A. Robinson
529 pages; Crown Business, 2012

Why do some countries' economies provide increasing standards of living for the common man while others leave the vast majority of people in grinding poverty? That is probably the most important economic question there is. In fact, one of the founding fathers of economics, Adam Smith, wrote a book—appropriately titled *The Wealth of Nations*—just to answer that question. Massachusetts Institute of Technology economist Daron Acemoglu and Harvard economist and political scientist James A. Robinson address the question in their new book, *Why Nations Fail*. Does Acemoglu and

Robinson's book succeed? On its major thesis, yes. Along the way, though, they make some major mistakes in economic history, especially about 19th century U.S. economic history, and display a lack of knowledge about 20th century economic thought.

Extractive and inclusive countries

Acemoglu and Robinson divide countries into two types: extractive and inclusive. In extractive countries, one group of people—usually a very small minority—uses coercive power to grab wealth from and, often literally, enslave a larger group. In inclusive countries, political power is widely shared and therefore it is hard for one small group to be in control. The majority of the people in extractive countries have very little incentive to produce wealth because they know that the powerful group will take it from them. Summarizing their case, the authors write, "Nations fail today because extractive economic institutions do not create the incentives needed for people to save, invest, and innovate." In inclusive countries, by contrast, no one small group is in control,

DAVID R. HENDERSON is a research fellow with the Hoover Institution and an associate professor of economics at the Graduate School of Business and Public Policy at the Naval Postgraduate School in Monterey, Calif. He is the editor of *The Concise Encyclopedia of Economics* (Liberty Fund, 2008). He blogs at www.econlog.econlib.org.

were less conducive to economic growth than the more free-market institutions in the non-Mexican part of North America. Acemoglu and Robinson make the same argument, although with much more detail and historical backing.

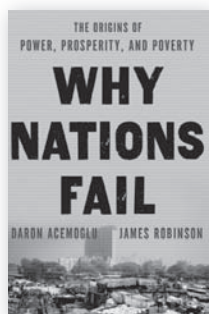
But they go further and try to answer an additional question: *Why* were the United States and Canada freer? Their answer, ironically, is that the two countries were the dregs—they were all that remained in the New World after the Spanish and Portuguese had staked their claims in Latin America. And because there was so little to work with, the colonists in North America, to keep from starving, had to be allowed to have private property, little or no taxation, and relatively free labor markets.

Maintaining extractive policies | The authors apply their extractive/inclusive dichotomy to countries around the world and get a lot of mileage from the paradigm. We have examples of highly extractive governments even in the modern world. One shocking one, to me at least, is the case of Uzbekistan. The Soviet government had imposed a highly extractive regime—communism—on Uzbekistan, with government ownership of all farmland. But when communism ended, the new government’s first president, Ismail Karimov, simply refashioned the extractive system. He forced farmers to grow cotton and sell it to him at artificially low prices, which he then exported at world prices. Because of the low prices they received, cotton farmers were unwilling to invest in new harvesting machinery, reducing the harvest. So what did Karimov do? He turned children into slaves, taking them out of school for the two months of harvest season and assigning them to farms. How much were they paid? In 2006, when the world price of cotton was about \$1.40 per kilogram, the children—who harvested 20 to 60 kilos per day (worth, therefore, between \$28 and \$84)—were paid *three cents per day*.

One of the authors’ best expositions is about the second-largest economy in the world, China. They trace the hor-

rible results of Chairman Mao’s homicidal policies in the 1950s and 1960s and unearth a quote in which he expressed his admiration for Adolf Hitler. They also lay out how the relaxation of government controls on agriculture in the early 1980s “led to a dramatic increase in agricultural productivity.” Surprisingly, they do not cite Kate Zhou’s *How the Farmers Changed China*, which tells the story in more detail. They argue persuasively, though, that Chinese growth “will run out of steam unless extractive political institutions make way for inclusive institutions.”

What about Africa, the basket case of the world’s continents? The authors tell detailed stories about the many failed nations in Africa and find colonization by European countries to be one of the main culprits. One of the few African countries that, in their opinion, succeeds is Botswana, and they tell a fascinating story about how an 1895 visit to London by three



African chiefs persuaded the British government to keep its hands off the territory. Such stories provide an antidote to two viewpoints that many other economists share. The first, formulated most clearly by Jeffrey Sachs, is that economies in tropical climates are destined for failure because of tropical diseases and the lack of arable land. Botswana is a strong counterexample. The second viewpoint is that much of colonialism was good for the countries made into colonies. One of the most tragic stories they tell is of the Congo, which King Leopold II of Belgium badly exploited. They also give chapter and verse on the damage done by colonization in Latin America.

Centralization confusion | One claim the authors make, though, that is not entirely consistent with their own evidence is that countries without central governments do worse than countries with central governments. They cite Afghanistan, Haiti, and Nepal as examples of countries that “failed to impose order over their territories” and, thus, failed to achieve economic progress. But elsewhere in the book, they point out the well-known fact that one of the chief sources of economic progress

in Europe after the decline of the Roman Empire was that many European cities “were outside the sphere of influence of monarchs and aristocrats.” And, as previously noted, Spanish conquerors found their extractive job made easier by the prior existence of a strong central state.

The authors’ confusion about this issue plays out in their discussion of Somalia. Somalia, they write, “is divided into deeply antagonistic clans that cannot dominate each other.” This, they claim, “leads not to inclusive institutions but to chaos.” While it’s true that Somalia is poor, its economic progress after losing its central government has been faster than that of most other African countries over that same time period. In “Somalia After State Collapse: Chaos or Improvement?” a 2008 article in the *Journal of Economic Behavior and Organization*, economists Benjamin Powell, Ryan Ford, and Alex Nowrasteh document that progress.

United States | The authors’ misstatements are greatest about the country I know most about: the United States, especially the United States after the Civil War. They get two central facts wrong. First, they claim that the so-called trusts run by people like Cornelius Vanderbilt and John D. Rockefeller were instances of competition giving “way to monopoly.” Interestingly, their bibliographic essay cites no sources for this claim. That’s not surprising. The reason is that Vanderbilt was a monopoly *buster* who won a major Supreme Court case against the New York state legislature’s attempt to monopolize steamship travel. And during the period that Rockefeller was gaining market share, he did so by *cutting* prices, not raising them. In his 1987 book *A Theory of Efficient Cooperation and Competition*, University of Chicago economist Lester Telser points out that between 1880 and 1890, the output of petroleum products rose 393 percent and the price fell 61 percent. Writes Telser: “The oil trust did not charge high prices because it had 90 percent of the market. It got 90 percent of the refined oil market by charging low prices.”

On the post-Civil War southern United States, the authors’ discussion is oblivious to mainstream economic scholarship on the topic. For instance, they make the

astonishing claim that in the century between the Civil War and the civil rights movement, “southern incomes fell further relative to the U.S. average.” In fact, scholars generally cite this era as one of the premier examples of economic *convergence*.

Possibly related to their mis-telling of the story of U.S. trusts, all the examples they give of extractive institutions are of small, wealthy minorities extracting wealth from large, poor majorities. They omit another possibility that seems to be happening in modern-day America under President Obama: A government of elitists who, claiming to represent a large, less-wealthy majority, extract wealth from a *small, wealthy minority*. This omission is somewhat surprising. In their discussion of Africa, the authors point out that for the Kongolese to be productive would not have been worthwhile “since any extra output that they produced using better technol-

ogy would have been subject to expropriation by the king and his elite.” We are not, in America, at the point where *any* extra output will be taken by the government, but we are much closer to that point than we were just a few years ago. In high-tax California, for example, where many productive people are rumored to live, those making \$1 million a year or more have 13.3 percent of their extra output taken by the state government, up from “only” 10.3 percent last year. Some 43.4 percent of their extra output is now taken by the federal government, up from “only” 37.9 percent last year. Marginal tax rates above 50 percent would certainly seem to damage incentives. Yet the authors never address this issue. That’s disappointing.

Acknowledging predecessors | Finally, the authors claim that “most economists” believe that countries are poor

because their rulers don’t know how to make them rich. Acemoglu and Robinson’s better explanation is that the rulers are out to feather their own nests by extracting wealth from their citizens. But they write as if they think they are the first economists to come up with this explanation. In fact, development expert Stanislav Andreski used the term “kleptocrat” to describe precisely the kind of ruler Acemoglu and Robinson describe. And a whole school of thought in economics starts with the assumption that political leaders are out for their own self-interest and concludes that those leaders, if not constrained, will do very bad things. That school of thought is Public Choice. One of its members, the late James Buchanan, even won a Nobel Prize for his contributions. It’s shocking that these obviously well-educated authors don’t even mention that school. **R**

IN REVIEW | WORKING PAPERS

Below is a summary of some recent papers that may be of interest to *Regulation’s* readers.

BY PETER VAN DOREN

Electricity Production

- “Resource Adequacy and the Impacts of Capacity Subsidies in Competitive Electricity Markets,” by R. J. Briggs and Andrew Kleit. October 2012. SSRN #2165412.
- “The Prospects for Cost-Competitive Solar PV Power,” by Stefan Reichelstein and Michael Yorston. October 2012. SSRN #2182828.
- “The Private and Public Economics of Renewable Electricity Generation,” by Severin Borenstein. December 2011. NBER #17695.

States that have deregulated their electricity generation markets, with the exception of Texas, have been reluctant to rely simply on market electricity prices to match peak supply and demand in the summer. Instead they cap prices below the market-clearing level. On the Pennsylvania–New Jersey–Maryland Interconnection (PJM) regional electricity grid, the price cap is \$1 per kilowatt hour. The price caps create what Massachusetts Institute of Technology economist Paul Joskow calls the “missing money” problem: because of the cap, peak supply generators do not make enough money during the few hours a year in which they generate electricity to cover their long-term average cost, and thus private merchant generators have insufficient incentive to invest in capacity to meet the absolute peak of summer demand.

PETER VAN DOREN is editor of *Regulation* and senior fellow at the Cato Institute.

As a response, state public service commissions or market administrators have created “installed capacity markets” in which the market operator pays generators to provide a stipulated amount of generation capacity above recent summer peak demand (usually 15–20 percent above). The administrator conducts an auction in which peak generation and demand reduction (contractual interruptible service) bid to fill the peak requirement. The price that clears the market for the additional supply above peak demand is then added to the price that clears the electricity spot market.

Some political actors in Maryland and New Jersey have been troubled by the results of these capacity market auctions. Prices for the capacity have been rising, but little additional generation has actually been built. The results are viewed as windfalls for existing generators. Both states have responded with additional specific subsidies for new generation built within their respective borders.

The effect of that subsidized generation is the same as described in Jonathan Lesser’s article on wind power subsidies (p. 22): it reduces returns to existing generators. In the short run, consumers appear to benefit from lower electricity prices; but in equilibrium, lower returns to existing, unsubsidized generators result in their exit, reduced supply, and higher prices overall.

The subsidized generators also distort capacity markets, unless low bids from the subsidized generators are excluded from the auction. To prevent this, PJM has implemented changes to its Minimum Offer Price Rule requiring all bids to be at least 90 per-

cent of the cost of new generation. Without this rule, the subsidy program exacerbates Joskow's missing money problem.

Texas is unique in the simplicity and "first-best" character of its electricity market: electricity is priced in real time to equilibrate supply and demand. In contrast, the "second-best" markets elsewhere get evermore complicated and less efficient.

President Obama and his Department of Energy have been vigorous financial and rhetorical supporters of the expansion of alternative energy generation, including photovoltaic electricity. What results have the taxpayers received for their investment? How competitive are solar panels relative to conventionally generated electricity?

Reichelstein and Yorston report that the "levelized cost" (the price of electricity that equates the present value of plant costs with the present value of its lifetime output) of utility-scale solar panel installations is 8 cents per kWh. Their estimate for the levelized cost of natural gas-generated electricity is 5.8 cents per kWh. Thus utility-scale solar panel installations are not competitive. The recent growth in utility-scale installations is the result of public subsidies and renewable portfolio standards.

Commercial-scale solar panel installations (e.g., arrays that supply a single building or factory) have levelized costs around 12 cents per kWh, or about the price of grid electricity to firms in Southern California. Commercial-scale grid parity is very dependent on stimulus subsidies, having a Southern California location, and the current temporary drop in solar panel prices. If all three were eliminated, then solar panel levelized costs would be 30 cents per kWh.

Would consideration of subsidies to fossil fuels and conventional and climate change externalities change the competitiveness conclusions? Borenstein reports that subsidies to fossil fuels are not really that distortionary because they amount to only 0.11 cents per kWh even if environmentalists' estimates are used. Moreover, subsidies for green power cannot be justified as a good "second best" policy alternative to Pigouvian taxes on brown power because the green subsidies reduce the price of electricity below its marginal cost and they do not take into account whether the renewable source displaces coal or a cleaner fuel like natural gas.

Borenstein concludes that the levelized cost of residential solar electricity panels is 24 cents per kWh. Natural gas-generated electricity is at least 15.8 cents per kWh less expensive, even taking the monetized cost of local pollution (0.15 cents per kWh) into account. If the purpose of residential solar is to reduce carbon emissions relative to natural gas-generated electricity, then the tax on carbon emissions would have to be \$316 a ton for solar to be competitive.

Bond-Rating Agencies

- "Does It Matter Who Pays for Bond Ratings? Historical Evidence," by John Jiang, Mary Stanford, and Yuan Xie. November 2011. SSRN #1950748.

Reform of the bond-rating agencies has been discussed in previous issues of *Regulation*. (See "The SEC's Other Problem," Winter 2002–2003, and "A New Law for the Bond-Rating

Industry," Spring 2007.) Those articles called for increased competition between the bond raters through a relaxation of regulatory entry barriers created by securities laws and their accompanying regulations. The recently announced Department of Justice civil suit against Standard and Poor's raises a different issue: Does the bond-rating agencies' business model matter? Are ratings of bonds inflated because the issuer of the bonds pays for the analysis rather than the buyer?

Using a sample of 797 corporate bonds issued between 1971 and 1978 and rated by both S&P and Moody's, the authors find that, between 1971 and June 1974, when Moody's charged issuers for bond ratings and S&P charged investors, Moody's ratings were higher on average than S&P's ratings for the same bond. During the subsequent period when both S&P and Moody's charged issuers for bond ratings—July 1974 through 1978—the authors find that Moody's ratings were no longer higher than those of S&P. The change in the difference between the two agencies' ratings was from an increase in S&P's ratings around 1974, rather than any change in Moody's ratings. This finding supports the view that the "issuer pays" model leads to higher bond ratings.

Community Reinvestment Act

- "Did the Community Reinvestment Act (CRA) Lead to Risky Lending?" by Sumit Agarwal, Efraim Benmelech, Nittai Bergman, and Amit Seru. December 2012. NBER #18609.

In previous Working Papers columns (Spring 2011 and Fall 2012) I described papers that examined evidence of the effects of the Community Reinvestment Act on the housing bubble. The research design employed in those papers is called a "discontinuity design"; the papers compare individuals and census tracts that just qualify for credit under CRA affordability goals and those that just miss qualification. The assumption is that the legal distinction of qualification is arbitrary and thus plausibly exogenous, so simple regressions and differences in descriptive statistics are adequate tests of the CRA's effect. Loan frequency should be arbitrarily higher for those individuals and census tracts for which eligible CRA institutions receive "CRA credit" relative to loan frequency for individuals and census tracts for which CRA institutions just miss receiving credit. If the CRA effect is real, subsequent defaults should be higher for those loans that receive credit.

The behavior of the banks in those papers was not consistent with the CRA effect hypothesis because loan performance was better or no different in CRA credit areas than in non-CRA areas. In addition, troublesome "exotic mortgages" such as interest-only, negative-amortization, or teaser-rate mortgages were used by higher-income people (\$141,000 average income) with high credit scores (only 7 percent of borrowers had a score below 620) to purchase more expensive houses in areas with high population growth and no price decline in the last

10 years. None of those stylized facts are consistent with the hypothesis that CRA loan affordability goals were causally important in the housing bubble.

Agarwal et al. use a different test to determine the CRA's effect. They compared banks in a particular census tract undergoing CRA exams over the years 1999–2009 with banks not undergoing exams in the same month. The loan origination rate for banks in the treatment group increased by 4 percentage points from the 72 percent average in the sample. Lending increased in CRA-eligible tracts by 8.2 percentage points. The 90-day delinquency rates increased by 0.1 percentage points from an average rate of 1.2 percent to 1.3 percent; the increase was 0.4 percentage points for loans in CRA census tracts. In the six quarters surrounding CRA exams, loan originations increased by 5 percent and loans defaulted 15 percent more often.

There is plausible exogeneity in this research design because under the CRA, small banks are reviewed every five years while large banks are reviewed every two years. The results stem from the random, calendar-driven review of some banks in an area and not others.

How can we reconcile the results of this paper with the others? In this paper, banks under scrutiny by regulators are compared to banks not under scrutiny. In the previous papers, all loans to eligible people and eligible tracts are compared to all other loans. In my view the research design of the previously reviewed papers is more useful in determining the effect of the CRA during the recent housing bubble. Thus the CRA can affect lending behavior as described in the current paper without overturning the no-effect result of the previous papers.

Housing and Unemployment

■ “Are American Homeowners Locked into Their Houses? The Impact of Housing Market Conditions on State-to-State Migration,” by Alicia Sasser Modestino and Julia Dennett. August 2012. SSRN #2125158.

Many analysts have speculated that a non-trivial component of the persistently high unemployment rates after the official end of the 2008–2009 recession may be homeowners who cannot easily sell their houses and move to find employment elsewhere because of negative equity: their houses are worth less than their mortgages. Some stylized facts are consistent with this theory. Between 2006 and 2009, the number of homeowners who moved out of state declined 25.5 percent, while renters who moved out of state declined only by 13.6 percent. Some 10.7 million (22.1 percent) of all residential properties with a mortgage were underwater by the third quarter of 2011, about the same as two years prior.

The authors of this paper conclude that a one-standard deviation share of households underwater reduces outflow by 2.93 percent, or about 4,000 residents, from the average origin state. For the entire United States this resulted in 110,000 to 150,000

fewer migrants out of 5.6 million people who migrate across state lines on average. If *all* those who did not migrate because of negative equity were to migrate, were job seekers, and *all* got jobs, the unemployment rate would decrease by 0.1 percent per year. Thus underwater mortgage “lock-in” would not appear to be an important cause of higher unemployment.

Energy

■ “Overriding Consumer Preferences with Energy Regulations,” by Ted Gayer and W. Kip Viscusi. July 2012. SSRN #2111450.

All economists teach their undergraduates that market regulation has the potential to improve consumer or firm welfare if and only if fundamental flaws in the market (the absence of property rights and prices) or consumer irrationality exist. In their absence, economic efficiency cannot be enhanced by government regulation.

This paper examines whether recent energy efficiency regulations pass the undergraduate test. In 2012 the National Highway Traffic Safety Administration and the Environmental Protection Agency announced revised auto and light truck fuel economy standards. The rationale was greenhouse gas reduction under the authority mandated by the 2007 *Massachusetts v. EPA* Supreme Court decision. But according to the agencies, 85 percent of the estimated \$521 billion in total benefits from improved fuel economy are savings to consumers—that is, *private* benefits rather than benefits from unpriced missing markets. Greenhouse gas reduction is only 8–9 percent of the estimated benefits.

Why would consumers forgo all those fuel savings? NHTSA reports that it “has been unable to reach a conclusive answer to the question of why the apparently large differences between its estimates of benefits from requiring higher fuel economy and the costs of supplying it do not result in higher average fuel economy for new cars and light trucks [from market forces alone].” The EPA also acknowledges that “it is a conundrum from an economic perspective that these large fuel savings have not been provided by automakers and purchased by consumers.”

Maybe ordinary consumers don’t realize that increased fuel economy is cost effective, but the agencies claim the same phenomenon is occurring for heavy commercial trucks, thus justifying the imposition of similar standards. Less than 10 percent of the benefits are greenhouse gas reduction, according to the agencies, while over 90 percent of the benefits are simply fuel cost reductions that truck owners don’t seem to value enough. Yet why would trucking firms forgo all those fuel savings?

Gayer and Viscusi tell similar stories about energy use regulations for clothes dryers, room air conditioners, and light bulbs. None would pass a benefit-cost test if environmental externality reduction were the only benefits. Gayer and Viscusi argue that something is wrong with an analysis that concludes that consumers and firms are leaving so many private benefits on the table through their choices.

R