FDR at Breakfast

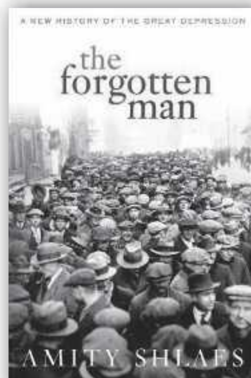
Reviewed by Ike Brannon

THE FORGOTTEN MAN: A New History of the Great Depression
By Amity Shlaes
464 pages; New York, N.Y.: HarperCollins, 2007

The Great Depression is a topic that, much like Abraham Lincoln or World War II, raises the question: What can another book tell us that we don't know already? The answer, in the case of *The Forgotten Man* by Amity Shlaes, is plenty. Shlaes eschews a deep analysis of the macroeconomic issues of the day (save for a succinct and dead-on analysis of the Federal Reserve's myriad blunders as well as the debate and passage of the Smoot-Hawley Tariff) to focus on the regulatory policies that developed during the period and did a preponderance of harm to the economy. Her approach is not only entertaining but also relevant: In the last 60 years, monetary policy has improved; we no longer cut the money supply in the teeth of a recession. But many Depression-era regulatory policies remain intact and popular, including the Davis-Bacon Act and the minimum wage.

Shlaes, a fellow at the Council on Foreign Relations and a columnist for Bloomberg (full disclosure: Shlaes is an acquaintance of mine, for whom I have occasionally been a source), takes us through the fallow years of the Depression at a breakneck pace, pausing only occasionally to explore some of the particularly vivid characters and tribulations of Franklin D. Roosevelt's administration and examine some its more egregious decisions, as well as how they came to be. It is not pretty.

FDR AT WORK Economists have had a field day detailing how monetary and fiscal policy were absolute disasters during the 1930s (none more memorably than my former professor, Elmus Wicker, a foremost authority on the history of monetary policy). There have also been plenty of words written about the tax and regulatory changes that drastically worsened the economic landscape. In contrast, Shlaes helps us understand the political milieu of the 1930s and how Roosevelt and his advisers arrived at so many of their decisions. The answer, then as always, is that policy is made with faulty information and for reasons of narrow self-interest, self-aggrandizement, myopic political goals, or sheer spite more often than anyone would care to admit.



The emphasis is not on the enduring policies that resulted from Roosevelt's tenure, but on how he and his advisers arrived at the policy decisions of the day. In order to explore this fully, a lot more attention is given to the machinations of individuals fighting for FDR's ear as well as the president's own motivations and calculations than in any standard discussion of the Depression. His daily habit of setting the price of gold while having his morning breakfast, based on nothing more than a hunch, will exasperate the policy wonks reading this, while his astonishment that wealthy Americans would deliberately arrange their finances so as to lower their tax burden seems almost quaint to us today.

Shlaes relates the Depression to present political reality in a number of ways. First, the book does a nice job of delving into the complex relationship Roosevelt had with Congress. Despite the fact that his party controlled both the House and Senate for his entire tenure (at times, overwhelmingly), his ability to get his legislation through eventually became quite difficult. Of course, early in his tenure his major pieces of legislation were enacted easily, thanks in part to the gravity of the economic morass. But that honeymoon gave way to a general wariness on the part of Congress toward the president, usually quite warranted. His attempt to force through a major piece of tax legislation (that increased marginal tax rates, corporate income taxes, and the tax on investment and capital gains) by attaching it as a rider to an unrelated piece of legislation without so much as giving a courtesy call to the chairman of the Senate Finance Committee is a case in point.

Shlaes also suggests that Roosevelt is the first modern politician in the sense that his strategy for getting and remaining in office was to put together a coalition of interest groups. Cultivating the union vote (and passing the Wagner Act, ensuring this would grow mightily for his subsequent elections) and the black vote began a 75-year (and counting) dominance of those groups by the Democrats. She makes a convincing argument that this approach to campaigning set the standard for how modern politicians do their campaigning — with a particular nod to fellow New Yorker Sen. Hillary Clinton.

RUSSIA TO WASHINGTON While Shlaes is quite critical of the Roosevelt administration, she portrays its members fairly, given the world they inhabited. For example, her discussion of a 1927 junket to Stalin's Russia taken by several men who later became Roosevelt's advisers captures intensely how Russia must have appealed to intellectuals dissatisfied with the progress in the United States and searching for a better way, yet she does not tar any of the travelers as naïve or ignorant. The six-hour meeting they had with Stalin and Paul Douglas's side trips (and professed doubts) were parts of a fascinating and important trek for these men and the future Roosevelt administration as well.

The visitors to Russia chafed at the inaction by Coolidge (and later Hoover) at the time, an impatience with the federal government that grew exponentially when the Depression hit. The inaction was mistaken by many as indifference

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rather than what it really was, namely a sheer cluelessness as to what to do. Of course, once in office, Roosevelt's people didn't have a good idea about how to cure the Depression either, but FDR assumed the presidency with political capital and the intention to use it to experiment with policy to attempt to end the downturn.

Shlaes' breezy tone captures the pace of FDR's administration, but sometimes makes reading difficult.

Two distinct themes emerge: First, Roosevelt felt the need to be doing *something* so as to let people know that their government cared and was marshalling as many resources as it could to help them. Second, Roosevelt believed that what needed to be done was to centralize economic regulation within the federal government.

Shlaes gives no truck to either notion. There were plenty of people (Keynes included) telling FDR that his reforms were not what the situation required, but Roosevelt was not looking beyond his re-election in 1936, like any good politician. By November of that year, his policies got the unemployment rate down to the lowest level since early in the Hoover administration — but it crept back up soon afterward, as any good economist today could have predicted.

And while Roosevelt's fireside chats and relentless optimism undoubtedly made many people feel better about their lot, the notion that this was an acceptable substitute for getting off of the back of business and letting it create jobs makes little sense, she argues. The sheer uncertainty created by his meddling in the economy led to all kinds of anxiety on the parts of many people, not just businessmen.

The book's breezy tone makes it an easy read, but is also its main flaw. The focus of the narrative often jumps quickly from person to person, across an entire range of economic (and geographic) activity, sometimes within a single paragraph. We begin a vignette at the Tennessee Valley Authority and then the next paragraph we jump to Nevada and then we are treated to a White House discussion before heading to New York to see Wendell Wilkie's reaction to all this action. The style both captures the frenetic pace at which Roosevelt and his people tried to move as well as the broader notion that he did not have any grand plan and that what was labeled "the New Deal" was really an agglomeration of grand economic experiments, personal fiefdoms, and muddled bureaucracy that carried the faint whiff of socialism but had little connection to anything FDR intended. This writing style comes at the cost of making it difficult at times to follow the story at the rapid pace Shlaes sets out.

The book is at its strongest when it narrows its focus down to specific vignettes, such as the memorable story of the Schichters — poultry men from Brooklyn whose adamant refusal to follow the New Deal's convoluted laws caused them to be convicted and sentenced to prison, only to have their judgment set aside by the Supreme Court in one of the Roosevelt administration's biggest political losses. Shlaes' description of their District Court trial, replete with the thinly veiled anti-Semitism that came from the prosecuting attorney, and Shlaes' uncanny ability to capture the halting speech of the Yiddish-accented Shlichter brothers, is the highlight of the book.

There are many such stories in this book and Shlaes sets them out masterfully. While C.S. Lewis suggests we read to know that we are not alone, we read policy books about the past, ideally, to learn about the universality of the problems we face today and how some of them are a direct result of what happened way back when. With *The Forgotten Man*, it is difficult to miss either lesson. R

Job Half-Finished

Reviewed by Richard L. Gordon

THE UNSUSTAINABLE COSTS OF PARTIAL DEREGULATION
By Paul W. MacAvoy
208 pages; New Haven, Conn.
Yale University Press, 2007

After the dismantling of regulation of air, truck, and rail transportation and natural gas production, questions arose about whether similar deregulation was appropriate for other realms such as gas pipelines, telecommunications, and electric power. In fact, in these cases, regulation was kept in place, but efforts were made to alter the industries and their regulation. The routes taken were very different.

In electric power, the ramshackle Public Utility Regulatory Policies Act of 1978 included a provision urging state regulators to encourage the purchase of electricity from various renewable and cogeneration sources. The act was largely ineffectual because it only suggested that the states consider a laundry list of alternatives of wildly different validity to alter regulation. Most ideas were ignored. However, several states encouraged power purchasing with a vengeance by setting generous cost targets for the independent producers to meet. In particular, the regulators assumed continued sharp rises in energy prices.

The even messier 1992 Energy Policy Act included a provision that broadened the scope of independent production by encompassing all forms of energy and allowing existing electric utilities to operate as independent producers in regions away from those they served. (Energy law over time has become more specific and, if possible, more ill-advised. The laws now contain numerous mandates on energy use and allow grants

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and loans to foster energy alternatives.) Proposal of the broadening of eligible independent producers divided the industry: companies owning capacity sufficient for their needs came out in opposition; a mix of capacity-short companies and those with excess engineering capacity came out in support. The adoption of independent power proved one of three apparently severe cost burdens on many utilities. The others were new generating units, mostly but not exclusively nuclear, that proved too expensive, and the burdens of programs to encourage lower electricity consumption.

Several states responded by designing reorganizations. The choices differed among the states. One major element was entrusting decisions about which plants would supply the covered area to an independent organization called the independent system operator (ISO). As it happened, three regional integrated power pools already served the Northeast; those pools were transformed into ISOs. In the case of the so-called PJM (Pennsylvania, New Jersey, Maryland) pool, the service area was greatly expanded. Several large, contiguous utilities joined, as did Chicago's Commonwealth Edison, which had merged with founding PJM member Philadelphia Electric. Elsewhere, most notoriously in California, totally new ISOs were created. Another element of this restructuring was requirements that differed among reorganizing states of sale of power plants to independent producers. The encouraged approaches ranged from mandatory total divestiture to making the choices voluntary. At the federal level, the Federal Energy Regulatory Commission (FERC) undertook initiatives to encourage further restructuring.

The natural gas situation was simpler. FERC totally changed its view of the proper role of natural gas pipelines. Previously, FERC wanted the pipelines to serve as the purchaser (under long-term contracts) of natural gas and the supplier of natural gas deliveries to regional distribution utilities and large users. The new vision was the pipelines were simply to serve only as supplier of transportation services to final users who would separately purchase the gas.

The telecommunications changes were initiated by the 1984 settlement of an antitrust suit against American Telephone and Telegraph (AT&T). The suit led to the severance of AT&T's long-distance service from local service. The regional subsidiaries of AT&T were transformed into independent entities popularly called Baby Bells. AT&T acquiesced because it faced the problem of new entrants into long distance that were taking advantage of regulatory pressures to keep long-distance rates well above cost in order to generate funds to subsidize local service. The adjustment was difficult and prompted yet another legislative fix, the Telecommunications Act of 1996.

PARTIAL DEREGULATION Public policy upheaval is fertile ground for economists, and we have eagerly seized the opportunity. A steady flow of book and articles on the troubles has emerged. Now one of the most persistent and perceptive of the participants in this debate, Paul W. MacAvoy, has weighed into the discussion with the book *The Unsustainable Costs of Partial Deregulation*, an examination of the problems of reform in the electricity, gas, and telephone areas. He chooses to term the situation in each of these areas as "partial deregulation." Whatever the name, the problem is imposition of regimes in which the pricing rules imposed made it unprofitable to invest in expanding capacity so better to serve peak demands. As MacAvoy states it, stress was on imposing an average price level that was lower than before the policy changes. However, companies could never exceed that average and impose charges during peak times that both repaid investments in capacity and dampened demand. This is MacAvoy's version of the peak-load pricing problem that is frequently examined in the electricity literature.

The book offers a challenging, thoughtful treatment of the subject.

His book contains six chapters. The first introduces the problem and the concepts that he employs in the subsequent chapters. The next chapter gives an overview of the regulatory changes in the three sectors and reviews and evaluates implementation. Chapter 3 gives an overall survey of gas and electricity changes and their consequences. The following chapter presents the case of Pacific Gas and Electric (PG&E), the most harmed victim of the worst failure of partial deregulation (the California electricity fiasco of 2000–2001). Chapter 5 turns to telephones. The final chapter suggests some possible remedies.

MARKET POWER MacAvoy uses some standard economic tools as the basis of his analysis. He stresses the measure of market imperfection developed by Abba Lerner, an economist who made important contributions in the middle of the 20th century. Lerner defined an index of monopoly power as the ratio of the excess of price over marginal cost to price. In competitive equilibrium, price equals marginal cost, and the Lerner ratio is zero. (The upper limit of 1 cannot be reached because costs are always greater than 0.)

MacAvoy also employs several related concept of market analysis. Following current fashion, he stresses the Cournot and Bertrand models of oligopoly behavior. In a Cournot model, firms set quantities and let the market set the price. In the model, firms ignore in each output setting action the responses of rivals and thus restrain output to less than what would be produced by a one-firm monopoly or cooperating oligopolists. In a Bertrand model, firms set prices, let the market set the quantities, and again ignore responses. For MacAvoy, Cournot is shorthand to imperfect cooperation and Bertrand denotes very weak cooperation. He adds the concept of conjectural variation to complete the oligopoly model; the variation adds in a measure of the expected response. That variation is positive when rivals take supporting actions and negative when they take retaliatory steps. The final element in the framework is the Herfindahl-Hirschman index of concentration, calculated as the sum of squares of market shares. His critical indicators then are based on relationships among those measures.

PRICE CAPS Chapter 2 proves an effective summary of the key changes in the regulation of the three sectors. Chapter 3 then involves the trickiest part of MacAvoy's exposition. He seeks to approximate the performance measures proposed in his first chapter. Since those specified, such as marginal costs, are not reported, he relies on price-cost margins. The data support his hypothesis that price caps preclude benefiting from demand surges and thus discourage investments to serve such surges.

In chapter 4, MacAvoy moves on to the particularly egregious case study of PG&E, which was thrown into bankruptcy by the California crisis. He well relates the problems that led to this disaster. He stresses that the California Public Utilities Commission deliberately interfered with PG&E actions that could have prevented the fiasco. The California price caps were supposed to be transitional until the companies recovered their "stranded costs"—the outlays on investments that proved uneconomic. (*Regulation* in 1996 ran several articles and letters of comment attacking such recovery programs. The critics argued against the contention that cost recovery was implicitly guaranteed when undertaking regulation and that the amount of stranded cost was too speculative to determine a priori.) In practice, many companies, including PG&E, also had facilities with market values greatly in excess of book value and secured much of their stranded-cost recoveries from sales of such plants. PG&E realized that full recovery and the resulting promised liberation from price caps could be effected by selling its hydroelectric facilities. The utilities commission ruled that simply raising the book value without sale would, when authorized, suffice to provide stranded cost recovery and then refused to approve the revaluation. This kept the price caps in place and made ruin inevitable.

In chapter 5, MacAvoy turns to performance in telecommunications. This is a much more convoluted case, and the exposition is more extensive than in the gas and electric chapter. Such details as pricing different types of long-distance service, charges by local telephone companies for access by long-distance telephone companies to the local exchanges, the entry of the Baby Bells into long distance, and universal service charges are examined. MacAvoy sees inadequate margins. Absent effects on telephone service, he sees the principal effect as precluding the provision of the speediest possible broadband-access technologies.

The concluding chapter starts with estimates of the economic costs of the price caps. He reviews two (of many possible) proposals for alternative pricing rules. He then devotes a scant three pages to "The Process for Complete Deregulation." The first step is clearly stated and one I long have advocated: stop undertaking imposed restructuring. A single paragraph is devoted to the second step of greater pricing freedom. Two final paragraphs describe changes that justify true, full deregulation of telecommunications and then note that one state is considering such deregulation. Gas and electricity are ignored.

CONCLUSION Overall, the book is a challenging, thoughtful treatment of the subject. The effort to distinguish the common elements in three very different regulatory cases is a major contribution, albeit one that should be closely examined. The biggest problem is that the solutions proposed are not as forceful as the criticism. Too much is left hanging.

Observers clearly will challenge many of the details. MacAvoy's conclusions about electricity differ from the tendency even among others objecting to the policies to argue that the eastern electricity restructurings were largely successful. The suggestions about pricing did not go far enough. Others argue that the feasibility for adopting more flexible pricing has greatly increased and that this opportunity should be taken. MacAvoy could have aided the reader with a few more pages of background. The mechanics have more than their fair share of problems. The most embarrassing is that MacAvoy, a long-time New Englander, refers to the *five* New England states. Nevertheless, these are challenging arguments from a leader in regulatory analysis. They will command attention, and it will be deserved. This then is yet another important addition to the literature. R

Fluctuating Power

Reviewed by Richard L. Gordon

COMPETITIVE ELECTRICITY MARKETS AND SUSTAINABILITY
Edited by François Lévêque
302 pages; Chelenham, UK: Edward Elgar, 2006

While the title *Competitive Markets and Sustainability* suggests another monograph favoring "renewable" energy, this book fortunately is an anthology of discussions on how to reform the regulation of electricity. The dominant tendency in such books is to prefer patching up regulation rather than to consider it an irredeemable failure. In this book, this orientation is mandated because the contributions were prepared for France's *Commission de Règulation de l'Electricité* as guidance about its assigned mission. The book comprises seven essays: an editor's introduction followed by three pairs of essays on the areas of generation, transmission, and the coordination of generation and transmission. The first of each pair of essays is devoted to a formal model; the second, to applications. The contributors, particularly of the applied articles, differ wildly in how they interpreted their mandates.

GENERATION Richard Green prepared the analytic chapter on generation; Jean-Michel Glachant wrote the applied chapter. Green nicely presents a clear, simple model for optimizing the mix of generating plants (with a mathematical appendix that uses a standard calculus-based formalization) and a sensible discussion of the problems of implementation. This further discussion centers on principles of investment analysis. Green concludes with a short discussion of the relationship between his principles and investment experience in several major countries. Glachant provides a well-done descriptive review of the shift in Europe and the United States to gas-fired generation, and he examines future prospects, including a possible nuclear revival in the next decade or so.

TRANSMISSION The two essays on transmission are written by Steven Stoft and Paul Joskow, respectively. Stoft starts with a very good, clear discussion of congestion and how optimally to reduce it. He then examines possible forms of implementation. He proposes three models: centrally-planned expansion, "merchant" transmission (reliance on independent suppliers), and centralization limited by caps on prices. He offers a very good discussion of the problems with all three forms. Stoft's only shortcoming is an undue concern with economies of scale; he could have benefited from attention to Green's discussion of how limiting capacity allows cost recovery.

Joskow characteristically presents interesting observations about the practice of transmission expansion. His organization, however, hinders comprehension. He starts by listing 15 conclusions about transmission, proceeds to discussion of investment and then of network organization, and then he offers principles to guide regulation. Next, he reviews transmission experiences in England and Wales as well as in the PJM pool in the United States. Joskow expands on a major concern about the invalid tendency to treat congestion reduction and reliability as independent actions and then concludes.

In several of these sections and in his conclusion, Joskow makes a series of summary judgments. His first four points deal with aspects of differences between academic economic models of the electric power industry and how the industry actually works. This culminates with his criticism of the widely used congestion-reliability distinction. He correctly observes, "This is nonsense." Increased transmission means both less congestion and greater reliability. What this point and its further development in subsequent discussion fail to unravel is what a correct analysis would include. Joskow does eventually conclude that industry decisions are too heavily influenced by reliability criteria unsubstantiated by proper economic analyses. Most of his further points deal directly with the drawbacks of regulation; others such as skepticism about the prospects for merchant generation and interconnections among regions are effectively concerns over the consequences of regulation. A later section proposes criteria for better regulation. The paper includes much useful evaluation of transmission operations.

COORDINATION Yves Smeers provided the analytic chapter on the coordination of generation and transmission; the applied chapter comes from Ignacio Pèrz-Arriga and Luis Olmos. Smeers's analysis starts with presentation of a 2005 "mixed-integer" programming model developed by five U.S. economists. To handle deficiencies in the original model, Smeers undertakes numerous extensions and modifications of the initial case. These are designed, in principle, to compute the optimum configuration of an electric power network. The models are conventional treatments of the issues of concern; the biggest problem of comprehension is plowing one's way through the notation. Smeers presents this analysis as a way to evaluate precisely different actual market design and pricing procedures. Ironically, a major motivation is to criticize earlier work by Pèrz-Arriga proposing cost-allocation approaches to regulatory price setting; the Pèrz-Arriga and Olmos contribution then maintains such a cost-allocation outlook. The Smeers results probably could have been generated more simply.

Pèrz-Arriga and Olmos prepared one of the most unsatisfactory papers on regulation that I have ever encountered. Ignoring Stoft's analysis, Pèrz-Arriga and Olmos devise an overly complex system of regulated prices for transmission. They are undaunted by the data they present showing the defects of existing regulated European transmission charges. Thus, the work inadvertently suggests that unregulated pricing would be far preferable.

CONCLUSION In short, this book is more technical and more variable in quality than is typical of electricity anthologies. Green and Stoft provide well-formulated, reasonable, accessible treatments; Joskow gives many valuable insights. These are well worth examination by specialists; the general reader may be less interested. R

Regulation Overview (Mostly in Britain)

Review by Richard L. Gordon

INTERNATIONAL HANDBOOK ON ECONOMIC REGULATION
Edited by Michael Crew and David Parker
405 pages; Cheltenham, U.K.: Edward Elgar, 2006

Literature surveys are a staple of commercial academic publishers like Edward Elgar. One of Elgar's most recent efforts is the *International Handbook on Economic Regulation,* edited by Michael Crew of Rutgers, a leading editor of anthologies on regulation, and David Parker of Cranfield University. The title suggests a trans-Atlantic outlook, but that is incompletely achieved.

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The participants are mostly British, and their discussions heavily, but not entirely, concern British experience. Thus, a good examination of efforts to establish new regulatory regimes is provided, but the problems of well-established regulatory agencies in the United States are barely touched, except in telecommunications.

The book contains 17 contributions, of which the first three treat overriding issues, the next eight deal with specific problems that arise in all forms of regulation, and the last six treat individual industries. The book opens with an unusually ambitious editors' introduction that presents an overview of changes in the practice and theory of regulation. Martin Rickets then provides a good survey of the debate over whether regulation can be, and is, designed to eliminate monopolistic inefficiency. Unfortunately, most subsequent contributions assume that improved efficiency is the goal. Crew then joins his regular collaborator Paul R. Kleindorfer to survey optimal pricing; their effort is solid as far as it goes, but many aspects of the pricing problem are only noted because the chapter is so short.

SPECIFIC PROBLEMS The topic chapters cover, respectively, regulating service quality, the special problems in developing countries, performance benchmarks, the cost of capital, information revelation, governance, consumer representation, and impact assessment. The discussions are mainly descriptive and, with the obvious exception of the treatment of less-developed countries, focus on experience in the United Kingdom. The first key exception is that the benchmarking chapter, by Parker, Thoralf Dassler, and David S. Saal, starts with a note on Andrei Shleifer's 1985 *Rand Journal of Economics* article "A Theory of Yardstick Competition," advocating using the performance of others as the benchmark for regulation. The information-revelation chapter by Phil Burns, Cloda Jenkins, and Thomas Weyman-Jones starts with a review of the underlying theory.

Overall, the chapters have a focus that is too limited in treating both the analytic underpinnings and experience in implementation. This gap was particularly problematic in the consumer-representation chapter; U.S. experience suggests that "consumer advocacy" is undertaken by ideologues who wish to impose their preferences on consumers without consideration of economic validity or any other basis for sound decisions. These chapters are rather dry, parochial, and likely to date quickly. The net impact is to show the numerous and problematic areas in which regulators must operate. While the chapters on benchmarks and information revelation recognize the enormous problems of implementation, in no case does the discussion tie back to the warnings in initial chapters of inherent weaknesses of regulation.

INDIVIDUAL INDUSTRIES The sector chapters deal with five subjects: the environment, telecommunications, energy, transport, and water and sewers; telecommunications rates two chapters. These six chapters are much less British-oriented than the topic chapters.

The environmental chapter by Anthony Heyes and Catherine Liston is policy-option focused. The main, economically sound methods of control are sketched and illustrated with examples of application. The conceptual treatments are necessarily better developed than the treatments of applications; the latter require much more space than was available to explain fully.

The two telecommunications chapters take completely different approaches. The first, by Timothy J. Tardiff on access charges, deals with the outcomes of numerous efforts to define optimal charges. Knowledge of the underlying economics is presumed. U.S. experience is used to demonstrate the problems of implementation. Tardiff nicely summarizes William J. Baumol's warning that charging is undesirably burdened by desires to accomplish multiple goals such as the regulators' fixation with promoting universal service. Gregory M. Duncan and Lisa J. Cameron's chapter presenting their view of regulation and structure, in contrast, presumes ignorance with economics and the characteristics of telecommunications. The chapter starts with a description of the participants and the technologies and protocols they employ. The conclusion is that some sectors — such as conventional wire line telephony and cable television — are natural monopolies but others — such as wireless telephones — are not. The authors also suspect that ultimately wired telephony and cable will merge. They adopt the conventional posture of advocating continued regulation of the monopoly portion. They endorse the present tendency to regulate by setting ceiling prices related to estimates of what good performance would produce, rather than cost-recovery. They promptly recognize the problems of implementation. Thus, once again, we have fear to advocate total deregulation in the face of multifaceted competition, with the most vibrant sector already being naturally competitive.

The energy chapter by Colin Robinson and Eileen Marshall, long-time prominent collaborators on energy-sector studies, undertakes the ambitious tasks of reviewing both the rationales for regulating all phases of energy and the actual interventions. In their limited space, they manage brilliantly to warn that, as usual, the potentially valid arguments are often cover for blatant protectionism and the excuses themselves are suspect. The implementation section is breathless and focuses on British electricity and gas regulation.

The transportation chapter by Ian Savage starts with the usual criteria of whether competitive problems exist. Savage notes their frequent nonexistence and reviews the move toward deregulation, particularly in the United States.

The water and sewer chapter by Ian Byatt, Tony Balance, and Scott Reid deals with the applicability of key economic theories of regulation to the water and sewer industry. The authors nicely and evenly mix discussion of the theory, the evidence about the underlying economics of the sector, and examination of experience, particularly in Britain and France. The French have adopted — apparently successfully — the approach advocated in a classic article by Demsetz, not cited in the chapter, of leasing government-owned facilities to private operators.

On balance, the reviews are useful. As the prior should suggest, a more useful effort could have arisen with fewer issue chapters and longer sector discussions.

In the process of locating this book, I discovered that Elgar's extensive series of anthologies of classic writings in economics includes several devoted to regulation. A 2006 effort by Ray Rees on *The Economics of Public Utilities* nicely collected the classic articles on optimal pricing. Thomas P. Lyon's 2007 *The Political Economy of Regulation* goes beyond public utilities to the environment and product safety. He includes 24 articles; while almost all are classics, several other key efforts appearing in earlier Elgar anthologies are omitted. The biggest drawback of both books is the price: about $225 a volume. R

The Drug Quagmire

Reviewed by M. Kevin McGee

LIES, DAMNED LIES, AND DRUG WAR STATISTICS: A Critical Analysis of Claims Made by the Office of National Drug Control Policy
By Matthew Robinson and Renee Scherlen
268 pages; Albany, N.Y.: State University of New York Press, 2007

It's official: nothing the government tells us about the war is true. Oh, but not *that* war. And not that other one either. No, I'm referring to a much older war, one old enough to vote, to drink, and even to run for president. The war that turned 36 this past June: the war on drugs.

At least, that's the message in *Lies, Damned Lies, and Drug War Statistics*, by Matthew Robinson and Renee Scherlen. In tedious detail, they document how the White House's Office of National Drug Control Policy (ONDCP) consistently spins the data in its annual drug control strategy report. All of the usual tricks of the trade appear in the reports, from judiciously selecting the beginning point for trend data presented in graphs, to making triumphant claims about small but favorable variations in trends that are essentially flat.

So the ONDCP doesn't really tell it like it is — this is a revelation to whom, exactly? Does anyone actually believe that some office within a memo's throw of the Oval Office (of this or any other president) would actually provide us with anything other than a well-rehearsed cheer for our team, with enough torque to power a small freighter to China and back? I am shocked, shocked to find that misinformation is going on in here!

Perhaps more of a concern is that the ONDCP puts so much stock in simple trend charts. Is no one able to pull several variables together and do some genuine statistical analysis? You know, hypothesis testing and the like? I don't mind a liar, but I do object to a cut-rate one. And the ONDCP reports' misleading presentations are decidedly cut-rate.

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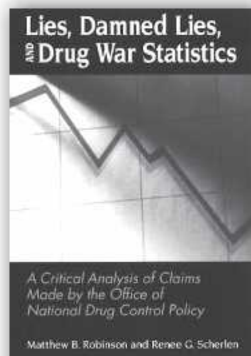
Robinson and Scherlen aren't much better, however. They made the unfortunate decision to discuss topical sections of the ONDCP reports individually, in annual sequence, one year at a time. This means that the same less-than-forthright interpretation that gets criticized in the 2000 report also gets panned with excruciating repetitiveness in the 2001 report, the 2002 report, etc. The result is not just tedium, it's stridency. And their repetitive use of the phrase "admission of failure… hidden in plain view" doesn't help. I mean, I get it: when the ONDCP admits that the trends aren't going its way, it doesn't exactly shoulder the blame. But the authors should not be allowed to roam free through any equine mortuaries, with beating instruments in hand.



COSTS AND BENEFITS Nevertheless, if you can get past the redundancy, Robinson and Scherlen are able to show that the Drug War is, if not exactly a failure, not a rousing success either. Let's call it a stalemate — we pour a ton of money into fighting drugs each year and as a result probably get somewhat less drug use, although one can reasonably question how much less.

If the goal is to get drug usage down to zero, we've made absolutely no progress whatsoever over the last two decades. Drug prices are down dramatically (the prices of heroin and powder cocaine are only about one-fifth of their 1988 levels). Availability to teens and other prospective young users is high and steady. And overall drug use rates are slowly creeping back up toward their late-1980s levels.

That may or may not be a good thing. Toward the end of the first chapter, Robinson and Scherlen correctly suggest that what we need here is some good old-fashioned cost-benefit analysis. What does it cost us to fight this war on drugs? And what are the payoffs — how much have we lowered drug use and abuse, and what costs of that additional use and abuse have we eliminated? Unfortunately, by the end of the book, Robinson and Scherlen are still suggesting that's what we need. If you're looking for such analysis here, you won't find it.

Not that I'd want the authors to do that analysis, anyway. They'd clearly do a better job than the ONDCP — they at least recognize, and point out, that the lost productivity and other costs of locking up drug users is not a cost of drug use, but a cost of fighting drug use. But like the ONDCP, they make the mistake of saying that this cost has been rising sharply over time. Maybe it has been rising, but all they actually show is that the way we report this cost is rising sharply over time. Suppose that every month you buy a bag of candy, charging it on your special Snickers Visa card. And every month when you get your Visa bill, you pay off 5 percent of the balance. That would result in a steadily increasing Visa payment each month. But if someone asked you about the cost of your chocolate habit and you reported to them that it's been going up a lot, you'd be wrong. The cost of this month's candy consumption is not what you're paying this month on your card; you're paying little bits of previous months' and years' candy, while deferring most of this month's candy costs to future months and years. Most of today's drug-related incarceration costs are the costs of fighting drugs last year, and the year before that, and so on. And most of the incarceration costs of locking up a drug user today will be paid out over the next five, 10, or 20 years. Apparently we can't even get the accounting right, so maybe it's no surprise that the most we can pull off in fighting drug use is a stalemate.

Robinson and Scherlen do document the degree of misinformation the ONDCP subjects us to, so this book does represent a small contribution to the discussion. But until we have that good, solid cost-benefit analysis in hand, I suspect we'll just blindly continue to throw money at making drug use go away. R