Book Reviews

The Myth of the Rational Voter: Why Democracies Choose Bad Policies

Bryan Caplan. 2007. Princeton: Princeton University Press. ISBN: 978–0–691–12942–6, $29.95.

Reviewed by P. J. Hill, Wheaton College.

In the 1950s and the 1960s economics was revolutionized by the advent of the sub-discipline known as Public Choice. Public Choice applied the rational behavior assumption of economics to collective activity, particularly the behavior of people in government and bureaucracies. It also analyzed voting behavior using the assumption of self-interest and applied the principal-agent framework, originally developed in discussing corporate behavior, to public sector activities.

Over the next several decades Public Choice continued to expand its sphere of influence, developing its own journals and its own annual meeting. In 1986 James Buchanan won the Nobel Prize, primarily for his contribution to development of this part of the economics discipline. Even more importantly, almost all economists have integrated the basic assumptions of Public Choice into their analysis, making little distinction between private and public sector activity in terms of the assumptions about human behavior and the appropriate ways to model that behavior.

Now Bryan Caplan, a professor at George Mason University, a center of Public Choice scholarship, has written a book that challenges the most fundamental assumptions of the Public Choice model. He agrees with the overall implication of Public Choice that democracy fails to deliver on its promises. However, standard Public Choice scholarship relies upon transaction cost problems in the aggregation of voter preferences. Many voters are "rationally ignorant" because there is not enough at stake for them to pursue good information about policies. On the other hand, some parts of the electorate are concentrated in particular groups which have a specific interest in seeing certain policies passed. Therefore, the principle of concentrated benefits and diffused costs leads to policies that are bad for the public as a whole, even though they generate benefits for special interest groups.

Caplan challenges this basic assumption, arguing that it is only at the margins of political choice that special interests dominate, and that on most issues voters are choosing policies that they think improve national well-being, not their own personal well-being. If that is the case, does this destroy one of the main implications of Public Choice, that there is a substantial amount of government failure and that many government policies do not actually advance the public good? Caplan's answer is a resounding no: government policies are bad because the overall understanding of economics (read rationality) is low. People are not voting their pocketbooks; they are voting their belief structure. But their belief structure is so strong that it overrides what an economist would think of as adequate knowledge about the world.

Caplan identifies four major biases that people hold that are systematically wrong. The first is the *antimarket* bias. The *antimarket* bias fails to understand how people pursuing their own self-interest can have their actions harmonized through market institutions. This means that people do not see how profits serve as a reward for correctly meeting the needs of other people. It also generates conspiracy theories about price determination, rather than an understanding of how prices result from the interaction of supply and demand.

The second is the *antiforeign* bias that fails to recognize the gains of exchange with foreigners. Few people would argue that residents of the state of South Carolina are made poorer because South Carolina trades with Ohio, but many believe that the residents of South Carolina would be richer if there were restraints on international trade.

The third misunderstanding is the *make-work* bias that sees employment as the primary goal of an economic system, instead of recognizing the benefits of conserving on labor. Finally, the general population also has a *pessimistic* bias that overestimates the severity of economic problems and underestimates how well the economy has done in the past and is performing in the present.

Since the political process works reasonably well, according to Caplan, the voters get the foolish policies that they want. How do we know that the policies are foolish? It is because economists, who have thought deeply about these issues, believe otherwise.

However, if the general public is biased, how do we know that economists are not also biased? It is at this point that the empirical evidence for Caplan's argument becomes somewhat sketchy. He relies upon a large 1996 survey project called the Survey of Americans and Economists on the Economy. He finds a substantial difference between the beliefs of economists and the general population about the functioning of markets, the gains from trade with other countries, the benefits of labor-saving devices, and the overall performance of the economy. He then estimates to what extent the positions of economists on a range of issues reflect their particular self-interest. In other words, he is asking, "What would Ph.D.

economists believe if their finances and political ideology matched those of the average person?" (p. 55). He finds that no more than twenty percent of the gap between the layperson and the expert (Ph.D. economist) can be explained by ideological bias or self-interest. This means that eighty percent of the gap occurs simply because economists have studied the issues and have generally come to common agreement as to the correct answers.

It is important to note in all of this discussion that Caplan is not arguing that it is simply the cost of information that keeps the general public from understanding economic issues. Rather it is basic worldviews, or the fact that people have preferences for certain beliefs, that keep them from learning more accurate information about how the world works. He calls people "rationally irrational" on matters of economics because they have a belief structure that gives easy explanations for price fluctuations and job losses due to foreign competition. Thus it is not that "people tire of the search for truth . . . but rather that they actively avoid the truth" (p. 123).

What should one make of this wide ranging and well-written argument for a fundamental rethinking of the basic assumptions about people's behavior in the political arena? Of course one problem with his work is the reliance upon a single survey which, although seemingly well constructed, is just that, one piece of evidence. Counter evidence that people do understand economics can be seen in migration patterns between states; empirical work indicates that states with economic policies that economists would call "sound" attract people, while states that pursue "unsound" policies lose residents. Nevertheless, one cannot lightly dismiss Caplan's work and there are some other parts of his argument that should give economists serious pause. One is the difference in the way that we approach our standard introductory economics class and the way that we write our journal articles. In the realm of refereed journal publications we do not assume any sort of systematic irrationality on the part of the population that we are modeling. However, for most of us, when we look at a class of students who are taking their first economics class we assume that they do have systematic biases and that part of our job as professors is to spend the semester providing evidence that these biases are incorrect.

Perhaps more interesting and more troubling for the Christian economist is the issue of where Caplan's work leads. He argues that economists are too friendly toward government. They should be even more pessimistic about government than they are, since government programs are instituted for and operated by people with a dismal understanding of economics.

Although this reinforces the Public Choice perspective that government failure is a significant problem, his solution is different than the Public Choice one, which argues for processes that do a better job of aggregating public preferences. Since he thinks public preferences are fundamentally wrong he does not want to expand the influence of the general public on governmental policies. It is not completely clear what he would recommend as appropriate policy prescriptions, but he does think that we should rely more heavily upon elites for decision-making. In the case of economics, that would mean using expert opinion to override or ignore public preferences. In fact, it might be worthwhile to limit the franchise to people who are economically literate. He thinks that it is no more objectionable to require a test of voter competence (which presumably would focus on matters economic) before entering the voting booth than it is to require a test for driving competence before allowing people to take the wheel of an automobile.

While Caplan's arguments are interesting and, to some extent, convincing, the implications are troubling. How do we decide that it is only in the area of economics that we need the rule of experts? What about other choices in the public realm? Should we also rely upon expert rule there? And on issues of morality and ethics it would surely become more complex to decide who is an expert and who is not. In those areas, "expert opinion" could well differ from what ordinary people (and many Christians) believe. As in matters economic, Caplan thinks expert opinion should be respected in other areas, and "a more knowledgeable public would be more pro-choice, more supportive of gay rights, and more opposed to prayer in school" (p. 27).

Caplan's argument for enhanced power for elites in certain decision-making processes can have an appeal to people when they are thinking of their own specialty. Economists may like the idea that if only they were more respected, economic policy would be improved. One should be quite cautious, however, about signing onto a "the public doesn't know what is in its own interest" agenda. Caplan is troubled by the fact that "instead of fairly weighing all claims, we can show nepotism toward our favorite beliefs" (p. 14). He quotes another author who gives insight into this problem: "Without some belief structure many people find this world meaningless and without comfort" (p. 14). Hmmm. This sounds a lot like the Christian faith. As thoughtful believers we do look at the world we live in, and hopefully we examine other claims. Once we have committed to our belief structure, however, we have a "preference for those beliefs." Caplan seems to think one does not need any ethical or religious framework for organizing one's life; we can simply weigh all claims and avoid "irrationality" in our understanding of the world.

Caplan has written a fascinating book, one that economists can profit from reading. It raises interesting questions about the role of belief structures, economic education, and how we interpret terms like rationality and informed public opinion. This book will undoubtedly cause a rethinking of some of the fundamental assumptions of Public Choice; it is doubtful that it provides a comprehensive model for thinking well about life in general. ■

Gross National Happiness: Why Happiness Matters for America—And How We Can Get More of It

Arthur C. Brooks. 2008. New York: Basic Books. ISBN: 978-0-465-00278-8, $26.95.

Reviewed by John P. Tiemstra, Calvin College.

This book presents for a popular audience some of the results of statistical research on what makes people happy according to their own reports. This is an important topic that deserves serious engagement by Christian economists. Cultural variables are considered in the first half of the book. These include religion, family status, political values, and government policies. The second half takes up more clearly economic variables, including income, inequality, jobs, and charity. The conclusion focuses on government policies that may promote happiness.

The author has a thoroughly conservative political agenda, with which I am not personally sympathetic. He concludes that the happiest people are devoutly religious, given to charity, politically conservative, married, working as much as possible, and living in a country with low levels of government expenditure. The nine "lessons for our leaders" in his conclusion include promoting opportunity, not economic equality; not imposing greater leisure (as the Europeans do with limited workweeks and mandatory vacations); and limiting government spending. His only departures from the Republican platform are recognition of the importance of unions for fairness in the labor market (p. 172), and support for an expanded Earned Income Tax Credit (p. 173). However, these points do not make it into the concluding nine lessons.

By claiming statistical validation for his conclusions, Brooks tries to appear objective and scientific (pp. 18, 39). However, he habitually dismisses research with which he disagrees as the product of allegedly pervasive liberal bias in the academic world (pp. 24, 138, 195). He dismisses data from San Francisco because, after all, how could a conservative be happy in San Francisco (pp. 25, 115)? This contributes to an annoyingly smug tone, at least in the first half of the book. Later on he acknowledges that legitimate disagreement with his position might be possible (p. 192).

Some of the statistical evidence presented for highly controversial conclusions turns out to be pretty thin. Brooks' idea that more government spending makes people unhappy is based on his own OLS time-series regression of the percentage of unhappy people on per capita income, per capita government spending, a constant, and a time trend. The R-squared is 0.31 (p. 215). On this hangs concluding lesson number nine. His claim that income inequality does not affect happiness is apparently based entirely on casual observation (pp. 136, 213).

Brooks' ideological presuppositions often get in the way of clear economic thinking. One of his pet ideas is that government activity makes people less happy by taking away their control over their own lives. He writes "It is terrible to feel like you are at the mercy of circumstances or other people" (p. 32), but he never acknowledges that the purpose and effect of social insurance is to mitigate exactly that feeling of helplessness in the face of impersonal circumstances, and in a way that only government can accomplish.

In another example with relevance to the role of government, Brooks states: "Osama bin Laden is a threat to America; trans fats in our food are an annoyance" (p. 108). The truth is that many more Americans will be killed by trans fats than by the plotting of Osama bin Laden. Dealing with this public health menace will cost much less than the effort to capture bin Laden and his henchmen, and has a much greater chance of success. By all means go after Al Qaeda, but pay attention to public health, too. Brooks' impatience with government focuses on things like airport security (p. 104). He should be more concerned about *habeas corpus* and "extraordinary rendition."

One of the key ideas in Brooks' argument concerns the connection between pay and success, or "creating value." Money doesn't make people happy—success does. But money is a measure of success. So when people appear to be chasing money in a greedy, materialist way, they are not. They are only engaged in a laudable pursuit of success, and with it, happiness (p. 131). On the other hand, those who want to redistribute money must be motivated by materialism and envy, because they think that redistribution will make the poor happier (pp. 138, 202). And of course high taxes reduce the incentive of the affluent to work (p. 202).

First, either money is a motivator or it is not. Brooks wants to claim that taxes make people unhappy independent of their incentive effects (p. 29) so he can say that pursuing wealth does not involve greed. But when it suits him, he appeals to incentive effects to argue against redistribution. He cannot have it both ways. Furthermore, Brooks gets the proponents of greater equality wrong. They are not trying to redistribute happiness. They want to see greater equality of incomes because of the effects that money has on power and status in our society. Brooks dismisses this idea in half a sentence (p. 201), but it is at the bottom of concerns with inequality. It is also an idea with biblical roots (see e.g., Prov. 22:22–23, 14:31).

This inconsistency also gives Brooks a problem with economic growth. He does not care about GDP growth (that would be materialism), but he wants success to grow, and since money measures success, GDP has to grow. The love of money leads to sin only because we forget that money is just a measure of success (p. 200). But the love of success is not evil—it has to be good.

The difficulty about inequality ties Brooks in knots. He does not take up the Easterlin Paradox. To do so would be inconvenient, since it would mean accepting that inequality does matter (see Clark, de Frijters, & Shields, 2008, pp. 123–125). The only argument in favor of equality that he entertains is the argument from diminishing marginal utility, and he does not in fact engage it, but merely dismisses it (p. 139). He does not consider the role of positional goods, or the ways in which we compete for position in this society, or whether that competition leads to a healthy result. He argues that more work always makes people happier without considering the role of positional competition in this rat race, or the effects it has on families, church life, and philanthropy (chapter seven).

A concept of sin more adequately based in scripture would have served Brooks better. We all have mixed motives for virtually all of our actions. This is what we Calvinists call "total depravity." People who pursue money are rarely free from greed, however much they may also desire success (whatever that is), or opportunities for giving, hospitality, or other good works. People who desire greater economic equality have serious reasons for holding this view. For example, they may want a society in which we can see people for who they are, not just for their clothes, their cars, their houses, or their resumes. Proponents of equality may also suffer from a touch of envy. Let us agree that we are all sinners in need of God's gift of salvation.

The best recent books on this topic are both by Robert H. Frank: *Luxury Fever* and *Falling Behind*. They are well worth the read and are interesting to both economists and laypeople. David Myers, the Christian psychologist from Hope College, did a wonderful book called *The Pursuit of Happiness,* which is still worth reading. Economists of a certain age remember with fondness Tibor Scitovsky's *The Joyless Economy,* which began this literature and makes all the important points.

In summary, Brooks is quite right to emphasize that happiness does not come from ever-greater consumption, but rather from faith, family, friends, and a sense of purpose in life. As our Lord said, a person's life does not consist in the abundance of possessions (Luke 12:15). It is important for us to see how this works out in social science data, and this book offers a good review. But the author tries to evade biblical warnings about the temptations of wealth by introducing a rather tenuous distinction between money and success. The Bible says not to lust after money, but it is all right to desire success, and the money that inevitably comes with it. That way Brooks can say that the profit motive is good while maintaining it is not greed. This does not work. He also tries to dismiss Christian concerns about economic inequality by maintaining that it has no effect on happiness. This is a dubious reading of the evidence, and does not do justice to the biblical underpinnings of this concern.

References

Clark, A. E., Frijters, P., & Shields, M. A. (2008). Relative income, happiness, and utility. *Journal of economic literature,* 46(1), 95–144.

Frank, R. H. (1999). *Luxury fever: Why money fails to satisfy in an era of excess*. Princeton: Princeton University Press.

Frank, R. H. (2007). *Falling behind: How rising inequality harms the middle class*. Berkeley: University of California Press.

Myers, D. G. (1992). *The pursuit of happiness: Who is happy, and why?* New York: William Morrow.

Scitovsky, T. (1976). *The joyless economy: An inquiry into human satisfaction and consumer dissatisfaction*. Oxford: Oxford University Press. ■

Less than Two Dollars a Day: A Christian View of World Poverty and the Free Market

Kent A. Van Til. 2007. Grand Rapids, MI: Eerdmans. ISBN: 978–0–8028–1767–9, $16.00.

Reviewed by Peter S. Heslam, University of Cambridge.

The free-market has become the predominant form of economy in the world today. But can it meet the basic material needs of all human beings? *Less than Two Dollars a Day* draws on ethics and economics to address this question.

Following an introductory chapter in which he defines terms, Van Til provides an overview of Adam Smith's intellectual legacy in contemporary market economics, or "mainstream economics." He then devotes a chapter to explaining that this form of economics is unable to accommodate the needs of the absolute poor because they lack the spending power to convert their needs into economic demands.

The chapters that follow survey the teachings of Scripture and the Church, from which Van Til concludes that meeting these needs is a requirement of justice. Because all humans share God's image and God's world, they merit access to the basic sustenance that allows them to take part in human society. Before suggesting practical ways to achieve this in his final chapter, he expounds three schools of thought that uphold the notion that economic justice depends on basic sustenance for all within a market framework that respects property rights, human rights, and commutative rights:

- the capability approach led by the development economist Amartya Sen;
- the neo-Calvinist school emanating from the Dutch theologian and statesman Abraham Kuyper (1837–1920);
- the school of "social economics" associated with the *International Journal of Social Economics*.

The discussion of the second of these three schools, which pays particular attention to the work of economists Bob Goudzwaard and John Tiemstra, contributes most to the originality of this book. Complementing Kuyper's ideas with those of the American Jewish political theorist Michael Walzer, Van Til propounds a system of justice, based on the notion of social "spheres," that recognizes human diversity and understands justice to mean not only that all human beings receive their basic needs but that citizens receive equal treatment and producers receive reward proportional to their contribution.

Van Til is adamant that his scheme incorporates and complements, rather than opposes, the system of distributive justice provided by the free market. Indeed, he insists that it does not entail any judgement of capitalism, any implication that all persons are due a handout, any requirement that the world's goods are distributed equally, or any condemnation of business or trade. He writes:

> I believe that most goods should be exchanged via the free market, because it is an extraordinarily effective means of distribution, and it promotes commutative justice within the economic sphere. It rewards those who contribute economically, and sometimes it punishes those who will not contribute. It provides tremendous freedoms within which individuals can choose how they use their resources. It does not compel anyone to make evil purchases; it permits everyone to make good purchases. What's more there is simply no better system for distributing goods available. Peoples and societies have tried various forms of socialism, communism, and egalitarianism, and they have failed. Replacing an effective market with an ineffective command system has been historically shown to cause greater harm than good. Therefore, I acknowledge—and even celebrate—the good and the justice that the market provides at this point (pp. 145–146).

Van Til also concedes that the way the market rewards economic contribution is appropriate in the "instrumental" sphere of business. Clearly for him, the justice of the marketplace is necessary, though not sufficient, in addressing absolute poverty.

It is refreshing to read a Christian approach to poverty and wealth that affirms what is good about the market economy. The rarity of such treatments is one of the reasons the church finds it hard to minister effectively to those of its members who spend their working lives in the commercial sphere. It is also, more importantly, why the church generally lacks the vision and courage to put business at the heart of its concern for and involvement in poverty alleviation.

Van Til's adoption of the notion of spheres helps ensure he avoids these pitfalls. It allows him to see the economy as a sphere of human life that is fundamental to human flourishing. This sphere is largely constituted, at least in the current era, by market-oriented institutions and practices—in a similar way to which, in the political sphere, democratically oriented institutions and practices are becoming predominant in most countries with growing economies. And just as democracy has proven, in theory and practice, to offer the best prospects for human flourishing over other systems of government, the same is true of the market economy. Both systems should, therefore, be accorded the kind of qualified ethical affirmation that characterizes Pope John Paul II's encyclical *Centesimus Annus* (John Paul II, 1991).

This is not to suggest that the market principle, any more than the democratic principle, should be read back into the pages of Scripture in an effort to gain blanket biblical endorsement, and Van Til is wise to avoid this. But it is to suggest that, in developing a Christian view of the free market, the positive as well as the normative is important (the way things are, not just the way things should be). If, in other words, democratic and economic freedom can be shown to contribute to human well being, this is of moral significance: the empirical is not necessarily antithetical to the ethical.

But with freedom comes responsibility, and this is where Van Til's analysis reveals some weaknesses. His scheme could have allowed a discussion of business as a moral agent that focused on the exercise of virtue within the economic sphere. Because the free market can be used to dominate, exploit, and demean, intellectuals in rich countries tend to dismiss it. But the experience of many ordinary people in low-income countries is that business can be a school of morality and a means to social justice, dignity, the strengthening of institutions, and freedom from tyranny and oppression.

It is probably due to Van Til's failure to appreciate fully the moral potential of the commercial sphere that he ends up commending the old solutions of increased taxation and charitable donations as the solution to absolute poverty. He almost entirely overlooks ways in which, in cases of market failure, business models can be used to achieve social ends. Examples include the rapidly growing fields of social enterprise, micro enterprise, and "bottom of the pyramid" enterprise. In such cases, the enlightened self-interest of business leaders is generally all it takes to ensure that the needs of the absolute poor operate as demands. Market failures do not necessarily challenge the free market model; they often reflect a failure of moral imagination.

A second weakness that stems from Van Til's reluctance to address the moral challenge of freedom is the lack of attention he gives to the development of institutions in the fight against poverty. This is ironic, as the Kuyperian tradition emphasises the importance of institutions, based on the notion of "sphere-sovereignty." No amount of aid can make up for the need for low-income countries to develop their own indigenous institutional infrastructures, including property rights, the rule of law, an independent judiciary, and a free press. A recent survey conducted on behalf of the Commission for Africa (2005, p. 41) found that most Africans lay the primary responsibility for the problems in their countries at the door not of global business, nor of the former colonial powers, but of their own national governments.

By underestimating the importance of institutions, Van Til overlooks the key role the free market can play in stimulating their development. The corporate culture of multinationals can, for instance, significantly impact the way business is done more broadly in host countries because of their capacity to act as a catalyst for the emergence and growth of indigenous businesses. Voluntary codes and standards of practice such as transparency and the rejection of bribery can act as standard-bearers for host-country companies, especially when business associations such as chambers of commerce encourage member companies to adopt them. Some such members are seeking to enhance the governance capacities of local enterprises through mentoring indigenous entrepreneurs, organizing enterprise incubators, carrying out relevant research, and offering policy advice.

Despite such weaknesses, Van Til has done a great service in outlining the advantages of the market economy while highlighting the injustice of those excluded from it. All Christian economists should be concerned about poverty and this book is a good place to start engaging with the issues.

References

John Paul II (1991). Encyclical letter *Centesimus Annus* (May 1).

Commission for Africa (2005). *Our common interest: Report of the commission for Africa*. London: Commission for Africa. ■

On Capitalism

Victor Nee and Richard Swedberg, eds. 2007. Stanford, CA: Stanford University Press. ISBN: 0–8047–5665–1, $24.95.

Reviewed by Gregory A. Krohn, Bucknell University.

This book is a product of a conference organized by the Center for the Study of Economy and Society at Cornell University in October 2004 in celebration of the centenary of Max Weber's *The Protestant Ethic and the Spirit of Capitalism*. Having read Weber's work and R. H. Tawney's *Religion and the Rise of Capitalism* years ago, I was looking forward to reading and reviewing *On Capitalism*. When I began to read it, I discovered that the editors and many of the contributors to the book were sociologists. As an economist with scant knowledge of sociological research, reading *On Capitalism* was something of a wilderness experience for me, so it was appropriate that I read the book during Lent. One can gain insight from wilderness experiences, and I certainly benefited from reading *On Capitalism*. It is informative and thought-provoking about the roles of beliefs and institutions in the evolution of capitalism and the process of economic growth. Some of the contributions I found most enlightening are described below.

Weber's thesis was that Calvinism, particularly English Puritanism, played an important role in creating moral and political conditions favorable to the development of capitalism (Tawney, 1926, p. 316). In the introduction to *On Capitalism*, editors Nee and Swedberg state that the enduring legacy of Weber's scholarship is perhaps not so much the Protestant ethic thesis, but that the dynamics of capitalism are rooted in the realm of ideas and institutional structures rather than in capital accumulation. They argue for a revision of the common view in sociology and other social sciences that "institutions are *the* key to what is happening in society in the long run." They claim that to be effective, institutions have to be grounded in the values, attitudes, and norms of society.

Charles Sabel provides a lucid description of the endowment explanation of economic development and an emerging alternative called the process or bootstrapping view. Weber emphasized individual motivation, particularly to entrepreneurial striving fostered by the theology of certain Protestant sects, as a key endowment. The current dominant institutional variant of the endowment notion emphasizes legal rules and systems that encourage investment by protecting property rights. The so-called "Washington Consensus" promulgated by the International

Monetary Fund and the World Bank is an official interpretation of this institutional perspective. Both of these views assume that the features that favor economic development are part of a society's fundamental endowments. Sabel states that recent failures of consensus-based reform programs in Russia, Bolivia, and East Germany and successful heterodox approaches in China, India, Mauritius, and Botswana have supported the process or bootstrapping view of economic development. In this view, economic growth and development depends on successive relaxation of constraints to growth. These constraints may be direct obstacles to market exchange or the absence of support institutions that help potential exporters with marketing, training, quality certification, physical infrastructure, and financing. In the bootstrapping view, economic growth requires continuing social learning. All economic actors, private and public, have limited knowledge and face coordination problems. The goal is to create institutions that can learn to identify and mitigate changing constraints on market activity. Such institutions are as much the outcome as the starting point of development. They cannot be viewed as "a foundation upon which a market order must be built if it is to stand" as in the endowment theory.

Victor Nee and Sonja Opper provide an illuminating description of a type of institutional order they call politicized capitalism that emerged in China in the 1980s. This is a type of mixed economy in which state officials set the regulatory framework and remain directly involved in guiding transactions at the firm level. The defining feature of politicized capitalism is "the overlap of political and economic markets and the absence of clearly defined state-firm boundaries." They offer a fascinating analysis of two types of state intervention at the firm level: (1) state assistance in the firm's external transactions, such as borrowing, and (2) state involvement in corporate governance inside the firm. Their evidence suggests that direct state involvement in decision-making at the firm level has a negative effect on performance, but that firms will not openly reject state involvement because state officials ease resource constraints of China's regulated markets, especially markets for credit and land-use rights. A central question is whether China's politicized capitalism will endure. Nee and Opper predict that political interference in economic life will decline. Rapid growth by the private enterprise sector, they argue, will encourage the state to shift to a custodial role characteristic of East Asian developed economies where the state operates within the framework of an independent legal system which guarantees clear and distinct state-firm boundaries.

Weber thought deeply about the connections between law and capitalism, and international financial institutions such as the International

Monetary Fund and the World Bank now recognize that legal institutions are critical foundations for market economies. Corporate bankruptcy or insolvency law has been of particular interest. Bruce Carruthers and Terence Hallidy trace the policy conversation concerning bankruptcy law leading to the adoption of the United Nations Commission on International Trade Law's *Legislative Guide on Insolvency Law* in 2004. There is widespread agreement that insolvency law should be transparent and predictable, but Carruthers and Halliday point out that the issue of what the law should predictably do remains. The *Legislative Guide* does not specify a single model to follow, but "assists the reader to evaluate different approaches and to choose the one most suitable in the national or local context." Carruthers and Halliday call attention to two overlooked aspects of Weber's thinking on law and capitalism. The first is that the creation of predictable law must involve legal professionals, not just legal texts. Legal predictability requires predictability in implementation, which necessarily depends on lawyers, judges, and other participants in the legal system. The second point concerns the support for legal predictability by the capitalists who benefit from it. Predictability may not be necessary or even desirable under all circumstances. Investors may tolerate or work around unpredictable law. Legal predictability can also pit locals against foreigners. Unpredictable law often means that extralegal considerations (e.g., family ties) affect legal outcomes, and these are usually better understood by locals, giving them an advantage over foreigners. It is not clear who will work to create legal predictability.

For those interested in the impact of corruption on society, Mark Granovetter's excellent chapter, "The Social Construction of Corruption," is highly recommended. He begins by noting limitations in the dictionary definition of corruption: "Perversion or destruction of integrity in the discharge of public duties by bribery or favor." Much corruption involves exchanges between individuals, the legitimacy of which depends on meanings and norms. An exchange described as a gift, favor, or loan in one situation may be interpreted as bribery or extortion under different circumstances. The relative status of parties to social exchange also matters a great deal in understanding corruption. Accepting a bribe is an acknowledgement of social inferiority, like accepting a tip or gratuity. Bribes can flow from those socially inferior to those socially superior, but this requires extensive management and buffering at a higher cost and complexity than simple monetary payments, and may require "corruption entrepreneurs." An example given is that of "Boss Lai," the central figure in a famous corruption scandal in China in 1998. Granovetter also distinguishes between market and nonmarket corruption. Market corruption is the "selling of government goods and services to the highest bidder." Such corruption is impersonal. Nonmarket, or network, corruption occurs where people honor obligations to others they know in ways that are considered illegal, improper, or corrupt. In economies undergoing difficult transitions where wages fell and jobs were insecure, people protected their friends at the expense of strangers. What looks like corruption were the survival skills of people living in uncertain times. An ideology of class solidarity based on friendship and reciprocity can effectively neutralize perceptions of corruption.

In their chapter, economists Robert Barro and Rachel McCleary investigate the two-way interaction between religion and political economy. Key questions addressed include how economic development and political institutions affect religious participation and beliefs, and how religiosity affects individual characteristics and economic performance. They explore these questions using a previously constructed cross-country data set expanded to include measures of religiosity for eighty-one countries. One of their findings is that per capita gross domestic product (GDP) has a significant negative effect on all of the religiosity indicators (attendance at religious services, personal prayer, belief in hell, belief in afterlife, and self-identification as a religious person). This finding supports the secularization hypothesis that religion would decline in response to advances in education and science, as well as the rational-choice perspective of Azzi and Ehrenberg (1975). The United States, however, has maintained a high level of religiosity over time even as incomes have risen, making it an outlier in their results, along with Singapore and Poland. Another finding is that in models of growth in real per capita GDP, belief in hell has a positive relationship with growth, but attendance at religious services is negatively related. These results accord with Weber's view that religion is an influence on individual traits and values. Religion does not appear to operate as a social organization that enhances productive social capital and networking.

Another economist, Robert Frank, writes a chapter in which he argues that "the Protestant ethic was by no mean necessary for capitalism's launch (although it may have helped), but that a revival of the progressive institutions inspired by it may be essential for the system's continued survival." Examples of progressive institutions Frank cites include the progressive income tax system, Social Security, and subsidies for education. I am not sure that progressive institutions were inspired by the "Protestant ethic" which I understand to emphasize disciplined work and thrift, and I did not find much support for the claim that capitalism's survival depends on the revival of these institutions. What I found compelling, however, was Frank's argument that rising inequality is harmful to middle-income families. His argument is based on psychological costs of inequality and what Frank calls "expenditure cascades." Expenditure cascades result when rising incomes and expenditures of the rich change the social frame of reference of what is necessary or appropriate. The costs of inequality raise it as a moral concern beyond how it reflects poverty, which is an emphasis in official social statements of Christian denominations.

In a stimulating chapter, Duncan Watts offers a critique of "rationalist" and "historicist" views of human behavior, and discusses a class of models in which individual decisions generate collective dynamics that are ambiguously related to both individual preferences and contextual variables. Rationalists, according to Watts, contend that historical outcomes result from individual actions based on consistent and timeless human traits and preferences. Historicists, among whom Max Weber would be counted, contend that no such traits and preferences exist, and that all action is historically contingent. Watts argues that a mistake both rationalists and historicists make is to treat collectives of individuals as an individual actor responding to its environment (the representative individual in economics). Watts contends that when individuals make decisions in response to the decisions of others, the relationship between individual preferences and collective action breaks down. An example of a crowd poised on the brink of a riot illustrates the point. Causal relationships meaningful for individual behavior are largely irrelevant to group behavior, and causality at the group level is deeply ambiguous. The implication for policy makers is sobering.

Although there is little on Christian theology and its relationship with economic life, even on Max Weber's understanding of it, I recommend *On Capitalism* to Christian economists and others interested in the roles of beliefs, social norms, and institutions in the process of economic growth and development. I learned much from reading the various contributions, but the chapters are loosely related. Be prepared for a rewarding wilderness experience.

References

Azzi, C., & Ehrenberg, R. (1975). Household allocation of time and church attendance. *Journal of Political Economy*, *83*(1), 27–56.

Tawney, R. H. [1926] (1962). *Religion and the rise of capitalism*. New York: Harcourt, Brace, & World.

UNCITRAL (2005). *Legislative guide on insolvency law*. New York: United Nations.

Weber, M. [1904–05] (1958). *The Protestant ethic and the spirit of capitalism* (Talcott Parsons, Trans.). New York: Charles Scribner and Sons. ■

Economic Facts and Fallacies

Thomas Sowell. 2008. New York: Basic Books. ISBN: 978–0–465–00349–5, $26.00.

Reviewed by Art Carden, Rhodes College.

Thomas Sowell is one of the great economic communicators of the twentieth century, and his output in the early twenty-first century has laid a solid foundation for understanding and communicating economic principles for years to come. Professor Sowell's latest contribution is *Economic Facts and Fallacies*, which would serve as an excellent text for a book club or discussion group; in addition, it would serve as a powerful supplement to an introductory economics course. Sowell's contribution provides a systematic discussion of matters that are often addressed by people of faith, and he comes to the familiar conclusion that good intentions do not always create good outcomes. As is usual in Sowell's work, *Economic Facts and Fallacies* is an exercise in careful theoretical analysis firmly rooted in fact.

Professor Sowell begins by identifying the kinds of fallacies people indulge in and the "power" that makes those fallacies so alluring. The book is less an examination of economic theory and bad economic reasoning and more a discussion of economic reality versus economic fiction. In this sense, the book might be better titled *Economic Facts and Fictions* because what Sowell identifies are often errors in fact rather than errors in reasoning, but this is at best a minor quibble and a matter of individual preference. I did not write the book; Professor Sowell did, and he makes a very useful contribution.

Sowell identifies several particular fallacies common in debate over economic subjects: the zero-sum fallacy, the fallacy of composition, the chess-pieces fallacy, and the open-ended fallacy. The first is the fallacy of believing that wealth exists in a fixed amount and that one person's gain is necessarily another person's loss. The second is the fallacy of believing that if one party benefits from a policy, everyone benefits (consider, for example, the belief that if steel workers benefit from protectionism, the country is better off). The third is the failure to recognize that people respond to incentives, following Adam Smith's famous rebuke against those who believe that people can simply be rearranged like pieces on a chessboard without any process costs. The final fallacy speaks in categorical terms about concepts like "safety" and "health" without recognizing first that the relevant units of analysis are marginal and that those marginal units of safety and health (for example) have to be traded off against other wants.

Sowell divides his book into individual chapters that address urban issues, gender issues, the academy, the earning and distribution of income, relations among races, and economic development in the Third World. In so doing, Sowell applies a sharp mind and a keen eye for data to policy issues that have received much (perhaps erroneous) attention in the national press.

Economic Facts and Fallacies provides a powerful antidote for social problems that are unfortunately treated as moral failures rather than as the outcomes generated by individual responses to the institutions and incentives in place. Spiritual leaders exhort their congregations to care more—to feed the hungry, clothe the naked, and so on—and injustices and inequalities are interpreted as the consequences of indifference on the part of those with the means to "make a difference." A political program that is built on a foundation of stylized "facts" that are either incorrect *per se* or incorrectly interpreted can be ineffective at best, dangerous at worst. In each chapter, Sowell carefully and correctly interprets the facts in light of economic theory; in so doing, he exposes the "fallacies" of today's policy debates.

Sowell's first chapter on policy issues considers the urban experience. In contrast to so-called "smart growth" policies, Sowell shows that central planning in urban environments has tended to create inflated prices (through land use restrictions), housing shortages (through rent control policies), and increased traffic density (through refusal to build appropriate infrastructure). Sowell takes the "elites" to task on account of their disdain for "ticky tacky houses," suggesting that "(t)hose whose sensitivities are affected by what they see out of airplane windows can of course close the shades. But some prefer instead to disrupt the lives of millions of people on the ground" (p. 54).

Much of the material covered by Sowell in his chapter on men and women will be familiar to readers of his earlier work. According to Sowell, women excelled in academia prior to anti-discrimination laws, and many of the trends people attribute to changing gender attitudes are, in Sowell's view, better explained by changing patterns of marriage and fertility.

Chapter four, on academia, is very interesting from the standpoint of an academic who has yet to achieve tenure. Sowell excoriates the academic establishment for its apparent focus on pacifying and serving faculty members rather than students; in addition, Sowell notes that educational institutions' non-profit status means that they are often able to enjoy subsidized inefficiency. Sowell notes—rightly, in my view—

that just because a particular institution has an excellent reputation as a research community, it is not necessarily the right place to go for an excellent college education.

I do not think Sowell offers a deep enough discussion of the role of the competitive marketplace, as restricted as it might be by government interference, in American higher education. In contrast to most of the world, the U.S. has a competitive mix of government-supported and private institutions, which provide a wide array of educational products. There are many aspects of the system that are broken, but by and large American higher education does work.

Sowell offers effective and entertaining chapters on income, race, and Third-World economic development. Sowell argues that we need to take great care in how we interpret statistics—in earlier work, he has made reference to what he calls "Aha!" statistics. It is a plea for intellectual clarity, because if we pursue an unthinking focus on specific numbers that are then misinterpreted, this will probably lead to undesirable policies. According to Sowell, focus on trends across income quintiles and deciles ignores many important facts. Examples include the fact that household income and per-capita income are not the same thing: changing household composition means that we might be misrepresenting changes in household composition as changes in meaningful inequality. Sowell's chapter on income provides a broad but succinct treatment of income dynamics in the United States.

Regular readers of Sowell will also find his chapters on race and third-world development very familiar, but they provide a key corrective to conventional theories of racial differences and third-world poverty. Sowell has long criticized the view that black poverty is due to "the legacy of slavery," arguing instead that blacks inherited a Southern white culture that was inimical to economic development. This is a provocative thesis, to be sure, but I am wary of accepting it completely in the absence of more refined statistical testing. In this particular chapter, he repeats many of his previous criticisms of the alleged link between slavery and under-development, noting, for example, that black families went to great lengths to reunite with one another in the years after emancipation. Sowell also discusses the familiar result that discrimination need not persist in a competitive marketplace as those who insist on indulging their tastes for discrimination will find themselves on the receiving end of a swift capitalist comeuppance courtesy of the invisible hand of the marketplace.

It is here that much work needs to be done. On the one hand, some analysts conclude that racism and discrimination exist in the unfettered marketplace and go about searching for evidence to support their foreordained conclusion. On the other hand, there are alternative channels through which one can indulge a taste for discrimination, like politics. In his recent book (reviewed in this issue), Bryan Caplan (2007) identifies what he calls *anti-foreign bias*, which represents voters' distrust of foreigners. The fact remains that many people dislike others on the basis of skin color, and it is possible—I would say likely—that people are able to indulge racist preferences due to institutional changes that eliminate the penalty for doing so. At the same time, it is possible (and again, I would say likely) that institutional changes aimed at eliminating discrimination have had the unintended consequence of turning race and gender into sorting mechanisms. These remain open questions, however.

Sowell's chapter on Third World poverty makes use of recent contributions by Hernando De Soto, Muhammad Yunus, and others to discuss the institutional and cultural factors restricting economic development, but there is no discussion of the empirical literature on institutions and development—perhaps most notably the research agenda being pursued by Daron Acemoglu, Simon Johnson, and James Robinson. While Sowell is correct to criticize foreign aid, he could bolster his exposition of the issues explaining economic development with a more complete review of recent empirical literature.

Sowell's discussion of poverty in developing countries also brings into high relief the contributions that economists can make to discussions of global "justice," however people choose to define it. It is by now well-known that the trillions of dollars in aid that have been transferred to foreign governments have not produced economic growth and have instead perhaps propped up kleptocratic regimes. Economics serves the discussion by illuminating the boundaries of feasibility that constrain what we might find ethically desirable.

Sowell closes the book with a few "parting thoughts" that squarely place this book within the context of the rest of the Sowell canon. What Sowell criticizes is a fundamental part of what he earlier called *A Conflict of Visions* (1987): people tend to let their vision drive which facts are acceptable instead of allowing the facts to modify and revise those visions. In short, an economist's work is never done. Sowell's analytical approach can be summarized with two principles, and it is an approach that deserves to be replicated everywhere: learn the theory, and get the facts straight. Only then can one develop insight.

The lesson for spiritual leaders and Christian economists is clear. Uninformed advocacy is a poor (and dangerous) substitute for careful understanding and critical analysis. The world is a complex place, and unreflective sloganeering rather than reflective discussion has the capacity to compound the miseries we so desperately wish to fix.

Sowell's short volume provides a tight guide to the facts and basic economic theories relevant to a number of important policy issues. On the one hand, it stands as a useful reference for scholars and teachers interested in these issues; on the other hand, it will be a valuable supplement to introductory economics courses around the world.

References

Caplan, B. (2007). *The myth of the rational voter: Why democracies choose bad policies*. Princeton: Princeton University Press.

Sowell, T. (1987). *A conflict of visions: Ideological origins of political struggles*. New York: W. Morrow. ■

The Good That Business Does

Robert G. Kennedy. 2006. Christian Social Thought Series No. 9. Grand Rapids, MI: Acton Institute. ISSN: 1531–4057, $6.00.

Reviewed by Joseph Anthony Burke, Ave Maria University.

This short booklet discusses the good that businesses do in the tradition of Christian social thought. After the introduction, Kennedy surveys the history of Christian thinking about business, discusses what economics and law say about business, presents an overview of Catholic Social Teaching, discusses business and the common good, and, in the last section, clarifies the good that business does. The thesis of the essay is that businesses do good works by producing goods and services, employing workers and providing them with incomes, and creating wealth for shareholders. As a corollary to this, the author argues for a limited view of corporate responsibility and rejects the idea that businesses are morally required to make any further contribution to their communities beyond their ordinary business operations. While this perspective is refreshing, the writing is occasionally confused or unclear, especially in the discussions of basic goods, the common good, and corporate responsibility.

Kennedy defines basic goods as goods that truly fulfill human beings (p. 42). He lists life, health, beauty, action, truth, harmony, and friendship as basic goods. He argues that there is no common scale for measuring the value of items in one basic group against the value of items in another. What is meant by this? Does he mean that human beings cannot substitute between different basic goods? It seems that he argues that each of these is absolutely essential when he makes an analogy to nutrition: “If calcium is really needed for health, then no amount of protein or Vitamin C can substitute.” There is also some confusion as to whether the basic goods form a basis for all other goods, so all goods are comprised of basic goods to some extent, or whether a good falls into only one category—e.g., a painting is a beautiful good, food is a healthy good. The assertion that these goods cannot be measured against each other is problematic in a utility context, where humans must inevitably choose between different goods, and must use some measure (e.g., their own preferences) in order to do so.

The author argues that the basic goods have moral consequences, and businesses must, at a minimum, “avoid harming basic goods” (p. 51). He also states that “[i]n the most fundamental way, organizations are superior to the extent that they are able to pursue and respect more instances of the basic goods more deeply.” What does this mean? It seems that Kennedy is arguing that the criterion of action for a business should be to "maximize respect for basic goods," instead of using some other criterion, such as "maximize profit." Is respect best conceived of as a continuous or a discrete variable, and does it have a bound? In the ordinary use of the word, a person either respects something or he does not, i.e. respect is an indicator variable, taking on a one if respect is shown and a zero if not. If this characterization of respect is correct, then the idea of ever increasing respect for basic goods without limit is nonsensical. By contrast, "love" and "appreciation" are concepts that seem unbounded, so perhaps the criterion suggested is better stated as "maximize love for basic goods," or "maximize appreciation for basic goods." While this may be a worthy practice for contemplation, it is wholly inadequate as a criterion for business decisions, being too vague to provide any clear direction and unrelated to the practice of business itself.

Kennedy defines a common good as a good that can be shared by a number of persons (p. 52). This is in contrast to the usual definition of the common good as the set of conditions necessary for prosperity. The author also defines an infinite common good as a good that can be distributed among an indefinite number of persons without diminishment, and a limited or finite common good as a good that cannot be distributed without diminishment. In economic terms, infinite goods are goods with zero marginal cost, and limited goods are goods with positive marginal cost. By definition, infinite goods are nonrivalrous, and limited goods are rivalrous. Table 1, which can be found in most Principles textbooks, clarifies the separate categories.

With the new terminology, infinite goods are either collective or public, and finite goods are either private or commons goods. Here we can see that moral philosophers and economists are in the habit of using different words to express the same concepts, and the lack of a common language between them is evidence of the absence of any dialogue.

The last chapter has a nice discussion about corporate responsibility. Kennedy identifies strong and weak views of corporate responsibility,

Table 1

	Rivalrous	Nonrivalrous
Excludable	Private good	Collective good
Nonexcludable	Commons good	Public good

where the former requires that businesses contribute some of their profits to the communities in which they operate, and the latter asserts that the only responsibility of business is to maximize shareholder wealth within the constraints of the law. He argues that the contribution that businesses make is that they provide a good to their customers, employment for their workers, and returns to their shareholders. Kennedy states:

> [b]usiness corporations…by their nature serve the common good when they function as they should…. It need not justify its existence on the ground that it addresses broad social injustices or performs general works of charity…. [T]he rationale sometimes offered for the strong view of corporate social responsibility implies that producing economic benefits is not enough; business corporations must do more. Insisting…that businesses must "give back something to the community" suggests that they are not adequately contributing to the common good through their normal operations (which include paying taxes) and that their normal operations unfairly take something away from the community (pp. 82–83).

In fact, Kennedy is even too generous to the critics, as the argument that businesses must "give back something to the community" implies that the goods and services that are produced in the ordinary operations of businesses contribute nothing to the community.

Kennedy argues that, while the strong view of corporate responsibility demands too much of businesses, the weak view requires too little. Here he presents an interesting characterization of law and its development:

> Law by its very nature is reactive; laws and regulations are enacted to prevent harms from occurring again. They rarely, if ever, anticipate harms we have never experienced and offer proactive protection. As a result, the law constitutes a minimal set of requirements for ethically sound behavior for individuals and organizations…. Corporations…have responsibilities that are not adequately described by laws and regulations (p. 83).

At this point, Kennedy inadvertently opens the door for an expansive scope of corporate responsibility. He argues that "corporations have a duty to treat their constituencies as fairly as they can," and "to avoid causing harms to the community (e.g., pollution) even when those harms are not prohibited by law" (p. 84). The problem with these two principles is the ambiguous definitions of what constitutes "fair" and "harm." Does a business have to employ fifty percent women in order to be "fair?" Does a business reduce its "carbon footprint" to zero, whatever the cost, in order to avoid “harming” the community? Furthermore, the author suggests that “wholesalers and retailers could be open to ways they could help insure that no one in the community goes hungry” and “construction companies could explore ways in which affordable housing could be built” (p. 84). Here Kennedy undermines his own argument: grocers serve the community by selling groceries and builders by building houses. Corporate charity is unnecessary to satisfy the problems of either hunger or homelessness, as members of the community, either individually or through voluntary organizations (e.g., the local parish church), can use their income to buy groceries and homes to donate to the hungry and the homeless.

Kennedy also suggests that businesses should be free to donate money or other assets to the community. This depends on the ownership structure of the business: if the business is privately held, then the owner may do with his wealth as he pleases, but if the business is a publicly held corporation, then corporate donations are effectively donations by the executive of the shareholder’s money. Since the executive works on behalf of the shareholders, he should not give their money away unless they direct him to do so. Kennedy acknowledges that shareholder consent is necessary for donations from publicly held corporations, but fails to consider the case when shareholder consent is not unanimous. In such a situation, some shareholders give the executive permission to give away not only their own wealth but that of the other shareholders as well.

The author ends the essay recognizing that corporate charity has accomplished much good and expresses a hope that it will continue. However, from his own example of Warren Buffet’s donations to population control programs (p. 80), it could equally be said that corporate charity has accomplished much evil, and it is not at all clear to me that it should continue.

Robert G. Kennedy’s essay is a welcome contribution to the dialogue between economics and Christian teaching. I am hopeful that the natural law tradition in which he presents his argument may provide a framework for fruitful dialogue among the various Christian communities. Clarification of issues he raises, especially those pertaining to basic goods, the common good, and corporate responsibility, present an important and challenging avenue of research from which I look forward to future contributions. ■