VOLUME XVII, NUMBER 1, WINTER 2016/17

# CLAREMONT REVIEW OF BOOKS

*A Journal of Political Thought and Statesmanship*

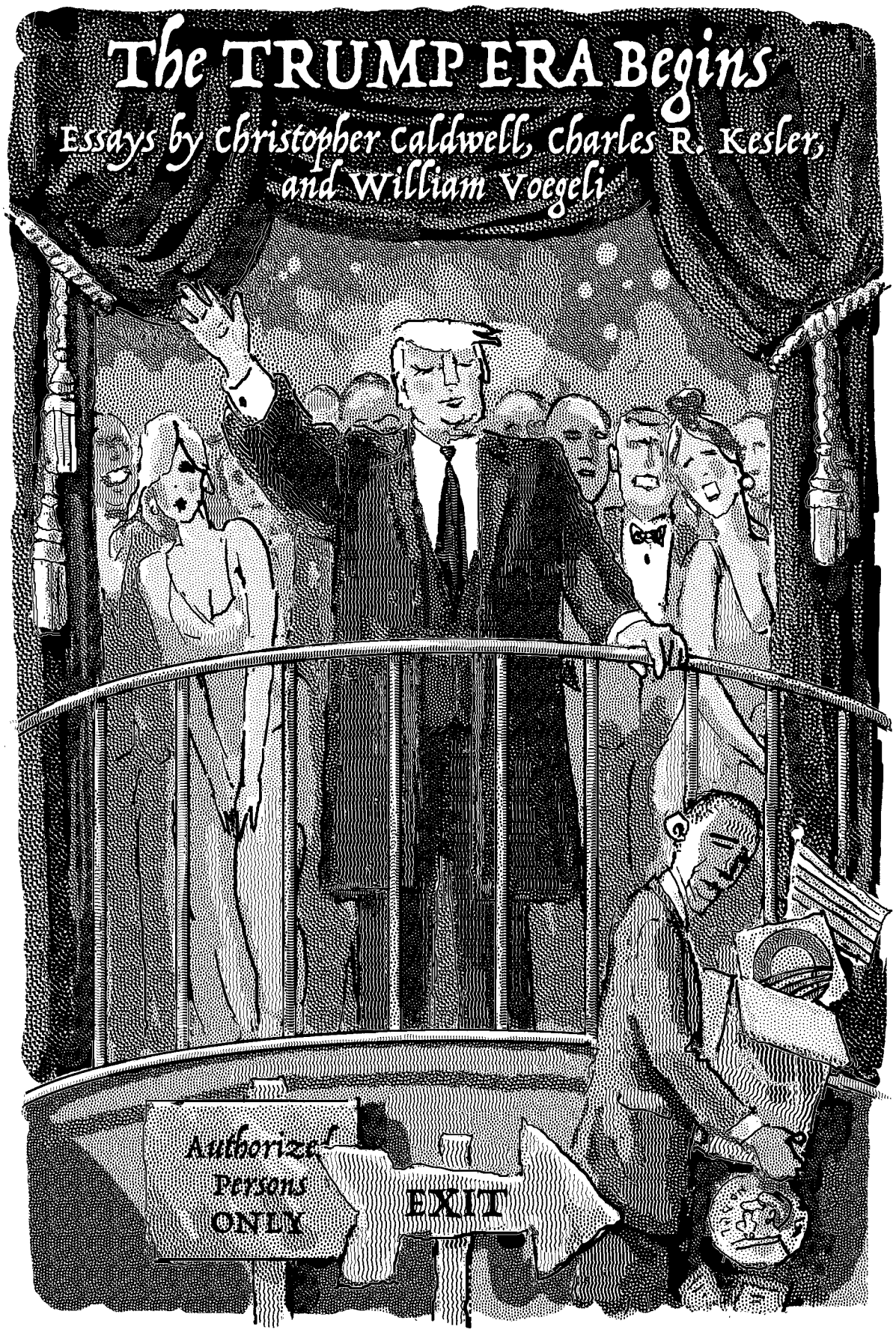
Truman Anderson ✦ Helen Andrews: Terror in France

Michael Barone ✦ Irwin Stelzer ✦ Richard Vedder: How America Got Rich

Tod Lindberg: A History of Tyranny

Algis Valiunas: Thomas Alva Edison

Martha Bayles: Le Carré's People




Steven F. Hayward: The Threat to Liberty

Gerard V. Bradley ✦ Keith Whitaker ✦ Scott Yenor: This Nation, Under God?

Richard Brookhiser: Encyclopedia Britannica

Robert J. Samuelson: Alan Greenspan

Roger Scruton: Existentialism & Me

A Publication of the Claremont Institute

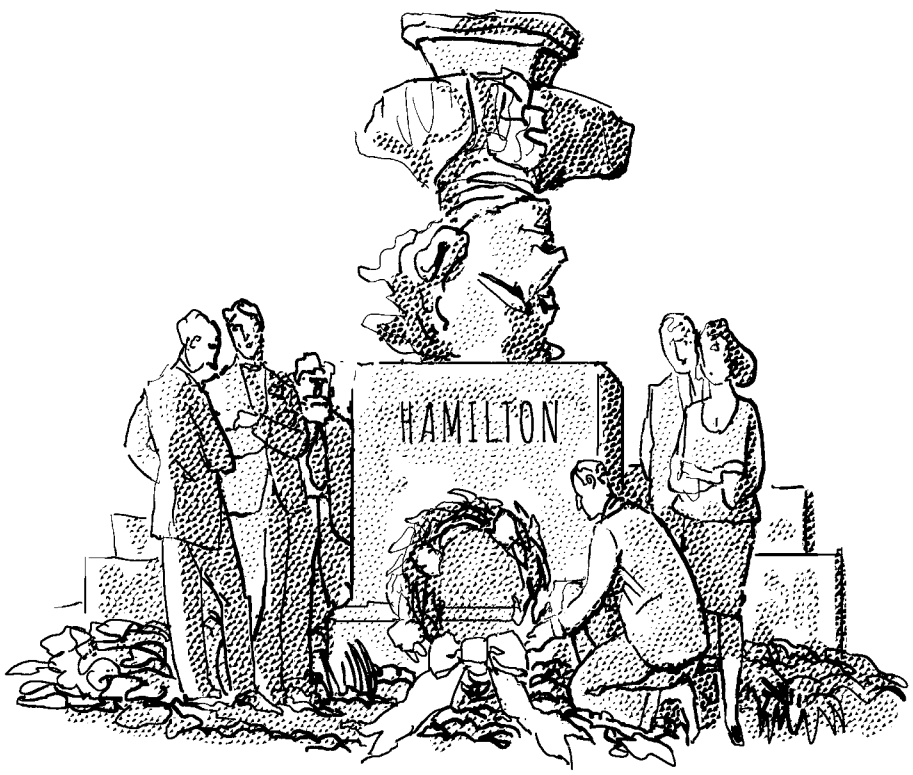
PRICE: $6.95

IN CANADA: $8.95

Book Review by Richard Vedder

# You Didn't Build That

*Concrete Economics: The Hamilton Approach to Economic Growth and Policy*, by Stephen S. Cohen and J. Bradford DeLong. Harvard Business Review Press, 240 pages, $28



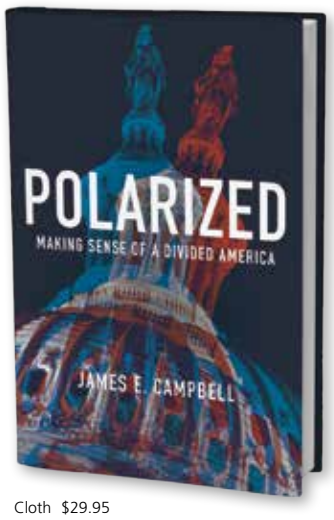

Starting with Alexis de Tocqueville in the 1830s, many scholars and writers have chronicled the rise of economic exceptionalism in the United States. They have emphasized such factors as American rugged individualism, the lack of barriers to economic and geographic mobility, the absence of burdensome laws and regulations, strong private property rights, a large internal free trade area, and relatively low taxes. Living on the frontier promoted ingenuity, risk-taking, and individual initiative—all vital to economic success. Economist Deidre McCloskey has argued that Americans excelled because our country was about the best place in the world where ordinary citizens could have a go at it, striving for material success by pursuing all sorts of innovative ideas. The U.S. proved that laissez faire capitalism works.

Now along comes Stephen Cohen, Professor Emeritus of City and Regional Planning, and Bradford DeLong, professor of economics, both at the University of California, Berkeley, with a much different interpretation. In *Concrete Economics*, they argue that, until recently, forward-looking and benevolent federal government has produced private sector success. Alexander Hamilton started the whole process, they claim, and for roughly two centuries the U.S. benefited mightily from a capitalism nudged into appropriate action by Hamilton-inspired federal activism. But American exceptionalism has broken down recently because waning government financial regulation has hampered our global economic leadership, while other economies like Japan and China have learned Hamilton's lesson and used governmentally-led policies to propel those nations into positions of global economic leadership.

Cohen and DeLong outline four pillars to Hamilton's economic system: high tariffs, high infrastructure spending, the federal government's assuming of state debts, and a central bank. Evidence is scanty on much of this, although that doesn't deter the authors. For example, take large infrastructure projects. The reality is that, with one exception, there were *no* federally funded infrastructure projects before 1850 (45 years after Hamilton's death), and the exception, the National Road, was successfully proposed by Thomas Jefferson's Treasury Secretary Albert Gallatin, Hamilton's nemesis, years after Hamilton died. There is a general sloppiness in *Concrete Economics*; the authors even get the dates wrong for the Smoot-Hawley tariff and the launching of Sputnik.

As to tariffs, Cohen and DeLong break from two centuries of economic thinking beginning with Adam Smith and David Ricardo, which has held that free trade benefits economies and that tariffs usually have significant detrimental effects. It is true that Hamilton was a high tariff man and that the U.S. adopted high protective and revenue-raising tariffs. It is also true, however, that there is a general consensus that what economist Walt Rostow famously called America's "take-off" into sustained economic growth occurred after 1840 (Rostow says 1843–1860), when tariffs were going *down* sharply. For example, shortly after the passage of the extremely high Tariff of Abominations in 1828, duties on imports were 61.69%, but as a consequence of tariff reductions (in 1832, 1833, 1846, and 1857), they fell sharply to 34.39% by 1840 and to 19.67% by 1860. Might rapid growth have started even earlier if we had *not* adopted the Hamilton high tariff policy praised by Cohen and DeLong? Students of tariffs from Frank Taussig to Paul David argued decades ago that the high tariffs were more an income redistributionist scheme for New England rent-seeking manufacturers than a sage policy to promote general economic growth.

# Changing the Conversations that Change the World



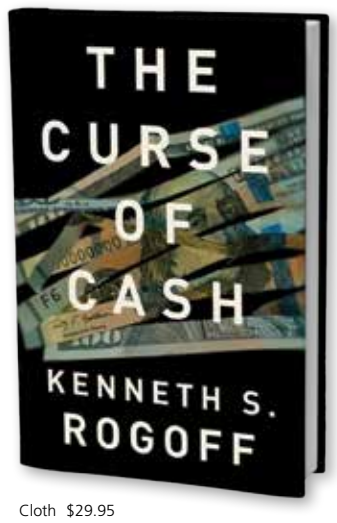

Cloth $29.95

## Polarized

### Making Sense of a Divided America

James E. Campbell

"If recent elections have proven anything, it is how deeply polarized American voters really are. In this remarkably perceptive and probing book, Campbell explains how and why this phenomenon began and developed. You'll be surprised by some of his findings. We can't reduce paralyzing polarization until we truly understand it. Thanks to Campbell, we're much better equipped."
—Larry J. Sabato, author of *The Kennedy Half-Century*




Cloth $29.95

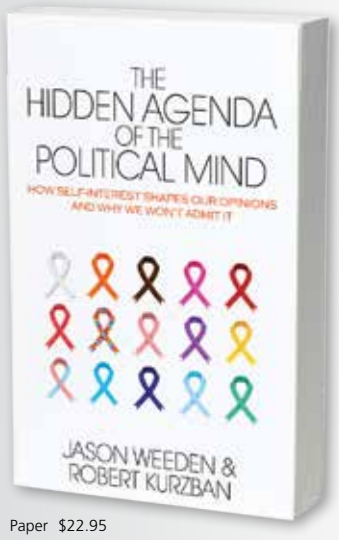
*Longlisted for the Financial Times & McKinsey Business Book of the Year 2016*

## The Curse of Cash

Kenneth S. Rogoff

"An illuminating, provocative and fact-packed work that does make you wonder why on earth we allow so much cash to slosh around. It also exposes some well-worn pub truths as urban myths."
—Patrick Hosking, *The Times* (London)

"An excellent book on the history and the origins of cash, which also goes into much depth on the issue of cash constraining monetary policy."
—Jon Hartley, Forbes.com




Paper $22.95

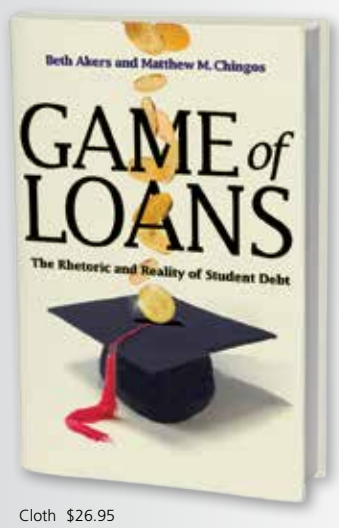
## The Hidden Agenda of the Political Mind

### How Self-Interest Shapes Our Opinions and Why We Won't Admit It

Jason Weeden & Robert Kurzban

"A thoughtful reminder that politics is often simply a contest over finite resources in which different voters want opposing things."
—John McDermott, *Financial Times*

"One of the most interesting books I have read on politics in quite a while. . . . Fascinating."
—Daniel Finkelstein, *The Times* (London)




Cloth $26.95

## Game of Loans

### The Rhetoric and Reality of Student Debt

Beth Akers & Matthew M. Chingos

"This insightful book provides an excellent overview of the current student loan system. Presenting evidence about who borrows, how much they borrow, and the burden of repayment, Akers and Chingos refute the idea that there is a general student loan crisis, highlight the real problems that do exist, and propose solutions."
—Sandy Baum, coauthor of the annual *Trends in Student Aid* and *Trends in College Pricing*

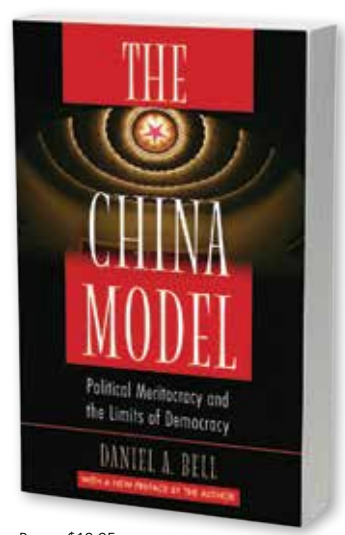

Cloth $32.95

## Blue Skies over Beijing

### Economic Growth and the Environment in China

Matthew E. Kahn & Siqi Zheng

"*Blue Skies over Beijing* comes at an important time for China, when the exploding incomes of urban dwellers are colliding with rising pollution in the cities where they live. With a strong economic backbone and a unique and timely focus on the rise of China's middle class, this inspiring book will change the way we think about the links between changing urban landscapes and environmental quality."
—Maximilian Auffhammer, University of California, Berkeley




Paper $19.95

*One of the Financial Times's Best Books of 2015*

## The China Model

### Political Meritocracy and the Limits of Democracy

Daniel A. Bell

"Fascinating. . . . Open-minded readers will find it equips them with a more intelligent understanding of Chinese politics and, no less valuable, forces them to examine their devotion to democracy. . . . From start to finish the book is a pleasure and an education."
—Clive Crook, *Bloomberg View*

PRINCETON UNIVERSITY PRESS

See our E-Books at
press.princeton.edu

Cohen and DeLong imply that Hamilton invented central banking in the U.S. and that it was a major contributor to economic growth. Certainly Hamilton successfully promoted the First Bank of the United States, which performed some very useful functions, but it was 80% privately owned and lasted a mere two decades. After the Second Bank of the United States lost its charter in 1836, the nation had 78 years with absolutely no central bank or effective monetary policy. Far from a disaster, the nation had its economic take-off, and passed Britain in total output and, in the first decade of the 20th century, even in per capita output. Meanwhile, we had a better record with regard to price stability—a key goal of central banks—than we've had in the era of the Federal Reserve System.

The authors claim, too, federal government actions promoted technological change and mass production techniques, starting with the use of interchangeable parts in gun manufacture at the Springfield Arsenal and elsewhere. Although the improvements in gun manufacture certainly did occur, the implication that the federal government remained at the forefront of technological change over the next two centuries is highly exaggerated. To be sure, the government's protection of intellectual property rights through patents was important, but with that exception, most of the great innovators of the 19th and early 20th centuries—Cyrus McCormick, John Deere, Charles Goodyear, Samuel F.B. Morse, Alexander Graham Bell, Thomas Edison, Henry Ford, the Wright brothers, George Westinghouse, Isaac Singer—got essentially no help from the federal government. And great entrepreneurs like Cornelius Vanderbilt, John D. Rockefeller, and Andrew Carnegie did not owe their success to "government-business partnerships." The federal government helped mainly by *not* "helping," staying out of the way, not even levying income (with brief exceptions during the Civil War and 1894), inheritance, broad-based sales taxes, or enacting much regulation, until the 20th century.

The authors claim that with the changing economy, there were necessary and highly successful "resets" of federal policy during the administrations of Abraham Lincoln, Theodore and Franklin Roosevelt, and Dwight Eisenhower. Here again Cohen and DeLong's account varies from what I think the facts show. Consider the New Deal. The authors argue that FDR cautiously used government spending to put workers to work, since letting "market forces sort it all out…had already proven not to work." The reality is it took more than a decade to get over the Great Depression, and that both Herbert Hoover and FDR pursued an interventionist high wage doctrine that resulted in unemployment remaining high long after it had returned to near normal levels in other countries. The New Deal's National Industrial Recovery Act and the Wagner Act both pushed wages up and seriously delayed recovery. The corrective power of "market forces" to reduce unemployment was negated by government action—markets were not allowed to work. Not only was the federal government itself much of the problem; so was its central bank, the Federal Reserve, as Milton Friedman and Anna Schwartz demonstrated brilliantly over a half-century ago in their book, *A Monetary History of the United States* (1963). And the high tariffs so cherished by Cohen and DeLong did not help matters, either—certainly not the Smoot-Hawley tariff of 1930.

The authors' most questionable arguments relate to the modern economy. They emphasize the rise of the East Asian economies, especially Japan and now China. Again, Cohen and Delong assert that these countries' high economic growth rates largely reflected astute governmental direction—marked by protectionist policies and the targeting of industries for investment where the possibility of taking a commanding market share was feasible, to the detriment of manufacturing in the United States. They argue that rather than using "pragmatic" policies to react to this challenge, the U.S. after 1980 adopted an ideologically based set of policies to reduce New Deal era financial laws and regulation, which, in turn, led to the vast expansion of the essentially non-productive financial sector at the expense of the more productive manufacturing and other "real" ("concrete") sectors. According to Cohen and DeLong, we have too many real estate agents, and an overabundance of Wall Street traders making too much money for doing too little of value.

With respect to Japan, Cohen and DeLong note that after 1990 "growth became dishearteningly elusive. Why? We do not claim to know." The answer is pretty simple: the nation went on a generation long splurge of Keynesian fiscal stimulus, including massive infrastructure spending, that has crowded out productive private investment and led to a ratio of national debt to output easily the highest of any nation in the world (much higher than in Greece, for example). It is the starkest case of government economic failure in modern times.

With respect to China, even the authors admit that growth began after 1978 when the government surrendered control over much of the economy, allowing private property rights and markets to flourish. They fail, however, to talk about government failures, such as the long-term demographic effects of the single-child policy, which aside from having created a moral catastrophe (massive female infanticide), is the single biggest threat to longer-term economic growth because the population will age drastically in the coming decades. Even now growth rates in China are declining as the rate of return on massive infrastructure spending is proving to be quite low, and the financial system is increasingly problematic.

With respect to the United States, I think there is a better explanation for the growth slowdown since 2000: massive growth in government regulation, along with increased marginal tax rates, has stifled innovation and investment. In the 1980s and '90s, when the financial deregulation that Cohen and DeLong decry occurred, the nation had respectably high rates of economic growth—typically over 3% a year. That has dropped significantly to the 2% range since 2000. The new millennium has been characterized by *expanding* regulation, including in the financial sector (e.g., Sarbanes-Oxley in 2002, Dodd-Frank in 2010). The overregulation of the financial sector has stifled lending and led to a decline in new business start-ups. Obamacare has exacerbated an already inefficient system of health care delivery. High taxes on businesses and individuals are pushing both corporations and—for the first time in American history—highly productive Americans to flee the country in growing numbers, while an undeclared but very real government-induced War on Work has reduced drastically the proportion of Americans employed or seeking jobs.

Perhaps *Concrete Economics*'s most frustrating theme is its call for government to abandon "ideology" in policymaking, instead doing pragmatic, "concrete" things. Ideology seems to be defined as adopting market-based solutions, whereas pragmatic approaches involve putting a strong emphasis on government action. Why the adoption of Keynesian, interventionist strategies is less "ideological" than market-oriented approaches with a lighter regulatory touch is beyond me. Indeed, I think many of the so-called "ideological" predilections towards free trade, low tariffs, and modest governmental economic involvement are, in fact, conclusions of practical wisdom amply supported by empirical evidence. Stephen Cohen and Bradford DeLong's claim that government played the key role in engineering American prosperity and economic exceptionalism—that government "built that," in President Obama's words—lacks a comparable foundation.

*Richard Vedder is Distinguished Professor of Economics Emeritus at Ohio University and an adjunct scholar at the American Enterprise Institute.*