

## IN REVIEW

# Impressive Details, Questionable Economics

◆ REVIEW BY DWIGHT R. LEE

In his new book, *Door to Door*, journalist Edward Humes provides the reader a wealth of interesting information on transportation, but with conclusions based on questionable economics. His subtitle is fitting: *The Magnificent, Maddening, Mysterious World of Transportation*. Our transportation system is magnificent in ways that Humes makes clear. Yet, in some places he doesn't fully appreciate how magnificent it is, and in other places he sees transportation failures that most economists see as successes. It is not clear what he finds mysterious about the transportation system, but gaps in economic understanding can make the world seem more mysterious than it actually is.

In his introduction, Humes begins with an interesting but somewhat misleading story of "Carmageddon" becoming "Carmaheaven." A 10-mile, 10-lane stretch of Interstate 405 that carried 400,000 vehicles daily in Los Angeles was completely closed during the weekend of July 15, 2011 to allow for the start of construction on a new lane. The predicted traffic jam that was expected to spread throughout the city was dubbed "Carmageddon." To the surprise of all, including "professional traffic czars," smog decreased, traffic congestion decreased citywide, no major traffic jams occurred, and accidents or deaths didn't increase for the entire week. "Carmageddon" was replaced by "Carmaheaven" in the headlines. According to Humes, "Every traffic truism held dear for the past sixty years had been turned on its head ... when closing lanes lessens congestion instead of causing it." He optimistically proclaims, "With Carmageddon, the lifeblood of our economy and way of life, the movement

of goods and people from door to door, had reached an unexpected tipping point."

Yet, his optimistic tone falters before the end of the introduction. He tells us that one year after the additional lane on I-405 was opened, it took commuters one minute longer on average to travel the widened 10 miles than before. He doesn't suggest closing the added lane to solve this problem. He also acknowledges that "the flow of goods [we depend on] has become so huge that our ports, rails, and roads can no longer handle the load" and we "desperately need investment in public capital that the nation does not seem to have. Yet it's an investment that must be made." Several times throughout the book, the importance of increasing investment in our transportation infrastructure is mentioned, but never the role of government regulation in diminishing, delaying, and distorting this investment.

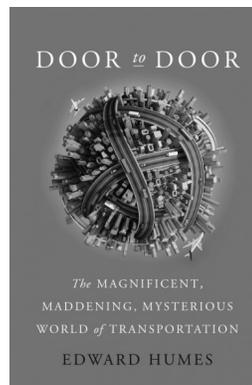
**Drinks and iPhones** / Humes captures our attention early on with three chapters on the transportation that makes possible three ubiquitous consumer items: iPhones, canned beverages, and coffee. There are parallels here to Leonard Read's 1958 "I, Pencil" (which discusses the transportation and processing required to produce a

wooden pencil) and economists will find these three chapters impressive. Indeed, they will find them more impressive than Humes does by virtue of their understanding the importance of market prices in orchestrating these goods' production and movement to market. This is particularly clear in the case of canned beverages.

In Chapter 1 Humes, without mentioning the cliché, proceeds to show that smart phones can be given only qualified credit for the "death of distance" by considering the travel of some of the parts that went into his iPhone 6 Plus. The parts he considers travel a combined 160,000 miles before they arrive ready to be assembled into an iPhone. And that doesn't include the miles traveled by the different metals in the iPhone from mining to refining to assembly, or the travel

of the chemicals and other agents needed in the refining, mining, and assembly processes. He estimates those considerations would easily add another 160,000 miles of transportation to the production of his iPhone, for a total distance equaling a trip to the moon and a third of the way back. The iPhone deserves some credit for the death of distance since Millennials can use it to conveniently arrange their meetings, including the one with the locavores talking about the importance of buying local.

Humes sees the "real breakthrough that makes the iPhone possible—along with most of today's consumer goods," as the shipping container. By significantly lowering the cost of shipping items long distances, the shipping container has made the iPhone commercially viable. Without faulting Humes for not writing an economics book, it is worth noting that without the global specialization and coordination made possible by market prices, the production process necessary for the iPhone would be impossible, no matter how impressive the transportation system.



**Door to Door: The Magnificent, Maddening, Mysterious World of Transportation**

By Edward Humes

384 pp.; Harper Collins, 2016

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And, of course, without the information and incentives communicated through market prices, the transportation system itself would not be very impressive.

Chapter 2 takes us on the journeys that go into producing aluminum beverage cans, with a can containing one of Humes' lime-flavored seltzers making occasional appearances. Without going into the details of the journeys taken by a number of resources—particular aluminum ore and recycled aluminum—that are part of the production of the cans, let me say they're interesting. So are the journeys of the different ingredients that go into the wide variety of beverages and the shipping of the finished products to convenient locations in the right quantities to satisfy the demands of millions of consumers.

Interestingly, he states that “my can of seltzer is worth far more than the beverage it holds.” This is understandable because, as he emphasizes, it is important to be able to transport “massive amounts of single-serve beverages more efficiently and cheaply than any other container type,” and he makes clear that today's aluminum cans make that possible. At this point I thought he appreciated the importance of comparing the value consumers place on convenience and the cost of providing it—and furthermore, that market prices are essential to making this comparison. But it becomes clear that he misses those points entirely.

Instead, he finds it maddening that 94 billion beverage cans, containing 95% to 99% water, are being transported to American consumers each year. He sees shipping all that water as wasteful compared to the good ol' days when people either purchased the concentrated syrup and mixed their drink at home or had it mixed for them at a local soda fountain—with the heaviest ingredient, water, being transported very cheaply in both cases through water pipes. Over time, however, soda producers shifted to bottling their drinks, first in glass bottles, then in plastic bottles, and now primarily in aluminum cans. Why the shift to what Humes considers a “less efficient” practice? According to him the answer is profits. But this ignores the role

of market prices and profits in informing producers that the convenience value of having ready-to-serve beverages available at home or in a nearby vending machine exceeds the extra transportation costs.

Humes is more relaxed in Chapter 3, which considers the miles it takes to make a cup of coffee. Possibly, he is comforted by the fact that coffee beans are typically shipped alone, with water added where the coffee is consumed—at home or the coffee shop—and he has no complaints based on naïve notions about profits. Interestingly, he mentions, without explanation, that the “bottom grades [of coffee] are too poor to be exported and are consumed locally, if at all.” Economists will appreciate this comment because they know the explanation.

**Hazard of safety**/ It is not profits and transporting water that most trouble Humes; it is something far more upsetting. In Chapter 4, after making the obligatory comments about the carbon emissions from automobiles, he gets really serious by turning to traffic fatalities. He points out that they are so routine and scattered that they don't command the attention of other disasters. To underscore this, he compares traffic fatalities to tragic events that do compel attention, like wars and plane crashes. In terms of deaths and injuries, we learn that “one year of car crash injuries and deaths in the U.S. is greater than all the dead and wounded from the *entire duration* of all [major wars in U.S. history] combined.” And the chapter title, “Four Airliners a Week,” emphasizes that every week as many people are killed on American highways as would be if four passenger jets crashed every week with no survivors.

In Chapter 5 he describes 27 different fatal accidents that all occurred on Friday, February 13, 2015. He provides enough information about the victims and circumstances to have an emotional impact. It's a disturbing chapter, and one can sense his frustration as he intersperses comments on the dangers of speeding, driving under the influence, the distractions caused by digital doodads, and not wearing seat belts. To his credit, he ends Chapter 5 by point-

ing out that regulatory agencies, the legal system, and advocacy groups are more concerned with recalls to check out possible mechanical defects in cars that, compared to human error, have a negligible effect on traffic deaths and injuries. (See “Working Papers: Auto Safety,” Spring 2016.)

Humes puts the safety issue largely on hold during the next several chapters on ocean shipping, the logistics of getting ever-larger cargo ships into ports and unloaded, and then delivering the cargo to consumers. He returns to traffic safety in Chapter 12, in a discussion of self-driving cars. He is enthusiastic about the safety potential of these vehicles, as he should be. He also recognizes the difficulty of going from a few self-driving cars to almost nothing but such vehicles on the road, but he is optimistic that it will happen. When it does, he sees tremendous improvements in safety, which he explains with a list of “don'ts.” In his words, “Robots don't drink and drive, or get distracted, or get drowsy at the wheel, or speed, or randomly cross the centerline, or blow through stop signs or red lights.” The items on his list are important, but no such list can be complete.

One point that Humes should have underscored is that robot drivers have the potential to remove the *hazard* of improved safety. By this I refer to the problem of moral hazard, which describes the general tendency for people to offset improved safety with greater risk taking. This is also known as the “Peltzman effect” after University of Chicago economist Sam Peltzman who, in a 1975 article, found that people were responding to improved vehicle safety by driving more recklessly. Because of the improvements, fewer occupants of cars die in traffic accidents, but the number of accidents increases, as does the number of pedestrian, bicyclist, and motorcyclist deaths. More recently, Russell Sobel and Todd Nesbit found that safer race cars result in more accidents but fewer injuries to NASCAR drivers.

I'm inclined to believe that Humes is aware of the importance of moral hazard to safe driving. When discussing ways to increase traffic safety, he confines his rec-

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ommendations almost entirely to devices that limit the ability of drunks to start their cars, prevent cars from exceeding the speed limit, and prevent cell phone use when cars are moving. He does point out when those who died in the 27 crashes he discussed in Chapter 5 were not wearing seat belts, and mentions that a 1968 federal requirement that seatbelts be installed in all new vehicles appears to have reduced traffic deaths, while parenthetically noting it didn't reduce traffic crashes, leaving open the possibility that it might have increased them. But he never mentions the moral hazard of making cars safer for occupants. His discussion of traffic safety would have been stronger if he had.

**Conclusion**/ Humes comes across as obsessively opposed to the automobile (more generally, to the internal combustion engine) as a social disaster for both safety and environmental reasons. Not only is it responsible for a death of an America every 15 minutes, but

no part of our infrastructure and daily lives wastes more energy and, by extension, more money than the modern automobile.... Our cars and trucks spew toxins and particulate waste into the atmosphere that ... measurably decrease our longevity—not by a matter of days, but years.

The indictment goes on to include, *surprise*, “the global climate crisis.” I might overlook Humes’ ignoring the convenience value of canned beverages, but not the enormous convenience value of cars and trucks. Of course, there are costs to that convenience, but the value we realize goes far beyond convenience. Does he really believe more people would have been born, and life expectancy would have increased as much as it has, without the increased wealth the internal combustion engine made possible through improvements in transportation? He never considers that question. At least he doesn't complain about the population growth that has occurred since 1900.

Interestingly, he considers some of the

tremendous advantages made possible by the internal combustion engine in chapters I don't discuss in this review. In particular, he has an interesting chapter on the incredible planning, calculating, and constant adjustments that make it possible for 10,000 UPS drivers to deliver 1.2 to 1.3 million packages on an average day in Southern California. Like a lot of amazing things, he points out that the public takes two-day delivery for granted, while hating the trucks that make it possible.

In another chapter Humes praises mass transit as an underappreciated opportunity to reduce our dependency on cars, and expects many car owners to soon start dis-

covering that they will be able to save money by replacing their cars with Uber and Lyft ridesharing services. Curiously, he ignores the convenience advantage of these services over that provided by mass transit, and the strong possibility that increased demand for the former will reduce demand for the latter.

Despite what I see as its shortcoming, I found Humes' book very informative, and I recommend it to those who are interested in fascinating facts about transportation. If you are interested in solid economic analysis of transportation, I recommend you also read *Gridlock: Why We're Stuck in Traffic and What to Do about It* (Cato Institute, 2016) by Randal O'Toole. R

## A New Bet?

◆ REVIEW BY ART CARDEN

In *Greening of Capitalism*, John A. Mathews contributes a thoughtful analysis to an intellectual space—environmental policy—not known for cool-headed, even-handed inquiry or rhetorical restraint. Mathews, a professor of competitive dynamics and global strategy at both the LUISS Guido Carli University in Rome and Macquarie University in Sydney, sets up his investigation by choosing a worthy implied interlocutor, Deirdre McCloskey. At the very beginning, Mathews writes:

I see this book as an imaginary dialogue with a fine economist, Deirdre McCloskey. Her current magnum opus on what she calls the virtues of capitalism, elaborated in text after text, adopts a strikingly original position that capitalism has been an unalloyed triumph for humanity and that so much of the opposition comes from a failure not just of imagination but also of appreciation of the evidence.

As a McCloskey co-author, this compelled me to dive right into the book. Mathews writes not to praise capitalism or bury it—rather, he writes to urge us to modify it where it seems to fail. When all is said and done, he proves himself a worthy adver-

sary, but I think the theory and evidence are still on McCloskey's side.

*Greening of Capitalism* is an ambitious effort. Where so many in the “end-is-nigh” literature are doing eschatology, Mathews works hard to do big-think social science by developing a perspective he causes “Schinskyan,” meaning “fundamentally Minskyan, blended with the flavor of Schumpeter, of Keynes, of Young, and of Holling.” He characterizes his ambitious undertaking as “neo-Schumpeterian” in that he emphasizes creative destruction, “neo-Gerschenkronian” in that he highlights the advantages of industrializing after leaders like the United States and Britain have shown in some senses what not to do, and “neo-Olsonian” in that he recognizes the importance of breaking through dense thickets of special interest groups in order to enact meaningful reforms. One might say that *Greening of Capitalism* is McCloskeyan: Mathews is ask-

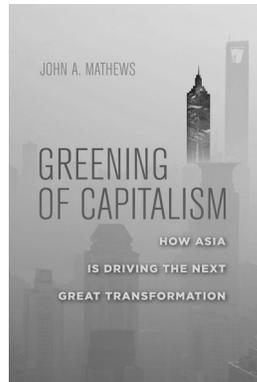
ing big questions and bringing a lot of data and different perspectives to bear on them.

Path dependence as discussed by the economists Paul David and Brian Arthur is fundamental to Mathews' analysis. He identifies the (Olsonian) forces keeping industrial economies dependent on fossil fuels and argues that "it will only be through smart state intervention in the economy" that industrializers will be able to avoid similar fates. Here is one of my main points of departure with Mathews' argument. Some state interventions are better than others, but I'm deeply skeptical of governments' abilities to choose the "right" technologies and the "right" industries. Throughout, many of his proposals sound like old-school industrial policy with a green collar.

In discussions of environmental issues, all roads should lead to Ronald Coase, who argued in his classic essay, "The Problem of Social Cost," that secure property rights and low transaction costs can lead people to bargain to efficient outcomes. Surprisingly, Coase does not appear in the bibliography, and even Elinor Ostrom (who, following Coase and Hayek, showed how institutions and rules evolve to solve tragedies of the commons) gets scant treatment. These are contributions that must be met head-on: as John Nye wrote in these pages in 2008, ignoring general equilibrium effects and implicit Coasean bargains creates a "Pigou Problem" in that measured spillover costs from driving or some other activity may not reflect the kinds of bargains—indeed, some of which will be mediated by culture—that internalize these externalities. (See "The Pigou Problem," Summer 2008.)

Beyond this, the externality problem is not a categorical problem recommending that we replace *this* technology (fossil fuels) with *that* technology (wind and solar) wholesale. If there is a problem, there

is a problem at the margin. How far are we from the level of carbon emissions at which marginal social cost equals marginal social benefit? Do we need radical changes? Throughout, Mathews refers to "irreparable" damage and "inevitable" wars over increasingly scarce resources. Here, I think McCloskey is right—it is from a failure of (economic) imagination that Mathews and others draw these conclusions.



**Greening of Capitalism: How Asia Is Driving the Next Great Transformation**

**By John A. Mathews**  
**368 pp.; Stanford Economics and Finance, 2014**

**Resource peak?** / The most intriguing part of the book, in my mind, is Mathews' discussion of resource prices, including the famed bet between Julian Simon and Paul Ehrlich. Mathews writes, "Simon was writing and publishing prior to the literature on peak oil (and peak coal, peak everything else)." This strikes me as an odd claim because M. King Hubbert (of "Hubbert's Peak" fame) did his foundational work in 1956 and predicted "peak oil" in the late 1960s. But never mind that.

What really intrigues me is this passage:

There can be no expectation that the long-term trend in the price of coal (and other minerals) will be anything but upward—and I would be prepared to bet on this with Simon if he were still alive.

Simon, who passed away in 1998, is not here to make such a bet, but I am. I hereby offer to revisit the Simon-Ehrlich bet with Mathews, but with a couple of small twists. First, we replicate the Simon-Ehrlich bet exactly with \$200 each worth of copper, chromium, nickel, tungsten, and tin, and with settlement 10 years after the bet begins. Second, if Mathews is game, we do another bet with energy resources. I propose a \$1,000 basket containing \$200 each worth of crude oil, coal, heating oil, gasoline, and natural gas. Finally, I propose that we (or our estates) re-settle the bet every 10 years to capture 20-year, 30-year, 40-year, and so

on horizons. Simon himself said that his victory over Ehrlich involved a great deal of luck as his predictions were all over very long terms. There are and have been many 10-year periods over which Simon would have won and many 10-year periods over which Ehrlich would have won. Revisiting the bet every 10 years would be a way to better examine which theory is more broadly correct over ever-longer horizons. Should I win, I would ask Mathews to donate the difference between the commodity baskets' prices and \$1,000 to the Cato Institute, publishers of *Regulation*. Should I lose, I will donate the difference to the research and education organization of Mathews' choice.

In this light, the book's weakest arguments are those based on supposedly exhaustible energy and resources. I agree that resource wars are a legitimate public policy concern, but not because we are "running out" of resources in any meaningful sense. Rather, they are a concern because most policymakers are dealing with deficient underlying theory. McCloskey argued that having a rich resource endowment (of coal, for example) didn't cause the Industrial Revolution for two reasons. First, the coal had been there for millennia and only became a *resource* in the last few hundred years (hence, it wasn't a fundamental cause). Second, coal can be imported. Resources like oil, minerals, and so on can be bought and sold in world markets. It's not clear to me that "energy independence" is important or meaningful, and the fact that one can trade for oil or anything else means that going to war over it is simply tragic and wasteful. Mathews argues that having to import oil creates "a disastrous dependence," but again, I'm not at all clear on why "energy independence" is such an important political goal while (say) "coffee independence" isn't.

**Beyond fossil fuels** / I agree with Mathews that burning fossil fuels is a serious environmental problem, but I think the problem is not too much capitalism, but too little. The largest petroleum concerns in the world are state-owned oil companies and governments generally own power grids and

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regulate power companies. Mathews notes that it is illegal to build private power lines across public streets. That restriction seriously limits the development of a private market in energy at the local level where one might imagine decentralized networks of power-generating entrepreneurs slowly weaning people off fossil fuels. Furthermore, given that burning coal to produce power generates pollution, monopoly pricing for energy would have the salutary effect of reducing—perhaps sharply—the amount of energy that gets produced while spurring people to economize on energy-consuming production processes.

A lot of the book is comfort food for people (like me) who enjoy TED talks, and Mathews offers a message that is fundamentally hopeful. While there is certainly an enormous amount of waste in directed environmental policy, the idea of a world without fossil fuels is tantalizing. Furthermore, I'm optimistic because of our surfeit of tech zillionaires with gobs of money to throw at things like backing up the planet.

Mathews extols the virtues of “a green development strategy involving circular economy initiatives (e.g., recycling, turning wastes into inputs),” but he does not specify exactly where there are big bills on the sidewalk that no one is picking up. Industrial history—as for example in the Chicago meatpacking industry and in the development of Kingsford Charcoal out of Henry Ford wondering what to do with the scrap wood produced in auto manufacture—is a history of turning trash into treasure. Here again the relevant questions concern incentives at the margin: do we need a wholesale replacement of the entire economic system or are there places where rights are poorly defined and enforced?

Mathews calls for “a revolution in economic thinking ... to match the revolution in economic practice,” but I'm not convinced this is necessary. There doesn't seem to be much in *Greening of Capitalism* that good old-fashioned price theory can't handle. If anything, the problems he identifies emerge from stubborn refusals on the part of policy makers and others to internalize the lessons that price theory can teach us. R

# An Alternative to the Dodd-Frank Resolution Approach

REVIEW BY VERN MCKINLEY

Six years after the passage of the Dodd-Frank Act, the argument over what would have been the most appropriate legislative response to the massive bailouts in 2008 and 2009 continues. *Making Failure Feasible* is a deep dive into the complex legal and policy issues involved in ending a storied 40-year history of U.S. authorities propping up troubled financial behemoths.

*Making Failure Feasible* is a collection of nine essays predominantly focused on a Chapter 14 of the bankruptcy code. The reason you may not have heard of that chapter before, as opposed to the more familiar Chapters 7, 11, and 13, is that Chapter 14 is not law—at least, not yet. It is the product of a working group out of the Hoover Institution, the so-called Resolution Project, which was formed in early 2009 while the after-effects of the financial crisis were still lingering.

The most recognizable name associated with the book is John B. Taylor, the former under secretary of the treasury for international affairs during the early years of the George W. Bush administration and developer of the Taylor Rule for monetary policy. His research makes him a competitive candidate for a Nobel Economics Prize. Taylor is one of the editors of the book and he also wrote its preface, which gives some background on the Resolution Project and the books that have flowed from it.

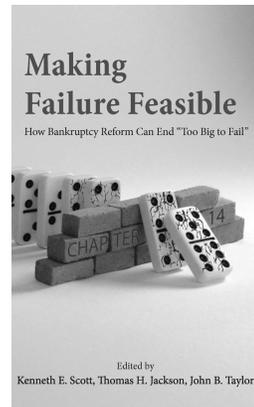
The financial authorities have moved forward with the Dodd-Frank one-two punch of Title I living wills and Title II

orderly liquidation authority (OLA) that are at the core of the legislation. These provisions would be applied to deal with the approaching failure of a so-called “systemically important financial institution” (SIFI) if we had a repeat of a Bear Stearns—or Lehman Brothers—type stumble in the future.

There has not been a resolution of a SIFI under this authority as of yet and we may have to wait for the next full-blown financial crisis for that to occur. But, the more entrenched the regulatory framework gets, the more difficult it becomes to make wholesale changes short of a new set of post-crisis reforms. The political outlook for Republicans, whose vocal criticism of Dodd-Frank was a theme of a number of their presidential candidates this year, is not looking good whether one considers the presidency or the congressional landscape. Alternatively, Democrats tend to think Dodd-Frank, passed by Democratic majorities in the

House and Senate on a partisan basis and signed by President Obama, was a step in the right direction. They would only favor comparatively modest adjustments to the legislation, including to existing provisions allowing the break-up of SIFIs.

The chapters in *Making Failure Feasible* are a little uneven in their pace, likely



**Making Failure Feasible:**  
How Bankruptcy  
Reform Can End  
“Too Big to Fail”

Edited by  
**Kenneth E. Scott, Thomas H. Jackson, and  
John B. Taylor**

**301 pp.; Hoover  
Institution Press, 2015**

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attributable to the varied backgrounds of the authors. Over half of the chapters are drafted by lawyers and law professors and at least one of the chapters has the feel of material you would find in a legal textbook, which gave me some flashbacks to my law school years. The remaining chapters are drafted by finance specialists. Overall, the chapters are readable for a general policy audience, especially if the reader is knowledgeable about the financial crisis and its policy and legislative aftermath. Given the limitations on the length of this review, I will highlight select chapters that I found to be particularly important to the analysis of a Chapter 14.

The book's first chapters are background in nature, providing basic definitions on Chapter 14 topical areas (capital, debt, liquidity, due process, international coordination, and systemic risk), followed by two proposed versions of Chapter 14 (Version 1.0 released in 2012 and Version 2.0 released in 2013). A chapter entitled "Building on Bankruptcy" notes that Chapter 14 "could be adopted either in addition or as an alternative to the new resolution regime of Dodd-Frank."

**The financing conundrum** / One cannot broach the subject of resolving a large financial institution without considering the topic of how that resolution will be paid for. The issue of how a proposed Chapter 14 would address the funding of a SIFI is tackled by University of Pennsylvania law professor David Skeel, who writes regularly on bankruptcy in the editorial pages of the *Wall Street Journal*. Dodd-Frank provides for a line of credit from the U.S. Treasury and largely keeps in place Federal Reserve lender-of-last-resort funding. That is the problem. Government funding has been too readily available, the exhortations from Walter Bagehot on central bank lending have been ignored, and the SIFIs take full advantage of these facts.

The current Chapter 11 does not provide for any type of SIFI financing. Skeel argues that under Chapter 14 such financing could be addressed through the market

similar to the current debtor-in-possession financing employed in bankruptcy. He speculates that Dodd-Frank regulatory changes, such as increased capital and liquidity requirements, mean less of a need for such financing. Finally, he suggests some form of prearranged private funding mechanism, while at the same time allowing the Fed's emergency lending powers to carry forward. Although Skeel's proposal tightens up on the current open-ended government lending, his suggestion of leaving in place Fed lending, largely as it is, is troubling given the Fed shows no signs of letting up on its present plenary authority to lend to any institution it sees fit to lend to.

**The cross-border challenge** / Under Chapter 14, could we resolve a massive cross-border institution? In 2008, so the standard narrative goes, it would have been impossible to resolve a massive cross-border institution like Citigroup, with its trillions of dollars of assets spread across thousands of subsidiaries operating in multiple-dozens of countries. The analysis of resolving cross-border institutions in *Making Failure Feasible* is bifurcated, with one chapter by legal specialist Simon Gleeson of Clifford Chance and another chapter by financial experts Jacopo Carmassi and Richard Herring of the University of Pennsylvania's Wharton School. The legal issues come down to whether the legal provisions are recognized in overseas bankruptcy proceedings. Gleeson makes a convincing case that this question is more clearly answered with a Chapter 14 regime as opposed to a Dodd-Frank resolution regime.

The resolvability analysis by Carmassi and Herring details the challenge at hand: the average globally systemic institution that will be subject to resolution has about \$1.6 trillion in assets, 42 percent of its assets outside of its jurisdiction, and over 1,000 subsidiaries to deal with in 44 countries. They parse out the central issues with regard to resolvability of cross-border institutions: international cooperation and the related phenomenon of ring-fencing. As

the term implies, ring-fencing is a procedure whereby local jurisdictions (host countries) "fence off" the assets within their borders, which gets in the way of an effective resolution of the entire cross-border institution. They conclude that "we do not yet have a reliable framework to undertake the orderly resolution of a [global systemically important bank]."

**Resolvability** / The topic of making a bank "resolvable" is addressed by Thomas Huertas of EY Global. The argument made during the financial crisis was that SIFIs were not resolvable because the process was too "disorderly" through existing bankruptcy. The standard narrative justified this argument by presenting the case of Lehman Brothers. In contrast, the objective now when it comes to resolvability is to assure that the institution is "safe to fail" (orderly), defined as doing so without expense to taxpayers and without massive disruption. Huertas builds one example on top of another from the simplest case (unit bank in a single jurisdiction with no branches or subsidiaries) to the more complex cases (branches, parent holding company with domestic and foreign subsidiaries).

William Kroener, former general counsel of the Federal Deposit Insurance Corporation, contributes a brief chapter on "living will" requirements. Those are the resolution plans that the large banks are required under Dodd-Frank to submit to the Federal Reserve and FDIC. They test how the bankruptcy law would be applied as part of a resolution exercise.

**Reliving Lehman** / The chapters discussed thus far progressively lead to a chapter by attorney and Stanford economics doctoral candidate Emily Kapur. Where much of the book is theoretical in discussing what Chapter 14 might look like, Kapur attempts to determine how Chapter 14 would have applied under a Lehman scenario of a prototypical disorderly resolution. Although this may be a case of "generals fighting the last war" in assuming that a crisis will play out in the same way

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during the next crisis as it did during the last, in some ways this is unavoidable.

For her case study, Kapur assumes that Dodd-Frank is in place with an overlay of Chapter 14. She also makes a simplifying assumption that foreign regulators do not ring-fence assets, which appears to be unrealistic, although it is not clear how material this assumption is to her case study. Under her counterfactual, Lehman moves assets and liabilities to a “bridge” structure a full 10 days before the bankruptcy filing actually occurred in 2008. In a section entitled “Business after Chapter 14,” Kapur traces through how she envisions the newly structured “New Lehman,” primarily from a standpoint of financing and any adverse systemic effects from implementation.

**Conclusion** / The Dodd-Frank resolution framework has had its share of high-profile setbacks this year, between an embarrassing slap-down by a federal judge who criticized the means by which the financial authorities designated SIFIs in the MetLife case, to the continuing inability of the banks to compose their living wills in a way that satisfies the Fed and the FDIC. Whether these setbacks are the beginning of a slow collapse of the Dodd-Frank framework remains to be seen. The proposed Chapter 14 offers an alternative to continuing down the Dodd-Frank road of granting expanded discretion to the financial authorities who failed in their efforts to assure financial stability and avoid drawing on government funding during the last crisis. R

as everyone called it, in the corporate public affairs office before going to graduate school in 1969, and my father worked as an engineer for the company during World War II and later dealt with many of its mid-level executives in his contracting business. I can attest that the voices Taft records sound authentic, even though she reveals the names of only a few (mainly public officials) of the 76 people she interviewed.

**Steel's social contract** / The weak point of her book is economics. In my introductory macroeconomics course, the economy is modeled as a giant machine that produces tangible stuff. I duly point out, however, that more than three-quarters of the American economy, and the economies of almost all other affluent nations, consists of nontangible services: airline travel, internet service, doctor's appointments, and entertainment such as visits to casinos. Technical progress has made producing commodities easier, allowing richer countries to produce and consume more services. My excuse for using production lines as examples—I sometimes use steelmaking—is that it is easier to envision the processes.

Taft makes much of the difference between the structural beams that the Steel once produced and the gambling entertainment provided by the Sands. For economists, though, the difference between services and commodities is immaterial. Gross domestic product is neither better nor worse for consisting more of services than commodities. Hers is not unlike the distinction that the Physiocrats—the original economists of France—made between agriculture and manufacturing, the former being both morally and materially more important than the latter. Balderdash, say modern economists. Goods and services have the value that consumers put on them, period. A bag of groceries and a turn at the baccarat table get their

## Oh, Little Town of Bethlehem

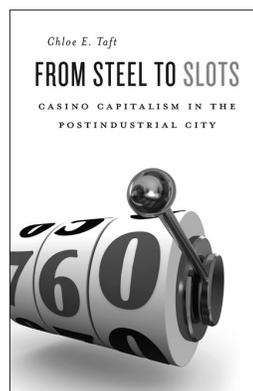
◆ REVIEW BY WILLIAM A. FISCHER

It is emblematic of a scholarly prejudice that Chloe Taft's impressive book about Bethlehem, PA does not mention the name of my hometown in its title. I can imagine why it's not there. Sounds too parochial, too place-specific, too wrapped up on a single city's problem. Professors compiling their reading lists in American Studies (Taft's graduate field and my shadow-major as an undergraduate) would be reluctant to include it for those reasons.

But the virtue of focusing on the experience of a single place is that she can get behind the statistical averages that necessarily dominate a more general study of several cities. Her book is about how Bethlehem's workers and civic institutions fared in the city's transition from a heavy-industry powerhouse to a service-industry knock-about player. The representative of the latter is the Sands casino, a full-scale gambling resort built in the center of the derelict steel works. A more dramatic emblem of the transformation of the American economy from the production of tangible stuff to ephemeral ser-

vices could hardly be found, and Taft deserves credit for seizing the opportunity to examine the sociology of the economic transformation. She did have some family connections with the city, but she could have studied other places, and she did not fall for the convenient charms of New Haven, Conn., where she got her doctorate from Yale.

My wife and I grew up in the Bethlehem area and went to school with the sons and daughters of steelworkers. We probably know many of the people Taft interviewed for her ethnographic study. I worked briefly for “the Steel,”



**From Steel to Slots: Casino Capitalism in the Postindustrial City**

By **Chloe E. Taft**

336 pp.; Harvard University Press, 2016

value from the preferences of the purchasers. Other methods of valuation don't respect the autonomy of ordinary people.

Fortunately, Taft has other insights about the shift from making stuff to providing services. Her interviews and archival research highlighted the strong sense of community that had developed around Bethlehem Steel. Workers could invest in local social capital because of the apparent permanence of the Steel. They knew that their neighbors and their children and other relatives were likely to be around to benefit from their effort at creating a Little League, a parish school, and public art project because the Steel would always be there to provide good jobs. Steel executives felt the same way. They led United Way fund drives and supported much of the public decoration that illuminated (literally) Bethlehem's self-appointed role as America's Christmas City. Taft refers to this reciprocal commitment as a "social contract."

The perceived permanence of the Steel also affected local institutions. Taft's strongest stories concern the development of ethnic churches that provided much of the social capital for workers and their families. The churches did not just supervise life events. Priests and ministers also mediated between the Steel's executives and workers in their parish, often acting as labor recruiters in their home counties and quelling the more extreme labor disputes. (The Steel was nonunion until World War II, when the Roosevelt administration leveraged the largesse of government contracts to induce the industry to accept unionization.) The bonds that workers formed with their churches were stronger because of the permanence of the major employer. Hungarian or Polish workers could commit to local social institutions allied with their church because they thought that their jobs would last for generations.

**Transformation** / But by about 1970, there were reasons to believe that Steel's prosperity and permanence would not last. The precipitating event was the 1959 industry-wide strike. It lasted almost four months, and the city was traumatized by it. Busi-

nesses that depended on the Steel and their workers' expenditures suffered along with the strikers. The strike's settlement, more or less dictated by federal mediators, was highly favorable to the labor unions. Management had wanted to change work rules to allow firms to reduce the number of workers for each task, which would have made it easier to take advantage of the technical advances that their international competitors had adopted. The unions would have none of it, and what many called "featherbedding" continued well into the rest of the century. The strike also opened the door to steel imports, and buyers of steel discovered that imported

*Goods and services have the value that consumers put on them. Other methods of valuation don't respect the autonomy of ordinary people.*

beams and sheet metal were as good as the domestic product and much cheaper.

Wages at the Steel continued to outpace those of other local industries, and Taft mentions some of the resentment by non-steel workers of the supposedly cushy jobs inside the plant. I had toured the mills, though, and concluded that the hot, dangerous, and dirty work many did certainly warranted higher pay. In any case, steel management was either unwilling or unable to renegotiate the terms of the 1959 labor contract after it became evident that their industry's prominence was at risk.

Top management was in no position to lecture workers about excessive pay, as executive compensation at Bethlehem was among the highest in a high-paying industry. But apparently the paycheck wasn't big enough for them. In my six-month stay in the Steel's public affairs department, I discovered that the top executives were using the stockholders' money to buy themselves honorary degrees from their alma maters. My boss would write internal memos justifying the business purpose—often hard to see—of the secret deals that

the executives made with their universities' fundraising offices. The donations were buried in the public affairs department's budget, and shareholders would be none the wiser. My distaste for both sides of these transactions—the universities hid them under the humble-sounding "anonymous" donations—has ever since made me look a bit askance at honorary degrees.

Both of these ongoing dysfunctions—featherbedding by union workers and self-dealing by top executives—were symptoms of a prosperous industry whose stakeholders knew it was in decline. The social contract was eroded by a sense that steel people should take what they can while the

ship was still afloat. That attitude had its upside. My high school friends whose parents worked for the Steel were told to get a good education instead of depending on a career at Bethlehem Steel. The adults thought that the

good wages were not likely to last another generation. They were right.

Bethlehem's civic elite also foresaw the decline of steel. Starting in 1959—the big strike year—they systematically established industrial parks to attract a more diverse industrial base. When the Steel finally went down, Bethlehem's civic leaders worked to establish a diversified research and entertainment district in the shadow of the dramatic symbols of the industrial past, the massive row of blast-furnaces. Bethlehem landed the Sands in a competition with its neighbor, Allentown. The Pennsylvania legislature proposed to allow one casino in the Lehigh Valley, but it let cities make a case for its specific location. Allentown, as I understand it, argued solely for its own needs. It had lost its Mack Truck plant to South Carolina, and it sought to replace the lost tax revenues (and redeem itself from the Billy Joel song "Allentown") with casino revenues. Bethlehem was founded by communitarian-minded Moravians, and perhaps their traditions shaped its response: Give us the casino, and we will share the extra tax revenues with Allen-

## IN REVIEW

town. Bethlehem got the casino.

The casino, though, is not the Steel. It employs less than a tenth of the labor force that steel had in its 1950s heyday. Bethlehem residents are still a little embarrassed by it despite the Sands' clever ploy of adopting a steel-mill theme and preserving several steel-related structures. Even if gaming (the nice term for gambling) were a larger presence in Bethlehem, it is unlikely that it would foster the kind of social capital that the Steel once did. Taft emphasizes that the Sands' major sources of revenue are its Macau and Las Vegas operations. Bethlehem is, in this context, a minor locus of profit and does not command the company's full attention. Steel executives lived in Bethlehem and were responsive to local opinion. Sands is a conscientious corporate citizen, but it is not a matrix for local social capital.

Taft points out that the Sands is part of the worldwide flow of financial capital, just as Bethlehem Steel was. Both had their most profitable operations in other cities. She is aware that capital mobility is hardly new, and it cannot account for the negligible influence of the Sands on Bethlehem's social capital. The difference, I would argue, is due to the special circumstances that made the Steel so prosperous. World War II left America's steel industry stronger than it was before the war, while much of the rest of the world's mills had been destroyed by the same event (in some cases, surely, with armaments manufactured in Bethlehem). A recovering world needed steel, and Bethlehem and other American steelmakers enjoyed a seller's market for several decades.

When the rest of the world caught up in steelmaking, America no longer had a comparative advantage in this messy industry. And even if the Steel had won all the protection from foreign competition that it sought (pursuant to which my Volkswagen was banned from the corporate parking garage), it would have had to deal with domestic demands for environmental improvements, which also raised costs and induced buyers to find substitutes. The computer revolution would have eventually introduced the labor-saving technolo-

gies that have greatly reduced the demand for labor in all manufacturing.

Taft does not address how the post-war era of steelmaking prosperity could have been extended. She often blames "neoliberal" policies for the Steel's decline without being specific about how alternatives to such policies would work. She complains that federal funding for urban programs has declined in the last 30 years, but Bethlehem's most prominent federal urban renewal project was a misconceived plan that decimated the city's main shopping street by attempting to turn it into a pedestrian mall. And she neglects the home-grown bright spots. The flashy alternative employer—the Sands casino—is a colorful hook for her study, but it overlooks jobs with new firms in the area's industrial parks and the growth of such successful Bethlehem-based employers as Just Born candies, the maker of marshmallow Peeps.

Bethlehem is like a lot of other medium-size cities that enjoyed a temporary prosperity and then had to fall back on a variety of

activities. The city's Moravian heritage, dating from the 1740s, perhaps made it more adept in adjusting to the Steel's demise, since the city had a history that predated the steel industry and knew that life was possible after it was gone. The city's proximity to New York and Philadelphia also helped it grow enough business to avoid the population losses that have crippled other steelmaking towns. The city does not look in bad shape—I have visited regularly over the years—and the air is a lot cleaner.

Taft does give voice to some of those she interviewed who were upbeat about jobs with the Sands, but she treats them in a slightly patronizing way. Her enthusiasm is greatest in interviews with old-timers who were nostalgic about the Steel. We Bethlehem natives don't begrudge the permanent residents their nostalgia, but most of those I knew did not pretend that there was a path that could have preserved that brief era when the American steel industry ruled the world. We need to get over the notion that it can or should be recreated. R

## Man vs. Nature?

◆ REVIEW BY GEORGE LEEF

Recently, I came across one of those fascinating side-by-side photographic comparisons, one showing a scene as it appeared in the 19th century and the other, taken from the exact same spot, showing how it looks today. The two photographs were of Yosemite Valley, the early one taken in 1866 and the other in 2009.

The striking difference between them was that trees were much more abundant in the later shot. Most Americans would probably assume the reverse to be the case.

Why is it that one of America's most iconic places is now more wilderness-like than it was before our great westward migration and the beginning of the industrial era? You will find the answer to that question within the pages of *Nature Unbound*. Authors Randy Simmons (professor of economics at Utah State University), Ryan

Wonk (director of the Institute of Political Economy at Utah State), and Kenneth Sim (director of the Reliable Energy Education Network) give readers a synoptic view of America's sprawling environmental protection bureaucracy: its assumptions, its numerous players, its frequently perverse incentives and often bizarre results. The book, in short, is a valuable corrective to the notion that the federal government has done a splendid job of protecting us from environmental disaster.

Before going any further, what about Yosemite?

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

Back in 1866, Yosemite Valley was inhabited by people who made use of the land. The Miwok Indian tribe had long lived there, growing their crops. Since the 1840s, some whites had moved in, keeping sheep and prospecting for minerals. When John Muir saw the magnificent valley, he decided that it would be still more magnificent if those people were removed so the land could once again be pure. As the authors write,

For Muir, it was more important to maintain the balance of nature than to allow the Miwok Indians to live off the land. Muir's ideology about the balance of nature within national parks was so influential that (citing another source) "the Yosemite model spread to other parks, including Yellowstone, where forced evictions killed 300 Shoshone in one day."

That's why once-open meadows are forested today: the idea that man must be kept out to save nature.

If the book can be said to have a villain, it is that "balance of nature" ideology, which holds that any sort of human intervention is harmful and dangerous, and thus must be minimized if not stopped altogether. The truth, argue the authors, is that nature is not so fragile as this ideology posits and human activity is not like introducing a cancer into it. Disturbance and change are constants in nature; ecosystems are resilient. Humans certainly can cause environmental damage, but "balance of nature" thinking is an immense overreaction that brings about results that most of us would find undesirable.

**Laws and the environment /** Just as nature has its ways of responding to environmental change, so do we humans. We dislike pollution and developed legal responses to

it centuries before the current environmental laws were written. English and American common law sided with those who suffered the effects of pollution. The authors provide illustrative cases going back to the 19th century where judges ordered polluters to cease and pay damages under common law rules of property.

*The words legislators put on paper are often interpreted by the courts or the bureaucrats to mean something that was not originally intended.*

No doubt, much pollution was deterred by those precedents and the authors suggest that we might be better off today if we had not veered away from common law and instead started placing our trust in federal statutes and bureaucrats.

The great bulk of the book is about those statutes and the officials who enforce them: the Clean Air Act, the National Environmental Policy Act, the Clean Water Act, the Endangered Species Act, and the Wilderness Act. The authors also devote a chapter to the closely related subject of "renewable energy" laws, which gave us Solyndra and other boondoggles. The authors do not maintain that all of those laws are failures, but argue that the environmental benefits they have brought us have come at a greatly inflated cost.

Consider first the Clean Air Act (CAA) of 1970. America certainly had suffered from befouled air, such as the hideous smog that killed 14 people in Donora, Pa. in 1948. What is little known, however, is that state, local, and private efforts (such as innovations by the Big Three U.S. automakers that prevented crankcase hydrocarbons from being vented into

the atmosphere, in use by 1961) had been steadily reducing air pollution. But because of media sensationalism, most Americans were convinced by the late 1960s that the nation faced an air pollution crisis. That led Sen. Edmund Muskie (the top Democratic contender for president in 1972) and President Richard Nixon to start competing to see who could be more "green" in voters' eyes.

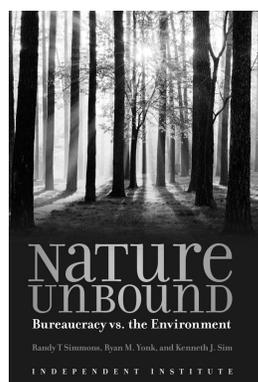
Nixon made use of his incumbency to push through the CAA and sign it into law in 1970. Henceforth, the country would take a top-down,

bureaucratic approach to air quality, run from Washington, D.C. What was the result? "Overall," write the authors, "the Clean Air Act and its amendments have been less successful in cleaning the air than in allowing the Environmental Protection Agency to extend its reach."

Apropos of that point, the authors detail the protracted litigation over the question of the EPA's authority (even duty) to regulate carbon dioxide, which is not a pollutant as defined by the law. Ultimately, the Supreme Court ruled in *Massachusetts v. EPA* that the agency did have both the power and the obligation to regulate carbon dioxide discharges to help prevent "catastrophic harm" to Massachusetts residents. The authors sum up the case, writing that it showed two fundamental problems with the law:

The first is the inability of the EPA to possess the knowledge or ability to tackle all of the problems now deemed to require regulation.... The second is that the expansion also increases the complexity of the CAA, which augments the ability of interest groups to engage in rent-seeking behaviors.

The case demonstrates a point that recurs throughout the book, namely that the words legislators put on paper are often interpreted by the courts or the bureaucrats to mean something that was not originally intended. The level of



**Nature Unbound:  
Bureaucracy vs. the  
Environment**

**By Randy T. Simmons,  
Ryan M. Yonk, and  
Kenneth J. Sim**

**287 pp.; Independent  
Institute, 2016**

## IN REVIEW

authority the legislators thought proper for regulators often grows exponentially under the processes of administrative law.

**Bureaucracy and red tape** / Such a concentration of power in bureaucratic hands is highly problematic, the authors argue. Assuming that agency personnel want to make the best decisions in the public interest, they confront Hayekian knowledge problems in that the information necessary to make ideal decisions about environmental conditions and responses is widely dispersed throughout society. Worse, many of those officials are ideologues who are determined to impose their will no matter the costs to the rest of us. The EPA, for instance, “consistently overlooks important variables and twists the science to match its political agenda,” the authors write.

Another serious problem the book highlights is the waste of time and money in getting projects done, given the maze of environmental laws and the possibilities they offer for obstructionism. Under the National Environmental Policy Act (NEPA), for example, applications to undertake construction projects must show that *all* other possibilities have been considered and that the current proposal is the one with the least environmental impact.

In one particularly risible case, the Army Corps of Engineers refused to approve a plan to improve a rural road on the grounds that the state had not explored *all* alternatives to the plan. The alternative that had not been considered was the possibility of building an *elevated road* over the existing one. More time and money had to be spent in analyzing that “alternative.” The authors comment, “The ridiculousness of this alternative is obvious, but it should be noted that reasonableness under NEPA is subjective, and political entrepreneurs will use whatever tools are at their disposal.”

Readers also learn that the Endangered Species Act creates some horribly perverse incentives that often lead to the needless destruction of wildlife. If an endangered

species is detected on private land, the owner may not use or develop the property in a way that could harm the creatures or their habitat. That amounts to a taking of the property, but one that the courts don’t view as compensable under eminent domain. Therefore, owners who suspect that a protected bird species like the red cockaded woodpecker might take up residence have an incentive to develop or otherwise exploit the land immediately, and if the bird should appear, the most rational response is to “shoot, shovel, and shut up.”

Some of the most distressing cases of the harm done by the balance of nature ideology occur when the Wilderness Act is invoked to prevent sensible land management. This ideology insists that humans must let nature run her course. So what if thinning underbrush would reduce the

likelihood of devastating forest fire, or adding lime to a stream could offset acidification, or removing landslide debris would allow fish to swim upstream to spawn, or killing destructive beetles might save healthy forests from being ravaged? The wilderness must remain “pristine.” Zealots have used the Wilderness Act to stop such human incursions, a triumph of ideology over what almost all of us would think of as common sense.

Students of regulation and public choice will find this book to be a feast. More encouragingly, environmentalists may find themselves rethinking their views on environmental policy after reading *Nature Unbound*. Someone might even send a copy to the descendants of the Miwoks, who still live in California, but where they can’t “ruin” nature for the environmental purists. R

## Of Hedgehogs, Foxes, and Superforecasters

◆ REVIEW BY VERN MCKINLEY

**T**o begin the first chapter of *Superforecasting*, Philip Tetlock and Dan Gardner make the point that “we are all forecasters. When we think about changing jobs, getting married, buying a home, making an investment, launching a product, or retiring, we decide based on how we expect the future will unfold.” The stated goal of the

book is to parse out of the general population those rare souls (roughly 2%) who are amazingly good forecasters or, as the term is coined by the authors, “superforecasters.” It is the authors’ goal not only to explain in detail why these forecasters are so good, but also to pass the knowledge about how they forecast on to others.

The secrets of superforecasters are unearthed in the old-fashioned way, by tracking thousands of predictions of the superforecasters—as well as the much more numerous not-so-superforecasters—that

have been “dated, recorded and assessed for accuracy by independent scientific observers.” Secondly, the authors want to make the reader think about the integral role that forecasting plays in our lives—both those forecasts we make ourselves and those forecasts that others make that affect our lives.

I agree that “we are all forecasters” based on my own experience. I regularly undertake forecasting as part of my professional work in the field of finance and also as an important part of my personal finances. Less often, some of my policy work has also involved forecasting. But as Tetlock and Gardner describe in detail the fore-

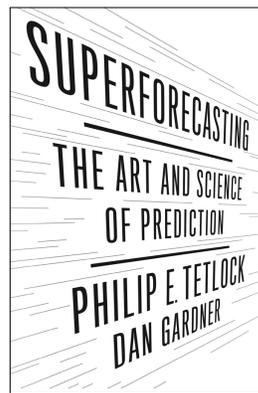
VERN MCKINLEY is a visiting scholar at George Washington University Law School and author of *Financing Failure: A Century of Bailouts* (Independent Institute: 2012).

casting process and develop the traits of superforecasters, it made me think a lot about the methods I have used and about how useful and accurate my own forecasting has actually been.

Tetlock is a professor at the University of Pennsylvania. In 2011, he launched the Good Judgment Project (GJP) with his research (and life) partner Barbara Mellers and invited volunteers to sign up and forecast the future. This became the platform for the analysis of forecasting in the book based on the work of more than 20,000 participants who volunteered for the GJP. These participants

gave their best forecasts for a variety of current events since the initiation of the GJP, including “if protests in Russia would spread, the price of gold would plummet, the Nikkei would close above 9,500, war would erupt on the Korean peninsula, and many other questions about complex, challenging global issues.” Gardner is a journalist whose book credits include titles on the intermingled issues of science, politics, and fear. Readers will note that the first-person narrative is often used in the book and it appears to be from the perspective of Tetlock.

**Hedgehogs and foxes** / The authors, likely based on a theme of one of Gardner’s previous books, make a nice distinction throughout the book between “hedgehogs,” who organize their thinking around Big Ideas and make high-profile public pronouncements expressed with a high degree of certainty; and “foxes,” who are more pragmatic experts who have a range of approaches and talk about possibilities and probabilities, not absolutes. The authors seem to hold a grudge against the hedgehogs: “Despite my all but begging the highest-profile pundits to take part, none would participate.” The authors proceed to cast aspersions on



**Superforecasting: The Art and Science of Prediction**

By Philip E. Tetlock and Dan Gardner

341 pp.; Crown Publishers, 2015

such high-profile “experts” who make predictions, bluntly stating that “Foxes beat hedgehogs” and citing the “inverse correlation between fame and accuracy.” In particular, they skewer supply-sider and Reaganite Larry Kudlow of CNBC fame for his rosy predictions on the Bush 43 economy circa 2007 and 2008. They also criticize Paul Krugman, although not for the quality of his predictions (they don’t pass judgement on that), but for his boorish behavior in engaging in public arguments that “looked less like a debate between great minds and more like

a food fight between rival fraternities.”

**Can you identify a superforecaster?** / So what are some of the characteristics of these so-called superforecasters that Tetlock and Gardner spend so much time dissecting?

- Although forecasters in general have above-average intelligence (higher than about 70% of the population), superforecasters are even more intelligent (higher than about 80% of the population).
- As you might guess, those with a quantitative background would be good candidates for superforecasters: “I have yet to find a superforecaster who isn’t comfortable with numbers and most are more than capable of putting them to practical use.”
- They regularly update their forecasts as new information becomes available, poring over the news on topics related to their forecasts to discern nuggets of useful information that might be applied to improve their accuracy. They note, “Superforecasters update much more frequently, on average, than regular forecasters.”
- Superforecasters also have what

the authors call a “growth mindset.” Unlike people who have a fixed mindset, displayed by a mentality of someone who thinks he or she is bad in math and that this is an immutable trait, those with a growth mindset have a completely different outlook. They believe that their abilities are “largely the product of effort—that you can ‘grow’ to the extent that you are willing to work and learn hard.”

- Going beyond the realm of individual superforecasters, the authors also determined that forecasting is a team sport. “The results were unequivocal: teams were 23% more accurate than individuals.” This is the case for a number of reasons, including the positive traits of gathering and sharing of information and sharing of perspectives, which outweigh any adverse inclination toward “cognitive loafing” whereby team members slack off hoping that others will do the heavy lifting that is needed to develop good forecasts.

But Tetlock and Gardner do not leave these superforecasters to wallow in anonymity. They get personal and “out” superforecasters like Doug Lorch: “He looks like a computer programmer, which he was, for IBM.... Doug has no special expertise in international affairs, but he has a healthy curiosity about what’s happening. He reads the *New York Times*. He can find Kazakhstan on a map.” Lorch developed forecasts for about 104 of the project questions and got an overall Brier score of 0.22 (on a scale of 0 to 2, which measures the distance between the forecast and subsequent reality, so the lower the better). Devyn Duffy volunteered for the GJP because he was unemployed: “My most useful talent is the ability to do well on tests, especially multiple-choice. This has made me appear more intelligent than I actually am, often even to myself.”

**Detour and dead end** / *Superforecasting* takes a bit of a detour at one point and tries to be a management book. One chapter

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dives into the use of forecasting by leaders, particularly military leaders. It does so by demonstrating uncertainty where a situation changes so dramatically that plans need to be abandoned and improvisation takes over: “No plan survives contact with the enemy.” This discussion diverts attention away from pure forecasting issues and I don’t see how it fits within the confines of the superforecasting theme.

**I am not a superforecaster** / As for trying to judge my own forecasts based on the methodologies set out in *Superforecasting*, the results are a mixed bag. In a Cato Policy Analysis (#293, December 1997) I referred to Fannie Mae and Freddie Mac, the government-sponsored mortgage giants, as “financial time bombs” based on the contingent liability they posed for the government combined with their inherent mix of leverage, hidden off-budget status, and high-profile political engagement, combined with a long history of similar government bailouts. I was publicly and roundly criticized by Adolfo Marzol, a senior Fannie Mae official, for making such a prediction.

Of course, Fannie and Freddie did go boom in 2008. Although I have always thought that mine was quite the impressive forecast, especially given that only a handful of people publicly predicted it, Tetlock and Gardner’s method casts some doubt on my positive self-assessment: “Forecasts must have clearly defined terms and timelines. They must use numbers.” So although what I predicted did ultimately occur, the fact that I made an open-ended forecast, without a certain date or estimated magnitude of the failure, makes it a much less impressive feat.

I think I have done a little better when it comes to personal finance-related forecasts. Like superforecasters, I like to update my forecasts on a regular basis. I also get a range of advice from what might be called a “team” of forecasters who undertake similar personal finance forecasts.

**What a policy reader will like** / Although the phenomenon of superforecasters

is interesting enough to keep a reader engaged, I think a policy audience will find the hedgehog vs. fox distinction and related analysis the most interesting of the topics addressed. The aftermath of the Brexit vote early this year is consistent with this useful lesson of *Superforecasting*. In the Brexit case we had the crazy whiplash of self-appointed “experts” shouting their disdain for the concept and forecasting a market crash if Brexit happened—in some cases, one of Lehman Brothers proportions. Market losses became a self-fulfilling prophecy in the

immediate aftermath. However, within a few days, with the exception of a select few sectors, the markets made up most of those losses.

Based on Tetlock and Gardner’s research, if you see well-known experts at a policy forum talking about what the future will hold, you can conclude that they are likely not very good forecasters, notwithstanding their boasting to the contrary. As Tetlock and Gardner also found, you should ask the experts for historical data on their prior forecasts and in most cases they will be at a loss to provide it. R

## Safety at Any Price?

◆ REVIEW BY PHIL R. MURRAY

**T**racey Brown, director of the United Kingdom science education charity Sense about Science, and Michael Hanlon, a London-based science journalist, begin their new book, *Playing by the Rules*, with a story: Two “safety sentinels” paddling a canoe in Lake Michigan warned swimmers to return to the “safe swim-

ming depth.” One swimmer protested that a lack of rain had reduced the water level, and asked for permission to swim out where the safety sentinels were paddling. A sentinel denied the request because “one of our patrol canoes might run into you.”

Brown and Hanlon’s book is a string of such anecdotes, which produce reactions ranging from incredulity, to laughter, to exasperation. What motivated the authors is the reality that “many safety rules enjoy an authority they don’t deserve.” They argue against such rules on grounds that they:

- are a waste of time and money; they look important but they just don’t work
- have unintended consequences
- are used as excuses to shirk responsibility
- are covers for vested interests
- distract from real danger and generate cynicism about the measures that *do* work

**Safe skies?** / Take air transportation. Naive airline passengers may learn the hard way that the United States’ Transportation Security Agency (TSA) prohibits boarding with “snow globes, bottles of aftershave, key rings, and a variety of artifacts and souvenirs whose plane-hijacking potential could never have been anticipated by their owners.” Britain’s equivalent of the TSA prohibits “toy guns, replicas, and imitation firearms *capable of being mistaken for real weapons*.” Despite that qualification, an official at Edinburgh airport prohibited a boy from carrying on a Nerf gun. In one of the more bizarre anecdotes, an official at Heathrow Airport stopped a passenger from boarding because his shirt had a *picture* of “a robot that was holding a gun.” The authors add, “Many airlines have a contract of carriage that includes refusing to carry people wearing obscene or offensive clothing.” However that seems insufficient to rationalize the official’s action. “It appears,” the authors suggest, “that the security guard merged

the prohibition on toy guns and the rules about clothing.”

Many rules that aim to make air transportation safe and secure are questionable for various reasons. Brown and Hanlon ask, “Would it really be any easier to hijack an airliner armed with a nail file than with, say, the jagged edge of a smashed whiskey bottle that you acquired *after* clearing airport security?” Alternatively, don’t break the bottle. “Fashion a handkerchief into a wick,” instead, “and you could turn a bottle of whiskey into a highly effective Molotov cocktail.” In addition to imagining how terrorists might select tactics that circumvent security rules, Brown and Hanlon share strategic insights. They recommend allocating fewer resources to stop terrorists from boarding a plane and more resources toward intelligence. “Disrupting attacks much farther upstream, through foreign policy and intelligence work,” they state, “has a far greater track record of being effective, as the official report on 9/11 made clear.”

Although the unintended consequences of rules loom large, officials and the public tend to ignore them. For example, rules that aim to make air transportation more secure have significant costs in terms of money and time. Travelers substitute more risky driving for less risky flying. The authors cite risk analyst Gerd Gigerenzer’s calculation that the unintended consequences of additional rules, plus the public’s perception that flying became more dangerous after 9/11, resulted in about 1,600 additional lives lost on highways during 2002.

**Think of the children** / Foreseeing unintended consequences, or even identifying them after the fact, demands critical thinking. The authors write about Tim Gill, a British writer who specializes in children and risk. According to Brown and Hanlon, Gill reasons that installing “rubberized playground surfaces” in the United Kingdom prevented up to two children from dying over approximately 20 years at a cost of £350 million (about \$450 million). Musing over whether each

of the two lives saved was worth the £175 million spent to save them is difficult to do in public. Gill’s way of presenting cost-benefit analysis is easier for the public to accept: In the two decades that cushy ground cover prevented two children from dying on playgrounds, over a thousand children died in traffic accidents. Had that £350 million been spent on “trafficalming measures,” it is likely that fewer deaths would have occurred. Yet another alternative, Gill points out, was to devote resources to building additional playgrounds. Children would have spent less time crossing streets on their ways to and from playgrounds farther from their homes, and fewer would have died. The reality, Brown and Hanlon spell out, is that the number of playgrounds decreased because of the more costly, higher playground safety standards.

Brown and Hanlon object to rules designed to avoid accountability. They share the story of a mother in Pittsburgh who took her son to a public pool. She wanted the boy to wear water wings because he has cerebral palsy. A lifeguard told her that water wings were prohibited. When asked to make an exception, the lifeguard was unwilling. Because the mother then defied the rule, police were called to the scene. A pool official claimed that the police intended to clarify the rules without evicting the mother.

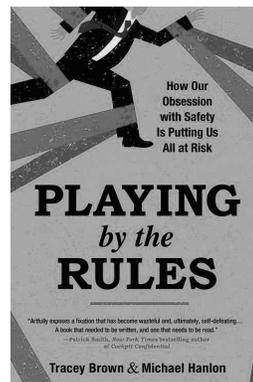
Despite what appears to be an alarming escalation over pool rules, reason and discretion eventually prevailed. The mother persuaded pool officials to make an exception with the ultimate leverage: a doctor’s note. From Brown and Hanlon’s perspective, “That doctor’s note meant that the pool and the lifeguards had managed to shift their responsibility, and probably also their legal liability.” The mother deserves praise for determina-

tion and resolving the issue for her son’s benefit. How many children suffer when their parents back down in front of inflexible authorities? The doctor also deserves praise for taking responsibility. Brown and Hanlon condemn the pool officials for trying to evade responsibility. “The enforcement of safety measures was initially driven by a vague sense of liability,” in the authors’ view, “and then by the pool managers’ relief that responsibility now rested with someone else.”

In fairness to the pool officials, safety did concern them. Lifeguards question the effectiveness of water wings because they encourage a false sense of security. That point is legitimate. Floatation aids are not good substitutes for real swimming skills, and parents themselves might use floatation aids to shirk responsibility for instruction and supervision.

Some rules exist to serve “vested interests.” Recall the “Y2K” problem. Experts knew that some computers would not correctly recognize the change from 1999

to 2000. An anxious public prepared for chaos. Brown and Hanlon blame three groups for stoking the public’s anxiety: Information technology workers, such as programmers and network administrators, sold their services in return for “making the computer system ‘Y2K compliant.’” Politicians seized the “opportunity to be seen to be doing something important about an ideologically neutral problem that was manifestly not their fault.” This is a stark reminder to those who view bipartisanship as a good thing: politicians spend taxpayers’ money on bipartisan efforts with little opposition. The media rounds out the groups that benefited from Y2K mania. Writers could craft hair-raising tales of all that might go wrong because of Y2K, or they could ask probing questions to better estimate the real threat from Y2K.



**Playing by the Rules:  
How Our Obsession  
with Safety Is Putting  
Us All at Risk**

**By Tracey Brown and  
Michael Hanlon**

**321 pp.; Sourcebooks,  
2016**

## IN REVIEW

According to Brown and Hanlon, “virtually every reporter” chose the former. The authors report that global spending to avoid the Y2K problem ranged from a low of \$300 billion to a high of \$1.4 trillion. After the turn of the century, of course, normalcy prevailed, even in countries that did not take precautionary measures. The authors draw this “valuable lesson” from the episode: “Politicians need to learn a bit of skepticism, and they should start asking, ‘*Cui bono?*’ (Who benefits?)” Citizens should ponder that question too.

**Asking for evidence/** Rules are a means to achieve the goal of safety. Intuition suggests that more rules will make us safer.

*Rest assured that we are safer, even if we do not sense that we are safer. A society with fewer rules is not necessarily riskier and, the authors lead us to believe, brings peace of mind.*

But sometimes that intuition is wrong. There is such a thing as too many rules, and an additional rule at some point reduces safety. Brown and Hanlon have a term for this: “rule fatigue.” Although individuals may flout rules on grounds of common sense or rebelliousness, according to the authors, sometimes individuals fail to comply “because the rules, however well meaning, can be so onerous and inconvenient that heeding them at all becomes impractical.”

Hans Monderman, an entrepreneurial street designer, theorized that fewer traffic rules would increase safety where he lived in Drachten, Netherlands. He convinced authorities to eliminate signs, signals, designated crosswalks, and more. Monderman’s insight shows that by keeping a speed limit and scrapping rules that aim to herd people and their vehicles through city streets, urbanites learn to “make eye contact” with each other. As a result, Drachten residents now experience “fewer accidents and fewer deaths.”

In order to combat insensible safety

rules, Brown and Hanlon recommend that citizens “ask for evidence.” When frustrated by an authority figure parroting a seemingly senseless rule, try asking the following questions:

Why? On what basis does this rule exist? Where are the cases of people getting into trouble while doing this? Give us the statistics. Is this rule really making us safer? What is it costing us? Why do different countries have different rules?

Posing effective questions is a forte of the authors. Here are two more: “Have you considered the other effects [the rule] is having? Who *really* benefits from it?” Questioning the authorities will not quickly alter attitudes toward safety, but the payoff may be large. Lori LeVar Pierce of Columbus, Miss. let her son walk alone to soccer practice. The sight of her 10-year-old walking by himself alarmed some-

one enough to call 911. Although Pierce broke no law, a police officer scolded her and likened her parental discretion to “child endangerment.” Editorial writers likewise expressed their disagreement with her judgment for fear that the boy might have been abducted or hit by a car. Unintimidated by the criticism, Pierce publicized her experience and encouraged other parents to let their kids walk to their destinations and play outdoors. Her effort changed both attitudes and infrastructure: the same editorial page rescinded its earlier condemnation and Columbus planned new sidewalks and bike paths.

Brown and Hanlon generally cite sources, though not always. They inform us, for example, that SWAT-team operations have risen from 3,000 annually during the 1980s to 50,000 per year this decade. Their source is the *Economist*. But just one page after that, they inform us that “in 2012, armed law officers killed 587 people in the United States.” They cite no source for that. Nor do they, as they usually

do, help us put that number into proper perspective by telling us numbers for other years and adjusting for population.

The authors do not oppose safety. “Sometimes we have found that a rule does make sense,” they admit. Consider driving. “There is strong evidence,” they proclaim, “that raising the minimum driving age saves lives.” Some of this evidence is international. Europeans start driving at a later age than Americans. Consequently, in Europe, “crash and death rates are generally far lower than in the United States.” The authors point out that the favorable European statistics could have multiple causes. Traffic is lighter in Europe, the higher price of gas there discourages teens from driving, and public mass transportation is a viable substitute. Other evidence that supports a lower minimum driving age comes from New Jersey. In that state the legal minimum driving age is 17 and newly licensed drivers are prohibited from driving in the wee hours of the morning. Based on research produced by the Insurance Institute for Highway Safety, Brown and Hanlon report, “Several hundred young New Jersey citizens are walking around in good health today as a direct result of these measures.” Teenagers, unsurprisingly, oppose an increase in the legal minimum driving age. Politicians hesitate to initiate the change, perhaps because parents look forward to letting their teens drive themselves rather than chauffeuring them.

In sum, the authors aim to convince the reader that many unnecessary rules exist by laying down a barrage of anecdotes. They focus on telling good stories, one after another, without delving into technical details. Their straightforward advice, that we persistently ask for evidence, pervades the book.

Rest assured that we are safer, even if we do not sense that we are safer. Brown and Hanlon are optimistic that attitudes are changing because they see that when citizens demand evidence, officials act on it. A society with fewer rules is not necessarily riskier and, the authors lead us to believe, brings peace of mind. R

# Resuming the American Dream

◆ REVIEW BY GEORGE LEEF

A century ago, one of America's best-known authors was Horatio Alger, whose books celebrated the virtues that led to success: hard work, honesty, thrift, and foresight. In his book *Ragged Dick*, for example, a boy who starts with nothing but his indomitable spirit works his way up from a bootblack to a respected gentleman in New York City. George Mason University law professor F. H. Buckley uses the book as a model for successful societies in his new book, *The Way Back*. The America of a century ago was a land where almost anyone could prosper through work, thrift, honesty, and foresight. It was a land of high income mobility, meaning that people born into poverty often ended up wealthy—and vice versa.

Today, however, there is much less income mobility in the United States. Compared with many other industrialized nations, we have become rigidly stratified. While it is still possible for an individual to rise out of poverty, to a disturbing extent the can-do spirit of Horatio Alger has been replaced by defeatism combined with hostility and cultural decay among the poor.

The high price we pay for this is the near death of “the American dream.” Millions of our fellow citizens, rather than emerging from poverty, find themselves living embittered lives, often turn to crime, raise children who are increasingly unable to thrive, and depend on government handouts. Naturally, that has unhealthy consequences. Buckley writes:

People feel better about each other when the game doesn't seem to be rigged against them. They're also happier and less likely to support demagogues who promise greater equality but would restrict political freedom and threaten the rule of law to attain it.

**Stagnancy and liberty** / We are, argues Buckley, trending toward a caste society where a child's economic prospects are pretty much dictated by the status of his parents. He devotes four chapters to explaining why he thinks that Republicans, conservatives, libertarians, and everyone else should pay more attention to this than they usually do.

Particularly interesting to most *Regulation* readers, I assume, is Buckley's case for libertarians to take seriously the income immobility problem. He writes:

The question is whether income inequality and immobility can lead to the loss of the freedoms the libertarian prizes. That's an argument attributed to Supreme Court Justice Louis Brandeis. “We can have a democratic society or we can have a great concentrated wealth in the hands of a few. We cannot have both.”

I happen to think that Brandeis was mistaken: democracy and, more importantly, liberty coexisted with concentrated wealth before Brandeis and still do today, despite the apparent increase in the “wealth gap” that progressives constantly complain about. Nevertheless, Buckley has a sound point that freedom is endangered by zealots who appeal to the masses in the name of “fairness.” He uses Venezuela

as a good example of a nation where an authoritarian won election by appealing to the desperately poor classes who believed that they would never advance without drastic political change. In the time since the book was written, the situation in Venezuela has gone from terrible to tragic, further supporting his argument.

The United States is less fragile than Venezuela, of course, but we have seen our own populist rabble rousers gain a huge following with the same basic message that put Chavez and Maduro in power. Therefore, we certainly should worry about

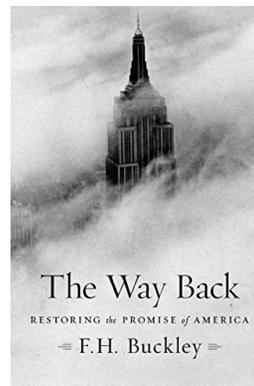
the decline of income mobility and especially the perception among poor people that the system is hopelessly unfair.

So, why is this economic stratification happening? There are plenty of bad explanations for it and Buckley usefully dismisses a number of popular but erroneous ones. Among them is the contention that we are stuck with low income mobility because our labor market is so geared toward “skill-based technological change.” Supposedly, the fortunate few who learn the right technological skills use them to make a killing, but for the great majority who don't, only

the crumbs remain. Interventionist-minded economists make much of this, declaring that we're in a “winner-take-all” economy for which the only solution is redistribution.

Buckley demurs. Skill-based technological change predates the onset of our economic stratification, he observes. He also notes that “new technologies can benefit from low-tech as well as high-tech workers.” In fact, today's technological advances spread the increasing wealth around just as technological advances did in the past. Furthermore, he observes, many of the super-rich didn't get that way because of any tech skills; they were just “risk takers who got lucky” in finance.

What about two favorite whipping boys, globalization and free trade? Dema-



**The Way Back:**  
Restoring the Promise  
of America

By F. H. Buckley  
359 pp.; Encounter  
Books, 2016

## IN REVIEW

gogues love to score points with voters who cling to their populist economics and fear anything foreign. If you listen to either of our current presidential candidates, you'll hear that free trade and global economic competition are scourges that enrich a few while decimating the working class. Although this pitch makes for an easy harvest of votes, Buckley correctly says that free trade and globalization have nothing to do with our economic sclerosis.

**Buckley's analysis** / What are the culprits, then? The author identifies several.

First, there is our dismal education system. The public education establishment is far more interested in maximizing its security and intake of tax dollars than in ensuring that all students learn. Wealthy people can escape from the really terrible schools by living in exclusive suburbs and/or sending their children to private schools. The poor have no such options. Their children, lacking in fundamental skills even if they manage to graduate from schools where the standards are low and discipline lacking, have difficulty finding any but menial jobs.

Buckley points out that in Canada (he's a Canadian immigrant), school choice prevails, so the poorest parents don't have to settle for bad schools. Kids from poor families are much more likely to climb the economic ladder in Canada than in the United States. Many people, including a few liberals, have been arguing for decades that the people most harmed by our education cartel are the children of the poor, but their case has gotten very little traction. Buckley offers this explanation:

If one wants to see people get ahead, as Lincoln did, a good place to start is with the public school system. Contrariwise, if the goal is to ensconce an aristocracy, one could scarcely do better than to weaken the public schools.

What he's getting at is a major theme of the book, namely that the elite "New Class" in the United States favors a host of policies that, whatever their stated intentions, shield the aristocracy against competition. An education system in which their

children can afford good schooling but the rest of the country has to settle for the poor offerings in the public system helps accomplish that objective.

Second, there is our increasingly unfree labor market. People who want to rise above poverty find more and more governmental obstacles in their way, including regulations that add greatly to the cost of opening a new business. Another barrier is occupational licensing laws that keep people from doing work they're capable of doing (such as barbering and cosmetics) unless they first go through a costly and mostly irrelevant state-approved training program.

Buckley recounts one particularly offensive regulatory scheme in Virginia. The state demanded a \$2,500 application fee for anyone who wanted to conduct yoga classes. The proffered reason was that an unlicensed, improperly trained instructor might harm students. Overseeing this was the State Council of Higher Education for Virginia. That burden was lifted after a few years (and much ridicule), but similar licensing rules are still found in a great many occupations, preventing mostly poor people from having chances to better themselves.

Another policy Buckley indicts is our immigration policy. He writes, "Consumers, particularly wealthy Americans, are better off when their goods and services are produced more cheaply by immigrants, but these gains aren't a blessing for the native-born employees who are displaced or whose wages are competed away by immigrant labor." He argues that the United States should adopt an immigration policy more like that of Canada, where "the system is geared towards economic entrants likely to benefit native-born Canadians." We should, in other words, stop admitting so many people without highly valued work skills and admit more who have them.

Of all the policy changes Buckley proposes, that is the only one I find dubious. Yes, we should admit anyone who has highly valued skills, but I don't think we should try to keep out people just because some federal official doesn't consider them to be valuable workers. Many immigrants who wouldn't have seemed destined for

success here nevertheless turned out to be great entrepreneurs. I'm not sold on the idea that having the government pick winners and losers among those who want to come here will have any beneficial effects.

Finally, Buckley observes that our whole legal culture has shifted, adding innumerable rules that waste resources and impede competition. A host of tax loopholes, corporate law rules, and other statutes work to protect the wealthiest Americans from competition from below. He points to a number of laws that ought to be repealed, such as the Williams Act, which protects top corporate managers against takeover bids that would increase the wealth of shareholders.

**Removing perverse incentives** / Buckley's analysis is almost always on target, but I think he has missed one huge aspect of the immobility problem: our welfare system. Its perverse incentives do at least as much to deaden personal initiative and keep the poor down as any other of our misbegotten policies. We pay people a (barely) living wage if they don't work, but quickly pull back the benefits once the individual starts earning. Millions of poor people are hooked on government handouts and expect steady increases in Uncle Sam's vicarious generosity.

Buckley mentions in passing that our welfare benefits are not stingy even when compared with such socialistic countries as Norway and Denmark, but he writes little else on the subject. If Ragged Dick could have just collected welfare and done some under-the-table work to put a few extra dollars in his pocket, he might have turned out differently. The United States made some important reforms to welfare during Bill Clinton's presidency and the results were good, but we have backslid badly under President Obama. I'd say that reforming the system so that it doesn't trap people in dependency should be a top priority.

Also, on the subject of omissions, Buckley doesn't discuss the damage to upward mobility done by minimum wage laws. Young people who've gone to lousy schools might be able to gain entry-level jobs despite their weak abilities if they

could work for a low wage while learning and improving themselves. Federal and state laws have eliminated that possibility, so the more ambitious kids turn to illegal activities where they can make much better money, but at the risk of going to prison. If we can get rid of occupational licensing laws, we should also get rid of (or at least liberalize) minimum wage laws.

Provocatively, Buckley says that he favors “capitalist means to achieve socialist ends.” That is, we will come much closer to the claimed socialist goal of economic equality if we adopt the capitalist ideals of free markets and minimal government. He makes a strong case and his book could win over liberals who want to see poor people make upward strides. **R**

if Keynes himself did not accept that label (see his 1925 speech, “Am I a Liberal?”). Ebenstein also declares Paul Samuelson a classical liberal, but the author of *Chicagonomics* also quotes the 1989 version of Samuelson’s popular textbook *Economics* as pontificating that the “Soviet economy is proof that ... a socialist command economy can function and even thrive.”

*Chicagonomics* suggests that classical liberalism has evolved only along the statist branch of its divide. I think a better case can be made that Chicago school economists were the real heirs of the classical liberals.

Made up of all those who embrace the laissez-faire strand in classical liberalism, libertarians are a diversified bunch. Like social democrats, they have their fair share—and perhaps more than their fair share—of cranks. Ebenstein’s criticisms must not be discounted. Is he wrong in claiming (along with Milton Friedman) that Austrian economists have evolved little in decades (which is not surprising if you think your whole system logically derives from self-evident premises)? “There hasn’t been an iota of progress,” Friedman said. But there is more to libertarianism than a particular school of economic thought.

The author of *Chicagonomics* explains that decades before the “Chicago school” appeared, the University of Chicago’s Department of Political Economy—rechristened the Department of Economics in 1925—was a heterogeneous place. Its first chairman, James Laughlin, established himself, says Ebenstein, “as a strong classical liberal” and “a staunch opponent of government intervention in the economy and as a proponent of laissez-faire,” which illustrates that laissez-faire is not inconsistent with classical liberalism. But the department also harbored figures such as progressive economists Thorstein Veblen and far-left labor economist Robert Hoxby.

The department’s 1930s

## A Ghostly Chasm

◆ REVIEW BY PIERRE LEMIEUX

In *Chicagonomics*, Lanny Ebenstein, an economist at the University of California, Santa Barbara, pursues a wide agenda and defends three theses: (1) there is a chasm between classical liberalism and libertarianism; (2) the recent “Chicago school” of economics was libertarian, not classical liberal; and (3) strong redistributionist policies are needed in America. (Disclosure: Ebenstein is an adjunct scholar at the Cato Institute, publisher of *Regulation*.)

Ebenstein argues that classical liberalism as defended by 18th- and 19th-century economists such as Adam Smith and John Stuart Mill was far from today’s libertarianism and the Chicago school. Classical liberals favored “a wide and appropriate area for government activity in a prosperous and just modern society.” Classical liberalism, Ebenstein writes, “is not ‘libertarianism’ as the latter term is used today. It is important to be crystal clear on this point.”

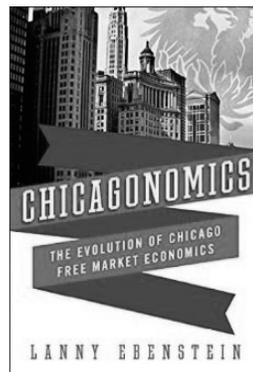
Contemporary libertarians, he continues, are neoanarchists and government haters. Many are “ideological crackpots and even charlatans.” “Contemporary libertarianism too often denotes cranky obscurantism, intolerance, irrelevance, and, frankly, poor scholarship and manipulation of data.” Murray Rothbard was “a crackpot ideologically.” To be fair, Ebenstein only claims that “many contemporary libertarians” are “too often” cranks (my italics).

He does not apply this diagnosis to major economists of the Chicago school.

But he does blame them for becoming more libertarian than classical liberal.

**Cranky libertarians** / We probably have to admit with Ebenstein that there was an ambiguity in classical liberalism. Classical liberals wanted both individual liberty and (some degree of) government intervention. This ambiguity persists in our own time. Today’s social democrats can be viewed as classical liberals who want more government intervention and less individual liberty. Today’s libertarians can be seen as classical liberals who want less government intervention and more individual liberty. The argument for a total break between classical liberals and libertarians does not quite work.

As much as he imagines a chasm between classical liberals and libertarians, Ebenstein, on the contrary, sees a smooth continuity between classical liberals and their more interventionist successors. He tells us that “Keynes was a classical liberal,” even



**Chicagonomics: The Evolution of Chicago Free Market Economics**

By Lanny Ebenstein  
304 pp.; St. Martin's Press, 2015

PIERRE LEMIEUX is an economist affiliated with the Department of Management Sciences of the Université du Québec en Outaouais. His latest book is *Who Needs Jobs? Spreading Poverty or Increasing Welfare* (Palgrave Macmillan, 2014).

## IN REVIEW

stars, such as Frank Knight and Henry Simons, were classical liberals in the ambiguous sense of their forebears. Ebenstein also lists Jacob Viner, whom Friedman apparently did not consider a classical liberal. Of all these pre-war Chicago economists, Ebenstein emphasizes their belief in certain forms of government intervention. They favored stimulative fiscal and monetary policies during the Great Depression: “They were more Keynesian at times than Keynes himself.” But they viewed these policies as temporary and opposed New Deal regulations. Viner thought that the U.S. welfare state, coexisting with a market economy, was “really worth fighting for and dying for as compared to any rival system.” Knight believed that “every member of society has a right to live at some minimum standard, at the expense of society as a whole.” Of course, these Chicago economists were free traders.

Perhaps contradicting again his chasm between laissez-faire and classical liberalism, Ebenstein explains that Simons claimed to believe in both. Simons said that his “underlying position may be characterized as severely libertarian or, in the English-continental sense, liberal.” According to John Hopkins University history professor Angus Burgin, Simons was the “first significant economist to refer to himself as ‘libertarian’” (quoted by Ebenstein). Yet, the author of *Chicagonomics* insists, Simons favored progressive taxation and government services. George Stigler, a later Chicago economist who was more libertarian than Simons, thought that much of the latter’s proposals were “almost as harmonious with socialism as with private-enterprise capitalism.” As presented in *Chicagonomics*, Simons illustrated the continuity between classical liberalism and libertarianism.

**Enter the Chicago school /** The Chicago school took off after the arrival of Milton Friedman in 1946 and only got its label in the 1950s. Friedman, who stayed at Chicago until 1976, “was the heart and soul of the Chicago school.” Aaron Director and Allen Wallis also arrived at Chicago in 1946. Other Chicago school economists included Stigler and Gary Becker. The fact

that Friedman, Stigler, and Becker each won a Nobel Economics Prize illustrates the remarkable intellectual contribution of the Chicago school.

The Chicago school also comprised scholars outside the Department of Economics. Director and Ronald Coase (another Nobel laureate) held appointments in the Law School. Friedrich Hayek, who taught at Chicago under the aegis of the Committee on Social Thought between 1950 and 1962, was indirectly related to the Chicago school and occupies a large place in Ebenstein’s book.

Like Friedman himself, the Chicago school had two intellectual thrusts: one academic and methodological, the other more normative and popular.

The methodological school was centered in the Department of Economics and revolved around monetarism, Marshallian neoclassical economics, the use of empirical and statistical methods, skepticism toward mathematical economic theory and perhaps especially large macroeconomic models, and the rejection of Keynesianism. Ebenstein is right to clearly distinguish between, on the one hand, mathematical economics, which is the mathematical modeling of economic theory (which the Chicago school was suspicious of), and on the other hand the use of statistical measurement and empirical analysis (which the school embraced).

The popular face of the Chicago school was the normative defense of free markets. Its main representative was Friedman, who played a major role as a public intellectual, but Becker and others had an impact. Ebenstein criticizes “the Friedman Chicago school of economics” for being “more ideological than scientific, at least in addressing the general public.” That qualification is important.

Hayek was on the normative side of the Chicago school. Ebenstein correctly emphasizes how Hayek’s methodology diverged from Friedman’s. A member of the Austrian school of economics, Hayek did not espouse Friedman’s positivism. But he defined himself as a classical liberal and was a great defender of economic freedom.

*Chicagonomics* gives him a lot of attention, perhaps because the book is as much interested in libertarianism as it is in economics.

Much of Hayek’s work dealt with political philosophy. Friedman discounted much of Hayek’s work in economics and claimed that his capital theory was “unreadable.” By a quirk of history, however, Hayek earned his Nobel Prize (shared with socialist economist Gunnar Myrdal) in 1974, two years before Friedman got his.

Ebenstein makes much of the ideological evolution of Friedman and Hayek who, he tells us, both started as classical liberals but became more and more libertarian as they grew older, up to espousing a “virtual neoanarchism.” It is unclear what Ebenstein means by that expression, other than that it is terminologically two steps removed from anarchism.

In the 1940s, according to Ebenstein, Hayek agreed with Simon’s brand of classical liberalism. Hayek declared he was “in favor of a minimum income for every person in the country.” Ebenstein blames the later Hayek for opposing compulsory participation in any sort of monopolistic government program except for law enforcement and national defense purposes.

For Ebenstein, a similar evolution is even more obvious in the case of Friedman. Friedman’s *Capitalism and Freedom* (University of Chicago Press, 1962) “is clearly a successor to John Stuart Mill’s *On Liberty*,” but it already “displayed a largely anarchist streak,” suggesting again a connection between the two strands of thought. *Capitalism and Freedom* approved many traditional functions of the contemporary state, while the later Friedman, Ebenstein explains, came to favor a night watchman state, a low-level negative income tax, less government expenditure, and an almost totally private education system.

Ebenstein may not be consistent in his evaluation of the later Friedman. Quoting a personal letter that Friedman wrote one year before his death, Ebenstein writes that “Friedman was, ultimately, a man of the left.” Or else, as I would argue, libertarianism is as much on the left as it is on the right, like classical liberalism was. But

then, there is no real chasm between the two strands of thought.

**A natural evolution** / Friedman's and Hayek's intellectual evolutions are easy to understand. From classical liberalism, one can easily move to libertarianism, especially with hindsight about the consequences of following the do-gooder branch of classical liberalism. Looking at today's Leviathan, it is quite understandable that Friedman and Hayek outgrew the naivety of their classical liberal forebears. The state is not so nice after all.

When he was (according to Ebenstein) still a classical liberal, Friedman explained how one can become more distrustful of government:

If, for example, existing government intervention is minor, we shall attach a smaller weight to the negative effects of additional government intervention. This is an important reason why many earlier liberals, like Henry Simons, writing at a time when government was small by today's standards, were willing to have government undertake activities that today's liberals would not accept now that government has become so overgrown. (*Capitalism and Freedom*, p. 32)

As government continued to grow, Friedman thought that the cost of new intervention in terms of freedom was rising and he thus naturally became radicalized.

Classical liberalism is closer to anarchism than Ebenstein realizes. A French philosopher, Raymond Ruyer, suggested an interesting reconciliation in his 1969 book *Éloge de la société de consommation* (*In Defense of the Consumer Society*): liberalism, he wrote, meaning classical liberalism, is "real anarchism, feasible and realized, as opposed to mere emotional declarations."

Despite his obvious learnedness, does the author of *Chicagonomics* really understand libertarianism and current politics? He approvingly quotes George Nash, "the great historian of modern conservatism," who claims that the mindset dominating the thought of "mainstream Republican organizations" is that of "radical libertarian

anarchists," while anarcho-capitalist slogans have become mainstream in the Tea Party if not in the Republican Party itself. This must occur in another dimension of the universe. And although Ayn Rand, whom Ebenstein—not without justification—puts among the cranks, was influential in bringing a whole generation to question the politically correct justifications of the state, she refused the libertarian label and little of today's libertarianism rests on her shoulders.

**Pink elephant** / Ebenstein is too knowledgeable to be "red" in the socialist sense. Yet, we can see a pink elephant in *Chicagonomics*: an overwhelming concern for economic equality. Ebenstein constantly laments growing inequality and repeats that higher marginal tax rates and government redistributive policies are needed to fight it. He blames libertarians for ignoring the problem. Without discussing the extent or evolution of income inequality, we can easily find flaws in his arguments.

Ebenstein does not seem interested in the sources of inequality. He repeats some statistics about unequal incomes and wealth, stressing that wealth has become even more unequal than income. But how is that possible? Since income is the return on wealth (including human capital), the distribution of wealth correctly measured should parallel the distribution of income—or else the statistics are missing something. This something could be the depreciation of the human capital of the poorly educated in the face of technological progress, coupled with unsatisfactory public education.

Another possible source of inequality, which Ebenstein mentions in passing, is the lower fertility of richer families. Still another factor is the change in the marriage market, where assortative marriage means that the rich (including in human capital) are now marrying more among themselves: male physicians marry female physicians, instead of nurses as before. The human-capital poor are left to marry among themselves, thereby increasing inequality. (See the work of Jeremy Greenwood, Nezih Guner, Georgi Kocharkov, and Cezar Santos on this.) Why and how

should inequality stemming from such individual choices be corrected?

A related point is that one should distinguish clearly between formal equality under the law, which is clearly a classical liberal ideal, and material equality, which is probably not.

Ebenstein focuses on relative inequality, not on poverty. Even if "a rising tide lifts all boats," he would still, I surmise, dislike inequality. It is not clear whether the classical liberals, living in an era where dire poverty existed, would have followed him. After all, 99% of American households own a TV set, and more than three-fourths own more than one.

Ebenstein underestimates the increase in state power that is needed to correct income inequality. As French political philosopher Bertrand de Jouvenel wrote, "The more one considers the matter, the clearer it becomes that redistribution is in effect far less a redistribution of free income from the richer to the poorer, as we imagined, than a redistribution of power from the individual to the State" (*The Ethics of Redistribution*, Cambridge University Press, 1952).

Adam Smith himself, even if he did argue for taxing the rich more and perhaps even for progressive taxation, saw the danger. In *The Wealth of Nations*, he wrote:

The tax upon shops, it was intended, should be the same upon all shops. It could not well have been otherwise. It would have been impossible to proportion with tolerable exactness the tax upon a shop to the extent of the trade carried on in it, without such an inquisition as would have been altogether insupportable in a free country. ... For these reasons, the project of a tax upon shops was laid aside.

In his 1763 *Lectures on Jurisprudence*, Smith had already noted: "No doubt the raising of a very exorbitant tax, as the raising as much in peace as in war, or the half or even the fifth of the wealth of the nation, would, as well as any other gross abuse of power, justify resistance in the people."

I am not as sure as Ebenstein that Smith, if he were to come back to life,

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would not become a radical libertarian.

On the problem of inequality, the author of *Chicagonomics* makes 13 practical proposals, which range from raising the federal minimum wage to steep increases in tax rates for the rich. From a Chicago-school viewpoint, a few of his proposals are good, but others are questionable or incompatible with his proposal to “reduce regulation.”

Ebenstein underestimates the role of regulation in fueling inequality. And he does not mention the role of crony capitalism or

the fabrication of a large class of criminals (partly because of the vicious war on drugs) who, with their criminal records, often cannot earn an honest living. The solution seems to reside in less government power, not more. Mistrusting the state has its advantages.

**Conclusion** | *Chicagonomics* is an instructive book about the history of economics at the University of Chicago. It raises interesting and challenging questions, but takes many shortcuts. Among the missing elements,

the reader might have liked to hear Ebenstein’s take on why the Chicago school as we knew it seems to have vanished.

As I have tried to show, two of the book’s main theses are overdone. Most of contemporary libertarianism is in continuity with classical libertarianism. And even if (a certain sort of) equality is a classical liberal value, a call for still more redistribution and government power ignores how far contemporary governments have drifted away from classical liberalism. **R**

## Working Papers ⇄ BY PETER VAN DOREN

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

### Ban the Box

“Ban the Box, Criminal Records, and Statistical Discrimination: A Field Experiment,” by Amanda Y. Agan and Sonja B. Starr. June 2016. SSRN #2795795.

People who have been incarcerated have greater difficulty finding subsequent employment. That, in turn, puts them under economic stress and increases the likelihood that they will commit new crimes and return to prison. This is costly for both the ex-convicts and society.

A currently popular policy remedy to this problem is “Ban-The-Box” (BTB)—prohibiting employers from asking about criminal history (the notorious “Have you been convicted of a crime?” checkbox) on initial job applications. The intent of such policies is to increase employment among black males, who have disproportionately more criminal convictions than other applicant groups.

But a potential downside of this policy is that employers, fearing the risk of unknowingly employing a former criminal, will engage in more statistical discrimination because they are prohibited from eliminating criminals from consideration at the outset. That is, employers will reduce their consideration of young black men, in general, because the employers are prohibited from determining initially which of them have criminal records.

To test for this possibility, the authors of this paper sent 15,000 fictitious online job applications to employers in New Jersey and New York City before and after both jurisdictions enacted BTB laws. They found that before BTB, white applicants received 7% more callbacks, while after BTB whites received 45% more callbacks.

Most black men do not have criminal convictions. Under BTB policies they are not allowed to signal that fact to employers. As a result of this well-intended policy, they are losing work opportunities.

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### Are Consumers Rational About Energy Prices?

“Are Home Buyers Myopic? Evidence from Housing Sales,” by Erica Myers. July 2016. E2e Working Paper #24. Available at <http://e2e.haas.berkeley.edu/working-papers.html>

The regulation of the energy usage of automobiles, air conditioners, and furnaces is rationalized by the alleged inability of consumers to calculate and utilize future energy costs in their decisions about how much to pay now for durable investments that have differing future energy costs. This rationalization has been challenged by a number of empirical papers. For instance, the Winter 2015–2016 “Working Papers” includes a discussion of a paper analyzing used car sales from 1993 through 2008 in which a \$1 increase in the present discounted value of the fuel cost over the remaining life of the vehicle resulted in a \$1 decrease in the price paid for the vehicle. That is, consumers were rational and took into account future energy prices when they decided how much to pay for used cars.

The current paper compares prices in Massachusetts from 1990 through 2011 for houses that heat with oil versus houses that heat with natural gas. Oil and natural gas prices diverge from each other for exogenous reasons (hurricanes in the Gulf of Mexico, for example) and the paper asks whether consumers take the differences in heating costs into account when they determine how much to pay for a house. The paper finds that when the relative cost of heating increases by \$1 per million BTUs, house prices decrease by \$1,000–\$1,200. This is consistent with the full capitalization of the present value of the cost increase at an 8%–10% discount rate.

Do energy-using products require regulation because consumers are myopic? The answer once again appears to be no. **R**

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