

# Regulation

THE CATO REVIEW OF BUSINESS AND GOVERNMENT

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Populist Left and Right P.6

Will the CRA Lead to  
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REGULATION, 2017, Vol. 40, No. 2 (ISSN 0147-0590). REGULATION is published four times a year by the Cato Institute ([www.cato.org](http://www.cato.org)). Copyright 2017, Cato Institute. REGULATION is available on the Internet at [www.cato.org](http://www.cato.org). The one-year subscription rate for an individual is \$20; the institutional subscription rate is \$40. Subscribe online or by writing to: REGULATION, 1000 Massachusetts Avenue NW, Washington, DC 20001. Please contact REGULATION by mail, telephone (202-842-0200), or fax (202-842-3490) for change of address and other subscription correspondence.

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REGULATION was first published in July 1977 "because the extension of regulation is piecemeal, the sources and targets diverse, the language complex and often opaque, and the volume overwhelming." REGULATION is devoted to analyzing the implications of government regulatory policy and its effects on our public and private endeavors.

**FOR THE RECORD****Keeping the Debate Alive**

I write a short but very sincere note of congratulations on celebrating *Regulation's* 40th anniversary. In 1977, under Anne Brunsdale excellent leadership, the first issue emerged in the midst of a Ford administration effort to reduce a rapidly growing regulatory burden. At the time, I was a foot soldier in Jim Miller's small band of regulatory economists working in the Government Operations Research (GOR) component of the President's Council on Wage and Price Stability. Writing comments on newly proposed regulations and interacting with regulatory agencies, GOR laid the first stones in the foundation for what would become the White House Office of Information and Regulatory Affairs.

To help celebrate that first issue, 40 years ago, I sent a bouquet of roses to Brunsdale's office with a note wishing that the new magazine would experience a

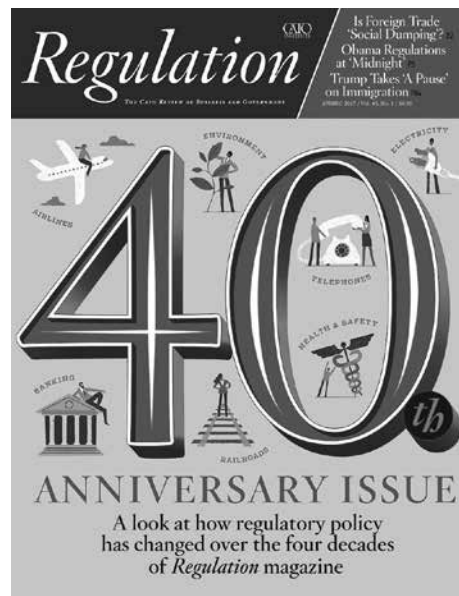
long and productive life. Needless to say, *Regulation* flourished, as has the object of the magazine's special topic.

But let us not forget that along the way, parts of the regulatory load have been made lighter in major ways. We no longer have an Interstate Commerce Commission, a Civil Aeronautics Board, restrictions on branch banking, mortgage usury laws, or environmental regulations that forbid plant operators from minimizing cost across multiple emission sources, just to mention a few changes for the better.

I thank you for helping keep the debate alive and send my best wishes to you.

**Bruce Yandle**

*Dean emeritus, College of Business and Behavioral Science, Clemson University  
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## BRIEFLY NOTED

# Legislating Drug Price Transparency

BY THOMAS A. HEMPHILL

The U.S. pharmaceutical industry has once again become a target of consumers' and politicians' ire. In the past few years, public outcry ensued after a new, blockbuster drug was marketed at a seemingly exorbitant price and an older, off-patent generic drug underwent a progression of price hikes.

The former controversy was over the drug Harvoni, first released by Gilead Sciences in 2014. Harvoni can completely cure many people of the most common type of hepatitis C (and with few side effects), resulting in its being hailed by the medical community as a major breakthrough. However, the patient cost of this "miracle drug"—\$94,500 for a 12-week treatment—elicited a firestorm of condemnation. By late 2014, both Democrats and Republicans on the U.S. Senate Finance Committee were demanding detailed cost data on Harvoni from Gilead Sciences because the new drug was already placing an additional strain on the budgets of state and federal health care assistance programs.

The latter controversy was over Turing Pharmaceutical's marketing of Daraprim, a medication used to treat protozoal infections in AIDS and cancer patients. Daraprim is on the World Health Organization's List of Essential Medicines. In the summer of 2015, Turing announced that the drug's price would rise from \$13.50 to \$750 per tablet—a 5,500% increase.

**Public and employer concern** / A recent national survey shows that the average American consumer is alarmed at these skyrocketing prescription and brand-name pharmaceutical prices. Just over three-fourths of those surveyed believe that brand-name prescription drug prices are unreasonably high today, including 80% of Democrats and 70% of

Republicans. Although media attention has focused on a small number of very high-priced medicines to treat debilitating diseases, a majority of survey respondents report greater concern for future rising prices for more routine brand-name drugs. This concern is fueling support for major governmental action to negotiate or set future drug prices.

American consumers aren't alone in their concern about rising drug prices; so are their employers. Willis Towers Watson, a leading global workforce advisory firm, surveyed employers about their top health coverage concerns heading into the 2017 open enrollment season. The firm found that nearly nine in 10 employers identified managing prescription drug expenses—especially for specialty drugs—as their top priority.

**State action** / According to Aaron Kesselheim, an associate professor of Medicine at Harvard Medical School, transparency initiatives may be more palatable than tackling price caps or patent protection. "Who could be opposed to transparency?" asked Kesselheim rhetorically, speaking at a March 2017 American Medical Association advocacy conference. "To the extent that all of them are difficult hills to climb, that one might be easier because we're not changing anything, we just want things to be more open. So that seems more doable in the short term."

According to the National Conference of State Legislatures (NCSL), at least 14 states considered legislation involving prescription drug manufacturer price transparency

in their 2015–2016 legislative sessions. In essence, such legislation would require drug makers to report and justify price increases that lawmakers consider questionably large. The NCSL also found that eight states considered bills that would place drug pricing transparency requirements on health insurers, with Arkansas, South Dakota, and Texas adopting such legislation. Ten states and Puerto Rico considered legislation requiring pharmacy benefit managers (PBMs)—third-party administrators of prescription drug programs—to provide price transparency, with Delaware and Maine signing those bills into law.

The NCSL reports that 15 states have legislation pending related to drug price transparency as of early March of this year. One such state is Maryland, which has two bills, one to require drug manufacturers to explain price hikes, and a second to allow legal action for excessive price increases.

**Vermont** / The first state to implement drug price transparency legislation was Vermont in June of 2016. "This bill is about accountability," explained Gov. Peter Shumlin of the enacting legislation. He continued:

The reality is that we have pharmaceutical companies raising prices on lifesaving drugs 5,000%. When asked about those outrageous increases, CEOs are literally laughing in front of Congress. That needs to change.

Under the legislation, the Green Mountain Care Board—a Vermont health care regulator—works in conjunction with the Department of Vermont Health Access to develop an annual list of either (1) the 15 drugs for which "significant health care dollars are spent and where list (i.e., 'wholesale acquisition cost') prices rose by 50 percent or more over the previous five-year period," or (2) 15 medicines whose list prices rose 15% or more over a 12-month period for the state's Medicaid program. Also, the 15 drugs identified by these agencies must represent different drug classes. The Green Mountain Care Board then provides the state attorney general the

compiled list, including the percentage of the wholesale acquisition cost increase for each drug. The drug cost information is made publicly available on the Green Mountain Care Board's website.

Under the law, pharmaceutical manufacturers need to disclose "all the factors that have contributed to a price increase," including detailed cost breakdowns, and justify the increases to the attorney general in a format that is "understandable and appropriate." The attorney general can seek injunctive relief, costs, and attorney fees if these companies decline to provide the requested information, where each civil violation carries a \$10,000 civil penalty.

**Congress Acts?** / On September 14, 2016, a bipartisan bill, the Fair Accountability and Innovative Research (FAIR) Drug Pricing Act, was introduced in Congress by cosponsors Sen. John McCain (R-Ariz.) and Sen. Tammy Baldwin (D-Wisc.) in the Senate, and by Rep. Jan Schakowsky (D-Ill.) in the House. This legislation was not enacted in the 114th Congress, and has yet to be re-introduced in the 115th Congress.

Under the legislation, drug manufacturers would have been required to report in advance to the U.S. Department of Health and Human Services (HHS) a price increase of more than 10% over a 12-month period for certain drugs. As part of their reports, the manufacturers would have had to provide a justification for each price increase, manufacturing and research and development costs for the qualifying drug, net profits attributable to the drug, marketing and advertising spending on the qualifying drug, and other information as deemed appropriate.

The bill would not have prohibited manufacturers from increasing prices, but it would have given taxpayers notice of price increases and would have brought a basic

level of transparency to the market for prescription drugs. The HHS would have made the information from these reports (excluding any proprietary and confidential information) publicly available in an understandable online format within 30 days. Moreover, the HHS would have been required to submit an annual report to Congress summarizing the information and reports submitted by drug manufacturers.

In a June 15, 2016 *Stat News* article, an unnamed spokeswoman for the Pharmaceutical Research & Manufacturers Association, the drug industry's trade association, said that the FAIR Drug Pricing Act "will not benefit patients" or provide information that they could use. "Instead it focuses on isolating research and development costs for the few medicines that make it to

patients in a thinly veiled attempt to build a case for government price setting," the spokeswoman argued. Moreover, she maintained that drug manufacturers already disclose "extensive information" about R&D costs, "a wealth of information about effectiveness and safety" before clinical research that is published on public websites, and "aggregated information about negotiated and required rebates is included in company financial filings."

**Will greater transparency work?** / Returning to Vermont, the state has been a bellwether for legislation addressing alleged "excesses" of the pharmaceutical industry. The recent legislation continues that trend. It will most likely capture popular generic drugs (and increase compli-

ance costs for those companies) among the state's list of the top 15 drugs, because it focuses on *percentage* price increases where this category of pharmaceutical has a low list price. Conversely, because the legislation focuses on price increases, Vermont's legislation will not capture newly introduced drugs initially offered to the public at seemingly exorbitant prices. Yet, the new legislation will provide information for the state's Medicaid program and the Green Mountain Care Board will have to decide whether the state will pay for certain drugs.

A December 2016 report issued by the Vermont attorney general's office identified 10 drugs of concern. While manufacturers were asked to submit explanations of all factors that contributed to price increases and estimate percentages attributable to each factor, none of those specific answers are explained in the report. Rather it merely summarizes some of the reasons given, including the industry's need to invest in research and development. As required in the state's legislation, the law has a confidentiality provision that does



## BRIEFLY NOTED

not allow for companies' written responses to be made publicly available. Thus, the efficacy of this transparency legislation is being called into question by many of the legislation's original critics.

An issue with many of the proposed state bills is that they offer percentage thresholds in annual (or multi-year) price increases that must be exceeded before a drug manufacturer is required to justify its cost to a state government's satisfaction. These percentage thresholds will offer visible targets for pharmaceutical manufacturers to consider when making their pricing decisions. While providing an annual price increase ceiling for some pharmaceutical manufacturers who do not want to make a state's list, these laws could perversely entice other drug manufacturers to raise prices yearly rather than risk one large (and reportable) increase in the future. Also, if other states pass legislation similar to Vermont, the lowest percentage price increase will likely establish a national threshold for pharmacy manufacturers concerned with such transparency legislation—unless the FAIR Drug Pricing Act is re-introduced and enacted in the 115th Congress, which would result in a 10% annual ceiling. The net result could conceivably be an overall increase in the price of prescription drugs.

Another legitimate criticism of these laws concerns the use of "list price" terminology. These wholesale prices are simply starting points for negotiations with PBMs and health care insurers. For example, according to data compiled in 2015 by the Drug Channels Institute, a pharmaceuticals consultancy, the combined top three PBMs (Express Scripts, CVS/Caremark, and United Health Group/OptimumRx/Catamarin) controlled 75% of market share by total equivalent prescriptions in 2014, worth an estimated \$263 billion annually. These large buyers will negotiate a final price for a pharmaceutical, and that price often includes substantial rebates. Depending on competition in the market for a drug, a pharmacy manufacturer may provide steep rebates, i.e., discounts, on their product to the increasingly concentrated PBM industry. For insulin, which

is a highly competitive market, Eli Lilly reportedly offered rebates off its list price in 2014 averaging 56% to PBMs and health insurers. As a result, the net price of insulin increased by only 3% over the previous five years.

Another area of concern to the pharmaceutical industry is the public release of trade secrets. In a May 30, 2016 letter to the editor in the *Pittsburgh Post-Gazette*, Robyn Boerstling, a vice president for the National Association of Manufacturers, noted the industry's concerns about the recently enacted Vermont legislation:

Manufacturers understand the need to reduce health care costs, but we have serious concerns related to the long-term implications of pharmaceutical pricing transparency proposals. Protection of trade secrets and intellectual

property is a necessity for manufacturers to succeed in today's intensely competitive global marketplace. No industry should be forced to turn over highly sensitive, proprietary information to any government—state or federal.

Boerstling goes on to note, "Trade secrets, which include pricing information, are protected by both federal and state laws."

Whether the Vermont legislation improperly asks for proprietary information that is part of the overall drug development process, and whether this request would cause competitive harm to a pharmaceutical manufacturer, is yet to be decided by the Vermont judiciary. At this time, the pharmaceutical industry has not challenged the lawfulness of the Vermont law—but that situation could change quickly. R

## Populism and Protectionism

BY PIERRE LEMIEUX

The recent French election illustrated what may look to many like an intriguing fact: the rejection of free trade by both extreme-left and extreme-right populism. The extreme-right candidate, Marine Le Pen, presented herself as an opponent of globalization, promising a "smart protectionism" and vowing to "reject free-trade agreements," to establish a "reindustrialization plan," and to hire 6,000 new customs agents. "We need protectionism," claimed a press release by the vice-president of the National Front, Le Pen's party. Jean-Luc Mélenchon, the extreme-left candidate, criticized "deindustrialization" and promised "solidary protectionism," "industrial sovereignty," and French exit from the World Trade Organization.

Both programs would undermine free trade and freedom to work within the European Union. In practice, there is

little difference between Le Pen's "smart protectionism" and Mélenchon's "solidary protectionism."

Today's populists oppose free trade even when they don't stand at the extremes of the political spectrum. In the United States, both Donald Trump and Bernie Sanders campaigned for protectionism. Many other examples could be given, including most if not all populist third parties in Europe.

**Authority and "the people"** / The *Encyclopedia Britannica* defines "populism" as a "political program or movement that champions the common person," noting that it "usually combines elements of the left and the right." Authoritarian populism is "typically critical of political rep-

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





resentation and anything that mediates the relation between the people and their leader or government.”

A number of reasons account for the marriage between populism and protectionism.

First, the common person does not understand how free trade benefits the vast majority of people. This ignorance is not surprising if only because the typical voter remains “rationally ignorant” of such matters. At least on this topic, ignorance is more prevalent among the less educated. There is evidence, including in a recent WSJ/NBC opinion poll, that individuals without a college degree are more likely to think free trade is detrimental (*Wall Street Journal*, February 26, 2017). But even among the educated, only a small minority understand the economic theory of trade.

A second reason why populists naturally favor protectionism is that the common person is more likely to fear foreigners, if only because he travels less and meets fewer strangers. As the word says, strangers are strange.

The third reason is that populism needs much state power, which free trade undermines. A populist leader may say he is work-

ing on behalf of “the people,” but at best he can only impose the preferences of the majority (or a large plurality) on the rest of the citizenry. “The people” do not have identical preferences and unanimous opinions. However much the populist leader wants to be loved, he will only be able to satisfy the preferences of some people. He will only satisfy his supporters—and then only some of their preferences. Power is required to steamroll minority preferences. Given the real or fictitious crises that typically spark and fuel populism, additional power will be needed. You don’t satisfy a mob by throwing roses to minorities.

When Trump said in a campaign advertisement, “We will be unified, we will be one, we will be happy again,” he was dreaming or uttering balderdash. No more unity would have been generated under Sanders; it would have been just another majority (or plurality) denying the preferences of another minority.

Free trade is an obstacle to any sort of government authoritarianism, including populist authoritarianism. Under free trade, domestic policies that would increase the cost of goods and services (say, by maintaining inefficient manufacturing) will be

circumvented by imports. The free movement of capital, which is part of free trade, is also a powerful restraint on authoritarian governments. If your savings are threatened, you can transfer them to another country. If worse comes to worse, you can leave and bring your money with you—or, today, telecommute from a foreign abode and receive payments from your customers over the border. Needing more power, populist leaders will favor protectionism.

Dual (or multiple) citizenship is an interesting case study. Populist or authoritarian governments don’t like dual citizenship because it allows their citizens to escape more easily. The more authoritarian the state is, the more captive a citizenry it wants. It is significant that Le Pen has voiced her opposition to dual citizenship.

These reasons are reinforced by a fourth one: the establishment—the populists’ *bête noire*—has come to side with institutions that appear to favor free trade—that is, with “globalization.” Established international organizations such as the World Trade Organization, the World Bank, the International Monetary Fund, and the Organisation for Economic Co-Operation and Development have acquired a bias against protectionism. The fact that many economists work for these organizations has reinforced their free trade orientation.

This is the result of seven decades of trade liberalization. Members of the political and economic establishment are typically more cosmopolitan than others: they travel more, are more likely to have dual citizenships, and so forth.

Yet, we are still very far from having truly free trade. Not only has the liberalization movement been stalled for two decades, but much of what passes for free trade is partially managed trade and is viewed as a concession from national states. The establishment’s free-trade bias is only a matter of degree. But it is apparently sufficient to provoke the populist ire.

These observations are not meant to depreciate common people, but to emphasize why they easily fall for populist rulers from whom, to borrow from H.L. Mencken, they will “get it good and hard.” R

## BRIEFLY NOTED

# Fearless Fosdick and Trump's Immigration 'Pause'

BY BRUCE YANDLE

The Trump administration's efforts to bar entry into the United States of people from several Muslim-majority countries have been justified as necessary to reduce Americans' risk of death from terrorism. Though these travelers—especially refugees—already are scrutinized before receiving entry visas, President Trump and his staffers claim this scrutiny is insufficient and must be “paused” so that “extreme vetting” mechanisms can be drawn up and implemented.

The Trump White House considers risk reduction of terrorism to be of paramount importance and no counterweighing concern—including the harm that could befall refugees attempting to flee to the United States, or the negative effects of such a ban on the United States' reputation, or the loss to American society and the economy from losing these immigrants—are adjudged important enough to offset the value of that risk reduction.

But removing risk is itself risky business. Through the travel ban and ensuing “extreme vetting,” President Trump hopes to avoid a false negative or “Type II” error—mistakenly considering “safe” a traveler with lethal intentions. However, strong sensitivity to Type II errors increases the likelihood of Type I errors, which in this case would be the turning away (whether temporarily or permanently) of benign travelers at a cost to both those travelers and the United States. Showing disregard for holders of travel visas (and in the ban's original form, U.S. green cards) generates costly uncertainty for a large category of people who contribute to the nation's well-being. When these and other costs are imposed on tens of thousands of innocent people, the cost becomes quite large.

BRUCE YANDLE is a distinguished adjunct professor of economics with the Mercatus Center at George Mason University and dean emeritus of the Clemson University College of Business and Behavioral Science. The essay expands on a Feb. 22nd op-ed Yandle published on the website *InsideSources.com*.



This point was made memorably years ago by Al Capp, the creator of the legendary comic strip *Li'l Abner*. Though the strip primarily dealt with the exploits of Li'l Abner, Daisy Mae, and the other denizens of Dogpatch, Capp would sometimes take a break from that storyline to tell tales (or in some cases, just a panel or two) of Li'l Abner's favorite comic book character, police detective Fearless Fosdick.

Fosdick was a parody of Dick Tracy, a combination of Barney Fife and Roscoe P. Coltrane (without the corruption), with Tracy's square jaw. One of Fosdick's nemeses was Anyface, a master of disguise who could appear at first as, say, an innocent

old woman, but then transform into a gasoline pump if Fosdick appeared to be on his trail. Anyface was determined to unleash mayhem on the unnamed metropolis Fosdick protected—in today's words, he was a terrorist.

In one episode, Anyface let it be known that he had poisoned a can of Old Faithful Pork-n-Beans, which happened to be the community's favorite delicacy. Hardly a meal was enjoyed without a serving of the beans, and Anyface knew that.

Wrestling with the problem and what to do about it, Fosdick's boss, The Chief, gathered together his inner circle to form a strategy. A bunker mentality prevailed. It was law and order against terrorism, good against evil, right against wrong.

After some deliberation, The Chief had a revelation: he simply instructed trusty Fosdick to make certain no one would die from eating Old Faithful beans. Fosdick took his orders seriously. To avoid a Type II error, he immediately went to the Old Faithful factory, shut it down, and impounded all the beans in the warehouse. He likewise impounded all the beans in grocery stores and at wholesalers.

But then he realized: what if someone had already purchased the poisoned can and the beans were simmering on the stove or in bowls ready to serve? Heaven forbid, what if people in some restaurant were lifting a forkful of the lethal beans to their lips at that very moment? Remembering his charge from The Chief—don't let anyone die from eating poisoned beans—Fosdick knew what to do.

Rushing from house to house and from café to restaurant, when Fosdick saw people about to heat up a can of beans, he shot them. If people appeared to be ready to eat some of the beans, he shot them, too.

When the episode ended, no one had died from Anyface's can of poisoned beans, but many had died from Fosdick's gun.

Still, with the terrorist Anyface held at bay, Fosdick smiled. He had made the classic Type I/Type II tradeoff. He had made sure that no one would fall ill or die from poisoned beans. Problem is, he had wiped out part of the population in doing so.

Our nation is exposed to terrorism risk. Because our president is sworn to protect us, extreme vetting and even more costly actions may be imposed on innocent people. While none will be shot in an effort to avoid allowing terrorists to enter the country, an abrupt slamming of the door on foreign travelers imposes a cost on each innocent traveler denied at the threshold. There is also a cost imposed on the rest of us when chastened, foreign

opportunity-seekers decide to seek their fortunes elsewhere.

President Trump, like Fosdick, may be successful in preventing death in this country from the hands of terrorists. But depending on how he does this, he can erode the wealth-creating process as well as bruise some precious ideas that define this nation.

Sadly, there is no such thing as free protection from terrorist harm. Knowing that, we should move cautiously when tightening the screen that, while guarding us from harm, limits the entry of the ultimate resource: creative and productive human beings who wish to pursue the American dream. R

participated, the EPA often seemed allied with the European Union and committed to working against U.S. interests. At home, its officials seemed to be taking their marching orders from the most radical elements of the environmental movement.

The EPA has unilaterally killed off entire, once-promising sectors of U.S. research and development. The use of genetically engineered microorganisms for bioremediation—that is, the biological cleanup of toxic wastes, including oil—is one.

Accidents that result in oil spills are inevitable as long as they can be caused by human or mechanical failures or the vagaries of weather. During the 1980s, microorganisms genetically engineered to degrade spilled oil were developed in laboratories. But draconian EPA regulations discouraged their testing and commercialization, ensuring that the techniques available for responding to these disasters remain low-tech and marginally effective. Those measures include such archaic methods as deploying booms to contain the oil, burning or spraying chemicals to disperse it, and spreading absorbent mats.

At the time of the catastrophic 1989 Exxon Valdez spill in Alaska, there were great expectations for modern biotechnology applied to bioremediation. William Reilly, then head of the EPA, later recalled, “When I saw the full scale of the disaster in Prince William Sound in Alaska ... my first thought was: Where are the exotic new technologies, the products of genetic engineering, that can help us clean this up?”

He of all people should have known. Innovation had been stymied by Reilly’s own agency’s hostile policies toward the most precise new genetic engineering techniques.

Another biotech sector that the EPA relegated to oblivion was protection of crops from frost damage. Peaches, plums, citrus, and other crops are regularly threatened by frost in the Southeast, resulting in losses that can total in the billions of dollars. California is also susceptible: A January 2007 freeze there cost farmers more than \$1 billion in losses of citrus, avocados, and strawberries, and a 1990 freeze caused

## Sorry Mr. Ruckelshaus, But Your Old Agency Is a Shambles

BY HENRY I. MILLER

William Ruckelshaus, who served twice as head of the U.S. Environmental Protection Agency, recently took to the opinion pages of the *New York Times* to defend his old agency (“A Lesson Trump and the E.P.A. Should Heed,” March 7, 2017). He claimed the EPA has achieved cleaner air and water for the nation and posited that it “represents one of the clearest examples of our political system listening and responding to the American people.”

Ruckelshaus, who is now in his mid-80s, has been away from the EPA for 32 years and the rosy picture he paints of expert, efficient bureaucracy is very different from the reality of recent decades. I know first-hand that it was different even during his second, short stint there from 1983 to 1985.

**Blocking innovation/** When I joined the U.S. Food and Drug Administration in 1979, I was essentially apolitical and knew next to nothing about federal regulation. A science

nerd, I had spent the previous 16 years in college, graduate school, medical school, and post-doctoral training. It didn’t take long until I learned about the jungle of government bureaucracies. And one of the darkest and most dangerous parts of that jungle was the perfidious and incompetent EPA, one of the FDA’s siblings.

I found the EPA, several of whose major programs I interacted with, to be relentlessly anti-science, anti-technology, and anti-industry. The only thing it seemed to be *for* was the Europeans’ innovation-busting “precautionary principle,” the view that until a product or activity has been proven safe definitively, it should be banned or at least smothered with regulation. (See “The Paralyzing Principle,” Winter 2002–2003.) In fact, during international discussions and negotiations over the harmonization of biotechnology regulations in which I

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## BRIEFLY NOTED

about \$800 million in damage to agriculture, resulting in the layoff of 12,000 citrus-industry workers, including pickers, packers, harvesters, and salespeople.

Farmers fight freeze damage with pathetically low-tech methods. These include burning smudge pots, which produce warm smoke; running wind machines to move the frigid air; and spraying water on the plants to form an insulating coat of ice.

In the early 1980s, scientists at the University of California, Berkeley and in industry devised a more ingenious approach. They knew that a harmless bacterium, *Pseudomonas syringae*, which normally lives on many plants, contains an “ice-nucleation” protein that promotes frost damage. They produced a variant of the bacterium that lacked the ice-nucleation protein, reasoning that spraying this variant bacterium (dubbed “ice-minus”) on plants might prevent frost damage by displacing the common, damage-promoting kind. Using precise genetic engineering techniques, the researchers deleted the gene for the ice-nucleation protein and planned field tests with ice-minus bacteria.

Then the EPA stepped in and that was the beginning of the end. Regulators classified as a *pesticide* the innocuous ice-minus bacterium, which was to be tested in Northern California on small, fenced-off plots of potatoes and strawberries. How could it be a pesticide? Because the regulators considered the naturally occurring, ubiquitous “ice-plus” bacterium a pest because its ice-nucleation protein promotes ice crystal formation that damages plants. Therefore, they reasoned, other bacteria intended to displace it would be a pesticide. This is the kind of absurd, sophistic reasoning that could lead the EPA to regulate trash-can lids as pesticides because they deter or mitigate a pest, namely raccoons.

At the time, scientists inside and outside the EPA were unanimous that the test posed negligible risk. (I wrote the FDA’s opinion.) No new genetic material had been added; only a single gene, whose function was well-known, had been removed, and the organism was obviously harmless. Nonetheless, the field trial was subjected to an

extraordinary long and burdensome review only because the organism was created with modern genetic engineering techniques.

It is noteworthy that experiments using bacteria with identical traits but constructed with older, cruder techniques require no governmental review of any kind. When tested on less than 10 acres, nongenetically engineered bacteria and chemical pesticides are exempt from regulation. Moreover, there is no government regulation of the use of vast quanti-

*Policy by policy and decision by decision, the EPA has damaged the nation’s competitiveness, ability to innovate, and capacity to create wealth.*

ties of the ice-plus organisms, which are commonly blown into the air during snow-making at ski resorts.

Although the ice-minus bacteria proved safe and effective at preventing frost damage in field trials, further research was discouraged by the combination of onerous government regulation, the inflated expense of doing the experiments, and the prospect of huge downstream costs of pesticide registration. As a result, the product was never commercialized and plants cultivated for food and fiber throughout much of the nation remain vulnerable to frost damage. We have the EPA to thank for putting farmers’ livelihoods in jeopardy, jobs lost, and inflated produce prices for consumers.

**Flawed decisions**/ During the two decades since I left government service, I’ve continued to watch the EPA’s missteps and excesses with a mixture of awe and vexation. Policy by policy and decision by decision, the EPA has damaged the nation’s competitiveness, ability to innovate, and capacity to create wealth.

The EPA’s ever-expanding regulation imposes huge costs on American businesses and ultimately on consumers. An analysis by the Competitive Enterprise

Institute estimates that the annual cost of compliance with EPA regulations is more than a third of a trillion dollars.

The EPA is the prototype of agencies that spend more and more to address smaller and smaller risks. In one analysis by the Office of Management and Budget of the 30 least cost-effective regulations throughout the government, the EPA had imposed no fewer than 17.

One of the EPA’s most controversial recent actions was to redefine “navigable waters” for the purpose of regulating them under the Clean Water Act. Under the new definition these include virtually every body of water in the nation right down to the smallest of streams, farm ponds, and ditches. (Pursuant to an order from President Trump, this travesty is now being reversed.)

Another example of flawed EPA decisionmaking was the imposition of overly stringent ambient air standards under the Clean Air Act. Clean air is desirable, of course, but an EPA rule finalized in February 2012 that created new emissions standards for coal- and oil-fired electric utilities was ill-conceived. According to an analysis (“Government Regulators Were Too Busy in 2012,” Dec. 28, 2012) by Diane Katz and James Gattuso of the Heritage Foundation:

The benefits are highly questionable, with the vast majority being unrelated to the emissions targeted by the regulation. The costs, however, are certain: an estimated \$9.6 billion annually. The regulations will produce a significant loss of electricity generating capacity, which [will] undermine energy reliability and raise energy costs across the entire economy.

**Transgressions**/ Regulatory excesses are one thing; dishonesty and mendacity are something else. An EPA subterfuge that has received attention from the U.S. Senate’s Environment and Public Works Committee is the “sue-and-settle” maneuver the EPA uses frequently to advance

its agenda in a way that substitutes a judicial mechanism for the customary, prescribed interface between legislation and agency rulemaking.

The way this works is that environmental groups (some of which receive government grants) sue the federal government on the grounds that agencies are failing to meet their regulatory obligations, and then—behind closed doors—the activists and regulators concoct a settlement agreement that furthers activists’ (and regulators’) extra-statutory goals. Thus, sue-and-settle is a strategy that circumvents both congressional intent and the rulemaking process.

Last year, investigators found two flagrant transgressions of federal law by the EPA: engaging in “covert propaganda” and “grassroots lobbying.” The Government Accountability Office discovered that the EPA illegally used Thunderclap, a social media site, “to correct what [the EPA] viewed as misinformation.” Government

use of social media is not unlawful per se and many agencies use it to communicate their actions and policies to the public. But the EPA crossed the line when it asked members of the public to share EPA-composed propaganda on Facebook or Twitter without attributing it to the government. Neglecting to reveal the source was the basis of the “covert propaganda” violation because the law says that citizens must know when messages presented to them were created by their government.

Federal agencies are supposed to be apolitical and federal law prohibits lobbying for or against proposed legislation. But an EPA blog post contained links to websites that encouraged the public to, for example, “urge your senators to defend Clean Water Act safeguards for critical streams and wetlands.” This “grassroots lobbying” was a violation of federal law because, at the time, Congress was considering a number of pieces of legislation to derail the EPA’s “waters of the United

States” regulation. Not surprisingly, the EPA wanted those bills to be defeated.

The above examples are by no means an exhaustive list. For at least the past three decades, the EPA has been a rogue agency—ideological, poorly managed, dishonest, and out of touch with sound science and common sense. It is emblematic of what *Wall Street Journal* columnist Bill McGurn has condemned as the “soft despotism” of the “unelected and increasingly assertive class that populates our federal bureaucracies and substitutes rule by regulation for the rule of law.”

The new head of the EPA, Scott Pruitt, made clear in a recent interview that things are about to change. According to Pruitt:

This past administration didn’t bother with statutes.... They displaced Congress, disregarded the law, and in general said they would act in their own way. That now ends.

About time.

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# A PRICE FOR INJUSTICE

*Efficiency and fairness in the justice system improve when the falsely convicted are compensated.*

✦ BY JONATHAN KLICK AND MURAT MUNGAN

**C**hristopher Ochoa was sentenced to life in prison for the October 1988 rape and murder of Nancy DePriest. The victim had been tied up, sexually assaulted, and shot in the head during an early morning robbery at an Austin, Texas Pizza Hut where she worked.

Ada JoAnn Taylor was sentenced to 40 years in prison for playing a role in the 1985 murder and rape of Helen Wilson. The victim was stabbed and suffocated in her Beatrice, Neb. apartment.

Brian Banks was sentenced to seven years in prison for raping a younger woman at the Los Angeles high school where he was attending summer school in 2002. After his release, he was required to register as a sex offender and to wear an electronic monitoring bracelet for a time.

Rodney Roberts was sentenced to seven years in prison for the 1996 kidnapping of a 17-year-old woman in Newark, N.J. After completing his sentence, he was classified as a sexually violent predator and required to spend time in a secure treatment facility.

Each of those convictions share two commonalities besides the horrific nature of the crimes. First, each of the individuals confessed and pleaded guilty to the crimes. Second, the individuals were subsequently exonerated on the basis of evidence or testimony that unequivocally demonstrated they had not committed the crimes in question.

In these cases, there was significant collateral damage. Ochoa, in his plea arrangement, agreed to testify against his roommate, Richard Danziger, for also being involved in the murder. Ochoa, who ultimately spent 13 years in prison, indicated he took his plea deal and testified against Danziger to avoid the risk of a death

sentence. Danziger was convicted and was also later found to have not been involved in DePriest's killing. He had an alibi for the day of the murder, but was convicted on the basis of Ochoa's testimony and some questionable lab evidence. Danziger, while serving his 12-year prison term, was attacked by another inmate, leaving him with permanent brain damage and confined to a mental institution.

Taylor, who spent 19 years in prison, accepted a plea deal in which she agreed to testify that Joseph White had raped Wilson. White served 19 years of a life sentence. White testified that he had never been in Wilson's apartment and fingerprints found at the scene were not matches for White, Taylor, or the victim. After White obtained access to DNA testing of semen found at the crime scene, his defense team discovered that the sample matched another individual who had been the leading suspect early in the investigation. Prior to this, White's requests to have the DNA evidence examined were repeatedly turned down. Taylor claims that police and prosecutors threatened her with the death penalty if she did not confess to the crime and provide testimony against White.

Banks, who before his conviction had received interest from the University of Southern California and the University of California, Los Angeles as a high school football recruit, insisted that the sexual contact between him and his accuser was consensual. Banks' mother sold her condo and car to fund his defense. Faced with the prospect of a life sentence, Banks pleaded no contest to forcible rape and spent more than five years in prison.

Roberts pleaded guilty to kidnapping to avoid a sexual assault charge that was based on a claim by the police that the victim had identified Roberts in a photographic lineup. Years later, the victim disputed the claim that she had identified anyone. Seventeen years later, DNA evidence excluded Roberts as the rapist.

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## WHY DO THE INNOCENT PLEAD GUILTY?

As sad as these individual cases are, if they were isolated incidents, they could be seen as the inevitable mistakes that arise in any sys-

tem. Humans and human institutions are fallible and the optimal number of such mistakes is surely not zero. However, there is some evidence that these kinds of problems are not exceedingly rare. According to data from the Innocence Project, in at least 360 cases where a convicted individual was later exonerated, the person had pleaded guilty to the crime.

Federal Judge Jed Rakoff of the Southern District of New York suggested in a *New York Review of Books* essay (“Why Innocent People Plead Guilty,” Nov. 20, 2014) that such guilty pleas by innocent defendants are a systematic part of the U.S. plea-bargaining system. In his view, prosecutors have significant leverage over defendants because they can use their discretion regarding what charges are filed. If the charges have severe mandatory minimum sentences, plea bargaining can look like a good deal to risk-averse defendants, even innocent ones.

The most attractive plea deals are offered early in the case, often when the defendant and his lawyer (usually an over-worked, under-funded public defender) have very little information regarding the evidence the state has. Turning down an early plea deal generally ensures that worse ones will be offered as time goes on, or at least that’s the threat communicated by prosecutors. Putting all of this together, it is arguably not surprising that plea bargains constitute around 95% of all resolutions of criminal cases (at least of those where charges are not dismissed) at both the state and federal level. Rakoff suggests that this plea-bargaining assembly line significantly undercuts what the nation’s founding fathers

viewed as a necessary backstop against tyranny: the jury trial.

### FIGHTING FALSE CONVICTIONS

Beyond guilty pleas from innocent defendants, the U.S. criminal justice system generates a non-trivial number of mistaken convictions. According to the National Registry of Exonerations, since 1989 there have been more than 2,000 individuals exonerated through late-coming evidence, such as DNA tests, recanted testimony, and admissions of guilt by others. Based on the registry’s data, these falsely convicted individuals have served a cumulative total of more than 17,000 years in prison—a great loss to both those individuals and society as a whole. Those numbers are likely just the tip of the iceberg.

Although public interest groups such as those affiliated with the Innocence Network work tirelessly to identify and provide legal resources to people who may have been wrongfully convicted, the groups’ resources are limited. Out of practical necessity, they focus their attention on the cases that are most likely to succeed. For cases not taken up by these groups, there is little hope because convicts typically have few financial resources and little human capital to pursue exonerations on their own.

Given the limited resources of groups like the Innocence Project (a founder and affiliate of the Innocence Network) and the limited ability of a convict’s own self-help efforts to reverse mistakes in the U.S. criminal system, a more systematic approach to avoiding errors is necessary. In the context of coercive plea



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deals, Judge Rakoff notes that reducing the severity of criminal penalties, including getting rid of mandatory minimums and other sentencing guidelines, would help to limit the leverage prosecutors have. That said, he acknowledges that there is little taste for this kind of leniency among the general public. Beyond that, such an approach, while reducing penalties for the innocent, would also reduce penalties for the guilty.

The English jurist William Blackstone famously opined that it is better to let 10 guilty people escape than to let a single innocent person suffer. But there are costs to such a position. Prison terms generate benefits in terms of both incapacitation and deterrence. Reducing penalties likely will increase crime directly as potential criminals fear punishment less and those who have chosen to commit criminal acts spend less time in prison, allowing them to recidivate. It would also increase crime indirectly because it would become more difficult for prosecutors to do their job because they would no longer have as much leverage to secure pleas, and thus they would have to spread their resources more thinly across cases.

Rakoff suggests establishing a sort of nonbinding arbitration where magistrates examine the available evidence and make recommendations about whether a case should proceed or be dropped by the prosecution. If the case is pursued, the magistrate would propose a sensible plea deal. The core of the idea is to provide more balance wherein the defendant is not merely at the mercy of the prosecutor. The process would limit the information advantage held by the prosecution. Also, by providing a neutral viewpoint, the defendant cannot be misled into thinking it is surely the case that if the plea is not taken, the ultimate outcome will certainly be worse for the defendant.

While this neutral broker approach has much to recommend it, it potentially involves a significant resource infusion into the system. The magistrate/arbitrator's time is obviously not free. Further, this extra step in the plea-bargaining system will require that both the prosecutor and the public defender spend more time and resources on a given case. These costs are not necessarily a reason to reject the proposal, but they may limit its feasibility.

### PAYMENTS TO THE INNOCENT

In a recent *Journal of Law and Economics* article ("Reducing False Guilty Pleas and Wrongful Convictions through Exonerate Compensation," 59:1, 173-189 [February 2016]), we take a different approach to the problem of legal mistakes. We propose a system in which innocent parties who are convicted are promised a potentially large payment in the event they are subsequently exonerated. As discussed below, such an approach has benefits both in terms of fairness concerns and in terms of the efficiency of the criminal justice system.

Our proposal uses what economists call a "mechanism design approach" to the plea bargaining "game." In many strategic situations, the various parties involved have private information: one party knows something relevant that the others do not, and vice

versa. In a mechanism design approach, the goal is to provide incentives for the parties to reveal their private information either directly or indirectly by making choices that expose important aspects of the private information.

These mechanism design approaches abound in non-criminal settings. To take a simple example, employers may have a desire to attract individuals who plan to remain at a firm for a long time. Employers would want this because the hiring process entails costs and the firm will also make some investments in training the employee. At the interview stage, although the firm would like to ask candidates if they plan to stick around for the long term, there is no way to tell which individuals are honest when they answer affirmatively. To screen for the individuals whose private information indicates they do plan to stay in the job, the employer may offer a package where the salary is relatively low (as compared to similar employment opportunities), while augmenting the pay with some longer-term bonus (e.g., retirement contributions that only vest after the employee has stayed in the job for a number of years). For those job applicants who believe they will leave after a year or so, this salary-plus-bonus arrangement is a bad deal, while for those planning to stay, the bonus can be set so as to make the job more attractive than other alternatives. Essentially, by offering a package that is only attractive to candidates who have the desired but unobservable characteristic, the firm can induce individuals to reveal their private information about whether they have that characteristic or not.

In the plea-bargaining setting, the defendant has private information regarding his guilt or innocence. Of course, much like the hiring setting, everyone has an incentive to claim he has the good characteristic, in this case innocence. Because everyone claims innocence, the defendant's assertion has no probative value. In such a case, defendants implicitly do a cost-benefit calculation in which they compare the plea deal (say, five years in prison with 100% certainty) to the trial alternative (say, a 50% chance of being acquitted plus a 50% chance of 20 years in prison). Faced with this choice, many people will take the plea deal.

Our contribution is to suggest that the state implement a system in which individuals who are falsely convicted are paid damages in the event that they are later found innocent through DNA evidence or some other method of exoneration. Using the comparison noted above, the plea deal of a certain five years in prison would be compared with the 50% chance of acquittal plus a 50% chance of 20 years in prison plus  $p$ % chance of an exoneration payment multiplied by the amount of the payment. For the guilty,  $p$  will essentially equal 0, leaving the decision problem unaffected. For the innocent, however, with a high enough expected exoneration payment, the outcome of the decision could be flipped where more innocent individuals take their chances at trial without affecting the choices of those who know they are, in fact, guilty.

The intuition behind this idea is relatively simple. Our technical paper demonstrates that the proportion of innocent indi-



viduals who plead guilty can be decreased through exoneration compensation. This, in turn, would result in a reduction in the number of wrongful convictions because fewer innocent people choose the option of serving time with certainty. Our article incorporates a realistic concern, namely that individuals do not only differ with respect to whether they are guilty or not, but on other dimensions that affect their willingness to plead guilty. This is why only a fraction of all innocent individuals can be incentivized to refuse pleading guilty.

**Other benefits** / Of course, the real world and the world of economic theory are often orthogonal. Real people may find it difficult to trade the prospect for probabilistic money damages against additional years of freedom lost. These problems most likely get even worse when the sentence avoided through a plea deal involves life in prison or even the potential for the death penalty. Therefore, in some cases, even large exoneration compensations may not have a substantial effect on the choices of innocent individuals.

However, even if the prospect of an exoneration payment only helps improve the plea bargain system on the margin (i.e., makes it slightly more likely that the innocent will forgo a plea deal without changing the incentives of the guilty), the proposal has other benefits that should be considered. First, such a payment accords with many people's normative views about fairness. Our tort system calls for damages in cases of false imprisonment when the one doing the imprisoning is a private party. Presumably, intuitions about fairness apply in the public context as well.

Additionally, the exoneration payments can improve incentives in other ways beyond the effect on choices in the plea-bargaining situation. On the prosecution side, if the damages are somehow linked to the prosecutor's budget or—perhaps more directly yet—the prosecutor's income or career prospects, it could induce prosecutors to make better decisions, be more honest in the evaluation and presentation of evidence, and focus on cases where there is less uncertainty regarding a defendant's guilt. Moreover, this would enhance deterrence because prosecutors would spend more resources on cases against guilty individuals and, therefore, criminals would expect more severe punishment.

Operationally, this might seem difficult to pull off. But presumably prosecutors' offices would secure some kind of insurance to cover the exoneration payments. Insurers would be attractive in this regard because they could address a time mismatch problem that could arise. That is, if the prosecutor is making legal decisions in year  $t$ , leaves the job in year  $t + 5$ , and any exoneration happens on average in year  $t + 9$  (the average indicated by the National Registry of Exonerations' count of exonerations and years served by those exonerated), it is perhaps unlikely that future payments influence the prosecutor's decisions. Insurers, however, have a longer time horizon and, therefore, could be incentivized to determine what constitute best practices to optimize exoneration risk and then impose them on the prosecutors' offices they insure. It might even prove to be sensible for the insurer to be the funder

and administrator of any retirement benefits that the prosecutors accrue. In such a set-up, the more exoneration payouts there are, the lower the retirement benefits, providing a back-end incentive to do better work on the front end.

John Rappaport, a law professor at the University of Chicago, has documented a similar insurance-based approach to reining in police misconduct. In that work, he demonstrates how insurance companies, through their decisions to offer or deny coverage to police departments and in the way they set premiums, affect police department policies (such as use-of-force policies), what training officers are provided, and even officer hiring and firing decisions. A benefit in using insurers to drive the risk management policies, whether it be those of police departments or prosecutors' offices, is that insurers tend to have access to much more data than the police department or prosecutor's office itself does, and the insurer often has much more of an incentive as well as the capability to use those data effectively.

On the defendant's side, the prospect of an exoneration payment may provide the incentive and the ability to continue to fight a conviction. The resource constraint most defendants and public interest groups face is a huge impediment to fighting wrongful convictions. The prospect of exoneration payments may allow the innocent to induce more parties to examine their cases in the hopes of earning both their freedom and a share of the payment. Essentially, the payments would allow for a criminal law analogue to a plaintiff's contingency fee arrangement with his lawyer in tort law. As things stand now, individuals fighting their convictions must rely on the goodwill of public interest lawyers and groups like the Innocence Project, or pursue freedom on their own with no training and few resources.

## CONCLUSION

Currently, 18 states have no compensation statute of any form, leaving little prospect for an exonerated individual to receive a payment when he is proved innocent. In such states, the only path to compensation would involve a private tort claim. In most cases, the claim fails because the relevant defendants (namely prosecutors) enjoy immunity to such suits. Of the other states, many take the approach of providing compensation only through private bills, which are essentially political petitions to a state legislature to provide compensation. Either of these options, tort claims or private bills, is so unlikely that it is doubtful they could affect anyone's decisionmaking in the plea process. Nor is it likely they could provide the impetus for anyone to seek out the evidence necessary to prove someone's innocence.

To harness the hypothesized incentive effects, damages for a mistaken conviction would need to be more reliable than low-probability tort awards and idiosyncratic private bills. Even many of the states with more robust statutory compensation frameworks might benefit from higher award amounts to get the benefit of these incentive effects. Compensation for mistaken convictions is an area where efficiency and fairness happily coincide. R

## REGULATORY REFORM

# SHOULD WE FEAR 'ZOMBIE' REGULATIONS?

*Federal agencies and courts will determine what new rules can be advanced following repeals under the Congressional Review Act.*

BY SAM BATKINS AND ADAM J. WHITE

**T**he year 2017 has seen the emergence of the Congressional Review Act (CRA) as a powerful political tool. The law allows Congress to fast-track legislation to supersede and cancel rules recently enacted by federal agencies.

Until now, the CRA has largely been an empty threat because legislation under the act requires the approval of both houses of Congress and the White House. Obviously, presidents are unlikely to approve the repeal of a rule that their administration has crafted. But this dynamic changes when control of the White House shifts between parties. Before this year, the CRA had been used just once, in 2001 by a Republican Congress and new George W. Bush administration to dispense with a workplace “ergonomics” rule adopted by the departed Bill Clinton administration. This year, the CRA has become a potent weapon under the new Trump administration and a Republican Congress intent on reversing regulatory initiatives undertaken by the departed Barack Obama administration.

Now that Congress and President Trump are making extensive use of the act, the ramifications of these repeal resolutions become more significant. A CRA resolution does not just nullify an existing rule; it categorically and permanently prohibits the agency from reissuing the rule “in substantially the same form” unless Congress someday passes new legislation authorizing the agency to reissue the regulation. The key question, then, is what it means for a new rule to be “substantially similar” to a CRA-canceled one.

Courts have never authoritatively interpreted this phrase precisely because the CRA has virtually never been used before this year. But with the act’s newfound life, it’s almost certain the federal judiciary will have to do this in the future. When such cases arise,

how will courts interpret the act’s terms? Will they simply look to the text of the CRA, the ambiguous “substantially the same form” language, or will they broaden their analysis to the legislative history of the CRA itself? How will current statements from members of Congress factor into the decisionmaking process? Congressmen and senators have already predicted that some of this year’s overturned rules will return in some form in the future.

In this article, we argue that future courts should place predominant weight upon the legislative history surrounding the disapproval of a rule under the CRA. For instance, when Congress recently used the CRA to cancel the Securities and Exchange Commission’s Resource Extraction Rule (discussed below), lawmakers repeatedly suggested that the SEC “go back to the drawing board” and craft a new rule. In contrast, when Congress used the CRA to cancel the Interior Department’s Stream Protection Rule (also discussed below), no supporters of the resolution expressed interest in the agency rewriting the regulation, suggesting that Congress’s purpose in that instance was to cancel the rule based on its general subject matter.

This interpretive approach won’t be dispositive for all rules, especially when legislative debate is lacking (which it has been for several votes). But it does mark the best approach, given the ambiguous text of the CRA.

## BRIEF HISTORY OF THE CRA

The CRA was adopted as part of a package of major regulatory reforms after the “Republican Revolution” following the 1994 elections. In a sign of the relatively limited reach of the CRA and the somewhat more bipartisan atmosphere of the 1990s, the legislation passed 100-0 in the Senate.

The CRA legislation was a response to the Supreme Court’s 1983 decision in *INS v. Chadha* in which Congress lost its “legislative veto,” the ability to undo executive actions through congress-

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sional action alone. In contrast to the procedure struck down in *Chadha*, however, every CRA resolution must be approved by both the House and Senate, and then signed by the president. In other words, a CRA resolution is just the passage of a law, only with expedited procedures in the House and Senate. According to the primary sponsors, Sens. Harry Reid (D-Nev.), Ted Stevens (R-Alaska), and Don Nickles (R-Okla.), it was designed to address “burdensome, excessive, inappropriate, or duplicative” federal rules.

The scope of the CRA, unlike many other regulatory reform initiatives, applies to all federal agencies, including independent commissions. For instance, actions from the Consumer Financial Protection Bureau and the SEC would be covered under the CRA. The legislation’s reach was intended to be as broad as possible. The drafters of the CRA were explicit on this, saying it covers:

- formal rulemaking, the relatively rare, trial-type process for formulating some regulations and for rate-setting,
- informal rulemaking, the much more common notice-and-comment rules found in the *Federal Register*,
- other public information from agencies, usually published in the *Federal Register*, and
- guidances and other interpretive documents that qualify as “rules” under the Administrative Procedure Act, but that are usually exempt from review under ordinary procedural requirements.

**President Trump signs legislation withdrawing the Stream Protection Rule, Feb. 16, 2017. (Credit: Ron Sachs/Pool via CNP Photo)**

Once an agency finalizes a rule and reports it to Congress, Congress has 60 session or legislative days to consider the rule for repeal under the CRA. Members simply introduce a resolution of disapproval and it cannot be filibustered in the Senate. Although CRA resolutions take up floor time, the current House and Senate have managed to pass more than a dozen measures repealing Obama-era regulations. The question now is how many of those rules could someday return from the grave, in some form or another?

**NEW LIFE FOR OLD RULES?**

As previously noted, the CRA states that a disapproved rule “may not be reissued in substantially the same form.” This language is ambiguous; the term “substantially similar” does not lend itself to an obvious single interpretation.

Fortunately, the lawmakers who originally drafted and enacted the CRA offered some useful guidance, preserved in the legislative history. Whether a subsequent regulation is “substantially similar” to a nullified regulation depends first and foremost on the original statute that authorized the regulation. The drafters of the CRA established a hierarchy of discretion, from broad to most restrictive, relying on the text and grant of authority of the underlying statute. This was set forth in detail by Reid, Stevens, and Nickles in a joint

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explanatory statement in the *Congressional Record*.

Three important points emerge from that statement. First, if the law authorizing the disapproved rule provided broad discretion to the agency, then regulators would likely have broad authority to issue a substantially different rule. That information is helpful, but it still does not clarify precisely where to draw the line between substantial differences and minor differences.

Second, if the original law that authorized the initial agency action did not mandate a particular rule, then regulators have discretion “not to issue any new rule.” While this does not go directly to the question of how to interpret “substantially similar,” it does illustrate how the drafters of the CRA place great importance on the intent of Congress when it enacted the statute authorizing the regulation with respect to whether a given agency could return to the regulatory drawing board. If Congress were to strike down the Clean Power Plan under the CRA, for example, then the Environmental Protection Agency could choose not to issue another rule at all because no statute specifically requires the EPA to do so.

That second category is important because a substantial fraction of federal rules do not have specific mandates and their underlying organic statutes are often silent on specifics. For example, the ergonomics rule that was struck down in 2001 was not explicitly authorized in statute. The Department of Labor initiated the rule on its own discretion; 16 years after it was struck down, the Labor Department has not issued another rule on the same subject matter. Apparently, Labor officials believe that any new ergonomics rule would be “substantially the same form” as the CRA-stricken rule and thus likely to be struck down by courts.

A third, and perhaps most important, point from the explanatory statement is that if Congress had been explicit in its authorizing statute and the grant of power to a federal agency was “narrowly circumscribed,” then “the enactment of a resolution of disapproval for that rule may work to prohibit the reissuance of any rule.” This can be interpreted to mean that if, say, Congress says the level of particulate matter in the atmosphere should be limited to 12 micrograms per cubic meter and a CRA measure strikes that down, the agency is prohibited from issuing that standard again.

The senators’ explanation of this third category has direct relevance for the measures Congress has struck down recently. For instance, Section 1504 of the 2010 Dodd-Frank finance legislation mandated that the SEC require resource extraction issuers to disclose payments to foreign governments. That section was explicit about the information that companies had to report. Yet Congress struck down the rule. For the attorneys at the SEC, how do they craft a new rule that follows section 1504 yet is somehow substantially dissimilar from the rule Congress struck down? It’s an unenviable position and one that might be answered by the legislative history when Congress repealed the rule.

In sum, where there is little agency discretion and Congress has expressly delegated certain tasks to an agency, even if the final rule comports with original intent, Congress can change its mind and strike down the rule. How can an agency issue a substantially

dissimilar rule while concurrently following the original intent of the statute? The agency likely cannot thread that narrow needle absent new congressional authorization.

### QUALITATIVE VS. QUANTITATIVE APPROACH

To examine the probability of agency action after a CRA resolution of disapproval, we suggest a “qualitative” versus “quantitative” comparison. By “qualitative” we mean broad grants of authority with no finite or numerical guidelines. This extends to original regulations as well. Such authority would seem to allow agencies to craft new rules, albeit after some time at the “drawing board.”

On the other hand, if agencies are implementing a statute by which Congress originally set quantitative standards, but Congress repeals the rule under the CRA, then it would seem almost impossible for an agency to promulgate a substantially different rule. If the EPA sets ground-level ozone concentrations at 70 parts per million and Congress strikes down those standards, what is a substantially different rule? Is 65? Is 75? Quantitative or numerical prescriptions in statutes or in the text of a regulation would seem to make crafting a new rule after a CRA action nearly impossible; Congress’s decision to cancel the agency’s rule would seem to effectively rescind the original statutory delegation of regulatory power altogether.

Below, we offer a few contemporaneous and hypothetical examples to illustrate this quantitative and qualitative dichotomy.

**Resource Extraction Rule** / This rule generally required specific disclosures from companies dealing with foreign governments. Dodd-Frank set no numerical standard, but it did include specific instructions for the information to be disclosed. For instance, section 1504 of Dodd-Frank mandated that an annual report contain the type and total amount of payments to foreign governments or corporations. This appears straightforward, but given the rulemaking history it is not. Generally, the resource extraction rule is more of a qualitative example with some caveats.

A federal court struck down the first iteration of the SEC’s resource extraction rule, so the agency issued a new rule in 2016, within the window for disapproval under the CRA. Congress acted and struck down the measure. After losing in the courts and failing with Congress and the president, many might assume this regulation is finished. However, the legislative history surrounding the CRA resolution reveals that even Republicans voting for the CRA resolution presumed that their act would not prevent the SEC from promulgating a different resource extraction rule someday. House Financial Services Committee Chairman Jeb Hensarling (R-Texas) remarked: “Let’s also remember that this joint resolution does not repeal section 1504 of Dodd-Frank. I wish it did, but it doesn’t.... It simply tells the SEC to go back to the drawing board.” Likewise, Sen. Mike Crapo (R-Idaho) explicitly noted that he expected yet another rule: “What the SEC will need to do is to go back to the drawing board and come up with a better rule that complies with the law of the land.”

Whether the SEC does actually draw up a new rule will be instructive, but Congress was hardly specific on the changes or the form of the third iteration of the resource extraction rule that lawmakers want to see. Ultimately, the discretion still lies with the regulators at the SEC to determine if and how a new rule will develop.

For those hoping it never does, the SEC has technically already fulfilled its statutory obligation. It did issue a final rule and then a court struck it down. It then issued another regulation and the elected leaders of the nation rescinded it. The SEC might defer to the other branches of government and acknowledge that creating a substantially different rule would be difficult and would almost assuredly lead to another lawsuit. If regulators do proceed, we'll at least have one interpretation of "substantially the same form" in the next two to three years.

**Stream Protection Rule** / In contrast to Congress's view of the resource extraction rule, congressional majorities clearly had no interest in preserving the Department of Interior's authority to promulgate a new "Stream Protection Rule." Interior's regulation was ostensibly designed to prevent dumping coal deposits into waterways, a largely qualitative and discretionary rulemaking.

The rule united environmentalists while also acknowledging it would adversely affect coal industry employment and have a social cost of more than \$1 billion. Given the political forces involved, as soon as the regulation was published, Senate Majority Leader Mitch McConnell (R-Ky.) declared he would use the CRA to undo the regulation. He noted the rule was "part of the [Obama] administration's plan to demolish these coal communities right now and long after the president has left office."

Presented with an opportunity to use the CRA to nullify this rule, majorities in both houses—including some Democrats—overturned the rule. And the commentary accompanying their votes contrasted sharply with the aforementioned commentary accompanying the Resource Extraction Rule's CRA resolution. As to the Stream Protection Rule, Rep. Paul Gosar (R-Ariz.) remarked: "But the fact is, you can't put lipstick on this pig. Whether you call it the Stream Buffer Zone Rule or the Stream Protection Rule, the rule still stinks." Rep. Rob Bishop (R-Utah) was even more frank, recognizing that Congress should go forward and set specific standards for stream protection, not let federal agencies write new rules. He noted, "What we are doing here today with this effort is to reestablish the Article I authority that we have in the Constitution by saying we are responsible for the policy, not some agency of the executive branch."

Democrats were also aware of the power of the CRA, predicting the Stream Protection Rule would not return. Sen. Chris Van Hollen (D-Md.) charged: "The Congressional Review Act doesn't make sense here. If you want to trim a tree, you don't chop it down and bury it under cement so it will never grow again." He also predicted the permanent end of the rule, remarking: "[A] resolution of disapproval under the Congressional Review Act

does not just send a rule back to the drawing board. Instead, the resolution repeals the rule and prohibits the agency from ever proposing anything like it again."

In contrast to the resource extraction measure, it is clear Republicans don't want the Stream Protection Rule returning and Democrats don't expect it to return. Given the congressional debate, a redo of the rule, at minimum, would likely have to demonstrate insignificant costs and neutral economic effects to the coal industry.

**Clean Power Plan** / The Clean Power Plan (CPP) mandates greenhouse gas standards for existing power plants, but the deadline for a CRA resolution repealing the CPP had already expired when President Trump took office. Still, the CPP offers an interesting interpretive hypothetical.

The CPP mandates a 32% reduction in the emission of greenhouse gases by 2030, brought about by using three "building blocks": heat-rate improvements at coal plants, a shift in electricity generation from coal to natural gas, and a build-out of zero-carbon energy. If Congress could use the CRA to nullify the CPP, then what would a "substantially" different CPP look like? Is a 28% cut sufficiently dissimilar? What about a 35% reduction? Suppose the next president sets a goal of reducing emissions by 80%; would that count as substantially different? Here, one might be able to reasonably argue that a 3% or 80% reduction would not be substantially similar to the original CPP, and thus not prohibited by the CRA.

Or suppose that current EPA Administrator Scott Pruitt reissues the CPP, but includes only one building block: limited heat rate improvements for some aging coal plants, reducing emissions by 2–3% but costing a mere fraction of the CPP's original \$8.4 billion estimated burden. Could the EPA reasonably argue that this new rule is substantially dissimilar from the prior regulation?

In this context, the EPA's argument would be bolstered by the broad discretion that the Clean Air Act vested in the agency in the first place. Congress never spoke explicitly about greenhouse gases in the Clean Air Act, so the EPA could be just as creative in reissuing a new rule. Even if a new CPP is terrible policy, it might be a terrible policy that the CRA does not prohibit.

**Overtime Rule** / In 2017, the Labor Department greatly expanded the overtime threshold for non-exempt employees, from those earning up to \$23,000 annually to those earning up to \$47,000. This rule fell just days outside of the CRA review window, but it offers a more restrictive quantitative example compared to the CPP.

Assume that Congress could have used the CRA to repeal the Overtime Rule. Indeed, before Congress adjourned in 2016, members and staffers openly discussed repealing the rule; many staffers suggested that they wanted new legislation establishing overtime thresholds, not a new rule. To them, a CRA vote would have meant no new expansions from the agency.

Like the other quantitative examples above, imagine a new administration attempts to resurrect the Overtime Rule after a CRA repeal. Is a \$40,000 employee earnings limit substantially similar,

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or \$55,000? Suppose it's two decades until a new rule is considered and it sets the threshold at \$75,000. Perhaps the agency could argue that rule would be dissimilar. However, adjusting for inflation the threshold would still be around \$47,000 in 2017 dollars.

There is hardly a knowable legal path to regulating again after Congress strikes down a rule with specific, quantifiable standards, whether in the regulation or from the authorizing statute. In practice, such a resolution would act as an absolute bar to a new rule, save new delegation from Congress.

**Endangerment Finding for Aircraft** / The final example involves a rule or determination from the EPA that aircraft emissions contribute to global climate change and endanger public health. Many legal experts consider the endangerment finding a necessary condition for regulating specific greenhouse gas emissions from aircraft under the Clean Air Act. There was a reason, after all, that the Obama administration chose to begin with similar endangerment findings and then followed with emissions regulations for vehicles and existing power plants.

What would have happened if Congress had used the CRA to disapprove and nullify the Aircraft Endangerment Finding? If it is a legal prerequisite to regulation, how could the EPA have conceived of a substantially different regulation? In cases like these, it is binary: either the EPA views these emissions as a danger to public health or it does not. With a CRA vote, Congress would have said the agency can't reissue a rule that determines the emissions endanger public health. Without a new finding, there is no subsequent regulation on aircraft. In the future, these sorts of binary, authority-or-no-authority rules might prove attractive to members of Congress who want to preclude specific rules from ever returning.

### WHAT DID CONGRESS REVEAL?

As the debates display, there was mixed opinion on whether all of the repealed rules would return in some form or if new versions were precluded by the CRA vote. Given that public remarks might not always mirror personal feelings, we reached out to several House and Senate staffers on the condition of anonymity to gauge their intentions and instincts on whether various disapproved rules would return.

One Senate aide remarked, "A majority voted for [repealing] each regulation, so it's fair to say they don't want to see the rule." However, he acknowledged, "In the next five to 10 years, the Federal Communications Commission rule [on consumer privacy] seems to have generated a lot of opposition, so an activist FCC head could be pretty clever coming back to that in a way that is plausibly not the 'same form.'"

There seems to be universal recognition that the FCC's privacy rules could return, although all agreed that would have to be decided by the courts. Another aide noted, "I think Congress will attempt to act on one this year or next through legislation that makes it clear [internet service providers] are subject to privacy

rules, but that the [Federal Trade Commission] (not the FCC) is the privacy regulator and it generally treats ISPs and edge providers like Google and Facebook the same." Another aide noted that his boss didn't want to see any new rules regardless of the form. If there were to be new regulation in these fields, Congress would act with new legislation.

Finally, the press has already begun speculating on the motives for repealing each rule and which ones might return. The *Huffington Post* focused on the rescission of drug testing requirements for unemployment applicants. The conventional thinking is that the Trump administration will write even tougher standards for more expansive testing than the Obama-era rule. That would mark the first chance to determine a substantially dissimilar rule. Rep. Kevin Brady (R-Texas), who sponsored the resolution to repeal the drug testing rule, acknowledged, "My understanding is that they will promulgate a new rule." It will then fall to the Trump administration and perhaps the courts to determine what "substantially the same form" means in the context of reissued rules.

### FROM CONGRESS TO THE COURTS

Of course, the CRA will not interpret itself. In the end, the federal courts will determine the act's capacious terms, once an appropriate case presents itself. Such cases might take a variety of forms.

First, pro-regulatory activists might try to bring a constitutional lawsuit challenging the CRA itself. Specifically, they might seek out sympathetic persons, companies, or other entities who would have benefited from a rule that Congress nullified with a CRA resolution and attempt to convince judges that the CRA itself violates the Constitution. (One progressive organization, the Center for Biological Diversity, already has filed a federal lawsuit in Alaska arguing that Congress and the president are constitutionally prohibited from using the CRA to impede an Interior Department regulation.) While a direct constitutional challenge would aim primarily to nullify the CRA, not interpret it, such litigation could theoretically urge the court to adopt a "narrowing construction" of the CRA's terms to limit the case's constitutional stakes.

In any event, this approach faces several jurisdictional and substantive impediments. First, plaintiffs attempting to bring such a constitutional challenge would need to show that they have standing to bring the suit, including a showing that a signed CRA resolution injures them in a way that can be redressed by the courts. Moreover, courts generally decline to hear cases in which plaintiffs desire simply to increase regulatory burdens on third parties. Second, even if the plaintiffs manage to leap these significant jurisdictional hurdles, they still would need to formulate a compelling substantive argument that the CRA is not just bad policy but unconstitutional, and so far the CRA's critics have failed to find such a silver bullet. (The Center for Biological Diversity, for example, argues that the CRA should be struck down because of *INS v. Chadha*, but the CRA contains precisely

what *Chadha*'s "one-house veto" lacked: a resolution approved by both houses of Congress and signed by the president.)

Instead of a direct constitutional lawsuit, the more likely scenario is one in which parties challenge an agency's action or inaction in the aftermath of a CRA resolution. That is, if Congress passes a CRA resolution nullifying a regulation and the relevant agency acquiescently declines to resurrect the rule, a pro-regulatory party might sue to try to force the agency to act. Or, if an agency attempts to resurrect a CRA-stricken regulation, perhaps after a change in presidential administrations, then a party might file a lawsuit to block the agency from implementing the new regulation.

A challenge to agency inaction would, like a direct constitutional challenge, face significant jurisdictional and substantive hurdles. Agencies generally retain immense discretion not to undertake a rulemaking process. The courts are generally loath to force agencies to regulate, just as courts are generally loath to force prosecutors to prosecute; thus, agencies possess something akin to "prosecutorial discretion."

But there are two important exceptions that the CRA's critics might seize upon. First, if a substantive statute like the Clean Air Act appears to require the agency to promulgate a regulation, then courts are more likely to entertain a lawsuit forcing the agency's hand. Second, if an agency announces that it cannot undertake a new rulemaking solely because a prior CRA resolution has stripped the agency of its authority on the subject, then a party could file a lawsuit challenging the agency's position that it lacks regulatory authority. In such a case, a court could conclude that the agency has not lost its regulatory authority—because new rules requested by the challengers would not be "substantially" similar to the CRA-repealed rule—and direct the agency to consider the merits of a new regulation. This would be similar to what the Supreme Court required of the EPA in *Massachusetts v. EPA*, where the EPA disclaimed authority to regulate greenhouse gas emissions as air "pollutants."

To avoid that latter option, an agency would be wise to cite two grounds for declining to undertake a post-CRA regulation: namely, that the CRA resolution stripped the agency of its authority, and that the agency would exercise discretion not to promulgate the new regulation even if the CRA did not prevent it. This might prevent challengers from suing over agency inaction, at least so long as the relevant underlying substantive statute does not require the agency to regulate.

If a lawsuit challenging agency inaction is an unlikely route to adjudicating the meaning of the CRA's "substantially the same form" provision, then a lawsuit challenging agency action is the most likely path. That is, if an agency—perhaps after another presidential election—attempts to promulgate a regulation relating to a matter that had been the subject of a previous CRA-nullified regulation, then parties affected by the new regulation will almost certainly file a lawsuit against the agency, arguing that the new regulation is unlawful under the CRA. In such a case, the court would

squarely confront the question of whether the new regulation is of "substantially the same form" as the old CRA-nullified regulation.

No matter how the issue reaches the court—be it a lawsuit challenging agency action or agency inaction—the court's analysis would not involve application of the increasingly controversial doctrine of "*Chevron* deference." Normally a court defers to an agency's interpretation of a statute's ambiguous terms—and the CRA's "substantially the same form" provision certainly seems ambiguous. But as the courts have stressed, *Chevron* deference is appropriate only when the statute at issue is one that has been committed to that particular agency's exclusive administration—e.g., provisions of the Clean Air Act, which are administered exclusively by the EPA. Thus, when an agency is administered by multiple agencies—e.g., the Freedom of Information Act or the Administrative Procedure Act—then no agency receives *Chevron* deference in interpreting it. The CRA falls neatly into this latter category, so the courts would likely interpret the CRA's terms undeferentially (or, in legal terms, "de novo").

But to be clear, the court's specific task would be to interpret the meaning of the CRA's terms and not the meaning of a CRA resolution, though the two are deeply intertwined. To interpret the CRA's "substantially the same form" provision, the court would apply the traditional tools of statutory construction: the meaning of the CRA's words, both as those words are normally understood and as they might be understood in this particular legal or legislative context; the CRA's broader structure; the CRA's legislative history; the broader set of presumptions (or "canons") of statutory construction that impute congressional intent in one interpretive direction or another; and so on. Taken together, the court would be attempting to ascertain Congress's "intent," though particular judges vary widely in the extent to which they are willing to look beyond the statutory text's plain meaning for indications of congressional intent.

## CONCLUSION

As we have sought to make clear in this article, the CRA is best understood as embodying Congress's understanding that proper application of the "substantially the same form" provision will turn, in each case, on both the substance of the statute that Congress originally enacted authorizing the regulation, and Congress's subsequent purpose in passing the CRA resolution. In other words, the Congress that enacted the CRA intended for courts and agencies to pay attention to the intentions of the subsequent Congresses that use the CRA.

But this is a difficult standard for any court to apply, especially for judges who are wary of ascribing such flexible meaning to any statute. Ironically, the judges who are ordinarily the most skeptical of agencies might also be the most skeptical of interpreting the CRA flexibly to limit future agencies. And the judges who ordinarily treat statutes more malleably might be the ones most likely to construe the CRA strictly—but in service of preserving the agencies' discretion and power in the future. R

# PROTECTING FREE SPEECH IN MEDICINE

*Why shouldn't drug makers have the right to distribute accurate information?*

BY CHRISTINA SANDEFUR

Nothing could be worse for medical patients than laws that prohibit them from learning about all their available treatment options. As Judge William Pryor of the Eleventh Circuit Court of Appeals recently observed: "Health-related information is more important than most topics because it affects matters of life and death. ... If anything, the doctor-patient relationship provides more justification for free speech, not less."

Yet medical professionals in the United States today operate under what amounts to a gag order that prevents doctors and patients from having the best, truthful information about their medical care. Under federal law, pharmaceutical companies can be charged with a *crime* simply for telling doctors about legal, safe, alternative uses for an approved medicine. In other words, government routinely censors the communication of valuable information that could help improve, and even save, people's lives.

## OFF-LABEL TREATMENTS

About one in five prescriptions in the United States is used "off-label." "Off-label" means that the medicine has been approved for use by the U.S. Food and Drug Administration, but the physician is prescribing it for a different use, or at a different dosage, than the FDA approved. Off-label prescriptions are entirely lawful; Medicare even covers them. And they are commonplace: among the 10 most frequently used cancer treatments in 2010, 30% were off-label. An overwhelming majority (87%) of oncologists report that off-label treatments are important to their practices.

Amoxicillin, approved as an antibiotic for adults, is often prescribed off-label to treat ear infections in children. Citalopram, a drug approved for treating depression, is sometimes prescribed off-label to treat symptoms such as stuttering, irritable bowel

syndrome, and hot flashes in menopausal women. Magnesium sulfate, which is approved to prevent seizures for women in pre-eclampsia and to control seizures in eclampsia, is commonly used off-label to stop women from undergoing pre-term labor. Even aspirin has off-label uses; it is FDA-approved for pain, fever reduction, and cardiovascular disease, but it is sometimes used off-label to prevent coronary disease in diabetics.

Yet while doctors can legally *prescribe* off-label, federal law generally prohibits pharmaceutical companies from *sharing information* about off-label uses with doctors. As a result, doctors and patients are often unaware of alternative treatment options that are lawfully available to them and, even if they are aware, the information they receive may be outdated.

The reason the FDA gives for barring speech about off-label uses is that it protects against "misbranding," which means misrepresenting what a drug or treatment can do. The FDA uses this concern to require pre-approval of a medication's advertisements, package label, brochures, and patient education materials.

In the FDA's eyes, it isn't just those who share *false or misleading* information about a drug who are subject to punishment for misbranding. Even if a drug is legal and prescribing it for off-label use is legal, it is "misbranding" for the drug maker to share *accurate information* about the off-label use. Thus the agency punishes drug companies and their employees if they promote or advertise truthful information about the legal use of a drug that the government has approved for sale.

The consequence is that doctors and patients may never learn of effective alternate uses for legally approved medications. In the words of Samuel Nussbaum, a senior fellow at the University of Southern California's Schaeffer Center on Health Economics and Policy, "Even if a health care decision maker asks all of the right questions, they may still not be able to access the necessary information they need because manufacturers are hesitant to provide some information due to uncertainties in the laws and regulations that govern what they can and cannot share."





### THE RIGHT TO SHARE INFORMATION

The right to speak and share information freely is protected by the U.S. Constitution and all state constitutions. Nothing in either the First Amendment or the state protections makes any distinction between different kinds of speech. Yet the U.S. Supreme Court has held that the Constitution does not provide the same protections for commercial speech—speech that advertises a product or service—that it provides for other types of speech. That means that government may sometimes censor even lawful, non-misleading advertisements.

That is the basis on which the FDA has prosecuted drug makers for honestly informing medical professionals about possible uses for their medicines. Fortunately, the courts have begun to take a skeptical view of this. In a 2013 case, *United States v. Caronia*, the Second Circuit Court of Appeals overturned the criminal conviction of a pharmaceutical sales representative who was punished for promoting off-label use of the drug Xyrem. The court held that the communication of information about a legal activity is fully protected by the First Amendment and that “the government cannot prosecute pharmaceutical manufacturers and their representatives ... for speech promoting the lawful, off-label use of an FDA-approved drug.”

Yet despite the apparent breadth of that decision, the FDA announced that the ruling would not significantly affect its enforcement practices. Instead, it resorted to a legal technicality:

rather than prosecuting off-label advertising outright, it would use off-label speech as evidence of misbranding, a maneuver that supposedly would not violate the First Amendment. But this is too clever by half: what is “branding” if not speech?

This legal tactic is representative of the FDA’s effort to avoid a showdown over the free speech rights of pharmaceutical companies in this area. As far back as 2000, the D.C. Circuit Court of Appeals struck down guidelines the FDA had issued that regulated what information drug companies could provide for use in textbooks and limited the ability of companies to sponsor continuing medical education programs. After the court opinion was issued, the FDA declared that its regulations did not actually prohibit off-label promotion in textbooks or education programs in the first place. That rendered the case moot, ensuring that the Supreme Court would never hear the case.

Then in 2015 a federal judge in New York issued a preliminary injunction against the FDA, permitting Amarin Pharmaceutical to share information about the off-label use of its fish-oil drug Vascepa. Vascepa was FDA-approved to treat adults with severe triglyceride levels, and Amarin was in the process of seeking approval for use in adults with slightly lower triglyceride levels. While that approval was pending, Amarin wanted to share its research regarding that larger population but feared the FDA would prosecute it for doing so. The firm asked the judge to bar the agency from punishing it. Amarin’s victory established that First Amendment protections extend to all

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truthful and non-misleading promotional speech, even when the FDA claimed it was only using the speech as evidence of conduct.

The *Amarin* case seemed on track to establish much-needed precedent to guide the pharmaceutical industry and settle the off-label speech question. But less than a year later, the FDA again managed to prevent an appellate court decision when it entered into a settlement agreement with Amarin that allows the company to market Vascepa as it desired. The FDA also agreed to review up to two proposed off-label communications from Amarin per year under an arbitration process.

That settlement was a deliberate move to avoid establishing legal

*It seems clearer than ever that federal rules making it illegal for pharmaceutical companies to tell doctors the truth about their products—especially when those products and their uses are legal—are unconstitutional.*

precedent that would make clear just when and how drug companies can share information. As attorney Coleen Klasmeier observes, “Most legal issues presented by the cases never get ventilated in court or any open legal forum,” and settlements “behind closed doors” undermine “nuanced interpretation” of complex legal matters. In fact, the FDA announced that its settlement “does not signify [any] position on the First Amendment and commercial speech.”

One reason the FDA may be trying to avoid an ultimate resolution by higher-level courts is that the courts have recently made clear how strong the protections of the First Amendment really are. In 2011, the Supreme Court reaffirmed in *Sorrell v. IMS Health* that pharmaceutical companies have free speech rights even when they engage in speech for a commercial purpose. That case struck down a Vermont law that prohibited the communication of information relating to doctors’ prescribing practices if the communication was intended to facilitate the sale of medicine. “A great deal of vital expression,” the justices wrote, “results from an economic motive.” Forbidding such communication—or targeting specific types of companies and activities for censorship—was unconstitutional.

More recently, in *Reed v. Town of Gilbert* (2015), the Supreme Court struck down an Arizona ordinance that imposed different restrictions on speech based on whether the speech related to political, commercial, or religious subjects. Any limit on freedom of expression that is triggered by the content of the message expressed, it said, was a content-based restriction subject to the most stringent constitutional limits. After these decisions, it seems clearer than ever that federal rules making it illegal for pharmaceutical companies to tell doctors the truth about their products—especially when those products are legal and the uses

in question are legal—are unconstitutional.

Yet thanks to the FDA’s efforts to prevent a final court decision about off-label promotion, uncertainty remains about the law and risk of punishment that drug and medical device manufacturers face. Only a few months ago, the FDA tried yet again to punish a company for sharing information about its products’ off-label use, this time threatening representatives of Vascular Solutions for telling doctors that one of their company’s medical devices could treat different kinds of varicose veins. According to the company’s chief executive, Howard Root, the FDA treated this communication as “a felony even though our device was FDA-cleared for treating all varicose veins, over two-thirds of our salespeople never sold even one unit of it, sales [of it] constituted only 0.1 percent of our total sales, and not a single patient was harmed.” Root’s company was ultimately vindicated, but the legal battle took five years and cost \$25 million—a serious cost for the right to speak the truth.

So long as Congress and the courts continue to allow the FDA to censor speech by medical experts about the legal use of legal medicines, they and their patients will suf-

fer from the lack of clear standards regarding what information can be shared about treatment options. Fortunately, there is another option: one that Arizona has recently put into place to protect patients, medical professionals, and health care freedom.

#### A NEW WAY

As Congress and the courts fail to rein in the FDA’s assault on free speech, states can step in to protect their citizens’ rights. But how, one might ask, can a state sidestep federal law?

The answer is that states can adopt laws that provide *greater* protections for a fundamental right than are provided by the federal system. Federal law cannot preempt state law when the federal law or act *itself* is unconstitutional. When the FDA silences truthful, scientific speech about lawful treatments, it is violating the constitutional right to free speech.

The Constitution provides a basic minimum of legal protection for individual rights, leaving states free to establish greater protections if they wish—a floor, not a ceiling. This was by design: America’s founders envisioned the federalist system providing a “double security ... to the rights of the people” by enabling each state to “exercise its police power or its sovereign right to adopt in its own Constitution individual liberties more expansive than those conferred by the Federal Constitution,” as Chief Justice William Rehnquist noted in his 1980 opinion in *Pruneyard Shopping Center v. Robins*. As Justice William Brennan wrote in his classic 1977 *Harvard Law Review* article “State Constitutions and the Protection of Individual Rights,” state constitutions “are a font of individual liberties, their protections often extending beyond those required by the Supreme Court’s interpretation of federal law.” States can

therefore “respond, through the enactment of positive law” to protect the rights of citizens “without having to rely solely upon the political processes that control a remote central power.”

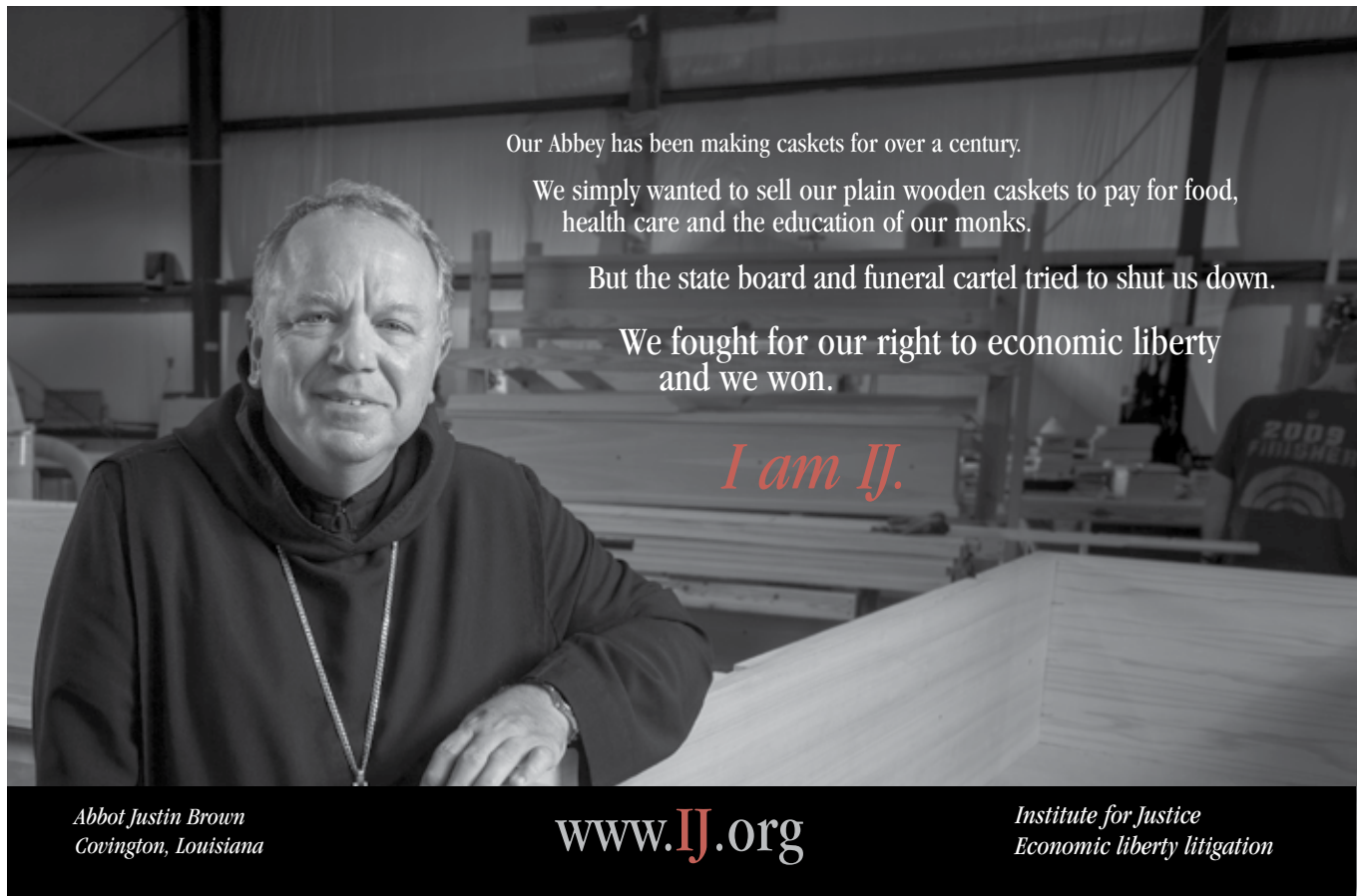
State constitutions already provide broader protections for free speech, property rights, and the right to privacy than their federal counterpart does. And the Supreme Court has recognized that “regulation of health and safety is ‘primarily, and historically, a matter of local concern.’” While federal officials can sometimes override state choices, states have “great latitude ... to legislate as to the protection of the lives, limbs, health, comfort, and quiet of all persons.” Thus, states can protect the rights of doctors, patients, and medical professionals to share truthful information about legal medical treatments.

The Grand Canyon State recently took the first step toward using this power to protect the freedom to share information about off-label uses. Last March, Gov. Doug Ducey signed the Free Speech in Medicine Act, a new state law that safeguards the free speech rights of those in the medical field to share truthful research and information about alternative uses for FDA-approved medicines. The act passed the state legislature with unanimous bipartisan support and made Arizona the first state in the country to enact this protection. It will expand the number of treatment options in doctors’ toolkits, enhance patients’ medical autonomy, and increase access to health care.

The act was an obvious and uncontroversial reform. When doctors are fully informed about the lawful treatment options available to them, they can best serve their patients’ individual needs. The law applies only to *truthful* communications, meaning information that is “not misleading, not contrary to fact, and consistent with generally accepted scientific principles.”

Some might argue that the new law does not go far enough, given that it only applies to communication between pharmaceutical manufacturers and licensed professionals, and does not allow pharmaceutical manufacturers to advertise off-label uses directly to the public. Patients will have to rely on doctors to receive, digest, and translate that information for their use. Nevertheless, the act is a major step forward in the effort to rescue patients and medical professionals from the FDA’s gag rule.

As the Supreme Court put it 40 years ago in *Virginia Board of Pharmacy v. Virginia Citizens Consumer Council*, “Information is not in itself harmful.... People will perceive their own best interests if only they are well enough informed, and ... the best means to that end is to open the channels of communication rather than to close them.” This is especially true in cases where the thing being communicated—here, prescribing off-label treatments—is itself lawful. Or, to borrow a line that the Court attributed to a Vermont doctor, “We have a saying in medicine: information is power. And the more you know, or anyone knows, the better decisions can be made.” **R**



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# SHOULD GOVERNMENT SUBSIDIZE AND REGULATE ELECTRONIC HEALTH RECORDS?

*Current law may be locking in deficient technology.*

BY MICHAEL L. MARLOW

**H**ealth information technology innovation focuses on electronic health records (EHRs), which can collect, store, and transmit health information within electronic health information exchanges. Exchanges enable doctors, nurses, pharmacists, other health care providers, and patients to gain access to and share medical information electronically in ways that potentially improve the speed, quality, and safety of patient care.

The potential benefits of EHRs are clear, given that the practice of medicine frequently relies on seemingly archaic methods of information delivery. These benefits, along with the perception that providers were too slow in adopting EHRs, motivated passage of the 2009 Health Information Technology for Economic and Clinical Health Act. That act authorized financial incentives of \$30 billion to eligible hospitals and professionals through Medicare and Medicaid to adopt and meaningfully use certified EHR technology.

Despite the laudable intent, government subsidies for EHR adoptions have “locked in” immature technology rather than spurred innovations that would otherwise have evolved over time. Lost opportunities for better patient care at lower expense are one major cost of the subsidy program. In place of the subsidies, government should adopt policies that are more likely to promote innovation that will improve public health.

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## WHAT ARE EHRs?

Most medical information is still stored on paper—for instance, in filing cabinets at various medical offices or in boxes and folders in patients' homes. When information is shared between providers, it often happens by mail, fax, or by way of patients themselves, who frequently carry their records from appointment to appointment. Current systems thus require users of information to duplicate past information numerous times. These systems are prone to missing data and to other mishaps that burden the health care system.

EHRs can record and store a treasure trove of data, including demographic information; problem list and active and past diagnoses; laboratory test orders and results; current prescriptions; radiological images and reports; hospitalization information; consultant reports; immunizations; pathology reports; social history; allergies; health screening study results; and physician, nurse, social worker, and physical therapy notes. Public health agencies and health care providers can also potentially receive updates on active disease outbreaks, diagnoses, and treatment recommendations.

THINKSTOCK



Fully interoperable systems are a key assumption behind government promises that EHRs will reduce hospital readmissions and medication errors, improve diagnoses, and decrease duplicate testing. Promises rest on the assumption that patient information will need to be recorded only once and will be easily accessible to all future providers through shared informational exchanges.

## SUBSIDY PROGRAM BASICS

Barack Obama, at the time the president-elect, summarized his support for EHR subsidies in a speech on January 8, 2009:

To improve the quality of our health care while lowering its cost, we will make the immediate investments necessary to ensure that, within five years, all of America's medical records are computerized. This will cut waste, eliminate red tape, and reduce the need to repeat expensive medical tests. But it just won't save billions of dollars and thousands of jobs; it will save lives by reducing the deadly but preventable medical errors that pervade our health care system.

Professionals and hospitals participating in the Medicare and Medicaid programs became eligible for financial incentives to adopt EHRs in 2011. Medicare-eligible providers include doctors of medicine or osteopathy, doctors of dental surgery or dental medicine, doctors of podiatric medicine, doctors of optometry, and chiropractors. Medicaid-eligible providers include physicians, nurse practitioners, certified nurse-midwives, dentists, and physician assistants. As of September 2015, more than 478,000 health care providers had received payments for participating in the EHR incentive programs, according to the Centers for Medicare and Medicaid Services.

Recipients must successfully demonstrate "meaningful use" (MU), as defined by the government, for each year of participation in the program. Beginning in 2015, recipients who fail to successfully demonstrate MU of EHRs became subject to Medicare and Medicaid payment reductions that start at 1% and increase each year that the professional does not demonstrate MU, to a maximum of 5%. Hospitals that do not successfully demonstrate MU of certified EHR technology also became subject to payment reductions beginning in 2015.

## IS THERE MARKET FAILURE?

Government subsidies are often justified by claims of "market failure"—the notion that obstructions keep certain markets from being

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acceptably efficient. Several different types of market failure are said to affect EHRs. Do these claims have merit?

**Network externalities** / Network effects occur when an increase in the number of users of some good raises benefits for all users. Telephone and fax technology offer good examples: benefits in the overall sharing network grow with the expansion of adopters. Markets fail as long as there are potential adopters who wait for others, because those holdouts are not taking into account benefits that accrue to all others in the network.

EHR technology appears to fit this profile because fully interoperable sharing networks will not emerge as long as network externalities cause potential adopters to delay adoption as they wait for others to adopt first. Businesses that simply focus on how their own costs will change or how treatment will change for only their patients (or both) would likely delay EHR adoption. Underinvestment in EHR—a symptom of market failure—is predictable as long as individuals narrowly focus on their own situation and ignore benefits to others.

But blanket use of the network externalities argument for market failure is not entirely convincing simply because networks currently lack interoperability. The network externalities argument applies to the cases in which fully interoperable systems are available for all potential users—a “perfect” scenario that does not exist today.

In a 2013 paper, Michael Furukawa et al. analyzed EHR activity at 2,805 hospitals in 2008 and 2,836 hospitals in 2012. They found that exchanges of clinical information (for example, problem list, medication list, medication allergies, and diagnostic test results) with outside providers increased significantly between 2008 and 2012, but a majority of hospitals still did not electronically exchange clinical care summaries and medication lists. A 2016 paper by Jeanne Madden et al. found that one major EHR system was missing roughly half of the clinical information for its patients in 2009. This study focused on insurance claims for depression and bipolar disorders, mood disorders that affect roughly 10% of the adult population. Apparently, “missing” information is common when patients protect their privacy by seeking behavioral care at a separate location from their somatic care.

In sum, today’s technology lacks interoperability. Thus, current adoption rates cannot be deemed symptoms of underinvestment as long as businesses that fail to adopt are reacting to concerns that EHR investments today do not guarantee interoperable systems today or tomorrow.

**Free-rider problems** / A business that invests in research may find that it is difficult to exclude other firms from benefiting from the knowledge resulting from that research. One firm conducting research must absorb all costs, but other firms “free ride” on benefits without incurring costs. Thus it becomes less likely that any single firm would find such research profitable. Markets are likely to underinvest in beneficial research when such research

is subject to “free riding.”

Underinvestment in interoperable systems like EHRs is likely as long as it remains difficult to exclude those who do not invest in research from benefiting from the research. Predictably, research is tilted toward non-interoperable systems when it is difficult to exclude free riders from benefiting from investments in interoperable systems. EHR vendors are thus reluctant to fund research on interoperable systems and face incentives to discourage data sharing with other vendors. Government policies that promote EHR systems should thus focus only on research into interoperable systems that allow the seamless sharing of health information with all other health providers.

**Incomplete information** / Incomplete information on the benefits and costs of goods and services hampers the ability of markets to allocate resources efficiently. Yet a market failure will arise only when there is information that is known to some, such as government policymakers, but that remains unknown or not effectively communicated to market participants.

It is difficult to argue that EHR systems are a classic case of incomplete information market failure simply because the benefits and costs of such systems remain speculative. EHR technology may also be initially disruptive, may pose harm to patients, is not interoperable, and is subject to rapidly changing standards. Recent reports that health records are not entirely safe raise an additional layer of complexity to the uncertainty surrounding EHR adoptions. Research by the Ponemon Institute estimates that of the 2.32 million Americans who have been victims of medical identity theft, almost 500,000 cases were in 2014 alone.

In sum, the evidence indicates that the case for market failure because of lack of information is unpersuasive. Waiting on the sidelines before fully committing to EHR purchases may be an efficient choice for those concerned with the many uncertainties surrounding costs and benefits of EHR systems.

#### EMPIRICAL LITERATURE ASSESSMENT

The empirical literature indicates ongoing uncertainty over the benefits and costs of EHR systems. Meta-analysis studies that combine the results of multiple scientific studies offer the best evidence to date. The basic idea is to uncover a common signal stemming from similar studies, but whose results have been measured with errors within each study. In effect, meta-analysis produces a weighted average of results from similar studies and requires researchers to identify a statistical measure common to these studies so that a weighted average can be calculated. Weighting usually considers sample sizes of the included studies, but study quality and other factors can also be considered. Meta-analysis is not without problems, but combining similar studies is believed to yield statistical power greater than that derived by examining studies in isolation.

Writing in *Critical Care Medicine* in 2015, Gwen Thompson et al. conducted a systematic review of the literature on whether EHRs

influence mortality, length of stay, and cost in hospitals. Of the 2,803 studies they screened, 45 met selection criteria (1.6%), and the authors extracted data on the year, design, intervention type, system used, comparator, sample sizes, and effect on outcomes. No substantial effects on mortality, length of stay, or cost were determined. The authors noted that the pool of studies examined was small because of the heterogeneity of study populations, interventions, and endpoints, and that the size of the pool may have influenced their findings. For example, they could not quantitatively evaluate costs.

A *Health Affairs* paper that same year by Saurabh Rahurkar et al. examined 27 scientific studies and concluded that the current state of the literature does not provide sufficient rigorous evidence for benefits from EHRs. The authors extracted selected characteristics from each study and then meta-analyzed those characteristics for trends that indicate whether EHRs affected cost, service use, and quality. While 57% of the studies reported some benefit, those employing strong study designs (e.g., RCTs or quasi-experiments) were significantly less likely to report benefits. Among six articles with strong study designs, one study reported negative effects, three found no effect, and two reported that EHRs led to benefits. The authors concluded that little generalizable evidence exists regarding benefits.

*Uncertainty pervades the evidence on what effects EHRs can be expected to exert on patient care and health care costs. It thus comes as no surprise that the market response to EHRs has been less enthusiastic than expected.*

In sum, uncertainty pervades the evidence on what effects EHRs can be expected to exert on patient care and health care costs. That the market response to EHRs has been less enthusiastic than what the systems' early proponents had speculated comes as no surprise when there is so little evidence of their benefits.

### EHR SUBSIDY PROGRAM FAILURES

Not only does the EHR program have questionable justifications, but its implementation has been badly flawed. A review of those flaws raises further questions about the program.

**Program rushed to policy/** As explained by Margo Edmunds et al., the EHR program was intended as a sort of "arranged marriage" between a Keynesian stimulus effort and a massive introduction of technology. The program significantly underestimated the degree of cultural and organizational change required for its success. Recall that Obama pledged that subsidies would result

in all medical records being computerized within five years; that came nowhere close to happening.

A kind interpretation is that the Obama administration was too optimistic about meeting its various promises by 2015. Spurring technological innovation in a health care market that accounted for 17.8% of GDP in 2015 is undeniably ambitious. Consider, as well, a subset of the many interactions involved in a nationwide rollout of EHRs:

- 83.2% of American adults and 92.4% of American children had contact with a health care professional in 2013.
- 929 million physician office visits were made in 2014.
- 126 million hospital outpatient visits were made in 2014.
- The 5,627 hospitals in the United States had nearly 35 million total admissions in 2014.
- In 2014, there were 708,300 physicians and surgeons, 591,300 medical assistants, 297,100 pharmacists, 210,900 physical therapists, 151,500 dentists, 200,500 dental hygienists, 40,600 optometrists, and 45,200 chiropractors operating in the United States.

**Subsidies locking in immature and incentivized technology/**Risks are abundant when pursuing immature technology. One of those

risks involves the costs of not waiting for more developed technology and instead "locking in" immature standards. In a 2009 paper, Michael Christensen and Dahlia Remler argued that the value of delaying EHR investments would be considerable because errors inadvertently introduced by immature technology are more devastating, more salient, more attention-getting, and more prone to engender strong emotions in the health care industry than in other industries (e.g., banking and insurance).

The costs of switching to a different system are also especially large in health care because of the many actors: patients, providers, insurers, and government entities.

Aggressive promotion by government also exacerbates existing problems by encouraging the purchase of today's hard-to-use systems that will be costly to replace at a later date. If market forces were allowed to work, providers might drive vendors to produce more usable products than the current systems that have been rushed to market because of time-limited subsidies. Current technology, for example, requires users to read thick manuals, attend tedious classes, and pay for periodic tutoring so that they can "master" the steps required to enter and retrieve data. Locking-in immature technology as a result of government subsidies is not wise public policy.

Subsidy payments also push technology toward incentivized activities and away from non-incentivized activities. A 2014 study by Andrew Ryan et al. examined 143 medical practices that imple-

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mented EHRs over 2009–2011, where 71 practices were randomized to receive financial incentives and quality feedback and 72 were randomized to receive feedback alone. The authors estimated the associations between exposure to clinical decision support, financial incentives, and quality of care. They also estimated associations for four cardiovascular quality measures that were rewarded by the

*The subsidies simply accelerated an ongoing trend; the rate of adoption realized by 2011 would have been achieved in 2013 without subsidies. That acceleration may not be preferable to awaiting better technology.*

financial incentive program and four quality measures that were not rewarded by incentives. Incentives were consistently associated with higher performance for incentivized measures and lower performance for non-incentivized measures. The incentive system may have also encouraged practitioners to pay less attention to non-incentivized measures that may also improve public health, such as reducing the incidence of inappropriate prescribing.

Research indicates that government subsidies merely accelerated EHR adoptions that were likely to have occurred without financial subsidies. A 2014 National Bureau of Economic Research paper by David Dranove et al. found that subsidies caused one in five non-adopters to adopt EHR technology by 2011. The authors concluded that subsidies simply accelerated an ongoing trend and therefore the rate of adoption realized by 2011 would have been achieved by 2013 without subsidies. Subsidies thus pushed the adoption rate up by at most two years. The authors question the incentive program because briefly accelerating adoption is not clearly desirable when waiting for better technology is more prudent.

### CONCLUSION

The EHR subsidy program is a prime example of how ill-suited government is in attempting to steer technology. Time-sensitive subsidies enticed many health care providers to purchase poorly functioning systems that will either have to undergo substantial and costly modification or simply be scrapped. Federal officials have only recently admitted that their attempts to steer universal data exchange need reform, though it remains unclear what system will replace the original program. Meanwhile, the program has wasted resources, locking in immature technologies by enticing adopters into the government subsidy program. It is thus not surprising that promised gains in patient care and reduced costs have yet to appear.

The best that government can do may be to establish a stan-

dard, similar to our convention of driving cars on the right side of the road or our system of weights and measures. In this case, a standard simply could mandate which data must be collected, with the added requirement that all data files must be available for sharing with all health providers at low or zero cost. Of course, the government could err by asking for too much data or by

not requiring the right data. But the point is that setting standards on data collection with interoperability mandates makes sense provided that the timeline allows the best system to emerge from the market.

Government is no match for the ability and incentives of market participants in steering innovation. It is foolish to mandate deadlines for the arrival of mature technologies. The prudent role for government is patience with an evolving technology that promises to improve the efficiency

of our health care system. A farsighted government allows technology to emerge rather than dictate an evolving technology that promises to improve our health care system. Markets then have a fighting chance at innovating EHR systems that improve public health and lower health care costs. R

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## LABOR

# THE ‘WAR’ AGAINST CHINESE RESTAURANTS

*A century ago, laws and regulation were mustered to ward off a different immigrant “threat.”*

◆ BY GABRIEL J. CHIN AND JOHN ORMONDE

For roughly 30 years, in the last decade of the 19th century and the first two decades of the 20th, a national movement sought to use the law to eliminate Chinese restaurants from the United States. This “war,” as it was then described, is a lost chapter in the history of U.S. racial regulation, with relevance to immigration policy today.

A century ago, Chinese restaurants were deemed “a serious menace to society” for two reasons. First, the restaurants employed Chinese workers and successfully competed with other restaurants, which prompted white unionists to claim the Chinese restaurants denied “our own race a chance to live.” Second, Chinese restaurants supposedly were morally hazardous to white women; one observer noted that “beer and noodles in Chinese joints have caused the downfall of countless American girls.” Accordingly, many Americans recognized “the necessity for stamping out” the “iniquitous Chinese Chop Suey joints.”

Fortunately, the effort failed. Today there are more Chinese restaurants in the United States than McDonald’s, Burger King, and KFC restaurants combined. But the “war,” unsuccessful in its nominal goal, helped propagate the idea of Chinese as morally and economically dangerous people, and contributed to the passage of the Immigration Acts of 1917 and 1924, which almost completely eliminated Asian immigration to the United States.

## LABOR UNIONS AND THE CHINESE RESTAURANT THREAT

For most of U.S. history, the nation’s borders were open.

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This article is based on their forthcoming article in the *Duke Law Journal*, a draft of which can be found online at [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2948030](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2948030).

Although criminal conviction, disease, and certain other characteristics disqualified a prospective immigrant, until 1921 there were no numerical limitations on immigration.

However, this open-border policy did not apply to Asians. Political, moral, and economic considerations led to perception of a “Yellow Peril,” the danger that untold numbers of racially dangerous Asians could immigrate and undermine America’s basic character.

Congress passed the Chinese Exclusion Act in 1882, suspending all immigration of skilled and unskilled Chinese laborers for 10 years. In 1892 the suspension was extended another 10 years by the Geary Act, and then was made permanent in 1902. That was not the end of discrimination against Asians. By 1902, Japanese and other Asian immigrants were migrating to the United States, and their racial assimilability and therefore their right to immigrate became public policy questions.

Chinese in the United States had limited opportunities for employment. Some jobs required licenses that were limited to U.S. citizens, a status immigrant Chinese could never achieve because of racial restrictions on naturalization. Even without law, social discrimination restricted employment opportunities. Accordingly, many Chinese were employed in services and small businesses such as restaurants and laundries.

Because many Americans liked Chinese food, the restaurant business seemed promising. The popularity of “chop suey” and other Americanized or American-Chinese dishes resulted in a boom in Chinese restaurants. Their numbers grew rapidly in the late 19th and early 20th century

Unions opposed Asian immigration in general and Chinese restaurants in particular. The Cooks’ and Waiters’ Union is an ancestor of the modern-day UNITE-HERE. Its members competed directly with Chinese restaurants and the union was a powerful force; by 1903, its membership exceeded 50,000. The



The interior of a small restaurant in New York's Chinatown, 1905.

union was affiliated with the American Federation of Labor, which by 1914 claimed nearly two million members.

The unions strongly supported Chinese exclusion and expansion of the exclusion policy to all Asian races. A report in the *Mixer and Server*, the union publication, explained:

View this matter from every angle, without heat or racial prejudice, and the fact stares us in the face that there is a conflict between the American wage-earner and the workers or employers from the Orient. Our Government has been compelled to close its doors to Asiatics in recognition of this fact.

**Riots and boycotts** / Early methods of eliminating Chinese competition included threats and violence. For example, Chinese restaurant owners in Selma, Calif., were “driven out” by organized labor. Boycott was another important tool.

Boycott was national union policy. The *Mixer and Server* and other media reported boycotts against Chinese restaurants

in cities across the country, including Phoenix, Tucson, and Willcox, Ariz.; San Francisco; Brockton, Mass.; Duluth, Minneapolis, and St. Paul, Minn.; Butte, Billings, and Deer Lodge, Mont.; Tonopah, Nev.; Cleveland; El Paso, Texas; Ogden, Utah; and Casper, Wyo. Chinese restaurants were inexpensive and thus union members were tempted to patronize them, boycotts notwithstanding; unions imposed fines on boycott breakers to compel compliance.

Litigation in Cleveland made clear that the boycotts of Chinese restaurants were of a different character than other sorts of labor action. Not intended to recruit new union members or persuade businesses to sign a contract, the actions sought to render Asian workers unemployed and shutter Asian businesses. In 1919, Cleveland unions proclaimed the growing threat of “the Chinese situation”: “one small [Chinese restaurant] twenty years ago to all of 25 at the present time.” Union members picketed two

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new Chinese restaurants, the Golden Pheasant and the Peacock Inn; the latter responded with a lawsuit. Judge Martin A. Foran found that picketers encouraged patrons to eat elsewhere “on the ground that they are Chinamen and members of the yellow race, and that Americans should not patronize a Chinese restaurant, but should confine their patronage and support to restaurants operated by Americans or by white persons.”

Judge Foran enjoined the picketing and scolded the unions, noting “that all men, even including Chinamen residents of the United States, stand equally before the law.” He noted that the picketing was not an attempt to unionize the workers: “No persons can become members who are not citizens by birth or naturalization. ... It is admitted that Chinamen cannot belong to any local of defendants’ international union.” Accordingly, the real aim was to “compel[] the management to discharge Chinese waiters and employ white waiters, and in default of so doing, compel the restaurant to cease doing business.”

Even when not enjoined, nonviolent boycotts were rarely wholly successful. Judge Foran seems to have been right when he wrote:

The law of competition in business controls business relations as immutably as the law of gravitation controls matter. If a Chinaman can furnish better food at less cost than a white man, he will be patronized, and I know of no law that will compel or force any patron to pay a higher price for inferior food merely because it is prepared and served by a white man.

Since there was no law reserving the food business to whites, the unions sought to create one.

### CHINESE RESTAURANTS AND THE LAW

When boycotts failed, unions invoked another rationale for regulation: Chinese restaurants harm white women. The restaurants were suspected of being locations for vice. Chinese restaurants and Chinatowns were often tourist attractions. Middle and upper class whites visited Chinatown restaurants out of “morbidity curiosity” for an evening of “slumming.”

Newspapers offered lurid reports that Chinese restaurants were fronts for opium dens, and that Chinese men used opium “as a trap for young girls.” The idea of white female victimization became a media trope. In 1899, *King of the Opium Ring*, by Charles E. Blaney and Charles A. Taylor, played at the Columbus Theater and the Academy of Music in New York. Later produced around the country, it featured a clown who rescues a young white woman from the balcony of a Chinese restaurant. Movies depicted similar scenes and renowned “realistic” artists painted Chinatown vistas.

As early as 1899, the question was asked, “Can any means be devised to prevent the employment of white girls in Chinese restaurants?” The *Madera Mercury* (Calif.) noted, “Beer and noodles in Chinese joints have caused the downfall of countless American girls.” The *Bridgeport Herald* (Conn.) reported, “Many a young girl

received her first lesson in sin in Chinese restaurants.” And the *Chicago Tribune* noted:

More than 300 Chicago white girls have sacrificed themselves to the influence of the chop suey “joints” during the last year, according to police statistics. ... Vanity and the desire for showy clothes led to their downfall, it is declared. It was accomplished only after they smoked and drank in the chop suey restaurants and permitted themselves to be hypnotized by the dreamy, seductive music that is always on tap.

The *St. Louis Post* warned that Chinese restaurants

are visited ... often by respectable girls and women on sight-seeing expeditions, or [those] who have “the chop suey habit.” The Chinese of these places soon find a way to form an acquaintance with young women customers who go to the place often. ... In Hop Alley several Chinese have white wives.

It “gave a girl a bad name” just to work in a Chinese restaurant, reported the *Labor World*, the union paper in Duluth, Minn.

Not all those visiting Chinatowns went for amusement or vice. Christian missionaries entered to evangelize, but sensational newspaper reports claimed that female missionaries too often succumbed to “the fatal lure of Chinese.” One clergyman explained: “I know the possible dangers of social intercourse between the races ... so our Chinese school is watched very strictly.” A Kansas City detective thought that society should “prevent young girls from wrecking their lives by attempting to Christianize Orientals.” The oldest Chinese mission worker in New York stated that she did not “believe in young girls teaching Chinamen” because the Chinese continue to “hold a fascination for young American girls ... after they once come in contact.”

The year 1909 was critical for regulation of Chinese. In an era when many Americans used over-the-counter patent medicines containing opiates or cocaine, Congress passed the Smoking Opium Exclusion Act of 1909. And then in June came tragedy and disaster. As recounted in Yale historian Ting Yi Lui’s award-winning book *The Chinese Trunk Murder* (Princeton University Press, 2007), Leon Ling, a New York Chinese restaurant worker, murdered Elsie Sigel, a young white missionary from a prominent family headed by Civil War hero Franz Sigel. In part because Ling was the subject of an unsuccessful national manhunt, the crime became a prolonged sensation.

Sigel was described as a Christian missionary seduced by her Chinese pupil. Lurid headlines such as “Was Strangled By Her Chinese Lover: Granddaughter of General Sigel Slain in the Slums of New York” captured public attention. The subsequent “wave of suspicion” put Chinese restaurants across the country in the spotlight. An Oregon newspaper stated “that the Sigel revelations have disgusted the Americans, and at present it is considered bad form to eat in a Chinese restaurant.”

The press followed the case for years and the murder stimulated race-based regulation under the guise of “protect[ing] young

women.” The *Washington Times* commented: “The Elsie Sigel case wasn’t enough. . . . Every state in the union should pass laws that would prohibit a white girl from ever crossing a Chinaman’s threshold.”

**White women’s labor law/** After the murder, there was a national movement to keep women out of Chinese restaurants. Arizona, Iowa, Massachusetts, Montana, Oregon, and Washington, as well as such cities as Los Angeles, Pittsburgh, and San Francisco, considered legislation or decrees banning white women from patronizing Chinese restaurants or being employed there. A bill also became law in Saskatchewan, Canada.

The national nature of the effort is reflected by the following resolution of the American Federation of Labor to exclude white women from Chinese and Japanese restaurants across the United States:

WHEREAS the evils arising from the employment of white women and girls in establishments owned or controlled by Chinese and Japanese constitute, both morally and economically, a serious menace to society; therefore be it  
RESOLVED, That the American Federation of Labor be requested to pledge its best endeavors to secure the passage of a law prohibiting the employment of white women or girls in all such establishments.

It is not clear that the ban, proposed before the Nineteenth Amendment, was congenial to women themselves. In 1916 the *Arizona Republican* reported that a wealthy woman “advertised for a cook and in thirty days one replied. In the same column of the paper was an ad for a girl cashier in a Chinese restaurant and forty answered in one day.” Nevertheless, the idea turned into legislation or other action in a number of jurisdictions.

The Pittsburgh City Council passed an ordinance in 1910, 49-2, banning all women from Chinese restaurants as patrons or employees, and restricting the restaurants’ hours of operation. But in a virtuoso explanation of its legal defects, Mayor William Magee vetoed the bill, explaining:

While the ordinance apparently treats the “Chinese” in an impersonal sense, it is plainly directed against the Chinese as a race. . . . The legal objections to this enactment are numerous and varied but I shall sum them up as to unreasonableness and discrimination as follows:

First: It invests the Director of the Department of Public Safety with unlimited discretion to grant or refuse said license, because he is not to grant the same “to any person who is not of good moral character,” and it need scarcely be said that what is or is not good moral character may be purely an arbitrary opinion.

Second: By implication it permits the Director to revoke said license in case of “the visit of disreputable persons to said restaurant or chop suey houses,” and here again the right to do

business is subject to an arbitrary opinion of the director.

Third: The ordinance forbids the visit of women or girls to these restaurants, thus arbitrarily confining and limiting the business of the same.

Fourth: The hours for doing business at these places is fixed from six A.M. until midnight which is a restriction not imposed on any other restaurant in the city.

In short the ordinance contains throughout provisions which are unreasonable and plain discriminations and are clearly illegal and invalid under the laws of Pennsylvania as well as under the provisions in the Federal Constitution and have been so held in the courts both Federal and State.

Massachusetts saw a protracted effort to regulate Chinese restaurants. In 1910, the “Yellow Peril Bill” was introduced, which would have prohibited all women under 21 from entering Chinese restaurants as patrons or employees, and requiring a non-Asian male escort for older women. Many legislators called the bill unconstitutional, some noting that the law applied to Chinese women married to Chinese men, and therefore forbade a Chinese woman from dining with her husband. Nevertheless, it passed a first and second reading. But State Attorney General Dana Malone found that the bill “discriminates against the Chinese by reason of their nationality, and, therefore, if passed, would be unconstitutional and void.” This turned the tide; the House rejected the bill. After it was reintroduced in 1911, the House asked the Supreme Judicial Court for an advisory opinion, which unanimously found the law unconstitutional. The Court stated:

It subjects Chinese to an oppressive burden that deprives them of liberty which all others enjoy, and interferes with their right to carry on business, acquire property and earn a livelihood, and denies them the protection of equal laws.

The bill was withdrawn the next day.

Serious attention was given to the idea in other jurisdictions. In September 1912, the *Los Angeles Times* reported that police chief and future mayor Charles E. Sebastian “says he will recommend to the Police Commission that an order be issued barring all white female help from oriental eating places, with the penalty that if the order is not instantly complied with that their license be revoked.” Two years later the *Los Angeles Herald* reported, “The police commission gave its unanimous approval today to the plan of Chief of Police Sebastian to exclude white girls as cashiers or waitresses from restaurants and cafes run by Japanese or Chinese.”

San Francisco officials considered legislation preventing white women from working in Chinese and Greek restaurants. The city attorney declared that while the legislation aimed at Greek restaurants amounted to “class legislation” and thus would be unconstitutional, validity of legislation aimed at Chinese restaurants “was a debatable question.” He reasoned that “if such places as generally operated are against the welfare of white women, it is more than

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probable that the constitutionality of the legislation as to them would be upheld on the ground of a reasonable exercise of the police power." It does not appear that the legislation was enacted.

In 1915, the Montana Senate approved a similar bill 31-0 with nine abstentions. However, U.S. Secretary of State William Jennings Bryan wrote to the House opposing the bill, and it failed. Oregon and Washington also considered similar bills. Members of the Arizona legislature reportedly considered drafting legislation prohibiting white girls from working in Chinese restaurants, but it does not appear that a bill was introduced.

There is one report of a ban imposed by judicial action. Iowa District Court Judge Lawrence De Graff reportedly issued an order enjoining the owner of a Chinese restaurant from serving women. However, he quickly reversed himself, finding that it was "not equitable to enjoin the owner of a chop suey restaurant to prevent women" from dining therein.

**Emergency police authority** / For the reasons articulated by Pittsburgh Mayor Magee and the Massachusetts Supreme Judicial Court, discriminatory legislation explicitly targeting Chinese restaurants was legally problematic. Nevertheless, government kept white women from patronizing or working in Chinese restaurants. This was done through emergency police authority, which was apparently more potent than legislation.

Most prominently in the wake of the Sigel murder but also on other occasions, police simply ordered white women and girls out of Chinese restaurants or neighborhoods. The head of the Washington, D.C. Police Department issued orders forbidding all "young white girls" from entering Chinese restaurants. In New York, police vowed to end the "slumming" expeditions and tourist attractions of Chinatown. In 1910, New York Deputy Police Commissioner Clement J. Driscoll announced that he was going to "force white women away from Chinatown and keep them away." Officers also searched for white women residing with Chinese men and prepared a list for "Tenement House Inspectors."

It is odd that police could force women out of Chinese restaurants when legislatures could not. Perhaps the explanation is exigency. Even today, there is a plausible argument that the police can order people to "move on" at their whim, and arrest them if they do not. Of course, police are free to act unilaterally, even forcibly, to protect lives and property in emergencies. Even today, authorities can discriminate on the basis of race when necessary to meet a pressing exigency. Police orders are temporary and specific, while laws are normally general and permanent (or at least open-ended) and thus represent a greater intrusion.

In addition, the war against Chinese restaurants was fought in a largely pre-modern era of law. Because many of the provisions of the Bill of Rights did not apply to the states, the police had much freer rein. Or the explanation may be that this was an era when police lawlessness was difficult to control.

**Citizenship discrimination** / An easy way to eliminate Asian res-

tauranteurs would have been to require citizenship for licensure or employment.

The media reported several attempts by Chicago officials to implement a citizenship requirement. In 1906, the City Council considered a bill requiring special licenses for "chop suey" restaurants. The *Chicago Tribune* reported, "When it was pointed out that the Chinese would be barred permanently as they cannot become citizens," one alderman said the city "could get along without any chop suey places." In 1918 it was reported that "Chicago's Chinese colony was given a severe jolt when it was announced at the city collector's office that many of them owning chop suey restaurants and other eating places would have to go out of business through inability to obtain licenses." By 1922 the Chicago Municipal Code required those seeking restaurant licenses to have "good character and reputation" and be "suitable for the purpose," leaving ample room for discretion. But there was no requirement that applicants be citizens. Similarly, Massachusetts legislators considered limiting victualer's licenses to citizens, but the proposal failed.

State laws requiring citizenship to operate a restaurant were probably doomed. In *Asakura v. City of Seattle*, a 1924 case involving a Japanese immigrant, the Supreme Court invalidated an ordinance restricting pawnbroker licenses to citizens.

Another method to eliminate Chinese restaurants would have been to prohibit Chinese from working. In 1914, Arizona enacted the Anti-Alien Employment Act prohibiting businesses from employing more than 20% noncitizens in their workforces. The February 1914 *Mixer and Server* crowed that "before long every restaurant in Phoenix will be conducted by white people instead of the Chinks, as has been the custom for many years in Arizona."

Chinese restaurant workers sued, but before their case could be heard, a federal court struck down the statute based on a suit by an Austrian restaurant worker. In a decision upheld by the U.S. Supreme Court, the district judge found that the right to labor was property and that the law violated equal protection. The November 1915 Supreme Court decision in *Truax v. Raich* presumably invalidated a similar Los Angeles ordinance passed in August that was "designed to do away with the employment of Orientals in saloons and restaurants and give their places to citizens."

**Licensing discrimination** / By the 1920s, it seemed clear that legislation targeting Chinese restaurants as such was unconstitutional. But if blatantly discriminatory laws were prohibited, facially neutral ones had a better chance of succeeding. The growth of the regulatory state meant that more activity could only be conducted with the permission of the government. Chinese laundries were discriminated against, as reflected by the Supreme Court's decision in *Yick Wo v. Hopkins*, holding that Chinese were selectively denied laundry licenses by San Francisco officials. Chinese restaurants were similarly targeted.

Court decisions and newspaper reports across the country indicated a push to deny licenses to Chinese restaurants. For instance, Chicago imposed restrictive zoning. In 1911, the city

council voted to order the commissioner of public works and the commissioner of buildings “to refuse the issuance of permits for contraction or remodeling of any building or buildings by any Chinaman” in the district near Wabash Avenue and 23rd Street. The resolution noted that “the Chinese in the city of Chicago are invading said neighborhood” and their presence “will materially affect and deprecate the value of property in said vicinity.”

In El Paso, a boycott bore fruit when a number of Chinese restaurants closed. According to the *American Federationist*, the American Federation of Labor’s journal: “There is a clear reason why” in El Paso in 1915 “six Chinese restaurants [were] replaced by Americans”: “Union men [were] appointed at the head of five departments in the city.” In Brockton, unions also turned to regulators to oppose the renewal of the licenses of Chinese restaurants.

Regulatory boards and commissions reportedly denied licenses as a matter of policy. The *Los Angeles Herald* reported that “the police are opposed to Chinese chop suey restaurants outside of Chinatown” because they have a “tendency to disturb the peace.” Similarly, the *San Francisco Call* reported on the denial of a license to a Chinese restaurant in Palo Alto: “There has never been a Chinese business house in Palo Alto and it has been the policy of the citizens to keep such places out at all hazards.” There were similar reports in Omaha, Mo.; Moline, Ill.; Minneapolis; and several cities in Massachusetts.

**Discriminatory enforcement** / To be sure, some misconduct reported in Chinese restaurants, or for which Chinese restaurateurs were convicted of crimes, represented actual wrongdoing. However, the special focus of law enforcement on Chinese may well have played a part. There is little reason to believe that Chinese were disproportionately inclined to lawbreaking. Thus, the many reports of apparent selective enforcement, or promises to place Chinese restaurants under particular scrutiny, suggest the possibility that Chinese were arrested or deprived of licenses for conduct that would not have led to adverse action if committed by members of other groups.

In 1899, the Boston police commissioners ordered all Chinese restaurants to close by midnight. The *Boston Daily Globe* reported that the action was “part of the commissioners’ plan to drive the Chinese places from Boston.” Chicago authorities also paid special attention to Chinese restaurants. In June 1905, the Chicago City Council considered a resolution calling for investigation of Chinese restaurants, and by October 1 the restaurants were under investigation by the state attorney’s office and the police. Rev. J. E. Copus reported in *Rosary Magazine*, “The police department has promised to ‘get after’ the ‘chop suey dump.’” The Chicago police chief ordered “rigid inspections at frequent intervals” of Chinese restaurants and ice cream parlors. A Chicago police lieutenant promised “a crusade on the many Chinese restaurants in his district.”

The St. Louis, Mo. police chief said, “The Chinese chop suey restaurants and Hop Alley will be closely watched by the police of St. Louis, who had their attention called to the Chinese problem

in American cities by the murder of Elsie Sigel.” In Washington, D.C. in 1914 the district attorney advised officers to pay special attention to “restaurants where liquor is served to women, motion picture theaters, and Chinese restaurants.”

**Prohibiting private booths** / Chinese restaurants in the early decades of the 20th century typically had private booths consisting of small rooms with doors or curtains. A national movement to prohibit booths and private rooms was aimed at least in part at Chinese restaurants. The U.S. Public Health Service published a model ordinance prohibiting booths in restaurants, explaining:

Recurring complaint was made that in “chop suey” places and in other types of refreshment places the boxes, partitions, and booths made favorable places of solicitation and operation for pimps and prostitutes. By requiring the partitions to be removed the entire establishment was thrown open to public gaze and opportunity of unlawful acts destroyed.

As the Supreme Court has noted, zoning requirements can impose a “substantial obstacle” on disfavored targets.

Beginning in Ogden, Utah, booth regulations appeared across the country. Some expressly targeted Chinese restaurants. Others were facially neutral, but they appeared in jurisdictions that had implemented or seriously considered other anti-Chinese restaurant measures.

## VICTORY AND NATIONAL IMMIGRATION POLICY

As the 1910s turned into the 1920s, something seemed to change. Perhaps union members and competing restaurateurs sensed that the Chinese had been vanquished. The Census reported 107,488 Chinese in the continental United States in 1890, 89,863 in 1900, and 71,531 in 1910. The 1920 Census showed a further decline to 61,639. Anti-Chinese policies had reduced the U.S. Chinese population by almost half.

The political goal sought by the unions had been almost fully realized. Congress barred immigration of members of races native to continental Asia in the Immigration Act of 1917. While Japanese immigration had been restricted by the Gentlemen’s Agreement of 1907–1908, in 1924 they were explicitly barred by statute. The problem of Asian immigration and competition with white workers seemed to have been permanently resolved.

Moreover, the perception of Chinese restaurants was in the process of changing. Officials began to say that Chinese restaurants were clean and wholesome. On both coasts, the “Chop Suey craze” continued, but slumming was being replaced with glamour:

Broadway between Times Square and Columbus Circle was home to fourteen big “chop suey jazz places.” ... In San Francisco, most of these new nightspots were in Chinatown.... Featuring all-Chinese singers, musicians, chorus lines, and even strippers, clubs like the Forbidden City attracted a clientele of politicians, movie stars, and businessmen out for an exotic good time.

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Bing Crosby, Bob Hope, Ronald Reagan, and other celebrities patronized the Forbidden City, a glamorous nightclub in San Francisco's Chinatown. The first major Chinese cookbook was published in English in 1945; Chinese food had been tamed enough to have around the house.

And yet, unions were right to fear that Chinese restaurants could be a Trojan horse, an economic toehold giving the Chinese community a chance to grow. As Daniel Patrick Moynihan and Nathan Glazer noted in *Beyond the Melting Pot*, restaurants could be centers of economic activity for the larger community: "The Chinese restaurant uses Chinese laundries, gets its provisions from Chinese food suppliers, provides orders for Chinese noodle makers." In addition, the late University of Hawaii political scientist Fred Riggs, in his 1950 book *Pressures on Congress: A Study of the Repeal of Chinese Exclusion* (MIT Press), noted:

An important factor ... was their entrance into characteristic occupations held as a natural monopoly, notably, the hand laundry and Chinese restaurant. ... This occupational specialization destroyed "white" labor's fear of competition, while enjoyment of the Chinese cuisine and other services won for the "Celestial" the patronizing good-will, if not the friendship, of a substantial section of the American public.

## REMEMBERING THE WAR

Recognizing that there was once a U.S. war against Chinese restaurants offers several insights into American law. It is an example of how legal ideas can propagate. Here, innovation occurred not through judges, international organizations, bureaucrats, or organizations of lawyers like the National Conference of Commissioners on Uniform State Laws or the American Law Institute. Instead, labor organizations and the motivated private citizens who belonged to them obtained hearings for their discriminatory ideas.

The war on Chinese restaurants is also an example of what UCLA law professor Douglas NeJaime has called "winning through losing." Unions and law enforcement declared war on Chinese restaurants, and the Chinese restaurants won. The innovative tool invented for the fight, banning white women from eating in Chinese restaurants, became law almost nowhere and was likely legally untenable. Yet, unionized workers had the benefits of Chinese restaurants and simultaneously restricted competition with Asian workers through federal immigration laws.

This story indicates how Asian Pacific American legal history—and, for that matter, history in general—has been under-investigated. It is no surprise that Arizona, California, Montana, Oregon, and Utah targeted Asians; those states enacted laws prohibiting Asians from intermarrying with whites and owning land. Given their animus, additional discriminatory actions were predictable. But Massachusetts, Minnesota, New York, Ohio, and Pennsylvania had no race-based miscegenation or land laws, yet those states or

cities within them carried on heretofore unexplored legal attacks on Chinese economic activity.

Perhaps the most important implication of the campaign is that it represents another chapter in the persistent, systematic economic exploitation of people of color in the United States. For example, the Constitution protected slavery, designed to derive advantage from forced African labor. After the Civil War, in many parts of the country African Americans were compelled to work by a compromised criminal justice system. Similarly, Latinos in the United States have often labored without the opportunity for equal treatment. The Indian tribes once possessed priceless real estate; now they do not. Later, the United States held a fortune in Indian property "in trust," an obligation that, in the decades it has been in force, has been honored occasionally if at all.

Chinese and other Asians were also targeted by law for economic reasons. On its face, the method was different than in other race-based cases. Southern planters and other business owners desired African slave labor at below-market prices, illegally importing enslaved persons before the Civil War and, even after the formal abolition of slavery, using law to prevent African American migration out of the South. With Chinese and other Asians, the concern was economic competition with workers on the Pacific coast. The legal solution was exclusion, both of future competitors and of those already present in the United States, with little regard for their lawful presence or the fact that some were citizens.

The effort to drive out lawful Chinese residents is reminiscent of the periods of economic difficulty when persons of Mexican ancestry—citizen and noncitizen alike—were "repatriated" to Mexico to ease their competition with whites for jobs. Although the specific techniques used against various non-white groups differed, they shared the underlying idea that public policy should be structured to benefit white Americans.

And, of course, history echoes in the present. Politicians are again talking about deporting Mexicans and other Hispanics, citing concerns about crime and a surplus of labor. New "extreme vetting" policies are being crafted for immigrants and refugees from the Middle East and North Africa. And the Department of Homeland Security posted a notice in the Feb. 15, 2017 *Federal Register* proposing the collection of social media information for people from China.

Back in 2015, Steve Bannon, now a top White House official, had a special guest on his radio program: Donald J. Trump. Trump spoke of his concern about immigration but added, "You know, we have to keep our talented people in this country." Bannon disagreed, saying: "When two-thirds or three-quarters of the CEOs in Silicon Valley are from South Asia or from Asia, I think. . . . A country is more than an economy. We're a civic society." In saying this, Bannon wildly overestimated the percentage of Silicon Valley professionals of Asian descent. More importantly, he repeated an old belief: that only white citizens should be a part of this nation's civic society R



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## IN REVIEW

# Black Hats and White Hats, But No Clear Methodology

◆ REVIEW BY VERN MCKINLEY

In 2003, well before most analysts looking at the housing industry were talking about a housing bubble, Danielle DiMartino Booth was writing about precisely that topic for the *Dallas Morning News*. A few years later, while still working for the newspaper, she received a call from Richard Fisher, then president of the Federal Reserve Bank of Dallas. That initial contact ultimately led to a job offer at the bank in 2006 because, in Fisher's words, "The Fed needed writers who could translate economic research into readable prose." DiMartino Booth would spend nearly a decade at the Fed's Dallas bank observing the financial crisis and advising Fisher regarding the Fed's response to it.

DiMartino Booth primarily draws on her experience working at the bank in composing *Fed Up*, a book that is at times a blistering critique of the Fed, as is obvious from its subtitle: *An Insider's Take on Why the Federal Reserve Is Bad for America*.

**Black hats, white hats** / DiMartino Booth can be found sporting a black cowboy hat in the book's promotional materials. The imagery is apropos because of how she classifies nearly every person or group she profiles in her book: she casts them either as having flawed methods and powers of analysis (black hats) or as being reality-based and accurate (white hats).

For example, members of the Fed's Federal Open Market Committee get black hats: "They returned to their lofty perches, some at the Eccles Building, others to the executive floors of Federal Reserve District Bank buildings, safely cushioned from the decision they had just made. ... They would feel no pain in their ivory towers." DiMartino Booth's condescending Ph.D. colleagues in Dallas also get black hats: "I didn't have a

Ph.D. As far as they were concerned, I had nothing interesting or valuable to say.... Few had even the slightest interest in financial markets. Nor in talking to me because of my lack of academic accomplishments."

Janet Yellen gets a black hat: "Tiny colorless Janet Yellen"; "Top corporate leaders in Yellen's district thought she was a clueless academic more interested in labor issues than the dilemmas of those running businesses."

On the other hand, Dick Fisher gets a big white hat: "Unlike the majority of those seated around the massive oval table, he'd been in the trenches as a manager of a hedge fund (Wall Street) and as a diplomat involved in negotiating NAFTA (government), and had been retained by the world's biggest player for strategic advice (private enterprise)." The Federal Reserve District Bank management also gets a collective white hat: "All twelve District Banks have a board of directors elected from their regions. Unlike members of the Board of Governors, they are not isolated from their constituents." Zoltan Pozsar, an analyst focused on "shadow banking," is another white hat: "Like me, Pozsar was a finance major and non-Ph.D. His work vividly reveals how an outsider sometimes sees things more clearly than those inside a system."

Some of DiMartino Booth's criticisms are well-founded, including her descriptions of the detached nature of many of the Fed's academic economists. She also highlights the fact that the Fed has largely bought off the economics profession, snuffing out most potential dissent. At the Fed, "the percentage of professional economists had grown exponentially.... The Federal Reserve is the single largest employer of Ph.D. economists in the nation, and presumably the world. ... They dare not bite the hand that feeds."

Additionally, she highlights the lack of diversity in the Federal Reserve System, not just in the sense of hiring women and minorities for senior management positions, but in the sense of background: "[Now-retired Dallas Fed research director Harvey] Rosenblum

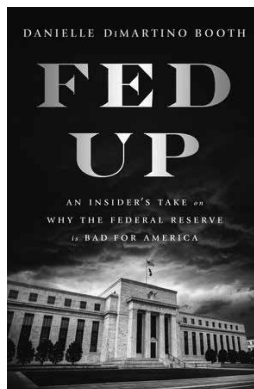
approached hiring by looking for variety in schools of economic thought and vintage, or the era candidates received their doctorate. Vintages tend to ossify.... Every five years you have to make sure you are bringing in new ideas. Diversity does matter."

## Forecasting a housing bubble?

A debilitating flaw of the book is that, although the critiques of the methodology for the Fed economists' predictions are often on point, the book is light on describing a cogent methodology that DiMartino Booth herself uses when forecasting the economy or market activity.

To take just one example, there is the case of her writing on the housing bubble. Given her harsh assessments, I would have expected her to explain some type of clear, underlying system to discern that a bubble was rising and also to apply that methodology when offering other forecasts.

Hoping to find that methodology, I looked up the article she cited to back her claim that "I first forecasted a housing bubble in a story that ran in the *Dallas Morning*



**Fed Up: An Insider's Take on Why the Federal Reserve Is Bad for America**

By Danielle DiMartino Booth

336 pp.; Portfolio (Penguin), 2017

*News* on January 2, 2003.” That column was similar to the *Wall Street Journal*’s “Heard on the Street” format, with a columnist in an ear-to-the-ground role giving market insights and commentary. As for her supposed forecast, she merely surveyed four industry analysts, one of whom was David Tice, a persistent bear on market forecasting. Tice said, “There’s definitely a housing bubble.” I don’t understand how quoting someone else who was bearish on housing back in 2003 amounts to DiMartino Booth forecasting the housing bubble. If this exemplary column is an indicator, she probably quoted hundreds of analysts in a similar way over the course of her years working at the *Dallas Morning News*. Which ones were right and which were wrong? And of those who were right, did she agree with them and why? The book does not address those basic questions.

This question of methodology carries through the entirety of *Fed Up*. At one point she dismisses the work of her economist colleagues at the Dallas Fed by saying, “I never learned anything from them that the markets hadn’t already told me.” Her so-called “market” methodology as detailed throughout the book has as its starting point various intense conversations she has with the “tremendous network of colleagues who are now friends in New York.” She refers to this input as “collective market intelligence” and “many prisms.” Apparently, after this information is assimilated and combined with what she hears on CNBC (her favorite cable network, which she mentions throughout the book), it is then fed into some type of “black box” where it is blended with her internal feelings about the future state of the economy. Maybe she did think there was a housing bubble brewing in 2003, but was she just lucky or did she really have some clear method that she could point to for thinking that way? Is her approach any more reliable over the long run than the academic economists that she criticizes?

**Unclear philosophy** / It is also difficult to say what DiMartino Booth’s underlying economic or political philosophy is. She

repeats the tired trope of a deregulation bogeyman combined with greed in the lead-up to the crisis: “Greenspan championed the era of financial deregulation that drove Wall Street to levels of greed that surprised even the most hardened investment banking veterans.” She is certainly not a free market advocate: “I listened to [Milton] Friedman’s full-throated defense of free-market capitalism. Loved the guy, but it was also true that unfettered, unregulated free markets can lead to disasters.” Her arguments for what caused the financial crisis are also difficult to classify, as they do not contain much in the way of substantive philosophy or analysis: “Shadow banking is what caused the financial crisis.”

There are not many new revelations about the financial crisis in *Fed Up*. Most of the descriptions of the failures and bailouts of Bear Stearns, AIG, and other institu-

tions just repeat the standard narrative of the crisis that the world would have come to an end if the Treasury, the New York Fed, and the Federal Deposit Insurance Corporation had not intervened. A perusal of the endnotes for *Fed Up* reveals a concentration of source materials in articles from the *Wall Street Journal*, *Bloomberg*, and the *New York Times*, and not much original research for the book. Finally, DiMartino Booth provides the reader with a great deal of color regarding the personal details of her life as the financial crisis unfolded, which I found unnecessary.

As a skeptic of many of the policies and statements that came out of the Federal Reserve System over the past decade and as a supporter of transparency measures such as “Audit the Fed,” I am open to well-documented critiques of the institution. Sadly, *Fed Up* does not meet that standard. **R**

## Great Background on Controversial Issues

◆ REVIEW BY DAVID R. HENDERSON

Three years ago in this magazine, I praised Peter Schuck’s *Why Government Fails So Often*, calling it one of the most important books of the year (“Why Isn’t Peter Schuck a Libertarian?” Summer 2014). Based on that book, I had high expectations for his latest, *One Nation Undecided*.

Though not quite as good as his 2014 book, the new one is, nevertheless, quite good. *One Nation Undecided* gives detailed background on the facts and analysis of five controversial U.S. issues: poverty, immigration, campaign finance, affirmative action, and religious exemptions from government policies. Whatever your views on these issues, it’s important to know the facts. Reading this book carefully made me, a policy wonk, realize how little I knew about four of those issues and that I didn’t

know quite as much as I thought I knew about the fifth, immigration.

In *Why Government Fails*, Schuck laid out in exquisite detail the ways that government fails. That led me to wonder why he considers himself a political moderate rather than a libertarian or classical liberal. The fact that he’s not a libertarian shows throughout *One Nation Undecided*. In it, he seems overly confident in government officials’ ability and willingness to craft effective policies on the five issues he addresses. That being said, he generally lays out the policy tradeoffs clearly, and sometimes both his reasoning and his conclusions will hearten a libertarian.

DAVID R. HENDERSON is a research fellow with the Hoover Institution and 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).

## IN REVIEW

To his great credit, he almost never pulls his punches and virtually never fights dirty. Moreover, even if all he presented were the facts, a public discussion informed by those facts would be head and shoulders above what we hear and read in most forums.

**Poverty** / Of the five issues he discusses, Schuck, the Simeon E. Baldwin Professor of Law Emeritus at Yale University, devotes the most space to U.S. poverty. He points out that many important social changes since 1965 distort “and vastly overstate” the current poverty rate in America. If we include noncash government benefits such as food and housing, if we take account of the Earned Income Tax Credit, and if we use a more realistic measure of inflation than the Consumer Price Index, then we would conclude that the 2013 poverty rate was not the reported 14.5%, but, rather, 4.8%. Moreover, he notes, the official double-digit poverty rate treats cohabiting couples differently than married ones. Treating them the same “would lower the poverty rate even more.”

One refreshing aspect of his chapter on poverty is that he distinguishes clearly between poverty and income inequality, and between inequality and inequity. Schuck writes that inequality is “an *empirical fact*,” whereas inequity “is not fact but a *moral judgment* about the moral fairness or justice of a particular level of inequality” (italics in original). Actually, inequity can also refer to unfair treatment that has nothing to do with inequality, but his distinction is a good one. It is one, moreover, that many economists—including Nobel prizewinner Joseph Stiglitz in his textbook *Economics of the Public Sector*—fail to make.

The poverty chapter is full of evidence, some not surprising and some quite surprising. As an example of the latter, Schuck notes that an important factor in being poor, not just as a child but also later in life, is being born to an unmarried mother and an absent father. This and other facts led poverty experts Isabel Sawhill and Ron Haskins to advocate the “success sequence,” three choices that

would substantially reduce the poverty rate, especially if carried out together. The sequence is: complete high school; work; and have children only when married and over the age of 21.

Another example of a surprising statistic is the small number of people who are in prison for mere drug possession: only “3 percent of state prisoners, who constitute 87 percent of U.S. prisoners.” He points out that almost half of prisoners “are violent offenders.” So why is our incarceration rate so much higher than Europe’s? It is, writes Schuck, “because our incidence of violent crime and recidivism is so much higher.” Interestingly, he reports, “incarceration is not a leading driver of poverty.”

On the idea of “banning the box” (BTB)—that is, prohibiting employers from asking potential employees about their criminal records—Schuck quotes a 2016 National Bureau of Economic Research (NBER) study that finds that BTB would *hurt* job prospects. While he doesn’t explain why, the reason is apparent to anyone who thinks about it. In the absence of information on applicants’ criminal records, employers will use other statistical categories in which they expect the number of criminals to be disproportionately high. And, sure enough, the authors of the NBER study, Jennifer Doleac and Benjamin Hansen, write that “BTB policies decrease the probability of being employed by 3.4 percentage points (5.1%) for young, low-skilled black men, and by 2.3 percentage points (2.9%) for young, low-skilled Hispanic men.” (See “Working Papers,” Fall 2016.)

In discussing how policymakers might change policy to help poor people, Schuck points out that most Americans distinguish between the “deserving” and “undeserving” poor. Specifically, only 14% of Americans “support giving [govern-

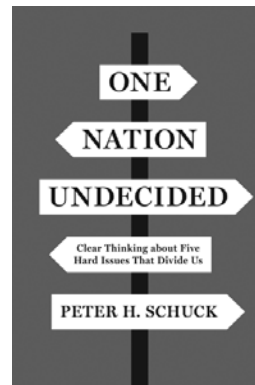
ment] cash to poor, able-bodied adults without dependent children.” He doesn’t make clear what he thinks about this, but I found this statistic heartening. Certainly, it helps make the case that a Universal Basic Income, which even some libertarians have proposed, is a political nonstarter.

**Immigration** / In his chapter on immigration, Schuck nicely lays out the history of U.S. immigration policy and some of the most relevant facts and numbers. Here’s one striking number: between 1993 and 2015, the Border Patrol’s budget increased from \$363 million to nearly \$3.8 billion. Even inflation-adjusted, that’s more than a five-fold increase.

Schuck shows what a complicated web immigration law and policy are. He made me realize that even I, a consciously pro-

immigration economist and an immigrant, had much less understanding of the history and facts than I had thought I had. To take one instance, I have long advocated that there be lengthy waiting periods—on the order of 20 years—before an immigrant can become a U.S. citizen. My reasoning is that it would handle the somewhat plausible objection that immigrants will “vote our system away” because they would have 20 years to learn about our system before being able to vote. Schuck points out that the 19th century Know-Nothings had proposed a 21-year wait for citizenship. Whatever

the Know-Nothings’ motives, I still think it’s a good idea. I became a resident alien in 1977 and didn’t vote until I obtained citizenship in 1986. Voting was a letdown, which I should have anticipated given that I’ve taught my students since the 1970s that an individual’s vote is unimportant. Had someone told me in 1977 that I could avoid all the hassles of hiring a lawyer and, for a short time, facing deportation, in return for being able to immigrate but



**One Nation Undecided: Clear Thinking about Five Hard Issues that Divide Us**

By Peter H. Schuck

425 pp.; Princeton University Press, 2017

never be able to vote or go on welfare, I would have said, “Where do I sign?”

Schuck is concerned that the naturalization rate for eligible Mexicans who are U.S. permanent residents is a low 36%. But is that bad? Given that many people worry that immigrants from more-regulated societies will vote to weaken U.S. economic freedom, couldn’t one just as easily see this as a glass that is 64% full?

Schuck, always a keen observer, notes “the relatively low quality of the immigration bureaucracy.” I experienced that first-hand in my dealings with the Immigration and Naturalization Service from about 1973 to the early 1980s. If he wants to understand why the quality is low, even compared to that of other U.S. government agencies, he would do well to consult public choice theory. Government employees have limited accountability to the public. They are hard to fire, and when you complain about them to your congressman, he might write a letter to the appropriate administrator but not do much else. However, limited accountability does not mean zero accountability. After all, if you’re a citizen, you can vote for or against your congressman if he fails to act on your behalf. But whom do immigration officials deal with primarily? Noncitizens. Noncitizens can’t vote legally. It should not be surprising, then, that accountability and, therefore, the quality of immigration officials are lower.

Schuck, who tends to think through the unintended consequences of various policy proposals, does not seem to do so with his call for compulsory E-Verify, a government program that would require employers to verify electronically that the person they hire is legally able to work. Consider the bugs that come along with any government program, ones that tend to be fixed only slowly. It’s quite conceivable that the federal government would nix the hiring of tens of thousands of people who are legal. But an even bigger problem is that E-Verify could well turn into a federal work permit program. It is not a big stretch to imagine that this or that administration, responding to the faddish

fears of the day, would prevent, say, people who are on the sex offender registry or who have past drug convictions from being able to work. On E-Verify, he discusses literally zero downsides.

**Campaign finance** / On campaign spending, Schuck puts the numbers into perspective. In 2014, Americans spent over \$31 billion on holiday gift cards, more than eight times the \$3.7 billion total

*Multiple academic studies conclude that campaign spending has only a small effect on election outcomes and not much effect on policy outcomes.*

spent on the 2014 campaigns. He does blow a decimal place, though, stating that the \$3.7 billion “represented a mere 0.0002 percent of U.S. GDP that year.” Actually, it was 100 times as much as his estimate, at 0.02% of GDP. Still, it was tiny.

What are the effects of campaign spending on election outcomes? Surprisingly, according to multiple academic studies, they are small. Moreover, the spending does not have much effect on policy outcomes. Schuck quotes one of the key studies: “Legislators’ votes depend almost entirely on their own beliefs and the preferences of the voters and their party” (Stephen Ansolabehere, John de Figueiredo and James M. Snyder Jr., “Why Is There So Little Money in U.S. Politics?” *Journal of Economic Perspectives* 17:1, 105–130 [2003]).

That helps explain “Tullock’s puzzle,” named after the late public choice economist Gordon Tullock. The puzzle is that political contributions are so low relative to the potential payoffs to beneficiaries of government policy. The resolution of the puzzle: it makes no sense to spend a lot of money to influence a politician who is influenced more by his own beliefs, party pressure, and constituents’ desires.

Schuck has an extensive and nuanced discussion of the various Supreme Court cases on campaign finance regulation and

freedom of speech. Unlike many other commentators, he distinguishes clearly between the famous *Citizens United* case and other important cases such as *McCutcheon* and *SpeechNow.org v. FEC*. One point he makes that helps explain the Supreme Court’s finding in *Citizens United* is that the government’s logic in preventing a movie from being shown just before the election would equally apply if the item at issue were a book. This, as Schuck notes, seemed

to sanction book-burning, something Justice Samuel Alito found “pretty incredible.” Indeed, although Schuck doesn’t mention this, in the Supreme Court hearings Deputy Solicitor General Malcolm Stewart

explicitly said as much. Under intense questioning, he admitted that his and the government’s logic would allow the government to ban books that were paid for with corporate funds if the books advocated voting for or against a candidate. In the limit, this would have meant a prison sentence for publishing a book.

**Affirmative action** / On affirmative action, Schuck writes, “No one doubts that blacks present the strongest case for affirmative action—historically, morally, and politically.” He continues: “If that case fails, as I believe my analysis will demonstrate, then the case for favoring other groups must fail as well.”

He disposes quite nicely of the “diversity” rationale for affirmative action in higher education. “The claim that members of the preferred minority groups actually create diversity value on campus,” he writes, “rests on certain essentialist premises that not only are false as a general matter but also tend to ratify the very stereotypes that the programs are intended to combat.”

As elsewhere in the book, Schuck deploys ample data to make his case. He notes a study finding that the admission bonus for being black “was equivalent to 310 SAT points relative to whites and even

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more relative to Asians.” One implication of these racial preferences is that black students, on average, “perform relatively poorly, yet they would have probably succeeded at less select institutions.”

Schuck favors nondiscrimination. Here, though, he slams “some” libertarians, writing that nondiscrimination “is no longer controversial in American society except among bigots and some libertarians.” In a book with 1,079 footnotes, he doesn’t footnote this disturbing claim. I suppose that some libertarians oppose nondiscrimination, but I, a libertarian, haven’t encountered one in decades. It’s possible that he is confusing favoring discrimination with the idea of *allowing* people to discriminate, something that many libertarians do favor.

**Religious freedom** / On religious tolerance, Schuck points out that U.S. society is one of the most religiously diverse in the world and that this came about mainly because of immigration of various religious sects. This diversity led bit by bit to religious tolerance. However, religious tolerance has been tested recently by government policies that force some people, especially employers, to violate their religious beliefs.

One interesting recent case involved Hobby Lobby, the family-owned company that was unwilling to pay for certain kinds of contraceptives for its employees despite being required to do so under the 2010 Patient Protection and Affordable Care Act. The case went all the way to the Supreme Court, where Hobby Lobby’s rights were upheld. Where most believers in freedom would see a clear-cut gain for freedom, Schuck instead sees a tough tradeoff. Referring to work by Harvard law professor Mary Ann Glendon, Schuck writes, “The proliferation and assertion of religious-based rights by A necessarily reduces the rights-free space in which B, C, D ... can exercise their freedom to act with reducing A’s rights.” In short, Glendon and presumably Schuck see a conflict of rights.

I don’t. Hobby Lobby’s exercise of its right to provide only a certain bundle of health care coverage does not infringe on its employees’ rights, if rights are prop-

erly understood. Simply by being your employee, I don’t have the right to *require* that you provide me certain items. They are part of a voluntary contract arranged between you and me.

Unfortunately, as Schuck realizes, conflicts between the religiously devout and others whose beliefs and behaviors they find offensive are multiplied by “the vast

increase in the number and scope of government policies that regulate people’s behaviors.” If only there were a solution. Who knows? The Peter Schuck who wrote *Why Government Fails So Often* could be just the person who could come up with a solution. My proposal for his next book title: *How to Reduce Social Strife by Reducing Government Power.* R

## Protectionism: How to Make America Grate

◆ REVIEW BY PIERRE LEMIEUX

**I**n 2002, Princeton University Press released *Free Trade under Fire*, a careful discussion and defense of free trade by Dartmouth economist and economic historian Douglas Irwin. The book was a follow-up of sorts for his excellent 1996 book *Against the Tide*, a history of economic thought on free trade.

The most recent edition of *Free Trade under Fire* was released in 2015. Though it is a couple of years old, it is worth reviewing now, as an avowed protectionist presides over what was once a trade-friendly United States, while European socialists and even the Chinese government are positioning themselves as defenders of free trade. The world, it seems, has turned upside down.

Free trade is intimately related to the ideal of individual liberty. It is probably impossible to cogently favor liberty and oppose free trade. As antebellum slavery advocate and protectionist George Fitzhugh once explained, “Admit liberty to be a good, and you leave no room to argue that free trade is an evil—because liberty is free trade.” (See “A Coherent Authoritarian,” Winter 2015–2016).

*Free Trade under Fire* is not a philosophical tract or a radical plea, but a book explaining the mainstream economic theory and empirical evidence behind the notion that free trade is good. In the first

chapter alone the reader will learn useful and often surprising facts about foreign trade in America. For example, the proportion of American consumption expenditures devoted to Chinese goods is barely more than 1%, while some 90% of goods and services consumed in America are made here. This is easy to understand when one realizes that two-thirds of consumption expenditures go to nontradable services such as health care, education, and housing. But there is much more in *Free Trade under Fire*.

**Trade theory** / The book provides a good introduction to the theory of comparative advantage. Factories in poor countries like Vietnam or China can outcompete more efficient producers in rich countries because, in the areas where the poor country has a comparative advantage (say, clothing or labor-intensive manufacturing assembly), its low productivity is offset by even lower wages. Poor countries are not exploited by rich countries nor are rich countries exploited by poor; the two claims, which are often heard, could not both be true anyway. All countries—

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that is, most of their residents—benefit by producing whatever goods cost them less to produce relative to other things. By exchanging efficiently produced goods, the residents of each country end up with more total goods than they would otherwise have enjoyed—that is, their lives are materially improved.

Many other conclusions of trade theory are covered, including the crucial point that imports, not exports, are what benefits a country: “Exports are the goods a country must give up in order to acquire imports,” explains Irwin. Look at it from the other side: if a country exports more, it will normally also import more, at least over time—for what else can be done with the foreign currency earned from exports? The trade deficit is thus a non-problem.

Perhaps Irwin could have emphasized that when we speak of an exporting or importing country, we are speaking about individual exporters and importers in each country. This would not change his arguments, but would help opponents of free trade see through the collective metaphor.

Numerous empirical studies summarized by Irwin suggest that international trade increases a country’s level of income and its growth over time. This is not surprising. A country is rich to the extent that its labor productivity is high, and free trade increases labor productivity. Higher labor productivity brings higher wages. A graph that Irwin reproduces from a study by Kathryn Marshall of Oxford College of Business and California Polytechnic State University, San Luis Obispo vividly shows the tight correlation between labor productivity and wages in a sample of 33 countries.

It is true that a country’s international trade is not the only cause of high incomes. Property rights, the rule of law, and a general context of freedom of contract are also required. But, Irwin explains, international

trade certainly “plays an important contributing role.”

Given those facts, why are so many American politicians now opposed to free trade? The answer is that some special interests benefit from protectionism, and politicians benefit from special interests’ support. Domestic producers want tariffs and other trade barriers (such as quotas or threats) because they raise the domestic price of what they sell. In poor countries, protectionism also allows the ruling elites to maintain their corrupt privileges, for instance by allocating import licenses among their favorites.

Irwin acknowledges the fact that, despite the net benefits of free trade, some workers are displaced by foreign competition and suffer unemployment or lower wages. Should the government help them, he asks. He answers, “What is the reason for providing more generous compensation to the apparel worker in Georgia who loses a job to imports than to the typewriter assembler at SmithCorona displaced because of computers or the

Kellogg’s worker laid off because General Mills begins producing tastier cereals?”

Irwin observes that the current assistance program, Trade Adjustment Assistance, “has not worked as promised, and may even be an impediment to economic efficiency” because it reduces the incentives of displaced workers to find another job. He is not a radical libertarian and he is willing to consider the idea of wage insurance or other ideas, but he remains generally skeptical about the capacity of government to efficiently help displaced workers. There is, he writes, “no obvious government policy that can address all of the concerns of workers adversely affected by economic change.”

*Free Trade under Fire* provides multiple examples of the high cost of protectionism. During the 1980s, textile and clothing

tariffs and quotas raised prices on American consumers, costing them \$140,000 for each domestic textile job saved. The 2009 American tariff on car and truck tires cost \$900,000 per *gross* job saved, but it may have actually reduced the *net* number of jobs because consumers spent less on other goods and services.

We may add—and Irwin could have emphasized this point—that the number of jobs created or saved by protectionist measures is a bad metric for income and welfare. If it were a good metric, banning chainsaws and computers would be good because that would result in the employment of more workers to cut trees and handle data. Banning tires would recreate a whole labor-intensive industry of buggies and slow transportation. But those bans would reduce welfare and certainly make America grate.

**History and institutions** / *Free Trade under Fire* also provides a masterful review of the history and institutions of the current system of international trade. Patiently built over the last seven decades around the multilateral rules of the World Trade Organization (WTO, successor to the General Agreement on Tariffs and Trade) and around bilateral or regional free trade agreements (FTAs), this system has been under attack since the 1990s.

Irwin notes that the FTAs signed by the U.S. government (14 are currently in force, involving Israel, Canada, Mexico, Chile, Columbia, Singapore, South Korea, and others) have more often resulted in larger cuts in foreign than in American tariffs simply because the latter were already lower. Those who claim that American producers have “lost” from free-trade agreements have generally got their data wrong.

As Irwin admits, the current multilateral system (under WTO rules) is far from perfect. A major problem lies in the “antidumping” exception, which allows domestic producers to request, and generally obtain, a protective tariff by claiming that foreign competitors charge less in foreign markets than in their home markets. But there are many good economic reasons



**Free Trade Under Fire, 4th ed.**

**By Douglas Irwin**

**368 pp.; Princeton University Press, 2015**

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to charge lower prices in one market than in another—for instance, charging less in more competitive markets or in markets where the elasticity of demand is higher—as happens all the time within a domestic market. “It is hard to avoid the conclusion,” Irwin writes, “that the antidumping laws are simply a popular means by which domestic firms can stifle foreign competition under the pretense of ‘fair trade.’”

Because of this and other exceptions, some industries have obtained “temporary” protection for decades. In the United States, “the steel industry has received nearly continuous protection for over thirty years and is still seeking limits on imports,” Irwin notes. Agriculture, clothing, and footwear remain heavily protected all over the world. And non-tariff barriers are not uncommon.

Yet, the current system is far preferable to the protectionism that reigned between the First World War and the end of the Second. A significant lowering of tariffs and non-tariff barriers has been achieved. WTO rules require that any specific protectionist measure be non-discriminatory among countries. Both WTO membership and specific FTAs keep special interests in check by offering general packages that contain something for everybody. Trade rules give governments legal reasons to resist protectionist pressures. Dispute settlement mechanisms—especially the opportunity for investors to sue national governments—have been pushed by the American government as a protection against rogue states. I would add that they have the benefit of constraining all national Leviathans.

With the liberalization of trade, global supply chains have developed. Irwin describes how a Boeing 787 assembled in Washington state gets its center fuselage from Italy, its engines from the United Kingdom, its wings from Japan, its passenger doors from France, its cargo doors from Sweden, its wing tips from South Korea, and its landing gear from Canada. A certain car model assembled in South Korea by an American manufacturer had 27% of its value originating in America when

it was imported by American consumers. Import statistics, which incorporate the whole value of an imported good, are thus often misleading.

**Developing world** / Over the past few decades, international trade has played a major role in the economic improvement of several poor countries. *Free Trade under Fire* includes a few striking graphs showing the growth of gross domestic product per capita in South Korea from the 1970s, in China since the 1980s, and in India since the 1990s. China’s share of world trade jumped from 1% in 1980 to more than 11% in 2013. There are many other examples. Honk Kong has followed “an almost pure free-market approach,” Irwin notes, and “greater trade openness ... has been a feature of virtually all rapid-growth developing country experiences in the past fifty years.”

In contrast, interventionism and protectionism have been a plague for underdeveloped countries. He writes,

According to one quip, India suffered under four hundred years of British imperialism and fifty years of the Fabian socialism of the London School of Economics [which was long dominated by that brand of socialism and where many Indian students went to study] and it is not clear which did the most damage.

Free trade, according to comparative advantage, leads to higher wages. For example, hourly compensation in manufacturing doubled in India from 2002 to 2010. A previously elusive economic take-off has benefited large groups of humankind. Extreme poverty dropped from 36% to 15% of the world population between 1990 and 2011. The liberalization of internal markets helped, but so did foreign trade.

Another effect has been declining economic inequality. Irwin cites the work of economist Branko Milanovic showing that the escape of so many individuals from dire poverty reduced inequality at the world level.

**Is reciprocity necessary?** / Are WTO-type

multilateral rules preferable to bilateral or regional free trade agreements? Irwin presents the arguments of both sides. The discriminatory benefits provided by bilateral or regional FTAs can generate trade diversions in favor of less efficient producers. Moreover, it is easier to burden FTAs with environmental and labor standards that not only shouldn’t be part of trade agreements but can also serve protectionism, for example, by protecting rich countries from the competition of poor, low-cost labor.

As I have argued elsewhere, some “free trade” agreements have a high content of managed trade. What passes for “free trade” is far from totally free trade.

Irwin does raise the question of whether multilateral, bilateral, or regional trade agreements—that is, reciprocity—are necessary at all for free trade. Can’t unilateral moves—one country dropping protectionist measures unconditioned on what other countries do—reap the benefits of free trade? Irwin reiterates mainstream economic theory when he writes:

Countries are better off pursuing a policy of free trade regardless of the trade policies pursued by others. ... The case for free trade is a unilateral one: as economist Joan Robinson once put it, a country should not throw rocks in its harbors simply because other countries have rocks in theirs. The mercantilist language of international trade negotiations—that a reduction in one’s own trade barriers is a “concession” to others—is wrong from an economic standpoint.

The standard counterargument to unilateral free trade is that reciprocity forces governments to keep their commitments. It is easier for a government to cancel unilateral moves than to renege on an agreed system of rule-based trade. There is certainly something true in that. But interestingly, as data reported by Irwin suggest, much of the existing free trade appears to depend on unilateral moves to liberalize imports. The actual tariffs imposed are very often lower than the maximum



allowed under reciprocal agreements. He points out:

Two-thirds of the tariff reductions in developing countries during the period 1983 to 2003 were due to unilateral reforms; just 25 percent were due to multilateral agreements (the Uruguay Round) and 10 percent due to regional agreements.

We should go further than Irwin on the road to unilateral free trade. It is true that a general declaration of unilateral free trade by the U.S. government—or by any other government in the world—is currently just a dream. Such a declaration would require government leaders who understand trade theory and citizens who support economic freedom, both of which are in short supply. But couldn't the unilateral option become topical if the current wave of protectionism leads to the demise of the existing system, which could not be rapidly rebuilt? Economic stagnation would cry for the solution of unilateral free trade.

Any reader will have quibbles with such a wide-ranging book as *Free Trade under Fire*. I've mentioned my relatively minor ones on its substance. But I also have a grammatical grumble. I find very annoying the book's adoption of the current fad to close compound nouns rather than hyphenate them, resulting in such unreadable words as "governmentto government" and "timetested." As if to illustrate the problem (a sort of *reductio ad absurdum*) the latter word was end-of-line hyphenated as "tim-etested"!

But don't let this stop you from reading the book. *Free Trade under Fire* is a must-read for anybody interested in trade. It will teach a lot to the intelligent layman. The seasoned economist will also find it a useful overview. R

#### READINGS

- *Against the Tide: An Intellectual History of Free Trade*, by Douglas A. Irwin. Princeton University Press, 1996.
- "Free Trade and TPP," by Pierre Lemieux. Library of Economics and Liberty ([www.econlib.com](http://www.econlib.com)), February 1, 2016.
- *The Logic of Collective Action: Public Goods and the Theory of Groups*, by Mancur Olson. Harvard University Press, 1966.

# Bootleggers and Coffee-Haters

◆ REVIEW BY ART CARDEN

Not many academic books could credibly be called good night-stand reading. Harvard professor Calestous Juma's *Innovation and Its Enemies* can, in part because of its use of entertaining stories and anecdotes to illustrate ideas concerning innovation. These stories will prompt many readers to reflect on what they think they know about how innovation occurs and how the resulting advances are accepted. I didn't know, for example, that there had been such strong resistance to the introduction of coffee in the Middle East, North Africa, and Europe, or that that resistance was spurred by rent seeking. The book will be a useful source for scholars, students, policymakers, business leaders, entrepreneurs, and those who wish to understand the political steps that need to be taken to reduce the obstacles to innovation.

This book is especially timely given the emergence of "sharing economy" apps and websites such as Uber, Lyft, Airbnb, Waitr, and others. These innovations have not been welcomed with open arms by incumbent businesses, but surprisingly some consumers have also given the innovations a cold welcome beyond the consumer right to say, "No, thanks."

The book is also timely in light of perpetual controversies over genetic engineering, vaccination, and conventional versus organic farming. People tend to embrace science in some areas and reject

it in others. Of course, we see this most clearly in political activism, where there is a curiously large overlap between the embrace of heavy-handed policies to curtail climate change in the name of science and the rejection of genetically modified

crops in spite of a scientific consensus that they are safe.

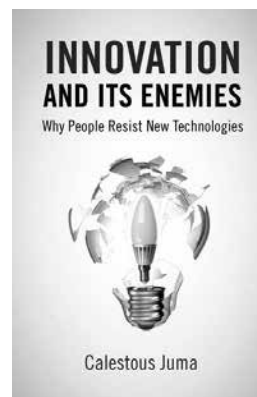
**Opposing the new** / Historically, innovations have often been killed in the crib by a combination of social and political forces. First, critics have subscribed to the notion that innovation is heretical; indeed, the term "innovation" originated to describe unorthodox interpretations of Scripture. Second, incumbents upset about the effect of innovative competitors on their

bottom lines have taken to political machinations. Juma gives us a series of tightly scripted tales about technologies that ran into problems that slowed their adoption, and he closes each chapter with a summary of the main lessons policymakers should draw from his analysis.

Stylistically, Juma has fun with his writing and readers will have fun with their reading. Almost every chapter title and heading, it seems, is a clever pun. At times, that gets to be a bit much, but it adds a pleasant lightness to the exposition. Juma is dealing with deep and impor-

tant topics in a serious way, but he's just irreverent enough to keep the narrative flowing. And he opens the book with a smart first line: "The quickest way to find out who your enemies are is to try doing something new."

Right from that start, he explicitly acknowledges that his analysis is Schumpeter-



**Innovation and Its Enemies: Why People Resist New Technologies**

By Calestous Juma

432 pp.; Oxford University Press, 2016

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## IN REVIEW

terian. He looks to go “under the hood” of the political economy and see how, exactly, the larger processes by which innovations are protested work, and the specific ways those protestations are overcome.

Many innovators who have tried something new have found they have a lot more enemies than they previously thought. Some innovations have been adopted with relatively little protest, e.g., cell phones, but others still have a long way to go before they are accepted widely, e.g., transgenic crops. This difference is central to our understanding of how technology changes over time. Different cultures and legal traditions have widely varying views about what constitutes an acceptable change and whether a new innovation is safe or risky. Navigating these differences is important to implement newly conceived technologies.

**Bootleggers and coffee-haters** / The book offers a series of case studies of the introductions of coffee, the printing press, margarine, farm mechanization, electricity, mechanical refrigeration, recorded music, transgenic crops, and transgenic salmon. It moves from areas where regulation seems most ridiculous to areas where it seems at first glance to have a semi-plausible rationale.

Some examples of regulation are understandable but off-putting. Others are more amusing. It is easy, from our 21st century vantage point, to chuckle at the protracted debates of early-modern Europe and the Middle East about the spiritual qualities of coffee. Naturally, the industries that sought government protection from the innovations did so in the name of protecting wholesome ways of life or advancing national security. The discussion of the dairy industry’s response to margarine makes sense in light of the rents that were at stake, but the way the industry pressured the president of Iowa State College to suppress a pamphlet on margarine’s safety written by future

Nobel laureate Theodore Schultz and colleagues illustrates the lengths people will go to when their comfortable status quo is threatened.

I was reminded of the importance of the rule of law when Juma offered this quote from Alaska congressman Don Young (R) about a salmon company: “You keep those damn fish out of my waters.... If I can keep this up long enough, I can

*Different cultures and legal traditions have widely varying views about what constitutes an acceptable change and whether a new innovation is safe or risky.*

break that company.... I admit that’s what I’m trying to do.” That an elected official can work to ruin a particular company underscores the importance of having a nation be ruled by laws and not by men.

It is easy to read a book and play a game of “citation bingo” in which one looks for all the thinkers the reviewer thinks the author should have engaged but didn’t. Forgive me for giving in to this temptation. I like Juma’s explicitly Schumpeterian framework, but it could have benefited by engaging with work by Ronald Coase, Mancur Olson, and Elinor Ostrom, among others. Some of Juma’s points about how regulators confront changing knowledge would have been stronger had they been expressed in the context of Hayek’s work on the knowledge problem, and a lot of Juma’s recommendations for policymakers could be better understood with reference to Douglass North, John Joseph Wallis, and Barry Weingast’s work on the differences between limited- and open-access orders.

I would like to see Juma and others work out the implicit political theory in greater detail when discussing how people seek to protect the status quo. On what grounds are people asserting that their comfortable ways of life should be maintained at others’ expense? Perhaps more particularly, why are observers and

other members of the polity inclined to agree with them? The economic reasons why incumbents oppose innovation are clear enough: they stand to see the value of their physical and human capital fall if the status quo does change. Consider the plight of the steelworker who has a skillset that becomes worthless as a result of automation and international trade. But it would be useful to see why so many others—including those who benefit from the technological changes—also oppose innovation. Enthusiasts for innovation such as, I suspect, most of the readers of this journal should take more seriously objections that incumbents have to challenges to the status quo. Juma points out how incumbents and others resist novelty even in seemingly uncontroversial cases such as the adoption of coffee and movable type and the mechanization of agriculture.

Juma at least gets us part of the way to an answer. Scary “what-if” scenarios about innovations have a lot of emotional and cultural currency. As we have learned from psychology and behavioral economics, the way a proposal is framed is of supreme importance to how it is received. Near the end of the book, Juma upbraids the scientific community for a failure to communicate: “Members of the scientific and engineering community often communicate in ways that alienate the general public.... Learning how to communicate to the general public is an important aspect of reducing distrust.” His point is implicitly McCloskeyan: Rhetoric matters. Persuasion is important. How we talk is essential to whether we adopt or reject innovation.

At the end of each chapter, the author offers a set of policy suggestions that should be of great value to those charged with making science and technology policy in the face of stiff opposition from beneficiaries of the status quo. Given that we don’t yet live in an anarchist paradise, I suspect that many libertarian readers will see the book’s proposals as steps in the right direction. *Innovation and Its Enemies* will be a valuable addition to the bookshelves of academics, students, policymakers, and entrepreneurs the world over. **R**

# The Grand Tour of Financial Policy

◆ REVIEW BY SAM BATKINS

If you want to know everything about the financial history of civilization, Yale finance professor William Goetzmann's *Money Changes Everything* won't completely satisfy that desire, but it will fulfill most of it. The book delivers on its promise to trace the foundational elements of finance from Sumerian culture to the great economies of Athens and Rome, to Fibonacci and Marco Polo, to the complex financial instruments of today. This substantial tome is Goetzmann's love letter to finance.

Of course, no one book can capture all there is to know about financial history. But *Money Changes Everything* comes awfully close to a comprehensive review of financial infrastructure. It tracks the development of finance's "hardware" (contracts, corporations, and banks) to its "software" (recording, calculation, algorithms, and probability theory). Beyond any critique, the book is fascinating. Who knew Louis Bachelier's work on option pricing, stock prediction, and the development of Brownian motion (the random movement of particles) were developed before Albert Einstein's work on motion? The intersection of war, nation-building, finance, mathematics, and even art is given an exhaustive analysis in this book.

**Ancient and medieval finance** / For many who follow history and the regulatory state, there are familiar trends that echo through our financial past. Typically, past is prologue. As early as 1,900 BCE, Rim-Sin, ruler of the Sumerian city-state of Ur, responded to a financial crisis by declaring all loans null and void. Later, he banned interest payments. Some scholars speculate that those interventions were responsible for capital and population shifts from Ur to nearby Lara. That's just one regulatory folly—and perhaps not the first—out of

many that have occurred in history.

Fast-forward to 396 BCE and the Athenian empire. Despite its prestige, grain dealers who "hoarded" their product faced the death penalty, making the modest punishment in *Wickard v. Filburn* seem like an afterthought. Beyond capital punishment, Athens set specific limitations on countless enterprises. Two-thirds of imported grain had to go to Athens. Athenian citizens were forbidden to ship to any other port. And, once grain was brought to the city, there were laws limiting profit margins. Regulators in ancient times evidently took their grain seriously.

Government power also extended to some of the novel financial and technological instruments that arose. Just as the internet, drones, and new financial products are regulated almost as soon as they are devised, throughout history the ruling class has often viewed innovation as a threat that must be micro-managed.

Consider the medieval Knights Templar, who were among the first international bankers. As they were trained soldiers who took a vow of poverty and were financially backed by the church, they were perhaps ideally suited to handle other people's gold and land. Kings and nobles often deposited valuables with the Knights; at one point, the English Crown

Jewels were kept with the Knights Templar rather than in the Tower of London. Kings would also borrow from the Knights to finance military operations. Pensions and annuities were funded from this nascent bank.

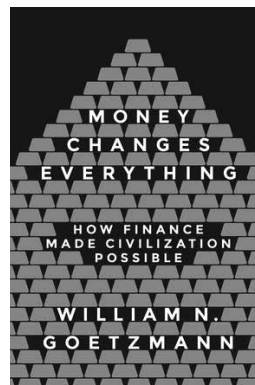
Government ultimately couldn't abide the power of the Knights. Early in the 14th century, King Philip IV of France became incensed that they wouldn't cancel the debt he was accruing in his War with the English. So he ordered his troops to seize the Knights' vaults and land, and imprison, torture, and execute all the Knights they could find.

**China** / Beyond war, betrayal, and frequent discussions of financially based artwork, a main theme of the book centers on China. Namely, how could a nation that invented metal coinage, paper money, and securitized lending not lead the world in finance? Why were all of the early corporate powers—e.g., the Dutch East India Company and the Honor del Bazacle (the oldest known corporation)—all formed in Europe? And why did China, of all places, adopt communism in the 20th century?

According to Goetzmann, the answer is that "when financial innovations occurred in China, they were often appropriated for the benefit of the government, not the individual." New private ventures were crowded out by state-run monopolies. This set the nation back compared to its early competitors, despite its innovative financial history.

Goetzmann does have a particular academic focus on China, so prepare for numer-

ous discussions on language, art, culture, and economics. (Curiously he fails to mention a major financial innovation by one of China's neighbors: one of the first futures markets in the world, the Dojima Rice Exchange in Japan.) The comparisons



**Money Changes Everything: How Finance Made Civilization Possible**

By William Goetzmann

600 pp.; Princeton University Press, 2016

## IN REVIEW

between Europe and China constitute a considerable chunk of the book, arguably to the exclusion of other notable developments in finance.

**Today's finance** / Naturally, most of the second half of the book centers on the American experiment and the somewhat surprising divergence of thought between U.S. and British investors.

Some argue that finance is more about avoiding risk than taking risks. Accordingly, Great Britain's Henry Lowenfeld attempted to manage risk by heavily investing in bonds. National bonds currently have a zero risk-weighting, so it might make sense to arrange a portfolio largely of safe investments.

As John Maynard Keynes observed, however, Americans are more risk-tolerant; they have a fascination with stocks, dividends, and greater returns. It was American Edgar Lawrence Smith in the 1920s who discovered the "equity premium": over the long-term, stocks beat bonds. Later, Harry Markowitz and Bill Sharpe proved that a diverse portfolio of stocks and bonds could be just as safe as all bonds and return a far greater profit. The technology of finance extends not just to instruments like stock puts and calls, but to the new math and theory that prove there are better ways of making money and advancing progress.

According to Goetzmann, the first element of finance is the reallocation of economic value through time. Whether it's charging interest, the modern mortgage, the concept of net present value, or a complex derivative, how economic actors value and discount money over time is a central tenet in both finance and regulation. Today, regulators struggle with the value to place on emitting a ton of carbon dioxide and how much to discount the potential benefit of an avoided emission centuries into the future. At a 3% discount rate, a particular rule may move forward. However, considering some rules forecast benefits generations into the future, a 7% rate can reduce the monetized gains to practically zero.

As the author notes, mathematics aids

in the calculation of how money changes over time or the acceptable level of risk, but many decisions are moral and political regardless of the arithmetic. In the past, banning interest used to be *de rigueur* even though that meant the lender lost money on virtually every deal. Today, political considerations often masquerade as moral imperatives, obscuring the rational decisions that should be guided by economics and mathematics. Doubling the minimum wage and the overtime threshold are sold on moral grounds, with specious economic arguments floundering in the background. Despite the litany of rigorous research, many decisions by those in today's governments

don't revolve around established financial or economic literature.

In sum, Goetzmann's work is a fascinating tour through the history of currency, finance, probability, and risk. Regardless of the reader, there will doubtless be several surprises in each chapter. From the libertarian perspective, the common theme through this historical journey is the innovative brilliance of our species to devise new technology to solve intricate problems—and how those innovations are often banned or curtailed by monarchs, dictators, and politicians acting in their own self-interest. From Ur to Wall Street and Silicon Valley, past is prologue in regulation. **R**

## Crusader for Liberty

◆ REVIEW BY DAVID R. HENDERSON

**T**he late Milton Friedman was arguably America's most prominent defender of freedom in the last half of the 20th century. Although his expertise was in empirical economics, especially in the area of monetary history and policy, he was an articulate advocate of liberty. His first major contribution to this cause, written with his wife and fellow economist Rose Director Friedman, was his 1962 classic *Capitalism and Freedom*. Together, the Friedmans co-authored the 1980 book *Free to Choose*, which was based on his PBS television series.

In *Milton Friedman on Freedom*, editors Robert Leeson and Charles Palm, both of the Hoover Institution, have assembled many of his most important articles and chapters that make his case for freedom. (Disclosure: I was a friend of both Milton and Rose Friedman and am a research fellow with the Hoover Institution, where Friedman was a senior fellow from 1977 to his death in 2006.)

The book is well worth reading. There is often overlap between sections so that you

will read the same data or important facts three or four times in working through the chapters. Some might find this annoying; others might find that the repetition reinforces the message. In this book, you will see Friedman making mainly a consequentialist case for freedom—it works so well, giving us prosperity—even though he takes pains to point out that his case is a philosophical one based on moral relativism. He is at his strongest when he draws on his economic and statistical skills. He is at his weakest in making his philosophical case.

**Disparate voices** / One of his strongest cases for freedom is that the typically impersonal forces in the market cause harmonious interaction between people who will never meet each other and who, if they did, might dislike each other. In a 1955 article in the volume, Friedman writes,

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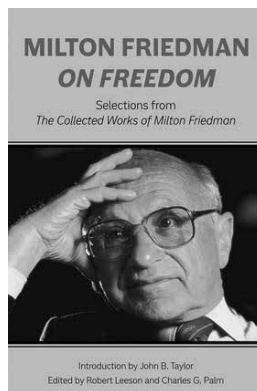
“The purchasers of the wheat do not know whether it has been produced by a Communist or a Fascist, a white man or a Negro; they could hardly discriminate if they wanted to.”

In that same article, he contrasts the relative ease with which socialists and communists in the United States can put together newspapers and magazines with the difficulty that proponents of capitalism would have publishing a pro-capitalist magazine in a socialist society. He writes:

Suppose a change to a collectivist economic society with government control of the bulk of economic activity. How could the proponents of a return to capitalism secure the resources with which to publish a magazine urging their point of view? Through a government fund for dissidents? Through the collection of small sums from millions of government employees? If they had the resources in the form of funds, what guarantee could they have that the government would sell them paper on the same terms as it does to others?

He points out that in a free market, by contrast, “The sellers of paper do not know whether the paper is going to the *Daily Worker* or the Foundation for Economic Education.” Strikingly, he points out, no proponent of socialism has “even faced this problem squarely.” Recall that he wrote this in 1955; 62 years later, I still don’t know of any socialist who has faced this problem squarely. Sadly, I can think of some socialists, such as the late philosopher Herbert Marcuse, who didn’t (and don’t) consider it a problem that advocates of capitalism wouldn’t be able to publish their ideas.

Always the empiricist, Friedman, in a chapter reprinted from *Capitalism and Freedom*, discusses how free market



**Milton Friedman on Freedom: Selections from The Collected Works of Milton Friedman**

Edited by Robert Leeson and Charles G. Palm  
246 pp.; Hoover Institution Press, 2017

forces undercut the Hollywood blacklist that was used against writers who were communists or alleged communists. Throughout his telling, his passion for and delight in freedom of speech—even for those whose message he detests—shines through.

**Free markets** / One of his biggest contributions to freedom was his active participation in President Nixon’s Commission on the All-Volunteer Force. In 1970 that commission came out 14-0, with one abstention, in favor of ending the draft, and the draft was officially ended in June 1973.

I would have liked to have seen in this volume Friedman’s “Why Not a Voluntary Army?” his cogent case against the draft on economic and philosophical grounds that was published in the *New Individualist Review* in 1967. Instead, the editors chose a speech that he gave at West Point in 1985. (In it, he mistakenly says that the commission had 12 members, initially split evenly for and against the draft, and that in the end all 12 favored ending the draft.) The speech is good, but not as good as his 1967 article.

However, the speech has the virtue of recounting his famous dialogue with Gen. William Westmoreland during the commission hearings. Here’s Friedman’s account of their exchange:

One person who testified was General Westmoreland. He was then, I believe, chief of staff of the army, and he was testifying in that capacity. Like almost all military men who testified, he testified against a volunteer armed force. In the course of his testimony, he made the statement that he did not want to command an army of mercenaries. I stopped him and said, “General, would you rather command an army of slaves?” He drew himself back and said, “I don’t like

to hear our patriotic draftees referred to as slaves.” I replied, “General, I don’t like to hear our patriotic volunteers referred to as mercenaries.” But I went on to say, “If they are mercenaries, then I, sir, am a mercenary professor, and you, sir, are a mercenary general; we are served by a mercenary physician, we use a mercenary lawyer, and we get our meat from a mercenary butcher.”

One of his most impressive abilities was his empirical sense. He was rarely swayed by the more-visible to ignore the less-visible. This shows clearly in a 1962 article, “Is a Free Society Stable?” originally published in the *New Individualist Review*. In it, Friedman points out that when he asks people to list the major industries in the United States, they always list those in which there are few firms. He writes, “They list the automobile industry, never the garment industry, although the garment industry is far larger by any economic measure than the automobile industry.” He continues, “I have never had anybody list the industry of providing domestic service, although it employs many more people than the steel industry.” His point is that the higher visibility of concentrated industries leads people to exaggerate the degree of industrial concentration and, because they tend to equate concentration and monopoly power, to exaggerate the degree of monopoly.

On monopoly, though, even Friedman got a little confused. In a chapter from *Capitalism and Freedom* he writes that monopoly “inhibits effective freedom by denying individuals alternatives to the particular exchange.” If the monopoly came about because of a government preventing competition, then he would be roughly right, although even in that case it’s the government that inhibits freedom, not the monopolist per se. But he is discussing monopoly more generally and he is making his argument even if the source of the monopoly is not government restrictions. Friedman argues that what’s great about competition is that “the consumer is protected from coercion by the seller because

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of the presence of other sellers with whom he can deal.” It’s true that it’s great to have other sellers so that a buyer is not at the mercy of one seller, but if there is only one seller, there is nothing inherently coercive about that. In a free market, even the most extreme monopoly can’t coerce me into buying from it.

I remember sitting at dinner with the Friedmans at the somewhat legendary first Austrian economics conference in South Royalton, Vt. in June 1974. I made a putdown of John Kenneth Galbraith, who, I knew, was one of their neighbors in Vermont where they had their summer home. Rose quickly upbraided me, quite correctly, pointing out that Ken was a friend and that they simply disagreed about economics. That was an important lesson for me at the age of 23. Milton deals with Galbraith the right way, by going after his ideas. In a 1976 article reprinted in this book, he writes:

Some years ago, in an article published in the *New York Times Magazine*, John Kenneth Galbraith said that there was no problem in New York City that would not be solved if the city government’s budget was doubled. In the interim the city government’s budget has been quadrupled and so have the problems.

**Morality and freedom** / What is Friedman’s basic argument for freedom? One might think that, given his emphasis on freedom’s consequences, his case is a combination of consequentialism—free markets do so well for us—and the standard libertarian moral arguments against the initiation of force. But at various points in the book, Friedman takes pains to say that his case for freedom is not about consequences at all but, rather, is based on our ignorance about what *is* moral.

In a 1974 *Reason* interview reprinted in the book he states that if we knew for sure what sin is, then if we saw someone sinning, we ourselves would be sinners if we didn’t forcibly prevent him from sinning. He asks, “How can you allow a man the freedom to sin?” He answers his own question: “The only answer I can give is that I

cannot be absolutely certain that I know what is sin.” In a 1991 article, “Say ‘No’ to Intolerance,” he repeats that argument.

I thought I knew Friedman’s thinking very well, but I confess I hadn’t known how strongly he believed this argument. I’m not a professional philosopher, but I suspect that philosophers could find large weaknesses in his argument. One is that if we can’t know what sin is, then we don’t

know what constitutes right and wrong. And if we don’t know that, how can we say that it’s wrong for government to use force to prevent people from doing what some people regard as sinning?

But Friedman did not make his living as a philosopher. He made it as an economist and, increasingly in his last 30 years, as an articulate, passionate, and effective crusader for liberty. Thank goodness he did. **R**

## Diminishing the Case Against Empathy

◆◆ REVIEW BY DWIGHT R. LEE

**M**any economists will find Yale psychology professor Paul Bloom’s new book very appealing. In *Against Empathy*, he frequently and favorably quotes Adam Smith, has nice things to say about economists, defends rationality, sees the importance of a utilitarian perspective, makes use of insights from public choice, and recognizes that the problem he sees with empathy is typically found in political settings. Yet I believe his case against empathy is seriously diminished in light of public choice considerations. Further, much of what he dislikes about empathy can be effectively dealt with by markets.

**Empathy explained** / Bloom spends much of his opening chapter distinguishing kindness, concern, compassion, love, and sympathy from empathy. These distinctions are appropriate; empathy—sharing in another person’s feelings—is not the same as other caring emotions. However, many of the problems that he blames primary on empathy also apply to other caring emotions, especially in the setting where he argues those problems are most pronounced—a setting that he calls “spotlighting,” which I discuss below.

Bloom points out that he agrees with Smith’s understanding of empathy, but

emphasizes that Smith used the word “sympathy” to mean empathy as Bloom understands the word. Smith defines sympathy in *The Theory of Moral Sentiments* (1759) as the capacity to think about another person and

place ourselves in his situation ... and become in some measure the same person with him, and thence form some idea of his sensations, and even feel something which, though weaker in degree, is not altogether unlike them.

That, says Bloom, is “how I am thinking about empathy.” In other words, if “your suffering makes me suffer, if I feel what you feel, that is empathy in the sense I’m interested in here.” This is often called “emotional empathy” and it “can occur automatically, even involuntarily.” This is to be distinguished from what is known as cognitive empathy, which is understanding that another is in pain without feeling the pain yourself. Unless specified otherwise, when Bloom uses the word “empathy” he is referring to emotional empathy.

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**Problems with empathy** / Bloom accepts the perspective of most economists that “when it comes to morality ... nobody can doubt that consequences matter.” While he recognizes that intentions are important, he focuses on what he sees as the consequentialist moral problems created by empathy. Among them is what he calls the “spotlight” effect: empathy focuses moral attention on

the one over the many. This perverse moral mathematics is part of the reason why governments and individuals care more about little girls stuck in wells than about events that affect millions or billions.

Consider three of Bloom’s examples of the spotlight effect. In 1949, the country’s attention was riveted on a 52-hour attempt to rescue 3-year-old Kathy Fiscus after she fell down a well in San Marino, Calif. The country later mourned when the rescue effort failed. In 1987, the country’s anxiety focused on another child who had fallen down a well: 18-month-old Jessica McClure of Midland, Texas. Nationwide rejoicing followed her successful 55-hour rescue. Bloom’s third example comes from ethicist Peter Singer, who argues against donating to the Make-A-Wish Foundation, which finances short-lived “experiences of a lifetime” for very ill children. Singer points out that the money spent on one of these “dream days” would save more lives if given to the Against Malaria Foundation to be spent on mosquito-repellent bed nets in malaria-prone areas. Similarly, the money spent on the rescue attempts of little Kathy and Jessica could plausibly have saved more lives if spent in other, less dramatic ways.

In fairness to Bloom, he acknowledges that “empathy is not the only facet of our moral lives that has a spotlight nature. Emotions such as anger, guilt, shame, and

gratitude are similar.” But this is his only mention of those emotions.

Instead of empathy, he counsels that people should act on compassion, as indicated by the book’s subtitle. He describes compassion as not

sharing the suffering of the other: rather, it is characterized by feelings of warmth, concern and care for the other, as well as a strong motivation to improve the other’s well-being. Compassion is feeling for and not feeling with the other.

The implication is that compassion is under our rational control to a greater degree than is empathy. He briefly acknowledges that when making some decisions, “many of my arguments against empathy apply to compassion as well.” Yet this comes after he tells us that when “struggling with a moral decision,” rather than relying on empathy when deciding “how to improve things,” it is “much better to use reason and cost-benefit analysis, drawing on a more distant compassion and kindness.” Leaving no doubt about how he feels about empathy, he tells us that “the capacity for emotional empathy, ... defended by so many scholars, theologians, educators, and politicians, is actually morally corrosive.”

Critical to Bloom’s argument is his discussion of the connection of reason and rationality to morality. He mentions the late ethicist James Rachels, “who sees reason as an essential part of morality.” Bloom then considers the claim that “most people are incapable of rational deliberation.” In doing so he observes that those emphasizing irrationality suggest that “they themselves—and those they are writing for, you and me—are the exceptions” because they make rational cases for irrationality.

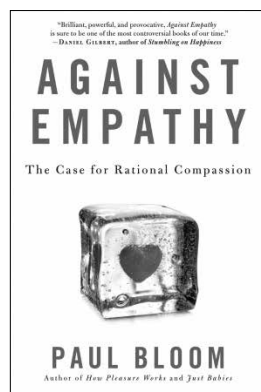
Bloom acknowledges human irrationality and accepts himself as being “only

human” when stating that his book no doubt “contains weak arguments, cherry-picked data, sneaky rhetorical moves, and unfair representations of those I disagree with.” In other words, he is subject to confirmation bias (he doesn’t use that term) like everyone else. Yet he makes the convincing claim that (hard) “science provides an excellent example of a community that establishes conditions where rational argument is able to flourish.” I am somewhat less convinced with his follow-up statement that “the same holds, to various extents, in other domains, such as philosophy, the humanities, and even some sorts of political discourse.”

**Emotions and political decisions** / But can the spotlighting of an emotion—whether empathy, compassion, sympathy, etc.—on identifiable people be expanded to include a much broader set of people, so that help can be directed to where it does the most good?

Bloom is clearly aware of the difficulties in achieving such an expansion. He quotes Mother Teresa: “If I look at the mass, I will never act. If I look at the one, I will.” In his prologue he states that “we will never live in a world without empathy—or without anger, shame or hate, for that matter.” But he holds out hope that “we can create a culture where these emotions are put in their proper place, and this book is a step in that direction.” Yet he never indicates how that culture might emerge or be created, or what the proper place for the various emotions might be, other than that we should moderate the influence of empathy on political decisions.

In his closing chapter, “The Age of Reason,” he tries to make a hopeful argument that the political influence of empathy can be moderated. Bloom recognizes the difficulty of achieving such moderation, using some general arguments from public choice economics. These are arguments he admits “I am unhappy making,” possibly because he recognizes how they overwhelm his more hopeful suggestions on the potential for moral reasoning, as well as those by Steven Pinker, Robert Wright,



**Against Empathy:  
The Case for Rational  
Compassion**

**By Paul Bloom**

**304 pp.; Ecco, 2016**

## IN REVIEW

Singer, and (yes) Smith, at least when applied to the political arena.

Bloom's concern over moderating the political influence of empathy begins with his comment that "there are areas of life where we certainly seem stupid. Take politics." His explanation for this "stupidity" is that unless we are members of a powerful interest group with a special interest in a political issue, our views on issues "don't have to be grounded in truth, because the truth value doesn't have any effect on [our lives]." He could have added that even when an issue does affect voters' lives, human emotions will exert the dominant influence on how we vote because the probability of one vote decisively determining an election's outcome is effectively zero.

It is difficult to see how he can maintain hope that political decisions can be influenced by fine distinctions between emotions. For example, a voter can realize personal satisfaction by voting for a policy she favors emotionally, while she can ignore with impunity any undesirable personal consequence of the policy because of the miniscule probability that her vote would determine whether it passes or not. Indeed, because the probability of a vote having a decisive effect on an election is effectively zero, the satisfaction from emotional expression is the primary driver of most voting decisions.

There can be little hope that a voter will make her decision only after determining whether her emotional satisfaction from voting a certain way is based on empathy, compassion, or some combination of those and other emotions, and then applying Bloom's analysis. In the political process, differences in how particular emotions affect our decisions effectively disappear, which seriously diminishes Bloom's case against empathy. The qualification that some political decisions can be decisively influenced with direct lobbying by organized interests does nothing to help his case because caring emotions such as empathy, compassion, and kindness have generally had little effect on decisions by organized interest groups to use their political influ-

ence to profit at public expense.

**Considering markets** / Many of the problems Bloom associates with empathy are addressed effectively by market information and incentives. Consider the following two examples of how markets overcome the spotlight effect and how they limit the negative effects of confirmation bias on rationality.

Markets are immune to the spotlight effect when appropriate to be so, although this is a virtue that often enrages many people. For example, those who work for or own stock in drug companies are no less sympathetic than the rest of us to the relatively few victims of rare diseases. However, market prices provide drug companies with the best information available on the tremendous human costs of developing drugs to benefit a few by diverting research away from developing drugs that benefit many. Politicians and journalists find advantage in spotlighting the heart-breaking stories of the identifiable few and excoriating the drug companies for ignoring or "overcharging" them. Yet far more human grief from illness is alleviated and more drugs to help the relatively few are developed in economies made more productive by the broad illumination that only market prices provide.

Next, consider the problem of confirmation bias. It is surely a less serious problem than behavioral economists and many psychologists would have us believe because of their own confirmation bias. No one would deny, however, that it is a serious problem in academics and politics, where feedback that could correct erroneous views is either absent or easily ignored. In markets, though, prices regularly make short work of even the strongest-held confirmation bias. For example, confirmation bias is seldom stronger than in the beliefs of entrepreneurs regarding the commercial value of their products. Yet when entrepreneurs confront market prices informing them that those products are worth less to consumers than they cost to produce, their confirmation biases quickly turn to dust and they begin to consider alternatives to their former

convictions. If the confirmation biases of university professors and politicians were confronted with information as accurate and compelling as that communicated by markets, scholarship and public policies would improve as absurd ideas and policies are promptly discarded.

**Conclusion** / As an economist, I am sympathetic to logical arguments against popular policies and beliefs that are based almost entirely on their emotional appeal. Such beliefs as "Import restrictions increase domestic employment" and "Higher minimum wages reduce poverty" come to mind. But Bloom is arguing against a specific emotion (empathy) that he believes is particularly harmful because it misdirects benevolent efforts away from where they would do the most good.

There may be some truth to his argument that empathy is more likely to cause such misdirection with spotlight effects, and that it poses a greater threat to rationality and morality than other emotions such as compassion. Even so, given the exaggerated influence of all emotions in political decisions, particularly by voters, any additional destructive power of empathy over other caring emotions is hardly worth worrying about.

The problem is that all caring emotions, when exercised in the political process, are exercised without the relevant information and sense of responsibility necessary to avoid spotlighting, the irrationality of confirmation bias, and other unfortunate outcomes. In sharp contrast, when decisions can be made through markets (which admittedly is not always practical), spotlighting, confirmation bias, and irresponsible emotional influences are strikingly reduced and outcomes are more rational and broadly beneficial.

The most important conclusion to be taken from Bloom's book is that the best hope for more rational and less emotional decisions is stronger constitutional limits—both procedural and substantive—on government. Those limits would make it more difficult for activities best left to markets to be shifted to the political process. **R**



# The Discontented Animal

REVIEW BY PIERRE LEMIEUX

If anybody thought that democracy is an unmixed blessing, he should have been disillusioned by the last U.S. election. At least Donald Trump's victory can be interpreted as public opposition to the rule of government bureaucrats, which Hillary Clinton would likely have strengthened. But are we condemned to have either the Charybdis of "totalitarian democracy" (to use an expression from Bertrand de Jouvenel) or the Scylla of the tyranny of experts?

Two recent books help us to think through these issues: *Democracy for Realists* by political scientists Christopher Achen of Princeton and Larry Bartels of Vanderbilt, and *Escape from Democracy* by economists David Levy of George Mason and Sandra Peart of the University of Richmond.

Achen and Bartels remind us that the Founders were suspicious of democracy and instituted a republic with many checks on democratic controls, such as a Constitution including a Bill of Rights, the Electoral College, and two houses of Congress. Divided and limited government were features of the republic, not bugs.

Unfortunately, those institutions have proven less hearty than the Founders had envisioned. James Madison, one of the major proponents of divided and limited government, would be distressed at how the U.S. government and popular ideology have become democratic. He would not be alone. "Even Thomas Jefferson, often remembered as a dedicated democrat in a republican age, was anxious to limit the influence of the urban masses," note Achen and Bartels.

**Danger of experts** / Federal bureaucratic power has grown, especially since the Progressive Era. The power of experts in and on government is the topic of Levy and Peart's *Escape from Democracy*. It will be

convenient to review this book first.

Levy and Peart argue that we should not escape democracy by accepting the rule of experts. They focus on economic experts, but their arguments apply to all experts who advise government. Following Chicago economist Frank Knight, they think of democracy as "government by discussion." In this tradition, exemplified by such economists as Adam Smith, John Stuart Mill, Lionel Robbins, and Milton Friedman, "the good society is one that governs itself by means of an emergent consensus among points of view."

*Escape from Democracy* claims that the discussion tradition "largely disappeared from the economics literature with the advent of new welfare economics" in the 1930s and its offshoot of cost-benefit analysis. Under this new school of thought, the goals of public policy are considered to be exogenously set by the citizens, while the experts analytically decide the means to accomplish those goals. Levy and Peart reject this notion. Discussion should continue about the means as well as about possible modifications of the goals. They reproduce a beautiful sentence from Knight:

In contrast with natural objects—even the higher animals—man is unique in that he is dissatisfied with himself; he is the discontented animal, the romantic, argumentative, aspiring animal.

The two economists insist that popular knowledge incorporates more wisdom than it is credited with. Their stance is contrary to that of Georgetown political philosopher Jason Brennan in his *Against Democracy* (Princeton University Press,

2016; see "Power to the Knowers!" Spring 2017), as well as in many ways to that of Achen and Bartels, as we will see. While the experts' input is required, it should not be blindly deferred to because it is biased: the experts have their own private motivations, self-interest, and incentives.

Two chapters of *Escape from Democracy* analyze two episodes where experts seriously erred: eugenics in the first part of the 20th century (see "Progressivism's Tainted Label," Summer 2016), and the gross overestimation of Soviet economic growth by economists—including Nobel prizewinner Paul Samuelson—from the 1960s to the 1980s. For several years, Samuelson attributed to bad weather the languishing of the Soviet economy. During the Progressive Era, virtually all experts favored eugenics, and eugenic sterilization lasted until 1974 in North Carolina. We might add that today's public health movement shows a similar authoritarian bias. (See "The Dangers of 'Public Health,'" Fall 2015.)

Levy and Peart favor institutions that minimize the biases of experts. "The goal is to generate plenty of unbiased expert judgments, for instance, by making transparency incentive-compatible or, if that is unattainable, by making nontransparencies transparent." In other words, experts' incentives must be structured away from biases or at least their biases must be transparent, like they are in legal litigation. The authors emphasize the importance of codes of professional ethics and the disclosure of conflicting interests (in scholarly articles, for example). They also present one "radical proposal": to have regulations approved by juries, an institution the authors see as "the paradigm of democracy." With the help of a sophisticated statistical argument, they show that "something akin to jury trials might be a viable means to obtain the benefits of expertise in the regulatory setting."

Levy and Peart are (brilliant) experts in the history of economic thought and their book is replete with original insights. They admit that experts, including themselves, have their own incentives, which may con-

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## IN REVIEW

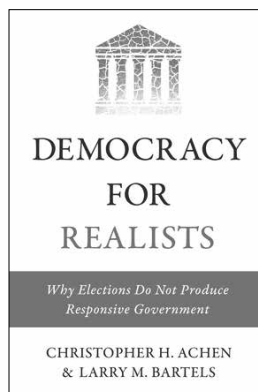
flict with the search for truth. Incentives are the bread and butter of economic analysis, and we should “*apply the tools of economics to the economists who use them*” (emphasis in original).

*Escape from Democracy* is a learned, fascinating, and wide-ranging book. It goes from alchemy to statistical analysis of jury-type decisions. It raises many deep questions and proposes original approaches.

Perhaps its arguments can be extended or improved in a few directions. Levy and Peart write about “group (societal) goals,” but it is unclear what those goals are. They also talk about “society’s goals,” and even slip into “we as a people,” but I will blame their editor for the latter. Are these group goals some sort of collective goals, or are they instead the “shared goals” of individuals? How can they be aggregated? The authors do suggest in passing that these “goals” are Hayekian-type conventions, but their thesis would benefit from hashing through these issues.

I think that by rejecting welfare economics, the authors of *Escape from Democracy* have deprived themselves of a useful way to think about these issues. The first theorists of the “new welfare economics” were no doubt mistaken in thinking that, with the so-called Kaldor-Hicks criterion, public policies could be proposed without making value judgments. In two 1950s articles, Samuelson himself demonstrated that it is generally impossible to make welfare evaluations (about all individuals) without bringing in normative, extra-economic judgments about distribution. In fact, Samuelson *supports* Levy and Peart’s claim that economic experts cannot prove the superiority of some public policies over others.

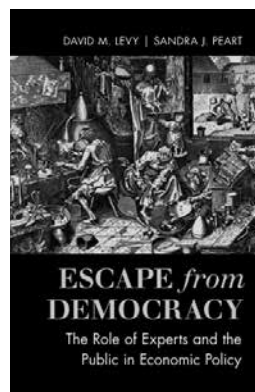
It is not only Kenneth Arrow who, as Levy and Peart write, “called into question the soundness of the new welfare enterprise.” With Samuelson, welfare economics itself finally proved what it had set out to disprove—that is, the methodological capacity of economic experts to dictate public policy. The fact that Levy and Peart mention Samuelson as part of the discussion tradition suggests that they are open



**Democracy for Realists: Why Elections Do Not Produce Responsive Government**

By Christopher H. Achen and Larry M. Bartels

408 pp.; Princeton University Press, 2016



**Escape from Democracy: The Role of Experts and the Public in Economic Policy**

By David M. Levy and Sandra J. Peart

288 pp.; Cambridge University Press, 2016

to putting some water in their anti-welfare-economics wine.

There is also a risk of exaggerating the import and justification of democratic discussion. Meaningful democratic discussion cannot cover everything and it should not try to. To the extent that it can result in coercive decisions, it should not encroach on private domains. (More on this later.)

I suspect that Levy and Peart would accept some of my objections—at least the last one, concerning the necessity to restrict the scope of democratic discussion. Achen and Bartels, on the other hand, would likely reject that objection.

**Very different book** / *Democracy for Realists* is a very different book, if only methodologically. It astutely marshals much empirical evidence and presents a host of interesting statistical analyses about what voters think and how democracy works. It is less rooted (if at all) in the school of rational choice and criticizes “economistic thinking.”

The two political scientists set out to “document the gap between democratic ideals and realities,” to show how the populist or folk theory of democracy is untenable and, in the second part of the book,

to propose a new justification for democracy.

According to the folk theory of democracy, the voters “have preferences about what their government should do,” and they “choose leaders who will do those things” or “enact their preferences directly in referendums.” In this perspective, voters really rule, as opposed to Madison’s “trustee model” where they elect a body of wise citizens to realize the public good.

Achen and Bartels deploy a trove of data and statistical analysis to show that the folk theory of democracy makes no sense. Elections don’t represent “the will of the people” because preferences cannot be aggregated in any coherent way. Voters are igno-

rant of facts pertaining to politics and they vote for or against parties and candidates, not on actual issues. At the end of 1996, for example, a majority of voters, both among Democrats and (even more) among Republican, thought that Bill Clinton had not significantly reduced the budget deficit, which had in fact been cut by 40% in three years—or 58% if we count the fiscal year at the end of which the survey was run. Politicians are not much constrained by voters’ opinions.

The least demanding version of folk democracy, “retrospective voting,” does not correspond to reality either. Retrospective voting occurs when voters at least know enough to “throw the bums out” when election time comes and they have not been served well. But in reality, voters engage in blind retrospection. Statistical analyses show that they punish the incumbents (of whichever party) only for the economic conditions obtaining in the last six months preceding the election, whether or not the politicians in power could have done anything to change those conditions. They punish incumbents for droughts and floods. In 1916, voters even punished Woodrow Wilson and his Democrats for shark attacks in New Jersey.

Despite such interesting analyses, Achen and Bartels suffer from their own blindness. They ignore the explanation of “rational ignorance,” the fact that a single voter has, for all practical purposes, a zero chance of changing the election result. Consequently, Achen and Bartels do not see how the rational voter votes his opinions, not his interests (except to the extent that he has rationalized his interests into his opinions or his whims).

More generally, the authors neglect the economic literature on voting. They cite George Mason law professor Ilya Somin’s *Democracy and Political Ignorance* (Stanford University Press, 2013), but not the work of his Mason economics colleague Bryan Caplan (*The Myth of the Rational Voter*, Princeton University Press, 2007) nor that of political philosophers Geoffrey Brennan and Loren Lomasky (*Democracy and Decision*, Cambridge University Press, 1997). Except for the old work of Brookings economist Anthony Downs, they neglect the whole public choice analysis of democracy. James Buchanan, who won the 1986 Nobel economics prize, is nowhere cited. They don’t mention and seem to ignore the economic analysis of collective action. They view the work of economists on democracy as “limited” and “naïve.”

Instead, they borrow from psychology and the soft field of sociology to develop a “group theory” of democracy. Individuals, they claim, are moved by “group loyalties and social identities.” Puppets of racial and other social groups, individuals just obey group norms. They don’t support political parties whose opinions match theirs, but instead take their opinions from the political parties (and other groups) they belong to.

There is something true in the idea that groups are important, and *Democracy for Realists* offers supporting statistics in the realm of politics. But standard economic theory explains most of that in terms of rational behavior; no need to invoke some soft-sociological theory of groups. Some of the gregarious behavior of individuals can also be explained by our tribal wiring inherited from evolution, but Achen and

Bartels don’t even cite Friedrich Hayek, another Nobel prizewinner, who has studied the implications of this fact for modern societies. Hayek also explained how methodological individualism is useful to study society.

**Disappointing climax** / Where the two political scientists are heading only becomes clear at the end of the book, although the attentive reader will not have missed the accumulating signs. Achen and Bartels want us to normatively embrace the power of groups over the individual and to accept that democracy is a contest among

*Achen and Bartels do not see that the rational voter votes his opinions, not his interests (except to the extent that his interests shape his opinions and whims).*

groups. It’s not just that individuals are inevitably group puppets; it is also good to empower groups, and this provides a new justification for democracy.

What is needed for democracy, they argue, is to enforce equality between the political groups, although perhaps it is between individuals—they’re not entirely clear. Campaign contributions must be controlled to make sure that some groups, such as the rich, don’t have more political influence than others, such as the poor. More than 300 pages (most of which admittedly are interesting) to come to this normative anticlimax!

But the authors have a problem. If groups are made equal irrespective of their sizes and other factors, individuals will be unequal. If, on the other hand, all individuals are valued equally, their groups—if freedom of association is protected—are unlikely to be equal. As usual, the mirage of material equality (equality of results) leads to absurdities.

Consider another instance. Achen and Bartels talk about “*economic and social equality*” (emphasis in original)—the whole package it seems. “The most powerful players

in the policy game are the educated, the wealthy, and the well-connected,” they write. They note that ideally “both corporate interests and college professors would get less weight in the democratic process.” Check your bright privilege, as it were. But if college professors have too much political influence, then *Democracy for Realists* is a book that should never have been. As an unrepentant sympathizer for old-fashioned classical liberalism (“antiquated in its ideas,” as Achen and Bartels would say), I still think that would have been a loss.

**The scope of democracy** / This drift of Achen and Bartels’ otherwise interesting book suggests that the fundamental problem of democracy as we know it is not ignorant voters, lurking bureaucrats, or people who get a bit more ink or electrons.

The fundamental problem is the *scope* of democracy. If democracy is “the rule of the people,” as Somin defines it in his 2013 book, the first problem is the rule. The second problem is identifying who “the people” are. Moreover, if everything is up for grabs, the volume, depth, and antagonism of discussion will exclude most people. Politics begets conflict and ultimately renders discussion impossible.

“Paradoxically,” writes Somin, “the best way to improve democratic deliberation may be to rely on it less. ... Democratic control of government works better when there is less government to control.” Going back to the problem of voters’ rational ignorance, “the problem of political ignorance may be more effectively addressed not by increasing knowledge but by trying to reduce the impact of ignorance.”

Or look at it from Buchanan’s constitutional perspective (as I understand it). We must distinguish between consumer tastes, which are a private matter, and political opinions, which—except in (most) libertarian opinions—imply imposing one’s preferred lifestyle on others. Democracy, even in its direct

## IN REVIEW

forms, may be good for issues relating to tastes for public goods. Think of national defense or even public land if you take John Locke's proviso seriously (private appropriation of land "at least where there is enough, and as good, left in common for others"). But no democracy, bureaucracy, or any other form of "-cracy" (which is derived from the Greek

*kratos*, meaning "power") is good when tastes concerning nonpublic goods are concerned: Joe's preference for white chocolate and Alice's preference for dark chocolate are nobody's business.

Both *Escape from Democracy* and *Democracy for Realists* are interesting books. But the latter is not consistent with real limitation of state power. **R**

## The Fed Just Does Not Have Sufficient Plenary Authority

◆ REVIEW BY VERN MCKINLEY

In mid-March 2008, Bear Stearns took its place in history as the first of the major bailouts during the most recent financial crisis. The minutes of the March 14, 2008 meeting of the Federal Reserve's Board of Governors rationalized the bailout by highlighting the "expected contagion that would result from the immediate failure of Bear Stearns." A few weeks later, in an early April 2008 hearing on Bear Stearns, then-Fed chairman Ben Bernanke jettisoned the references to contagion and instead spoke of how "extremely complex and interconnected" the financial system was, spawning use of the phrase "too interconnected to fail." That became the phrase du jour to describe the risk of allowing Bear Stearns and, later, other institutions to fail.

What should we make of the use of such technical and ever-changing terminology as the response to the crisis evolved? In *Connectedness and Contagion*, Hal Scott brings to light what is meant by phrases like "connectedness" and "contagion," and applies these concepts to the context of the recent financial crisis as well as other historical financial crises.

Scott is a professor at Harvard Law School and director of the school's Program on International Financial Systems. He is also the director of the Committee on Capital Markets Regulation, a biparti-

san and nonprofit group whose objective is to enhance the competitiveness of U.S. capital markets and ensure the stability of the U.S. financial system via research and advocacy. Scott's publications include the Foundation Press textbooks *International Finance: Transactions, Policy, and Regulation* (with Anna Gelpern, now in its 20th edition) and *The Global Financial Crisis* (a new paperback edition comes out this year). Earlier this year, the Trump administration considered him for the position of vice chairman for supervision at the Board of Governors of the Federal Reserve, an important position that was created as part of the post-crisis Dodd-Frank reforms.

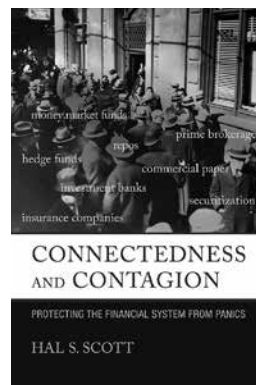
As the Trump administration, along with the House Financial Services and Senate Banking Committees, begins to consider banking reform, some have argued that the Dodd-Frank Act went too

far in retaining the tools for the Federal Reserve to intervene in large, weak institutions. Scott takes a different tack in *Connectedness and Contagion*, arguing that Dodd-Frank actually went too far in *trimming back* those powers.

**Clarifying concepts** / Scott wastes no time in providing a lucid set of definitions for "connectedness" ("concern that the failure of one bank will cause the failure of others"); "correlation" ("failure of multiple institutions due to a collapse in asset prices"); and "contagion" ("indiscriminate spread of run-like behavior throughout the financial system, including to healthy institutions"). He labels these the "three Cs of systemic risk." These concepts were widely used during the financial crisis by the financial authorities and repeated by the media, but rarely defined. He then launches into a summary of the academic literature for the "three Cs."

Scott lays out compelling examples from the crisis (particularly Lehman Brothers and AIG) to argue that the extent of interconnectedness was overstated and concludes that interconnectedness was not a major problem. He makes the further point that changes in the Dodd-Frank Act, such as imposition of central clearing, exposure limitations, and designation of Systemically Important Financial Institutions, were based on a false narrative: "Thus the Dodd-Frank Act has strong measures to combat connectedness despite the lack of evidence that this was a real problem in the crisis."

He argues, rather than the ongoing focus on interconnectedness, that contagion was actually at work during the crisis in the money market fund and investment bank industry, as well as the commercial paper, interbank lending, and repo markets after the failure of Lehman. On



**Connectedness and Contagion: Protecting the Financial System from Panics**

By Hal S. Scott

440 pp.; MIT Press, 2016

money market funds, he states, “Clearly, investors were running as a result of general panic and not concern over a particular fund’s fundamentals.” As for the third C, correlation, Scott concludes, “Although correlation played an important role in the recent crisis, contagion is what transformed \$100–200 billion in losses on subprime mortgage products into the destruction of roughly \$8 trillion of equity market capitalization between October 2007 and October 2009.”

**An open-ended power to lend/** Scott dedicates nearly a quarter of the book to the Fed in its role as lender of last resort (LLR), arguing that LLR is a very effective means to fight contagion. He builds his case for a strong LLR with plenary authority, arguing that it “is even more important than a strong and independent manager of monetary policy.” He tips his hand from the start, describing the Fed’s LLR measures during the financial crisis as “heroic and creative,” which follows up on the book’s up-front dedication: “To all those who so successfully fought the panic created by the financial crisis of 2008.”

He traces the history of LLR back to the days of Walter Bagehot and the nation’s early central banks, the First and Second Banks of the United States. Throughout this section, he rants against “populist” sentiment, a phrase he applies with derision, which is also a tactic Bernanke deployed in his memoir of the financial crisis. Scott targets those who question the efficacy of concentrating such broad-based lending powers in the hands of the government:

It is important to understand this history not only because it explains why it took so long to create the Fed but also because the populist objections to any kind of government bank are still with us today and indeed are the main factor why the Fed is now such a weak lender of last resort.

As you might expect, he is not pleased with the provisions in the Dodd-Frank Act that reduce the extent of plenary authority

the Fed exercises as LLR. Among the provisions he dislikes:

- no loans to single institutions
- nonbank loans must be approved by the treasury secretary
- no loans to insolvent institutions
- no funding to nonbank affiliates
- tougher collateral requirements
- disclosure to the public and Congress

He claims that these provisions “have made our financial system much less stable” and argues for the elimination of most of the restrictions. In doing so, he ignores the whole line of argument—most articulately advanced by Anna Schwartz in her 1992 paper, “The Misuse of the Fed’s Discount Window”—that the Fed has abused its plenary authority by propping up weak (particularly large) institutions going back at least as far as the 1920s. This is in conflict with Bagehot’s dictum to only lend to “sound” institutions.

Scott rounds out this LLR discussion by laying out a side-by-side comparison of the powers of the Fed, Bank of England, European Central Bank, and Bank of Japan. He concludes that the United States “grants by far the weakest [LLR] powers to its central bank, particularly with respect to nonbanks.” He concludes that reversing some of the Dodd-Frank changes and granting further discretion to the Fed are the answers for stability.


**Hooray for bailouts/** The last major section of *Connectedness and Contagion* addresses bailouts, which Scott euphemistically calls “Public Capital Injections into Insolvent Financial Institutions.” He lays out what is probably the most full-throated defense of bailouts that has been published since the memoirs of Bernanke and Obama administration treasury secretary Timothy Geithner.

In the introduction to this section, he offers the oft-repeated argument in Chicken Little-style language that “bailouts are realistically the lesser of two evils, if economic collapse is the alternative.” As

with most commenters who take such an approach, he engages in speculation and, I believe, wildly overstates the likelihood of economic collapse.

Rather than defend bailouts head-on, most of his discussion is spent raising up various criticisms of bailouts and then, in straw man fashion, debunking them. For example, he admits that the moral hazard concerns are the “strongest argument against government bailouts.” But he does not really address the fact that in a market economy failing institutions should be subject to the same elements of market discipline as any other institution and that banks are simply not as “special” as bailout defenders make them out to be. Additionally, Scott does not offer any evidence that “bridge banks” do not work. This is a major oversight because a bridge bank is an available method for resolving large, complex, “too big to fail” institution (TBTF) and any complete analysis of resolving these mega institutions would have addressed it. He only mentions bridge banks in reference to the Japanese system, but he does not address bridge banks and their use to ease a TBTF bank through a marketing process by temporary nationalization.

The depth and level of detail in the endnotes for *Connectedness and Contagion* (which take up a full 100 pages of the book) are truly impressive. The notes reveal a deep level of analysis of the studies, speeches, testimony, legislative provisions, and media materials for the range of topics under scrutiny in the book. I expect to refer to them many times in the future as I do my own research on LLR and bailout-related topics.

*Connectedness and Contagion* is thus a useful reference guide and the views presented on connectedness and contagion are well-supported. However, the arguments regarding the issues of LLR and bailouts are the same tired arguments we have heard over the past decade, about how we should trust the financial authorities like the Federal Reserve to “do the right thing” when it comes to propping up our largest financial institutions. If you buy into that policy approach, then *Connectedness and Contagion* should be on your reading list. 

# The Lost Contract Clause

◆ REVIEW BY GEORGE LEEF

The play *Sunset Boulevard* is enjoying a Broadway revival. Just as its central character, Norma Desmond, was once a beautiful star who has become a shriveled has-been, so has the U.S. Constitution's Contract Clause. Once a star in the Constitution's plan for liberty and limited state power, it now is almost completely forgotten.

Vanderbilt Law School professor James W. Ely Jr. tells that unhappy story in *The Contract Clause: A Constitutional History*. Explaining the clause's importance to the Framers, he writes:

Inserted into the Constitution without extensive debate, the Contract Clause was clearly prompted by the sour experience with state debt relief laws during the Post-Revolution Era. It was grounded in the premise that honoring contractual commitments served the public interest by encouraging commerce.

Unfortunately, like a number of other key constitutional provisions, the Contract Clause eventually fell victim to judicial interpretations that, by the latter stages of the New Deal, rendered it almost a dead letter. Ely's book gives the reader a fascinating account of the "roller-coaster ride" of this clause.

**Need for commerce** / The young American nation developed a commercial economy in which the enforceability of contracts for land, goods, and services was crucial. But, as John Marshall observed, state legislatures were inclined to "break in upon the ordinary intercourse of society, and destroy all confidence between man and man." In an attempt to stop that, the Constitution's drafters—probably at the urging of Alexander Hamilton, Ely notes—included in Article I, Section 10 the provision, "No state shall pass any law impairing the obligation of contracts." (In the same section, states were forbidden to issue paper money

or enact *ex post facto* laws.)

That language did not, however, stop state governments from attempting to meddle with contracts, usually to help struggling debtors. Much of our early constitutional litigation revolved around such laws. For example, the first federal court decision to invalidate a state law, *Champion and Dickason v. Casey* (1792), involved a Rhode Island law that gave a particular debtor, Silas Casey (a prominent merchant) an extended period of time to pay his creditors. When two British merchants sued him to collect on their contracts, Casey defended on the grounds that the state law—which he had lobbied for—barred their suit. The circuit court, with Chief Justice John Jay presiding, dismissed Casey's defense on the ground that the Rhode Island law violated Article I, Section 10. That decision was important both in the development of judicial review and in demonstrating the young nation's commitment to the security of contracts.

Another early case was *Fletcher v. Peck*, an 1810 decision of the Supreme Court. To greatly condense a convoluted factual situation, the Georgia legislature had attempted to rescind its sale of a large tract of land. Chief Justice Marshall ruled that act invalid, declaring that the Contract Clause applied to public as well as private contracts and was intended "to shield against the effects of sudden passions." Thus, the reach of the clause was extended and the reliability of contracts broadened.

Undoubtedly the most famous of Marshall's Contract Clause decisions is *Dartmouth College v. Woodward* (1819), which held that a corporate charter (albeit for

a nonprofit educational enterprise) was a contract that the state legislature could not change. While the corporate charter at issue in the case was for a charitable institution, the holding over time was extended to safeguard business corporations against subsequent legislative interference by changing their charters.

By the end of the Marshall era, the Contract Clause provided a firm defense against legislative interference for rights under public and private contracts. But that would be its high-water mark. Soon state and federal courts would begin to whittle away at it.

**First slips** / In the years following Marshall's death, the Contract Clause proved inadequate to prevent various kinds of state actions that impaired the obligation of contracts. Chief among them were abridgements of corporate charters on "police power" grounds. That is, legislatures altered or revoked business charters they had granted in order to protect "public health and morals." Such powers are nowhere conferred upon the states in the Constitution, but the courts began to regard them as inherent in state sovereignty and overrode the Contract Clause when the two clashed.

For example, beginning in the 1820s, a strong alcohol prohibition movement started to grow in many states and, as a consequence, state legislatures forced businesses that made or sold alcoholic beverages to close, despite their charters. Didn't that impair those contracts, making the legislative actions unconstitutional? No, answered most courts, state police power took precedence. Business charters to operate lotteries met the same fate. Eventually, the police power exception would mostly swallow up the rule against legislation impairing contracts.

On the whole, however, the Contract Clause held strong during the Taney Court period (1835–1864). The Court's decisions "harmonized with the widely shared desire to foster economic growth by honoring contractual arrangements," writes Ely. Moreover, state court decisions in the main reinforced the importance of contractual reliability.

After the Civil War, the importance of contracts was strengthened by the passage of the Civil Rights Act of 1866, which specifically included “the right to make and enforce contracts” among those accorded to former slaves. Ely quotes University of Chicago historian Amy Dru Stanley: “In postbellum America contract was above all a metaphor of freedom.”

Then, in one of the first major Supreme Court decisions following the war, *Hepburn v. Griswold*, Chief Justice Salmon P. Chase sought to extend the reach of the Contract Clause from state laws to federal enactments. That case involved the federal government’s mandate that paper “greenback” currency be accepted in contracts that had called for payment in gold. Chase’s opinion held that the Contract Clause applied to federal statutes and not just state laws because it would be inconsistent with “the spirit of the Constitution” to allow the federal government to do what the states could not. This was, one might say, an early “living Constitution” decision, but with the twist that it was meant to further restrict government power, not to justify its expansion.

**Losing the clause** / But Chase’s attempt to expand the Contract Clause was quickly crushed. The next year, after President Ulysses S. Grant had filled two vacancies on the Court, the Legal Tender Act was back before the justices and this time it was upheld in a decision (*Knox v. Lee*) that overruled *Hepburn*. Ominously, Justice William Strong’s concurring opinion stated, “No obligation of a contract can extend to the defeat of a legitimate governmental authority.”

During Reconstruction, state courts, especially in the South, became increasingly sympathetic to pro-debtor laws on the grounds that because of “policy and humanity,” such laws did not impair con-

tracts but were “paramount to debts.” And the erosion of the Contract Clause continued during the Gilded Age as the courts upheld laws that imposed rate regulation on railroads despite charter provisions stating that the individual railroads were not subject to such controls. Also during this period, “police power” justifications for laws impairing contracts grew more frequent.

By the late 1800s, with Progressivism gaining ground, private contracts were looked upon with disdain and, as Ely puts it, the Contract Clause was “viewed in a new and diminished light.”

Evidence for that included the fact that the challenge in *Lochner v. New York* (1905) to New York’s law placing limits on the number of hours bakers worked did not include a Contract Clause claim. Instead, it relied upon the rather vague idea that the law was unconstitutional as a violation of due process

under the 14th Amendment. Evidently, the defenders of contractual freedom thought it better to fight this “police power” expansion on a different ground than that it ran afoul of the Contract Clause.

During the New Deal, the battered and weakened Contract Clause suffered body blows. Once again, poor economic circumstances provoked legislatures to pass laws favoring debtors, such as mortgage moratorium laws. A few state courts bravely struck them down as Contract Clause violations, but in 1934 the Supreme Court shredded that defense in *Home Building and Loan v. Blaisdell*. In a tortured majority opinion upholding the law, Chief Justice Charles Evans Hughes wrote that economic emergencies do not create new power under the Constitution, but then proceeded to expatiate on a five-part test for circumstances when it did. In dissent, Justice George Sutherland warned that the decision would mean “ever-advancing encroachments upon the sanctity of pri-

vate and public contracts.” Exactly so.

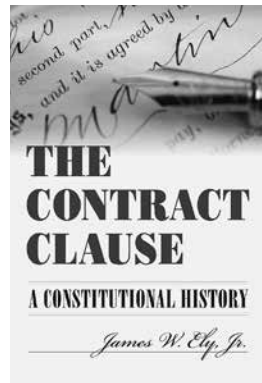
Further undermining the Contract Clause during and after the New Deal was the advancing idea that courts should defer to legislative authority in almost every case where it could be argued that a measure was intended to protect the public. In a 1945 case, Justice Felix Frankfurter wrote that the police power should be regarded as an implied term of every contract so that when the state acts, it cannot possibly impair a contract, and that courts should respect political judgments about whatever is necessary to protect the public. The Contract Clause, therefore, falls before any political whim.

**Zombie clause** / So, is it now dead? In a 1978 case, *Allied Structural Steel v. Spannaus*, Justice Potter Stewart said that it “is not a dead letter” but then proceeded to drive more nails into its coffin.

The case involved a Minnesota law that retroactively imposed substantial new financial obligations on firms by forcing them to pay pension benefits to employees who had not vested for them under their voluntary plans. The Court came up with an ambiguous balancing test of the kind many jurists love, pitting the “social interest” against the importance of contractual stability. Ely comments, “Much depends on the weight assigned by courts to the various factors to be balanced. How severe is a contractual impairment? What constitutes a broad societal interest? ... The various criteria are so malleable that a court could justify almost any decision.”

Thus, state governments now have nearly unlimited power to tamper with contractual obligations and the reliability of a contract depends upon how judges might weigh several vague factors. Where the Founders wanted certainty, we now have a great deal of uncertainty.

Ely concludes by taking us into recent cases where the clause has been resurrected in efforts by public employee unions to prevent legislatures from whittling away any of their promised benefits by legislative efforts to lower budget deficits. Some have gone in favor of the legislatures, some in



**The Contract Clause: A Constitutional History**

By James W. Ely Jr.

376 pp.; University Press of Kansas, 2016

## IN REVIEW

favor of the unions. In the latter cases, that bespeaks the Norma Desmond-like metamorphosis of the Contract Clause. Language put into the Constitution to protect

the growth of commerce has been turned into a way of protecting special interest gains wrung from one legislative session against any future reduction.

This illuminating book will appeal not only to lawyers, but to anyone who has an interest in the way our laws can change over time without the altering of a single word. **R**

## Working Papers **↔** BY PETER VAN DOREN

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

### Bank Subsidies

"Are Larger Banks Valued More Highly?" by Bernadette A. Minton, Rene M. Stulz, and Alvaro G. Taboada. March 2017. NBER #23212.

Everyone asserts that large banks have an implicit subsidy from being "too big to fail" (TBTF)—that is, the banks affect so many people that federal officials would come to the banks' rescue if they were to get into financial trouble. Is this belief supported by bank share prices? Does the market value banks more highly if they are larger?

One way to measure this is to use Tobin's  $q$ , the market value of assets divided by the book value of assets. If TBTF is right, then Tobin's  $q$  will be larger for larger banks.

The authors find that Tobin's  $q$  for large banks are smaller than for small banks. And once a bank exceeds the Dodd-Frank regulatory threshold for large banks, Tobin's  $q$  decreases with size. Within banks over time, the relation between size and valuation is negative over the period 1987–2006. So the market does not value banks more if they are larger.

Strictly speaking, the paper does not show that TBTF does not add value to large banks. But if TBTF does add value, it is not enough to overcome other negatives that make large banks worth less than small banks.

### Water Pollution

"Consequences of the Clean Water Act and the Demand for Water Quality," by David A. Keiser and Joseph S. Shapiro. January 2017. NBER #23070.

Since 1972 the United States has spent \$1 trillion on water pollution abatement, which amounts to over \$100 per person per year. What have we gained from this expenditure?

The authors study data from 170,000 pollution monitoring sites from 1962 to 2001. Dissolved oxygen increased by 5 percentage points and the share of waters that met fishing standards increased by 11 percentage points after 1972. But the time series shows no visually obvious evidence of a mean-shift or trend-break in water pollution after the start of the grant program in 1972. In fact, the rate of decrease in pollution levels actually *slowed* after 1972. The declining rate of reduction suggests decreasing returns to pollution

abatement or increases in non-point sources (agricultural land runoff) canceling whatever positive effects point-source control had.

To estimate benefits of the water treatment grants, the authors examine housing values within 25 miles of treated rivers and conclude that for the average grant of \$35 million (2014 dollars), housing values downstream increased by \$9 million in the aggregate relative to housing values upstream that were unaffected by the sewerage treatment.

The authors put a positive spin on these estimates, arguing, "The benefits of these Clean Water Act grants exceed their costs if [the] unmeasured components of willingness to pay exceed the components of willingness to pay that we measure by a factor of three or more." In other words, if there are \$27 million in benefits that do not factor into increased willingness to pay for housing near cleaner rivers, then the \$35 million expenditure results in \$36 million in benefits and is cost effective.

### Building Codes

"Economic Effectiveness of Implementing a Statewide Building Code: The Case of Florida," by Kevin M. Simmons, Jeffrey Czajkowski, and James M. Done. May 2017. SSRN #2963244.

Hurricane Andrew in 1992 destroyed 25,000 homes, damaged 100,000 others, and resulted in \$26 billion in damages in South Florida. Homes built before 1960 suffered less damage than those built later. Analysts concluded from this that Florida building code quality and enforcement had deteriorated over time.

In response, Florida enacted one of the strictest building codes in the country in 2001. (See "Do Coastal Building Codes Make Homes Stronger?" Summer 2014.) Since then, Florida has experienced 18 large wind events. This paper examines how damages were affected by the new building code using loss data from 2001 through 2010 on about a million homes.

The paper concludes that houses built since 2000 suffered losses that were 72% less than homes built prior to 2000. Many of the newer homes suffered no damage. For those homes that suffered some damage, losses were 47% less.

The authors then ask whether the additional construction costs were cost effective. The additional building costs from the codes were approximately \$1.66 per square foot, or \$3,254 for the average 1,960 square-foot structure. The average annual loss for homes built prior to the building code change was \$466 per house



for a present value of \$21,474 over the 50-year life of a house. The 47% decrease in losses from the new building codes would equal \$10,093 present-value over the 50 years. So \$3,254 in costs prevents \$10,093 in damages. The building code is very cost effective.

## Plastic Bag Bans

“Bag ‘Leakage’: The Effect of Disposable Carryout Bag Regulations on Unregulated Bags,” by Rebecca Taylor. May 2017. SSRN #2964036.

Many people criticize retail stores’ use of thin plastic bags to package purchases because many shoppers do not dispose of the bags properly. As a result, the bags clutter roadsides, yards, trees, and waterways, where they are unsightly and can be a hazard for wildlife.

Some local jurisdictions have responded to this with plastic bag taxes and prohibitions. Consumers often respond to such policies by finding close substitutes that undermine some of the effects of the policy. To determine if this is happening with plastic bag policies and if this results in net harm, this paper studies the effect of plastic bag bans in California over the period 2008–2015 using scanner data from 201 food stores.

Bans on plastic bags resulted in an immediate and large

increase in the purchase of small (67%) and medium (50%) garbage bags relative to jurisdictions in California with no bag controls. (Other categories of plastic and paper bags exhibited no change in sales.) The author concludes that people were reusing the shopping bags as trash bags at home, and after the bags were banned they purchased other bags for trash. The ban thus resulted in a 40.3 million-pound reduction in plastic shopping bag use but an *increase* in plastic garbage bag use of 16 million pounds and in paper bag use of 68.7 million pounds.

Is this change better or worse for the environment? To answer that the author considers the bags’ effects on carbon emissions. Manufacturing a plastic bag results in fewer emissions than substitutes like paper, trash, or cloth bags. However, the latter bags can be reused, so multiple uses can offset the emissions difference. To have fewer carbon emissions, a paper bag would have to be reused three times, a plastic trash bag four times, a polypropylene bag 11 times, and a cotton bag 131 times. Those reuse rates seem unlikely.

If such reuse does not occur, the simple carbon footprint of the ban may be adverse. But many people would argue there is a large, unmeasured benefit from not having plastic bags hanging in trees and floating on waterways. The author responds to this point with a question: “Do the benefits of reduced litter and marine debris outweigh the costs of greater greenhouse gas emissions and thicker plastics going into landfills?” R

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## FINAL WORD ↻ BY A. BARTON HINKLE

# The Sound of Rent-Seeking

Not long ago, National Public Radio aired a story about Kristen Liu, a woman with severe hearing impairment who helped design a new kind of hearing aid. Her Hear Buds resemble wireless ear buds and work like them, too. You can use them to listen to music, or talk on the phone—or hear things you otherwise couldn't.

The Hear Buds “can be adjusted to individual hearing using a smartphone app to control volume, cut out background noise, or turn up the sound in a theater,” the story noted. Liu says the technology “is pretty much a hearing aid.” Just one problem, NPR notes: “The company isn't allowed to call it that.”

Of course not, because the Food and Drug Administration won't permit hearing aids to be sold over the counter. The agency will permit over-the-counter products to be marketed only as “personal sound amplification products” for the hearing-able. That means people with moderate hearing loss who could benefit from devices like Hear Buds can't be informed of that fact.

Washington being what it is, the issue has turned into a lobbying battle. The Hearing Loss Association of America is encouraging Congress to pass the Over-the-Counter Hearing Aid Act, which would create new standards for hearing aids that could be used by people with moderate impairment. But the American Speech-Language-Hearing Association is displeased. You will be shocked to learn that the association, which represents audiologists, believes “the absence of audiological involvement” would be “detrimental to patient outcomes.”

Or maybe it wouldn't, given the price difference between Hear One Hear Buds

(\$300) and conventional hearing aids, which can cost 20 times as much.

Regulations are supposed to safeguard the public weal, not private gain, at least in theory. In practice they often end up doing precisely the opposite. Hearing aids offer one example. Opioid addiction treatment offers another.

Ninety people or more die of an opioid overdose every day, according to the Pew Charitable Trusts. Pew recently reported—*mirabile dictu*—that the Drug Enforcement Administration and the Substance Abuse and Mental Health Services Administration have begun licensing nurse practitioners and physician assistants to prescribe buprenorphine. Better known by its brand name Suboxone, buprenorphine is a treatment for opioid addiction. Allowing nurse practitioners to prescribe it would increase the availability of a palliative for a nationwide scourge. But despite the federal government's (relative) open-mindedness, 28 states forbid nurse practitioners from prescribing buprenorphine without the supervision of a doctor who is federally licensed to prescribe it. And, Pew reports, “half of all counties in the U.S. do not have a single physician with a license to prescribe buprenorphine.”

The buprenorphine issue constitutes just a small piece of a larger prob-

lem regarding the scope of practice for advanced-practice nurse practitioners (APRNs). Roughly half the states forbid APRNs to work without supervision by a physician. But the states don't require physicians to agree to supervisory arrangements, which leaves the fate of an APRN up to a doctor's whim.

Freeing APRNs from such restrictions could increase the supply of medical care, lower costs, and alleviate shortages in rural communities. At various times, the Institute of Medicine, the National Health Policy Forum, the Federal Trade Commission, and others have examined the issue and determined that expanding the scope of practice for APRNs would not lower the quality of care—and, in certain areas, might even improve it. But doctors' guilds want scope-of-practice laws to remain in place for the obvious reason: limiting competition drives up what physicians can charge. State lawmakers could heed the facts instead of campaign donations from physician groups, of course. They also could wear body glitter and replace Kate Upton on the cover of the *Sports Illustrated* swimsuit issue. Neither seems likely.

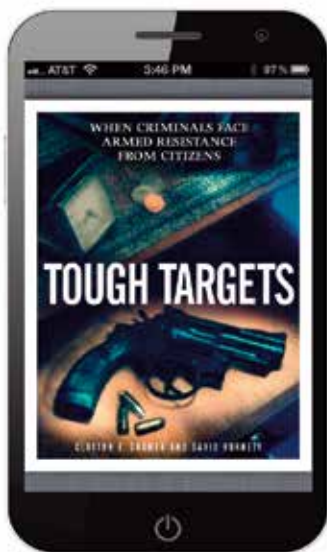
Scope-of-practice laws themselves are merely a small part of the larger issue of occupational licensing, about which a great deal already has been said. Libertarians did most of the talking about that subject at first, but conservatives caught on and eventually so did such improbable allies as the Obama White House. When the president who gave the country Dodd-Frank and the Affordable Care Act joins the chorus, you know regulation has gotten out of hand.

That's what makes the NPR story so refreshing. The coverage suggests the government-funded radio network recognizes and wants to alert the public to the possibility that sometimes the world can be made a better place by relaxing rules instead of tightening them. Now if only it could get more government officials to listen. R



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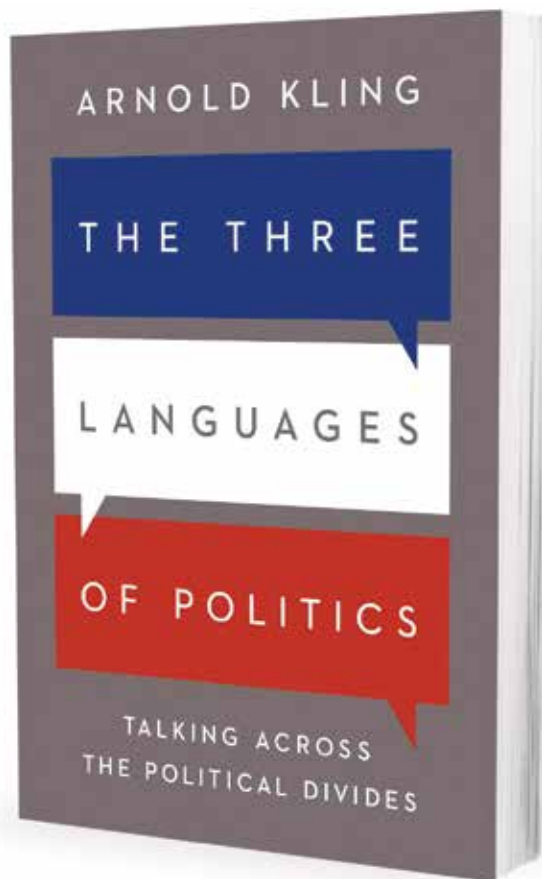
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