BOOK REVIEW ESSAY

On the Morality of the Market and Government

Chang, Ha-Joon (2010). *23 Things They Don't Tell You About Capitalism* (New York: Penguin Books).
Roth, Timothy P. (2010). *Politicians, Economists and the Supreme Court at Work: The Founders Betrayed* (Cheltenham, UK and Northampton, MA: Edward Elgar).

For the dismal science, the academy of economists certainly does have its share of jokes. Two of my favorites revolve around the awarding of the Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel in 1974 and 2002. Gunnar Myrdal and Friedrich Hayek shared the Nobel Prize in 1974 for "their pioneering work in the theory of money and economic fluctuations and for their penetrating analysis of the inter-dependence of economic, social and institutional phenomena" despite the fact that the analyses really were at opposite ends of the political spectrum, thus spawning the stab that economics is the only discipline where you can win a share of a Nobel Prize (even though it technically is not a Nobel Prize but rather a prize named in memory of Alfred Nobel) for saying the opposite of what the person with whom you are sharing the prize is saying. Similarly, in 2002, when Vernon Smith won "for having established laboratory experiments as a tool in empirical economic analysis, especially in the study of alter-native market mechanisms," his research showed how economic theory could be confirmed by experiment. Yet, the person with whom he shared the prize was Daniel Kahneman "for having integrated insights from psychological research into economic science, especially concerning human judgment and decision-making under uncertainty." The joke is Kahneman, along with longtime co-author Amos Tversky (who died in 1996), basically showed using experiments that economic theory doesn't work the way the books tell us it should.

I only hope the juxtaposition of these two books in the same essay does not provoke a similar laugh because although the authors come at the material from two entirely different perspectives (Roth is for a limited government perspective, while Chang sees much the government can do), their argument the current economic (and, by extension,

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political) system is morally bankrupt is one that should be listened to by all sides of the current debate over the proper role (or lack thereof) of government in the economy.

Roth's book is the more narrowly focused (and slimmer) volume. Professor Roth, the A.B. Templeton Professor and Chairman of the Department of Economics and Finance at the University of Texas, El Paso, makes the argument the increasing girth and reach of the Federal Government is something the founders of this nation would not have recognized nor would they have approved. It is an intellectually dense book filled with citations and quotations from original source documents of those who were present and involved in the birth of this nation and its constitution. Roth notes both Democrats and Republicans have presided over what the founders would consider an unwarranted and unbridled expansion of federal government activity into a myriad of places.

Roth makes a compelling case the Commerce Clause, the General Welfare and Necessary and Proper Clauses and the Legislative Powers Clause have been stretched beyond belief and to the point their interpretations would not be recognizable by the Founders. Ironically, notes Roth, the Commerce Clause, allowing the US government to regulate *interstate* and *international* commerce is invoked by the Obama Administration to regulate a purely *intrastate* activity: the purchase of health insurance. Since each health insurer is licensed by the state in which it operates, the interstate commerce clause cannot be used. This would not have been the case had the ability to purchase health insurance across state lines been included in the legislation, but it was not.

Similarly, actions undertaken under the stimulus bill, which went to propping up individual companies could not be justified under the General Welfare and Necessary and Proper Clauses and, furthermore, violates the moral equivalency of persons so cherished by enlightenment thinkers such as the Founders. Indeed, by requiring the general taxpayer to pay for individual corporations, it is about as far from the Founders' intentions with regard to the conception of these clauses as can be.

Then there are the mini-fiefdoms created in *Executive Branch* agencies such as the Food and Drug Administration and the Environmental Protection Agency. These entities have gone so far as to usurp those powers specifically granted *exclusively* to Congress as to upset the delicate balance of powers between the various branches of government. The recent pronouncement by the EPA it can regulate carbon emissions and other greenhouse gases as a type of pollutant under the Clean Air Act is arrogant in the least and more likely unconstitutional from the standpoint of being an illegal delegation of power that is “strictly and exclusively legislative” (Chief Justice Marshall in *Wayman v. Southard* as quoted by Roth, p. 109).

Roth’s most damning critique, however, is saved for his fellow economists. Roth notes a fundamental incompatibility between the Smithian/Kantian perspective embraced by the Founders and the Utilitarianism as practiced by economists. The means to the end are important according to the Founders’ doctrine. Whereas health care for all may be a noble goal, the means to undertake it through a federal government health care bill is constitutionally in doubt. On the other hand, utilitarianism follows a consequentialist argument: the end justifies the means under the “greatest happiness for the greatest number” principle. However, Roth practicing such a philosophy can lead to deep-seated resentment and eventual disrespect for government that would render it impotent in its most important mission, the maintenance of public order and national defense.

Where Roth’s argument fails is where he treads a little too far afield. He argues in favor of a balanced budget amendment by stating “political discrimination against future taxpayers by in-period majorities is clearly inconsistent with the Founders’ prior ethical commitment to the moral equivalence of persons” (*emphasis as in original*, p. 21) and that “the Founders would reject federal deficit spending on moral grounds” (*emphasis as in original*, p. 22). Yet, the Constitution of the United States, as approved by those same Founders provides in Article I, Section 8 that “The Congress shall have Power to lay and collect Taxes, Duties, Imports and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States” (*emphasis added*). Furthermore, the next enumerated power of Congress that is listed is to be able “[t]o borrow money on the credit of the United States.” The notion that debt was anathema to the Founders is actually a contradiction in analysis from an otherwise fine tome. To hammer home this point, the Founders’ actions belie Roth's argument, for, from the very founding of the Republic, the new nation was in debt to the tune of $75 million when it assumed the debts of the Continental Congress and the obligation to make payments on the national debt was not extinguished for the first 40 years of the country's existence, by which point all but Charles Carroll (signer of the Declaration of Independence) and James Madison (who wrote most of the US Constitution) among the Founders had died.

Still, on balance, this is a very useful book in understanding the rather conservative nature of our Founding Fathers and the founding document, the US Constitution. Even as he disagrees with its actions, Roth does a good job of describing how the political economy of the country has been shaped by the Supreme Court, much in the same way as a book that he should have cited did 86 years before: that book being *The Legal Foundations of Capitalism* by John R. Commons.

Ha-Joon Chang, Reader in the Political Economy of Development at the University of Cambridge, takes a broader approach. It is written more for the lay person with fewer citations and the style is more conversational. Chang has little regard for legal questions encompassing Roth's tome but instead provides the neoclassical/neoliberal perspective and then demonstrates most economists are inconsistent in their application of theory. Among the *23 Things They Don't Tell You About Capitalism* is "there is no such things as a free market" (p. 1), "companies should *not* be run in the interest of their owners" (p. 11), "despite the fall of communism, we are still living in planned economies" (p. 199), "financial markets need to become less, not more, efficient" (p. 231), and "good economic policy does not require good economists" (p. 242).

His style is to begin with the "lie" economists tell the general public and then provide the "truth", all the while pointing out the inconsistencies in the positions of economists, oftentimes appealing to the history of economic thought and the history of the economy to buttress his position. His positions, while probably castigated by many as being on the "left" of the political spectrum, should appeal to the right as well if properly understood. The limited liability enterprise known as the corporation was skewered by the founder of economics, Adam Smith, for good reason: it tends to cause people to take more risk than they ought because you get all the upside with a limit on the downside. As Dr. Chang correctly points out, it was Karl Marx, hardly an apologist for capitalism, who recognized the ability of corporations to advance human progress precisely because of this tendency. People are always looking for a mechanism to do this and the corporation provides that vehicle. *It gets worse*. Stockholders are easily the most fleet-footed of stakeholders, able to exit the investment virtually instantaneously by simply selling it to someone else (whether they will receive a price that they like is open to debate but anyone who instructs his or her stockbroker to sell "at market" can exit their ownership position in one company and enter into an ownership position in another company within minutes, if not seconds) and they can keep doing this every day of every year, multiple times per day. Others (such as workers in those companies) are not so mobile. This leads to myopic behavior of the worst sort. The solution from a right-wing stand-point would be to abolish corporations entirely since they are creations of the state, although Dr. Chang prefers to argue corporations need to be more inclined to respect interests of all stakeholders through broader corporate governance schemes.

Chang points out restrictions on labor mobility are standing in the way of neoclassical nirvana, yet few economists argue in favor of lifting immigration controls. A cynic could argue the reason so few examine this with any degree of intellectual honesty is because they personally benefit: economics is one field that is practiced no different in Bangalore than Boston and, if anything, is probably practiced *better* in Bangalore. Yet, having good economists is no substitute for good economic policy. Chang quotes John Kenneth Galbraith, although noting the case is overstated, that "economics is extremely useful as a form of employment for economists" (p. 245).

Indeed, perhaps Chang's greatest contribution is the indictment of neoclassicals and neoliberals who run the profession:

> Over the last three decades, economists played an important role in creating the conditions of the 2008 crisis (and dozens of smaller financial crises that came before it since the early 1980s, such as the 1982 Third World debt crisis, the 1995 Mexican peso crisis, the 1997 Asian crisis and the 1998 Russian crisis) by providing theoretical justifications for financial deregulation and the unrestrained pursuit of short term profits. More broadly, they advanced theories that justified the policies that have led to slower growth, higher inequality, heightened job insecurity and more frequent financial crises that have dogged the world in the last three decades. . . .
> . . . In other words, economists have been worse than irrelevant. Economics, as it has been practiced in the last three decades, has been positively harmful for most people. (pp. 247-48)

Therein lies the rub: economics as currently practiced is positively immoral and it encourages everyone to behave the same. As Chang notes, free-market economists state that "If people look as if they are behaving morally . . . it is only because the observers do not see the *hidden* rewards and sanctions that they are responding to" (p.

48). Thus, people are honest not because of an inherent belief in honesty but rather because they wish to develop a reputation for honesty, so as to be more successful. It is the seeking of success, not honesty, that captivates them. Chang notes, however, the inherent illogic of this line of argument since there are many things that we do each day that simply do not have such hidden rewards and sanctions (unless those rewards and sanctions are internal to the individuals, which would mean that people really were moral creatures in any case). Indeed, this is Thing 5, according to Dr. Chang, “Assume the worst about people and you get the worst” (p. 41).

Instead, Chang supports the heterodox economists as they exist in many folds “from the very right-wing [Friedrich] List to the very left-wing [Karl] Marx” (p. 249). These economists share one commonality: an inherent belief the conditions of “free market economics” can *and should* be altered by government action, whether it be reshaping institutional characteristics in which market flourish (a right-wing approach) or by direct government regulation and ownership of economic resources (a left-wing approach).

Getting back to why neoclassical economics has failed so miserably, it is as if the profession has completely forgotten the Lancaster and Lipsey general theory of the second best: if you cannot optimize in all spheres, sometimes it is better to deviate from optimality in those areas that you can control. This paper, published in 1957 and rooted in the general equilibrium theory that is (mis)used by many to justify free market policies, serves to showcase how far afield neoclassical economics really is even from its own roots. Indeed, that one paper probably ended up shaping my perspective on economics more than any other that I have ever read. Let’s hope that Chang’s book can do the same for a new generation of economists.

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