Hook-onomics

Reviewed by David R. Henderson

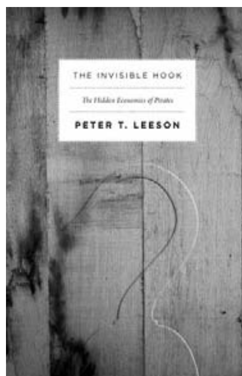
THE INVISIBLE HOOK:
The Hidden Economics of Pirates
By Peter Leeson
271 pages; Princeton University Press, 2009

What possible connection could there be between economics and a book on piracy? A lot, as it turns out. Peter Leeson explains this seemingly bizarre connection in page after page of his witty new book, *The Invisible Hook*.

Leeson, an economics professor at George Mason University, has had a lifelong fascination with piracy. It shows. His central thesis is that the vast majority of pirates during the time period he explores, the 17th and 18th centuries, were rational. That is, they weighed costs and benefits and followed their self-interest. Despite the book's title, a takeoff on Adam Smith's "invisible hand," Leeson does not claim that pirates were led by their self-interest, as Smith's businessmen were, to make things better for the non-criminal class. Rather, he argues, we can understand pirate behavior by applying the economic tools that we use to understand the behavior of non-criminal businessmen. Leeson does so relentlessly, explaining why they showed the Jolly Roger, established a reputation for savagery, shared the loot relatively equally, didn't discriminate against black people, and had — believe it or not — tight restrictions preventing their leaders from having too much power.

BUCCANEER GOVERNANCE I'll consider the leadership point first because it is Leeson's biggest contribution to the ongoing debate about the powers of government.

In two chapters titled, "Vote for Blackbeard" and "An-aargh-chy," Leeson points out that because the pirates were outlaws, they couldn't use legitimate governments to enforce their agreements. Therefore, pirates needed to come up with their own institutions of governance. Leeson makes a strong distinction between government and governance. Government, he writes, "is always based on force," but governance needn't be. Although pirates had an anarchist society, it was not chaotic. The pirates essentially solved the problem that founding father James Madison posed but never solved: how to give the governors enough power, but not let them abuse it. The pirates, Leeson writes, actually had written constitutions with a division of powers so that no one leader could have too much power. Leeson even reproduces one of the constitutions in the book.



A key division of power was between the captain and the quartermaster. The captain had absolute power in times of battle, but the quartermaster, who was democratically elected, had the power to allocate provisions, divide the loot, and administer discipline. And the crews disciplined the captains. Leeson tells of one episode in which the captains of a pirate fleet borrowed some fancy clothes that were part of the loot and wore them to attract local women. The crews became outraged at this transgression. Writes Leeson: "[I]f only all citizens guarded their polity's division of power as jealously as pirates." He has a point. Notice how accustomed we've become, for example, to the U.S. president using Air Force One for political purposes or for going on vacation (or dates). And yet we do nothing.

PIRATE BEHAVIOR Why did pirates fly the Jolly Roger? Leeson answers by drawing on the economic literature on signaling. The buccaneers wanted to communicate to their victims that resistance was futile or worse, so as to avoid a costly, violent confrontation. The Jolly Roger, Leeson writes, "signaled 'pirate,' which meant two things. If you resist us, we'll slaughter you. If you submit to us peacefully, we'll let you live." That same signaling idea explains why many pirates fed their image as ruthless cutthroats. Some of them *were* ruthless cutthroats, of course, but for others, ruthlessness had a practical purpose: sometimes the image must be backed up with deeds if the word "cutthroat" is to be credible. Interestingly, though, one of the most famous pirates, Blackbeard, had such a fearsome reputation that he went to his death without having killed a single man.

Pirates were also very practical when it came to race. In the 1950s, University of Chicago economist Gary Becker wrote his dissertation, later turned into a book, on the economics of discrimination. Becker showed that there are strong forces in a free market for employers not to discriminate on grounds of race. Becker's argument is that those employers would miss a profit opportunity and, therefore, would do less well than those who didn't discriminate on racial grounds. In short, free markets make people pay a cost for discrimination. In *The Invisible Hook*, Leeson applies Becker's insight to the buccaneers. He presents striking data showing just how racially diverse pirate crews were. In laying out the argument, though, he overstates his case. He discusses a hypothetical situation in which a bigoted employer hates redheads and shows how the employer will either ignore his prejudice and employ redheads or go out of business. This, in itself, is not an overstatement. But Leeson's implication seems to be that the case with black people is the same. It's not, or at least it wasn't a few decades ago, and the reason is that there were many, not just one, anti-black employers. As Becker himself pointed

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

out more correctly, the free market makes racial discrimination costly, but it doesn't necessarily eliminate it.

Although Leeson is a great writer, there was one little annoyance: his "politically correct" use of gender. Because of Leeson's use of the words "her" and "she," a reader might get the impression from *The Invisible Hook* that the majority of employers and the majority of MIT graduates are women.

One last note: Leeson is obviously a romantic. The sole line on the dedication page is, "Ania, I love you; will you marry me?" How many people do you know who are so romantic that they will use a page of their first single-authored book to propose? Apparently, the fair damsel said yes. Aargh

Preparing for Billions of Cars

Reviewed by Gabriel Roth

TWO BILLION CARS:
Driving Toward Sustainability
By Daniel Sperling and Deborah Gordon
304 pages; Oxford University Press, 2009

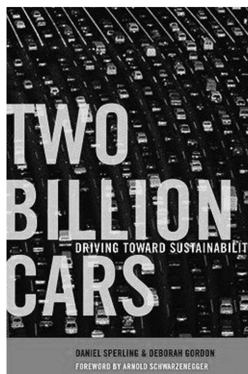
Starting from the proposition that "cars are arguably one of the greatest man-made threats to human society" this challenging book has been written as a "call to action" to enable our planet to "sustain" a doubling of the current motor vehicle fleet of one billion. *Two Billion Cars*, which is particularly well written and laid out, concludes that the planet can indeed accommodate two billion cars, provided the actions recommended in the book are taken.

This reviewer is not convinced that significant "global warming" is occurring, or that any significant warming is caused by human action, or that warming would do humanity more harm than good. He is, nevertheless impressed by the work done to produce this attractive book, in which he finds much of interest.

"SUSTAINABILITY" The first of the book's nine chapters describes the crisis it addresses, explains its purpose, and provides a helpful guide to the eight chapters that follow.

Chapter 2 ("Beyond the Gas-Guzzler Monoculture") recognizes that "cars have become our transportation mode of choice" and that they "are here to stay." It sketches the history of motorized mobility and deplores the "monoculture" that it considers to be "unsustainable." It considers alternative vehicle engines and fuels and concludes that, to be "sustainable," vehicles have to be smaller and more fuel efficient. This likely makes them less safe.

"Sustainability" is, however, not defined. And the chapter does not convincingly explain why "today's car-based transportation system, as pioneered in America, isn't optimal or sustainable for either society or individuals." Transportation in America is certainly not "optimal" (nor is it anywhere else), but it has existed for over a century and therefore cannot yet be classed as "unsustainable."



The authors state correctly that "with so many vehicles and drivers flooding the roads, the system breaks down in gridlock, exacting a high price in wasted time." It is true that when roads and parking spaces are provided by governments at no additional charge, "the system breaks down in gridlock." But this problem can, in principle, be dealt with by requiring road users to pay the costs of their travel, and providing them with the roads they are prepared to pay for, thus applying to roads the principles we take for granted for the supply of food, water, and other necessities.

The traffic congestion problem is thus due to the mismanagement of road space. The chapter does indeed recommend "greater use of pricing" to restrain the demand for road use and to create "a more diversified and efficient transportation system," but the authors do not discuss whether market pricing and investment for roads could, by themselves, mitigate many of the ills described in the first chapter.

A major deficiency in this chapter is that it does not state whether going "beyond the Gas-Guzzler Monoculture" will result in a decline in the miles traveled or trips made per person per day. The frequent references to car sharing and better public transport suggest that adoption of the book's recommendations would reduce the amount of travel because travel time is limited and public transport, however good, cannot match the door-to-door speed offered by the private car. But the book is silent on this critical issue.

Another deficiency in this chapter is the meager discussion of road safety and the effect of vehicle size on fatalities. Safety experts estimated that fuel efficiency standards mandated by Congress increase fatalities on U.S. roads by some 2,000 lives a year. The authors ignore this issue and even criticize heavier vehicles for damaging lighter ones in accidents. But heavier vehicles are safer in single-vehicle accidents and also when accidents involving only heavy vehicles are compared with accidents involving only light ones. Road accidents now cost one million lives a year worldwide, and 10 million serious injuries. Further reductions in vehicle weights and sizes are likely to increase this carnage.

Chapter 2 also contains an interesting and welcome discussion of "paratransit" and other "informal" methods of public transport. The chapter points out that such systems have been regulated out of existence in the United States, and recommends their development.

Less welcome is the call for "better land use management ... [because] greater geographic density leads to less travel." This claim is often made but difficult to support. California has the highest residential densities in the United States (that in Los Angeles being 30 percent higher than New York's), but high levels of traffic and congestion. High densities in European cities are not associated with smooth

Gabriel Roth is a research fellow at the Independent Institute. He is the author of *Paying for Roads: The Economics of Traffic Congestion* (1967), *Roads in the Market Economy* (1996), and editor of the award-winning *Street Smart — Competition, Entrepreneurship and the Future of Roads* (2006).

traffic flows. Land use controls tend to reduce available accommodation and thus to increase its price. This recommendation merits further discussion.

Chapter 3, "Breaking Detroit's Hold on Energy and Climate Policy," discusses the influence of American automakers and deplores the fact that they were unable to make small cars at a profit. This chapter has now been overtaken by events, with General Motors becoming "sustainable" only with the aid of taxpayer funding. The authors predict, probably correctly, that the Japanese will retain their lead in the development and production of small, energy-efficient cars.

Chapter 4, "In Search of Low-Carbon Fuels," is devoted to the search for alternatives to gasoline to power the forecasted two billion cars. This is an informative review of fuels such as coal, diesel, ethanol, hydrogen, methanol, and natural gas. It concludes that it will not be easy to replace gasoline in the near future.

Chapter 5, "Aligning Big Oil with the Public Interest," describes the growth of the oil industry and the ways it is trying to "greenwash" itself into an "energy" industry worthy of "government intervention ... to assure timely investments in clean energy." This chapter contains much of interest, including a discussion of when the world will run out of oil (not soon) and whether "cap and trade" is a good idea (for transportations, it's not). It reminds readers that many oil resources outside the United States have not been seriously explored: "More than 60 percent of all oil producing oil-wells in the world are in the United States, even though it has less than 3 percent of the world's oil."

But the authors do not recommend more oil exploration. They focus on alternative methods of reducing the demand for fossil fuels and favor a combination of a low-carbon fuel standard combined with high taxes on gasoline and diesel fuels in order to create a "price floor," giving $4 a gallon as an example. They argue that this would have the additional advantage of reducing the flow of petrol-dollars to regimes seeking to harm the West.

CHANGING CONSUMER BEHAVIOR

Chapter 6, "The Motivated Consumer," considers the behavior of American travelers and ways to influence it. This chapter is less convincing, and so is its conclusion that consumer behavior "must" change. The argument is based on two assumptions:

- The American desire for increased motorized mobility is in conflict "with the greater public good."
- Americans differ from other nations' citizens in their much greater use of cars, or as the authors put it, "Traveling alone by car is the American way."

The first assumption is inherent in the book's thesis, which this reviewer does not accept, that cars harm humanity by contributing significantly to global warming. But even if one accepts this assumption, it does not follow that any benefit to humanity, however small, justifies any restriction on mobility, however severe. Restrictions on mobility can only be accepted to the extent that "the punishment fits the crime," to borrow a phrase from *The Mikado*. The recognized way of dealing with "externalities" is to impose on the damaging activity a tax equal to the damage caused, and a tax on carbon is indeed one of the authors' principal recommendations. So why not stop there, by just imposing the requisite taxes (not forgetting to also grant subsidies to activities generating positive externalities) and leave it to those seeking mobility to adjust their behavior accordingly?

The answer to this question may lie in the authors' discussion of "small carbon and fuel taxes." The authors write that "a carbon (or fuel) tax would have to be huge to induce change," and that even a tax of $50 per ton of carbon dioxide (which would raise the price of gasoline "only" about 45 cents a gallon) would not "motivate" road users to change their behavior. A "non-motivating" tax of $50 a ton can be compared with the price of $3.50 a ton charged on the U.S. Regional Greenhouse Gas Initiative for the right to emit a ton of carbon dioxide, and $13.50 a ton charged on the European market. It seems, then, that the authors recommend that those seeking motorized mobility be taxed at far higher rates than other users of carbon.

Why is this? The authors certainly recognize the importance of mobility, but apparently not the right of travelers to use the mode of their choice. Thus they observe that "attempts to get Americans out of their cars have failed," as if getting people out of cars is an acceptable objective of government policy. Do the authors share the Duke of Wellington's fear that the development of modern transport modes would "encourage the lower classes to move about needlessly"?

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Most travel is undertaken not for its own sake, but to facilitate other objectives, such as work, shopping, or social activities. Travel restrictions are universally resisted because they restrict activities and reduce opportunities. Yes, the failures of governments (except in Singapore) to deal with traffic congestion create major problems, but those failures can be addressed directly and do not justify the subjection of road users worldwide to discriminatory taxation and less-safe vehicles.

And Americans are not unique in their desire for mobility. According to a poll carried out in Beijing, "Younger workers in China's capital want to own a car more than any other product." The late transportation analyst Yacov Zahavi, who studied travel characteristics in many countries, noted in a 1976 World Bank paper that when similar income groups are compared, people all over the world behave similarly and maximize their travel within the constraints of time and money facing them. Rich people travel more than poor people, increases in income being associated with more than proportionate increases in travel by car.

Americans do, as mentioned in this chapter, travel greater distances than others, but that is because their greater wealth has enabled their governments to build roads that accommodate higher speeds. When this reviewer lived in the Los Angeles area in 1980 he would not hesitate to drive 60 miles to an evening concert, an

activity not practicable in the London area, much less in Bogota or Manila.

Chapter 7, "California's Pioneering Role," presents California as "a model in leading the world." This interesting chapter reviews California's history, emphasizing the role and achievements of Gov. Arnold Schwarzenegger, who also contributed the book's foreword.

Unfortunately this chapter has also been overtaken by events. As Victor Davis Hanson noted in a March 8, 2009, *Washington Times* op-ed, California now has "the worst credit in the nation … the fourth-highest unemployment rate and the second-highest home foreclosure rate, thanks to enormously inflated prices due in part to complicated building regulations, high labor costs, and often Byzantine land-use restrictions" of the kind recommended in Chapter 2 of this book. But those who have suffered from California's inability to manage its transport infrastructure — for example, the inability to deal with traffic congestion in wealthy Los Angeles — will find it hard to accept the transport policies of 21st century California as models for others to follow.

Chapter 8 focuses on China, for three reasons:

- China is now the largest contributor of greenhouse gases to the atmosphere.
- The authors want China to become a model to other developing countries on how to avoid the transport errors of the West.
- The authors believe that China could export fuel-saving, unsafe vehicles, such as battery-powered bicycles, to Western countries.

This chapter presents an interesting review of these and other issues. China could, in fact, have avoided much of its urban transport problems by following Singapore in the 1970s and pricing the use of its congested roads, but economic sophistication has not been a strong point in recent Chinese regimes. Some readers might also wonder whether a totalitarian government that seeks to control the number of children permitted to families is likely to do more good than harm if encouraged to involve itself further in transport policy.

The book's final chapter presents the authors' recommendations for a "sustainable future" able to accommodate two billion cars. They seek "a different vision … one that accommodates the desire for personal mobility but with a reduced environmental and geopolitical footprint." What might this involve? The authors focus on three kinds of reform:

- transforming vehicles,
- transforming fuels, and
- transforming consumer and local government behavior.

Summarizing the materials in the earlier chapters, the authors envisage the widespread use of smaller, lighter, more expensive, and less safe vehicles, replacing those we know now. They also expect significant changes in travel behavior, resulting from more responsive road pricing (which GPS navigation systems now make practicable) and higher density living, though they do not tell us whether "sustainable" living will involve less travel.

How likely is all this to happen? Will such changes be "sustainable"? As Niels Bohr noted, "Prediction is very difficult, especially if it's about the future" Readers will have to form their own opinions after studying the options described in this valuable and informative book. The taxation of gasoline to give it a "floor" cost of $4 a gallon is obviously appealing to politicians whose aspirations outstrip current government revenues, but Americans have shown themselves to be reluctant to reduce the size of their vehicles, nor — unless their incomes fall — will they be likely to travel less, nor to switch to living at higher densities.

The world's population is expected to hit nine billion by 2040. Not two, not three, but four to five billion cars will be needed then for the majority to have the level of motorized mobility available in, say, France, today. Will the prescriptions given in this book enable this level of mobility to be achieved? Or might the application of market economy principles to roads suffice? Or will growing traffic congestion dominate the development of urban areas and thus inhibit motorization? Only time will tell. R

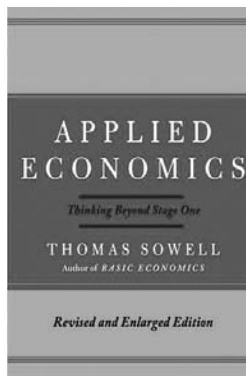
Seeing the Unseen

Reviewed by George Leef

APPLIED ECONOMICS:
Thinking Beyond Stage One
By Thomas Sowell
256 pages; Basic Books, 2009

In one of his early economics courses as a Harvard undergraduate, Thomas Sowell was asked by the professor to say what policy he advocated to deal with some major issue. Sowell eagerly replied, giving a standard interventionist prescription that he figured would impress the professor. (In his youthful days, Sowell was a leftist.) The professor, Arthur Smithies, then surprised Sowell by asking, "And then what will happen?" Sowell stumbled around for an answer to the unexpected question, and after he gave it, Smithies again asked, "And then what will happen?"

From that encounter, Sowell drew a crucial lesson: Don't stop thinking at stage one. Professor Smithies, to whom the book is dedicated, had taught him that a good economist doesn't simply look at the immediate and obvious consequences of an action, but tries to think through all of the long-run consequences as well. Unfortunately, most Americans are not good economists and therefore are easy prey for crusading politicians who say, "Elect me and I'll pass laws to ensure good education (or housing, or medical care, etc.)."



In 1850, Frédéric Bastiat observed that people usually focus only on the *seen* and ignore the *unseen*. Sowell has written a book that applies Bastiat's insight to seven contemporary issues: the labor market, health care, housing, risk assumption, immigration, discrimination, and national economic development. This volume is a revised and enlarged edition of Sowell's 2004 book, with one entirely new chapter

George Leef is director of research for the John W. Pope Center for Higher Education Policy.

(immigration) and new material on several issues, including health care and especially housing. Since the publication of the earlier edition, the U.S. economy has been thrown into turmoil with the bursting of the housing bubble. Sowell wants to help Americans understand that seismic event by taking them past the "stage one" political rhetoric and media commentary.

POLITICS Even if the reader never went past Sowell's first chapter, "Politics versus Economics," he would have received a splendid introduction to the branch of economics that deals with the peculiarities (and mostly inefficiencies) of political decision-making: Public Choice theory. In school, Americans are taught to revere democracy and are put into something like a trance with regard to the ability of government to improve society. Sowell challenges all that. Voters often choose candidates without having more than the flimsiest idea about their proposals, he argues, much less any consideration of the effects those proposals would have beyond stage one.

Sowell also points out that politicians are usually fixated on the next election, causing even the most honest of them to dwell on short-run policies meant to show voters that they're concerned and "doing something." Most of them will support laws and regulations that have *hoped-for* beneficial effects, knowing that few voters will think past the hoped-for to understand the panoply of *actual* effects. That is why devastating policies like rent control are enacted — the hoped-for result of making housing "affordable" sounds appealing and that's enough to win popularity with most voters. The gradual deterioration of the rental housing stock will happen too slowly to have political repercussions — and in any case can be blamed on landlords.

One of the hallmarks of Sowell's work is his impatience with the mindless tropes of politics. Among those he slays right off the bat is the phrase "politics is the art of the possible." Often, he observes, politics amounts to foolish efforts at attempting impossible things, such as demanding low electricity prices while at the same time passing laws that obstruct the building of new power plants.

By itself, Sowell's chapter on politics would make a terrific handout in political science classes where the professor wants his students to understand the economic case for limiting government to defense and order-keeping functions. Political decision-making is apt to lead to waste and folly because the actors rarely go beyond stage-one thinking. Therefore, the fewer decisions that are made in the political realm, the better.

Probably foremost on the minds of many readers will be Sowell's discussion of the economics of housing, where the damage done by failing to think past stage one has been enormous. Only a small portion of his chapter pertains to the late housing bubble. Before getting to that, he covers the adverse effect that many government policies have on housing prices, such as large minimum lot size regulations, historic preservation mandates, "open space" laws, rent controls, and other legal devices that supplant the free market with the goals of third parties, most of whom already have just the kind of housing they want. Sowell makes it clear that there would be no "affordable housing problem" if it weren't for such interventions.

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The housing boom and bust of recent years was a result of government meddling, Sowell argues. A California resident (Sowell is a senior fellow at the Hoover Institution at Stanford University), he was near the epicenter of the housing earthquake. In March 2005, he notes, housing prices in San Mateo County were rising by an average of $2,000 per day. But the skyrocketing prices and accompanying increases in home equity that so many people came to depend on were artificial. Sowell places much of the blame for the housing bubble on the Federal Reserve, claiming it drove interest rates to extraordinarily low levels, inducing people to buy houses they could only afford as long as rates remained abnormally low and the bubble kept expanding. Unfortunately, he does not go into other government interventions that have also come under criticism, such as Fannie Mae, Freddie Mac, and the Community Reinvestment Act. A few more pages on the federal government's responsibility and refuting the excuses being offered by the political establishment (that deregulation was the cause, allowing financial institutions to take too much risk, is a common line) would have made the chapter more powerful.

RISK Speaking of risk, the book's chapter on how people respond to risk is equally illustrative of the damage done when stage-one thinking shoves aside the market. "Since risk is inescapable," Sowell writes, "the question of how much risk to tolerate is a question of weighing one cost against another. Often this is not done, especially when those who make such decisions do not pay the costs."

A good example (and one showing that it is not only politicians who make decisions without paying the costs) is the automobile safety "movement." That movement took off in 1965 with the publication of Ralph Nader's book *Unsafe at Any Speed*. The book was a brilliant piece of chicanery, using deceptive arguments to convince the public that there was an auto safety problem, and worse, that the automakers didn't care about safety. Focusing on the Chevrolet Corvair, Nader insinuated that General Motors was almost criminally negligent in selling a deathtrap to unsuspecting Americans. As intended, this attack on GM led to a public relations disaster for the company, causing it to quickly drop the model. Also as intended, it was a public relations triumph for Nader and others eager to influence the way cars are made.

Sowell shows that Nader's attack on the Corvair and his broader insinuation that the auto manufacturers weren't interested in safety was bogus. In points of fact, the Corvair was as safe as other compact models of the time and the long-run trend of auto safety was very positive. Without any government interference, manufacturers had been improving car safety steadily. The fatality rate in 1965 was less than one third what it had been in the 1920s.

Nevertheless, Nader's crusade was a success. Influenced by "pro-safety" groups, the federal government soon began to intrude into auto design with mandates

that made cars more expensive but did little to make them safer. Political grandstanding replaced the careful balancing of safety benefits with their costs. When safety groups and politicians demand that they are entitled to make decision on safety tradeoffs, they harm consumers.

Government meddling in insurance markets is just as detrimental. Insurance companies need to charge high-enough premiums to cover the anticipated risk of loss, but it's common for "compassionate" politicians to step in to help the insured. For example, government has prevented private insurers from charging enough to property owners in hurricane-prone areas to continue to provide coverage. As a result, private insurance is leaving and that great insurer of last resort, the federal government, is moving in. Property owners get subsidized insurance, with the costs spread to the rest of the population. It's economically inefficient to encourage people to live in high-risk areas and it's a bad deal for Americans forced to pay the subsidies, but that's what happens when you transfer private decision-making to government.

Another hot political issue facing the country is medical care. As this goes to press, the Obama administration is pushing a "public option" government-operated health care plan that, if you think past stage one, amounts to a health care system run by politicians and bureaucrats. The president and his allies profess that their system will reduce health care costs, but Sowell maintains that such assurances are implausible. The increasing demand for medical services will make prices rise, and if the government tries to combat that with price controls (as other countries have done) the result will be a reduction in the supply of doctors, hospitals, and pharmaceuticals. Is that what anyone really wants?

Sowell constantly reminds us that we live in a world of scarcity. Trying to get more of one thing means giving up something else. At an abstract level, no one can disagree. But when it comes to specific policy questions, stage-one thinking often takes over, with politicians and activists advancing utopian schemes. The great virtue of this book, as well as any of Sowell's other books, is that it teaches the individual to say, "Wait a minute — here's what you're forgetting..." when he hears those schemes. R

Documenting *U.S. v. Microsoft*

Reviewed by David R. Henderson

THE MICROSOFT CASE: Antitrust, High Technology, and Consumer Welfare
By William H. Page and John E. Lopatka
347 pages; University of Chicago Press, 2009

In politics, no issue is ever settled. No matter how strong the evidence and arguments on one side, there will always be people on the other side and, if the political forces are aligned just so, they will be able to raise the issue again and, sometimes, get their way.

For that reason, books and articles that thoroughly document and evaluate both sides of an issue serve an important purpose. *The Microsoft Case*, originally published in 2007 and now out in paperback, is such a book. Authors William Page and John Lopatka, law professors at the University of Florida and Penn State University respectively, do a painstaking job of laying out the allegations, facts, and analysis in *U.S. v. Microsoft*, the biggest antitrust case of the Clinton administration. Like all good law professors, they footnote virtually every claim: the book has 1,517 footnotes and, for that reason alone, will surely be an important source on the case for years to come.

But *The Microsoft Case* is far more than a source. It's also a coherent analysis by two economically literate legal scholars who are obviously doing their best to present an unbiased account. Page and Lopatka do not start tabula rasa. They are strong adherents of the "Chicago school" of antitrust law, which holds that the only legitimate purpose of antitrust is to promote economic efficiency and that, by that standard, most antitrust case law fails. Not surprisingly, therefore, their bottom line is that most of the case against Microsoft was faulty and that the few parts of Microsoft's behavior that one could justifiably object to had only a small effect. Although they never quite come out and say it, the reader is led to conclude that the country would have been better off had the case never been brought.

I should make a few disclosures before I go any further. First, I earned my Ph.D. in economics at UCLA during the 1970s, and much of what I know of antitrust economics comes from having studied under Harold Demsetz, Sam Peltzman, and Benjamin Klein, all of whom are steeped in the Chicago school tradition. Second, in the late 1990s and in 2000, as a regular columnist for *Red Herring*, I wrote a number of articles analyzing Microsoft's behavior and arguing that there was no good case for antitrust measures against the firm. Finally, in 2002, after I had written all those articles, Microsoft hired me to write more on the case, which I did. My association with Microsoft ended in 2003.

JUDGE JACKSON Page and Lopatka's first chapter, "Origins," takes the reader on an excursion through the development of economic and legal thinking on antitrust law and monopolization. It also lays out the basics of Microsoft's behavior and the arguments made by its attackers, chief among them Netscape. The authors introduce the idea of "network effects," an increase in value that a user derives from a good that is brought about by an increase in the number of other users of the same good.

In the second chapter, "Decisions,"

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

Page and Lopatka methodically lay out the decisions that Judge Thomas Penfield Jackson made in presiding over the case and that the Court of Appeals made in rejecting much of what Jackson found. This chapter, though dense, will be important for those who want to know the exact details of the decisions. The chapter's discussion of the judge's misconduct is especially colorful. Two months before he issued his findings of fact, Jackson gave a series of interviews to reporters from the *New Yorker* and the *New York Times*. In the interviews, he expressed negative views about the leading Microsoft officials, including Bill Gates. He said he viewed Gates as arrogant and unethical, and referred to him as "a smart-mouthed young kid ... who needs a little discipline." And Jackson compared Microsoft's behavior to that of gangland killers. Who knew? Many of us thought Microsoft was just selling a fairly good product and figuring out how to extract from consumers as much of the value of the product as it could. Silly us. It was this conduct by Jackson that led the Court of Appeals to disqualify him and hand the case to Judge Colleen Kollar-Kotelly.

The authors don't quite come out and say this, but I will: Judge Jackson seemed to see the case as a grudge match against both Bill Gates and the Court of Appeals. In the above quote about Gates being "smart-mouthed," Jackson added a line that the book's authors don't quote. According to his interviewer, the *New Yorker*'s Ken Auletta, Jackson said: "I've often said to colleagues that Gates would be better off if he had finished Harvard." Auletta also quotes Jackson saying that part of his motive in splitting his finding of facts from his finding of the law was "to confront the Court of Appeals with an established factual record which is a fait accompli." There's nothing wrong with that, except that Jackson confessed that "part of the inspiration for doing that is that I take mild offense at their reversal of my preliminary injunction in the consent-decree case." Rule of law, anyone?

THE ECONOMICS The third through fifth chapters, titled "Markets," "Practices I: Integration," and "Practices II: The Market Division Proposal, Exclusive Contracts, and Java," contain the guts of the economic analysis. The authors integrate nicely the facts of the case with the economic analysis.

The authors' analysis is so comprehensive that a short review cannot do their book justice. Instead, I'll highlight some of the ways they hit the bull's-eye. Take, for example, the path dependence theory espoused by some critics of Microsoft. According to the theory, people can get locked into an inferior technology because network effects give the early innovator an advantage. Page and Lopatka point out, though, that there is no necessary market failure from that fact alone. Citing the work of economists Stan Liebowitz and Steven Margolis, they point out that if the cost of switching from the inferior to the superior technology is less than the incremental benefit from switching, people will switch. The authors also point out that Judge Jackson mistakenly saw network effects as something bad, but the Court of Appeals got it right, understanding that network effects add value for consumers.

A particularly persuasive part of their book is their refutation of Jackson's idea that Microsoft's bundling of its browser, Internet Explorer (IE), with its operating system, Windows, was anticompetitive. His argument was that this bundling made it difficult for Netscape to compete with its Navigator browser. Of course, the bundling made Netscape's life difficult — competition from an implicitly zero-price product with low distribution costs tends to do that. But, note the authors in seconding the Court of Appeal's reasoning, "Such an action raises Netscape's costs of distributing its browser only to the extent it reduces the consumers' costs of acquiring Microsoft's browser." In other words, this alleged anticompetitive action, however much it hurt Netscape, benefited consumers.

Jackson disputed this, the authors note, actually claiming that Microsoft hurt consumers by giving them something for free. How so? Maybe, Jackson argued, they wanted a browser other than IE, or they wanted no browser at all. Page and Lopatka point out that this "harm," if there was one, had to be dwarfed by the huge benefit to consumers from a free browser that came with the operating system. Moreover, they note, if there was a harm done with the free IE that consumers supposedly didn't want, this harm was not due to bundling per se, but to a failure to allow easy unbundling. Finally, echoing the Court of Appeals, they note that "all other commercially significant PC operating system manufacturers include a browser." This is strong evidence that consumers wanted a browser.

Prosecutors in an antitrust case against a monopolist typically argue that restricting the monopolist's conduct or, in the extreme, breaking up the monopolist will allow more competition. Page and Lopatka write, though, that the argument the government made in the Microsoft case was that the competition was "a battle between standards for the hearts and minds of developers." Therefore, the authors point out, if the government had gotten its way, the result would not have been less monopoly but, rather, a different monopolist. They note that this discussion was prominent in the oral argument before the Court of Appeals. They reproduce a hilarious 2.5-page dialogue between one of the judges and the government's appellate counsel, Jeffrey Minear, in which the judge drags Minear to a begrudging admission of that fact.

This is not to say that the Court of Appeals was always wise. In remanding the case to a different judge, the court required the government to show that Microsoft harmed competition in the market for browsers. That sounds like a plausible thing for the court to require until you learn that the same court precluded the government from proving that such a market existed. That could be raw material for a Monty Python skit.

CRITICISMS I have two criticisms of the book: one as an economist and the other as a logician. My criticism as an economist is of the authors' statement, "If Microsoft had required the consumer to pay a positive price for IE to purchase Windows, then the consumer would have had a reduced incentive to pay a second price to acquire another browser." This is false. Once the consumer, by their assumption, has paid a positive price for IE, this price becomes a sunk cost. Unless this price is so high that it would have a substantial effect on the buyer's wealth — and no one claimed that — then the already-paid price

would have no effect on the decision to buy a second browser.

My logical criticism is of the authors' claim about the government's motives for bringing the Microsoft case. They quote the view of economists Milton Friedman, Thomas Sowell, Fred McChesney, and William Shughart that the case was brought because Microsoft's competitors wanted to hobble competition from Microsoft. Then they respond, "Difficult as it is for libertarians to accept, *Microsoft* has defenders among scholars who have no personal interest in protecting inefficient firms." But I would bet that Friedman had no difficulty whatsoever in accepting this. Friedman always made clear, no matter what issue he discussed, that most of those who disagreed with him were well-intentioned. But he also realized that special interests often play a role in the political process. One can think that the case was brought because of special interests, while also thinking that some of the supporters represented no special interests. R

A Failure of Progressivism

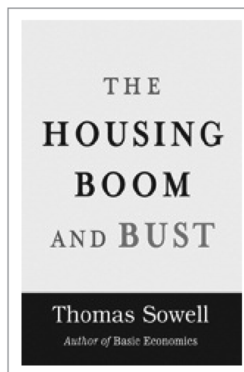
Reviewed by Jeremy Lott

THE HOUSING BOOM AND BUST
By Thomas Sowell
184 pages; Basic Books, 2009

Thomas Sowell's *The Housing Boom and Bust* comes to us wrapped in Spartan simplicity: no subtitle, no author photo, no "Sowell is a genius!" or "Buy this book!" blurbs. The title and packaging convey the sense that this book is too important and too impatient for that sort of thing (or, perhaps, too rushed in order to take advantage of the news cycle). Fortunately, the book does deliver a powerful —and timely — argument.

Sowell writes of the U.S. housing crisis that there was, in fact, "no single dramatic event that set this off, the way the assassination of the Archduke Ferdinand set off the chain of events that led to the First World War or the way the arrest of political operatives committing burglary at the Watergate Hotel led to the resignation of President Richard Nixon." That emphatically does not mean that moral agency played no part in the dramatic rise and collapse of housing prices. It simply means that the guilty parties are going to have an easier time when they try to spread the blame and point the finger elsewhere.

For some observers, the misdirection has worked. Richard Posner's deeply misguided new book called the housing-driven recession "a failure of capitalism." Sowell knows better. He explains that a "series of very questionable decisions by many people, in many places, over a period of years, built up the pressures that led to a sudden collapse of the housing market and of financial institutions that began to fall like dominoes." Okay, but what decisions? Which people? The author's long lifetime as an economic historian comes in handy for this financial and political whodunit, because he knows where more than a few bad arguments are buried. He marshals the statistics and other data to show us the ugly truth of what happened.



We know part of the story: U.S. housing prices ballooned, then quickly deflated. The value of the securities based on housing prices took a big hit, imperiling many financial institutions in the United States and elsewhere. But the growth and the deflation were not evenly spread out over the country. Between 2000 and 2005, the national median price of homes rose from $143,600 to $209,600 — 46 percent, not adjusting for inflation. In several states and localities, the increase was much higher: 79 percent in New York City, 110 percent in Los Angeles, 127 percent in San Diego. The bust has depressed prices in most housing markets. In markets with price growth well above the national average, sales have cratered. This has created new crises for several state governments. The State of California, which used tax revenues from boom times to go on a mad spending spree, is near bankruptcy.

Why was the housing boom so much more explosive in a few states and localities? Sowell argues that misguided policies played a role. He marshals several studies showing that the places with strict growth policies caused housing prices to become progressively more expensive. The rise in prices, coupled with low interest rates, prompted a lot of speculation in real estate. Additionally, many first-time buyers jumped into the market, figuring they'd better get in now before everything had shot completely out of their price range. The buyers were helped along by new financial arrangements that made it easier to purchase a home with little or no down payment, even if their credit histories were awful.

But why did banks so drastically lower their standards to accommodate first-time and subprime home buyers? Some loosening of standards might have been tempting in a bull real estate market but, really, loans with no down payments? Down payments have historically worked like economic hostages to ensure that mortgages get paid back. Why give up that necessary leverage?

"Economics cannot explain such things," writes Sowell. "For that we must turn to the politics of housing." While some interested parties are furiously fingering the "greed" of banks and the dangerous "deregulatory" approach of the U.S. government, Sowell argues that's exactly the opposite of what happened: "In reality, government loan agencies not only approved the more lax standards for mortgage loan applicants, government officials were in fact the driving force behind the loosening of mortgage loan requirements."

Take Barney Frank, current chairman of the House Financial Services Committee. In 2003, he brushed aside warnings that government-sponsored loan guarantors Fannie Mae and Freddie Mac, at the urging of Congress, were enabling too many marginal loans. Critics, Frank said, were trying to "conjure up the possibility of serious financial losses to the Treasury" when, really, the federal government

Jeremy Lott is an editor at Capital Research Center and author of *The Warm Bucket Brigade: The Story of the American Vice Presidency* (Thomas Nelson, 2008).

had "probably done too little rather than too much to push [Fannie and Freddie] to meet the goals of affordable housing." He would, he said at the time, prefer to "get Fannie and Freddie into helping low-income housing and possibly moving into something that is more explicitly a subsidy." He added, "I want to roll the dice a little bit more" on housing subsidy.

Sowell doesn't stop there. Rather than a large, unexpected systemic failure, he tells a tale of individuals in the grip of a grand, unyielding vision: of congressmen and presidents hell-bent on expanding homeownership regardless of cost, of regulators vilified for trying to halt this slow-motion train wreck, of banks forced to give bad loans by regulators and shake-down community activists, of people in power who glimpsed the coming disaster but spoke too softly or too late.

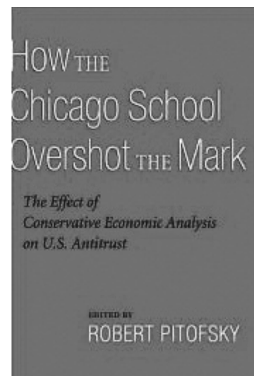
Rather than a failure of capitalism, Sowell has shown us the failure of progressivism. R

The Trustbusters' Revival Misfires

Reviewed by Richard L. Gordon

HOW THE CHICAGO SCHOOL OVERSHOT THE MARK:
The Effect of Conservative Economic Analysis on U.S. Antirust
Edited by Robert Pitofsky
309 pages; Oxford University Press, 2008

One of the most important developments in U.S. legal history has been the courts' mid-20th century adoption of the "Chicago school" view of antitrust. Before that time, antitrust law seemed to accept the simplistic view that "big is bad" — that almost any action by a large corporation and even many moves by smaller firms were legally suspect. The Chicago insight — so named because many of the economists and legal scholars who laid its foundations have ties to the University of Chicago — was that, many times, actions by big firms that result in larger market shares are beneficial to consumers, and actions by large and small firms that somehow seem unfair to their competitors often benefit consumers nonetheless. The result of this insight is greater skepticism by the courts and by antitrust enforcers that, though a firm's actions may cause its competitors distress, that does not mean the firm has violated the antitrust laws.



In more recent decades, the Chicago revelation has been challenged by "post-Chicago" discoveries that some business actions that seemed to be rehabilitated by Chicago should still come under scrutiny (though they may ultimately prove both benign and legal). Nonetheless, U.S. antitrust has been realigned by Chicago, and that is a good thing for consumers.

However, some still yearn for the old days of "big is bad" antitrust, while others remain uncomfortable with Chicago's broad insight (even if amended with post-Chicago thinking). The book reviewed here, *How the Chicago School Overshot the Mark*, is a product of those two groups. In some ways the book — unintentionally — represents a battle between them: the "big is bad" folks want to toss out Chicago, while the "uncomfortable" folks realize that can't (and shouldn't) be done. For this reviewer, who accepts the Chicago insight, the clash is fascinating even as the book fails to make its case.

The book editor is Georgetown law professor Robert Pitofsky, a prominent big-is-bad-er who chaired Bill Clinton's Federal Trade Commission. The book contains 14 articles, of which two are coauthored, examining aspects of the case. Nominally, the five absurdly short pieces that comprise the book's first part are overviews of both Chicago and post-Chicago antitrust. The rest of the book's contents are not well delineated, though they are grouped under five general subject areas: Chicago's stress on efficiency, dominant firms, two aspects of vertical relations, and horizontal mergers.

The origins and actual timing of this effort are unclear. One paper refers to an underlying conference, but it is not mentioned elsewhere and a Google search produced nothing. Lawyers outnumber economists in this volume; eight articles are lawyer-written; five are by economists; the last is by an economist and lawyer-economist. More importantly, the majority once were government antitrust officials.

Given the repetition between papers and the law journal–like devotion to extensive notes, the book relies heavily on assertions instead of the extensive reasoning that is needed to make its case. What we get are claims that stronger enforcement of antitrust is desirable and possible, in ways about which the different contributors seem to disagree.

THE OVERVIEW Four of the five overview essays deal in slightly different ways with key points about the Chicago approach:

- Antitrust during the "pre-Chicago" era was governed by unsound economics and ill-defined objectives.
- Chicago economists and lawyers seized on those deficiencies to mount devastating attacks.
- However, considerable variation prevailed among the legal scholars and economists who are identified with Chicago.
- Not all of the criticism of pre-Chicago antitrust came from Chicago.
- The criticisms were enormously influential on the practice of antitrust.
- The acceptance of the Chicago view was not complete.
- A subsequent post-Chicago school of new industrial economics arose to show that under some circumstances the Chicago arguments did not hold.
- The post-Chicago findings should be used to develop a stronger approach to antitrust.

Richard L. Gordon is professor emeritus of mineral economics at Pennsylvania State University.

Only the last point is contentious; the previous seven are historical facts. Yet the book devotes most of its space to discussing the first seven points instead of the provocative eighth one.

The pre-Chicago defects of antitrust involved an underlying excessive concern about the pervasiveness of monopoly and a resulting undue suspicion of various business techniques. The obvious targets were clear overreaches such as mergers with nonexistent impacts on the vigor of competition or, worse, protecting high-cost firms from more efficient competitors. At the second level, the commentators analyzed the invalidity of prevailing fears about such tactics as predatory pricing, tying, exclusive dealing, and minimum-pricing requirements by sellers.

In the first of the book's five overview chapters, MIT's Richard Schmalensee, who leads off as the "defender" of Chicago, gives fairly straight-forward developments of these points. Curiously, it is Schmalensee who makes a greater concession to post-Chicago than a later, similar treatment by Thomas E. Kauper, a University of Michigan law professor. The strangeness goes far beyond undermining his nominal role in the book as defender. Schmalensee was a prime victim of blatant misuse of post-Chicago analysis — he served as the lone expert witness for Microsoft in its 1999 antitrust case. In the Microsoft case, such arguments were asserted without elaboration, and accepted, in which the government limited itself to repeating the post-Chicago phrase "raising rivals' costs"; the only serious discussion of the phrase's meaning was Schmalensee's short oral response that such actions may or may not be anticompetitive. The concept encompasses all actions that make it harder to compete.

F.M. Scherer, author of a once-prominent industrial organization text, contributes a chapter to the book's first section. He provides offhandedly the only hint in the book that *repeal* of antitrust has strong advocates; he notes the existence of people at Auburn University who have an alternative view of antitrust (though he doesn't explain what that view is). His is an inadequate discussion. The book clearly is more for casual observers than for people familiar with antitrust, and such readers would not know what Scherer means in all of this.

Another overview chapter is contributed by Irving M. Steltzer, whose career is in consulting and think tanks. He mostly makes unsubstantiated assertions about where antitrust can be stronger than Chicago argues, and ends by attacking the undue influence of think tanks. He uses as his example, not the repeal advocates at Cato, but the reformers at the American Enterprise Institute, his former employer (and publisher of his own gushy tributes to antitrust).

THE ANALYSIS The book's next section examines the Chicago school's focus on efficiency. NYU law professor Eleanor Fox offers a puzzling first chapter in which she takes Chicago disciple Robert Bork to task for stressing that efficiency should be the sole concern of antitrust. However, as has long been true in this literature (including the rest of this book), she does not make a case for using antitrust to attain any other goal, such as preserving a large class of independent business people or redistributing income. She is smart enough to know that such arguments are indefensible. What she does effectively argue is that efficiency is difficult to define. She claims that because of this, Bork fostered an approach that is too loose. Interestingly, her concern about defining efficiency is exactly the same as those who would do away with antitrust law altogether, because antitrust complaints too often incorrectly assert inefficiency.

Fox does not help her argument by frequent unsubstantiated assertions that only the opinions of "conservative" economists justify the decisions that she feels were too lenient. The cases she examines do little for her cause. The worst-selected case is one allowing dentists to restrict advertising; Chicago analysis opposes rather than approves such restrictions. The other choices are also unconvincing, and other contributors to the book write that at least two of Fox's exemplar cases were correctly decided.

The following chapter by two law professors, John B. Kirkwood and Robert E. Lande, is simply silly. They argue Bork is wrong because the framers and the courts wanted to prevent damage to consumers rather than inefficiency. At least where I studied and taught economics, inefficiency meant damage to consumers.

The book's third section focuses on dominant firm behavior. It opens with a chapter by Herbert Hovenkamp summarizing his search for a middle ground between Chicago and post-Chicago theories that he came to recognize could not be applied. Predictably, he is unconvincing in this effort to boil down a prior long article and a book (reviewed by me here in 2006, and longer than all of Pitofsky) that themselves were not credible. His theme is that post-Chicago "Harvard" antitrust is more nuanced and more influential. He develops his case by rushing too quickly through a survey of a few problem areas.

The second piece, by Harvey J. Goldschmid (co-editor of a classic 1974 conference proceedings volume in which Chicago economists demolished the case for breaking up large corporations), nominally is a comment on Hovenkamp. The bulk is devoted to parsing two Supreme Court decisions. In one case, Goldschmid accepts the outcome but attacks Justice Antonin Scalia's decision for going too Chicago. In the other, he disagrees with Hovenkamp's attack on a successful prosecution of Eastman-Kodak for tying repairs to the purchase of its (unsuccessful) copiers.

The fourth section examines vertical arrangements, focusing on exclusion and exclusive dealing. Both chapters in this section follow the book's frustrating practice of asserting without substantiation. In the first of these chapters, Steven Salop, the creator of the "raising rivals' costs" theory of antitrust, restates his theory without regard to the devastating subsequent criticism that has been leveled against it. This reflects the general failure of Pitofsky's book to note new post-post-Chicago literature that weakens the book's intrinsically overly expansive case. Worse, in Salop's case, his chapter treats only the theory, when the key issue is whether the theory provides sufficient guidance for use in antitrust enforcement.

Stephen Calkins offers the next chapter, giving a history of exclusive dealing decisions, from which he deduces that the courts correctly rejected Chicago positions. Among his prime examples is the Microsoft case; my examination of the record in that case produced dis-

agreement with the court decision Calkins lauds.

The next section also concerns vertical arrangements, this time questioning whether resale price fixing is a sensible response to free riding. Inadvertently, the two papers in this section demonstrate that the Chicago analysis is right. Being old enough to remember when resale price maintenance was a device to protect small retail businesses from chain-store competition, I was suspicious of the Chicago position. However, the two papers reveal that Chicago was talking about something quite different — the effort of individual producers, often facing extensive rivalry and in many key cases poor market performance. In that case, Chicago argued that a valid, pro-competitive strategy was for producers to require retailers to adhere to a minimum price as part of an agreement in which the retailers provide better customer service. The two papers claim to identify several examples of unsound court acceptance of the Chicago position, but in fact those examples seem to support Chicago. Also-ran companies resort to outlet control to counter their weaknesses.

The book ends with an effort by Jonathan Baker (with degrees in economics and law) and economist Carl Shapiro to justify greater challenge to mergers. Again, a necessarily cursory review of history is used to assert that Chicago-inspired leniency is overdone. Their key example is the Justice Department's failure to challenge Whirlpool's 2007 acquisition of Maytag. The concern is the large market shares of the two. They ignore that a far larger company, General Electric, also competes in the major household appliance market and surely would expand its market share if Whirlpool/Maytag became a less vigorous competitor in the wake of their merger. Worse, Baker and Shapiro assert that only presently unutilized foreign capacity is available to compete (and accuse those with a broader view of error). Apparently, they have forgotten about such cases as the automobile industry.

HISTORY None of the authors in this volume, particularly Scherer and Hovenkamp, manage to deal accurately with the history about which they are obsessed. The complexities are great. Early advocacy of antitrust came from anti-theoretic "institutional" economists. In response, Harvard's Edward S. Mason encouraged sound economic analysis of major antitrust cases. Among his students was Joe E. Bain, who became a University of California economics professor. Bain tried to use theory and pioneering statistical analysis to support the institutionalists' proposals. Bain and later Carl Kaysen, Mason's successor at Harvard, thought that theory justified radical increases in antitrust activity, including the breakup of all large companies. Bain's views on this, however, were at the extreme among Harvard graduates and quite different from Mason's.

Many people who talk of the transition from Chicago to post-Chicago antitrust rely on the work of Chicago professor Richard Posner. Unfortunately, Posner oversimplifies the intellectual dispute as one between Harvard and Chicago, and he manages to convince both sides of the validity of this sharp division. In fact, the ties to Chicago of the "Chicago" people were wildly variable. Chicago scholars differ among themselves, and many of the Chicago concerns are general among antitrust economists, including many post-Chicago and Harvard economists. Of particular importance is the contrast between Posner's belief that antitrust should be repealed (except perhaps for prohibitions on price fixing), in contrast to Bork's optimism that antitrust law only needs reform. What unifies Chicago, however, is the belief taken from Mason that sound economic analysis should replace the prevailing intuitive "big is bad" basis for the creation and enforcement of antitrust. Chicago strongly, but not uniquely, opposes extreme measures and the overall use of misguided arguments.

The original Chicago reform efforts inspired attacks from both those who wanted to preserve the original antitrust philosophy and from those who wanted to abolish antitrust altogether: First, a school of new industrial economics arose to challenge Chicago, citing fears about business practices. However, the developers of those new theories were divided about the relevance of their work. Some admitted that the ambiguities about when the practices had anticompetitive effects were too difficult to resolve in practice. Other argued that they had developed a post-Chicago theory strong enough for application. Their efforts matured by 1990, and subsequently great debate arose, including much work criticizing the new theories.

Second, new efforts were devoted to the long-standing argument that, in the absence of government assistance, monopoly would not endure and governments lacked the competence and motivation to detect and correct monopoly. This view is far more radical than the Chicago perspective, yet it was held by many economists when antitrust was enacted in 1890. For reasons that are unclear, this view had weakened greatly by the 1930s. A pioneering article reviving the argument was written by Alan Greenspan in his Ayn Rand days; in 1982, Dominic Armentano developed the first full exposition of the point; Fred McChesney and William Shughart edited a major 1995 anthology examining the idea.

CONCLUSION This quick history of U.S. antitrust suggests that the development of specifics is indispensable to understanding the relevance of both the Chicago movement and the post-Chicago movement. Sadly, this book fails in that important task. The result is contrasting and often conflicting chapters by the book's contributors, many of whom disagree with each other and with Pitofsky. The discussions are invariably assertions unsupported by meaningful analysis. Several contributions are worthless. The effort does not match a good symposium in a law journal and certainly does not rise to the excellence that justifies publication by a major press.

Within as well as among articles, the contributors try to argue simultaneously that Chicago positions were not fully adopted, but that Chicago had an undue influence. At best, this is too glib. Proof requires far more explicit attention than the book devotes to this or any other issue it examines.

As usual in such debates, apologists will say that fewer, fuller articles would have done the job better. However, Hovenkamp's effort at full-scale defense failed as well. Thus, the alternative conclusion that the case is invalid is more plausible. Antitrust should go no further than the most restrictive Chicago suggestions. R

Unchained Ideas

Reviewed by George Leef

AGAINST INTELLECTUAL MONOPOLY
By Michele Boldrin and David K. Levine
298 pages; Cambridge University Press, 2008

Article I, Section 8 of the Constitution provides that Congress may establish a system of patents and copyrights to promote progress in "science and useful arts." The drafters of the Constitution were, overwhelmingly, governmental minimalists who wanted to keep the authority of the state as limited as possible, consistent with societal order. Over the years, however, free market scholars have argued that some of the Constitution's provisions give power to government where it would have been better not to. The coining of money could, for example, have been left to business firms competing to provide the service of turning raw metal into easily traded coins. (See my review of George Selgin's *Good Money*, Winter 2008.) Arguably, we'd be better off if the Constitution hadn't put the government into the money business.

Now we have two scholars contending that the power to issue patents and copyrights was also a mistake and that we would be a lot better off if government could not create those intellectual monopolies. Michele Boldrin and David Levine, both economics professors at Washington University in St. Louis, offer their new book *Against Intellectual Monopoly*, which makes an extremely powerful case against patents and copyrights.

Most people are likely to believe, as the Constitution's drafters did, that we need patents and copyrights to stimulate innovation and creativity. Boldrin and Levine argue that this belief is mistaken. Just as other supposedly helpful interventions by the state actually obstruct economic progress — the authors mention trade protectionism and I would add government schooling, central banking, and many others — creating intellectual monopolies does far more harm than good.

George Leef is director of research for the John W. Pope Center for Higher Education Policy.

There is much disagreement over our intellectual property regime. Some argue strenuously that it doesn't go far enough in "protecting" creators, while others claim that it goes too far, stifling innovation by unduly limiting the freedom to use ideas. (See, for instance, "Of Patents and Property," Winter 2008, and "Courts and the Patent System," Summer 2009.) Boldrin and Levine take a truly radical position: We should get rid of our system of intellectual monopoly entirely. The authors write:

> Our analysis leads us to conclusions that are at variance with both sides.... Creators of new goods are not different from producers of old ones: they want to be compensated for their effort. However, it is a long and dangerous jump from the assertion that innovators deserve compensation for their efforts to the conclusion that patents and copyrights, that is, a monopoly, are the best or only way to provide that reward.

In short, Boldrin and Levine argue that intellectual monopolies are an unnecessary evil with large costs and scant benefits.

HISTORY The authors proceed to make their case against governmentally conferred intellectual monopolies (of course, they aren't opposed to allowing innovators to *privately* exploit the fact that they have an idea that no one else does) by a traversal of history and theory. The history that is relevant includes a lot of debunking of widely accepted beliefs about famous inventors who relied on patents, evidence that creativity has flourished in the absence of any system of patent and copyright, and demonstration that patents and copyrights have placed obstacles in the way of progress. (Some of this history will be familiar to those who have read James Bessen and Michael Meurer's recent book *Patent Failure*.)

For instance, consider James Watt. His steam engine is often regarded as the catalyst that brought about the Industrial Revolution, and defenders of intellectual monopoly assert that his patenting of his innovation was instrumental in its spread. But in fact, the steam engine already existed when Watt devised an improvement on it in 1764, freely utilizing a number of unpatented ideas. The next year, he applied for a patent, supported by wealthy industrialist Matthew Boulton. The patent was granted, but Watt and Boulton did little with their engine until 1775, when they asked Parliament to extend the patent until 1800. (Edmund Burke denounced the monopoly, but to no avail.) Only then did production of the engine begin — along with rigorous efforts to block other inventors who came up with improvements. Numerous innovations were kept at bay until Watt's patent expired. Further, Watt was to some degree "hoist with his own petard" because several technical improvements he might have used to make his own engine more efficient had been patented by others. Summing up Watt's tale, Boldrin and Levine write, "In fact, it is only after their patents have expired that Boulton and Watt really started to manufacture steam engines. Before then, their actions consisted principally of extracting hefty monopoly royalties through licensing." Thus, the British patent system did not catalyze Watt's invention, but after he had secured his patent, it diverted his efforts and obstructed further progress. Watt's steam engine monopoly did society about as much good as the infamous royal monopolies of earlier centuries.

Among many similar stories in the book, the one that will no doubt raise the most eyebrows is that of the Wright flyer. Wilbur and Orville did make some innovations important to flight, building upon previous ideas that fortunately weren't roped off by patents. After receiving their patent, however, the Wrights took the typical rent-seeking route, squabbling with other innovators (particularly Glenn Curtiss) over alleged patent infringements. Most of the early development of the airplane occurred in France, where the Wright patents held no force.

Those and many other instances lead the authors to conclude, "Intellectual monopoly is not a cause of innovation, but rather an unwelcome consequence of it."

Boldrin and Levine also take on the notion that patents and copyrights are necessary to spark innovation by pointing to many examples of fast-paced develop-

ment and creativity where there were no intellectual monopoly laws. For example, innovators in plant breeding kept making strides even though it was not possible to patent new strains of plant life. The same, they argue, was true in music; there was no copyright law in Austria and the numerous German states at the time when Mozart and Beethoven were writing, but that didn't stop them from their amazing creativity. What if there had been copyright, though? Would the irascible Beethoven have spent time in legal battles against composers like Schubert, whom he might have accused of pirating his ideas? Maybe, and if so, we might not have as many of his late string quartets to enjoy.

Third, intellectual monopoly leads to great inefficiency as people try to game the system. Among other shenanigans, Boldrin and Levine point to the phenomenon of "submarine" patents. These are vague patents (and one of the book's many surprising revelations is how liberal the Patent Office is with its favors) that people obtain not because they have any intention of producing anything, but simply so they can later launch a sneak attack on others who actually do want to produce something, by claiming patent infringement and forcing a costly settlement. It's clear that the patent and copyright system has a lot of hidden costs that impede real innovation.

Turning to theory, the authors include a brilliant discussion of the nature of competition, focusing especially on the "first mover advantage." Being first in the market confers (or at least can confer) great profit advantages. It is as if white didn't just get the first move in a chess game, but the first three. Boldrin and Levine write, "Ultimately, no academic work can do more than scratch the surface of the first mover advantage; it is limited only by human ingenuity, an area in which academic economists have no special advantage." In the absence of intellectual monopoly, innovators would put more effort into capitalizing on their ideas and stop wasting time and resources on rent-seeking.

PHARMACEUTICALS When I mentioned the thesis of the book to my son, a college student, his immediate reply was, "What about pharmaceuticals? Without patents, wouldn't drug innovation stop?" That is a good question, and the authors are aware that few people will take them seriously if they can't allay the fear that drug companies wouldn't continue to develop new medicines if they couldn't recoup the high costs with patent-protected profits. Indeed, in recent *Regulation* articles, both James Bessen and Michael Meurer, and Dan Burk and Mark Lemley suspended their general skepticism of patents and copyrights when they turned their discussions to pharmaceuticals and chemicals.

It would unduly extend this review to examine the arguments Boldrin and Levine advance to support their claim that patents are not necessary even in the drug industry. Undoubtedly, their book will receive a great deal of critical attention, much of it directed at their conclusion that we'd have at least as much innovation in the absence of patents. In my view, they make a convincing case, but I would be eager to hear counter-arguments.

If the authors are right, we should abandon our intellectual monopoly system. But is it possible that we will do so? Boldrin and Levine are cognizant of the Public Choice reasons for pessimism. The status quo has a lot of powerful beneficiaries who will vigorously defend it, including a large number of lawyers, patent and copyright officials, Disney, the recorded music industry, and others. Those who would benefit from ending the system of intellectual monopoly — mainly the public at large — are not politically organized and have little or no idea of the losses they suffer from patent and copyright impediments. But if no one brings the undesirability of intellectual monopoly to our attention, we're sure to be stuck with it. I give the authors high marks for making such a strong case for a radical, and to most people counter-intuitive, position.

And not only does *Against Intellectual Monopoly* advance a striking proposition, but it's also very witty. Free market advocates will find it a pleasure to read and a challenge to the mind. This is a book that deserves to be widely read and debated. R

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