REVIEW ESSAY

A Crisis of Authority

Pierre Lemieux's *Somebody in Charge: A Solution to Recessions?*

✦

JOHN P. COCHRAN

On January 9, 2009, President-elect Barack Obama stated, "There is no disagreement that we need action by our government, a recovery plan that will help to jump-start the economy." A month later, in a full-page response paid for by the Cato Institute (2009), more than two hundred prominent economists responded, "With all due respect, Mr. President, that is not true." The economists' statement, which in retrospect proved much more prophetic than the administration's claim that the stimulus bill was necessary to keep the unemployment rate from reaching 8 percent, went on to argue that "it is a triumph of hope over experience to believe that more government spending will help the U.S. today." Three years later, despite massive actions by the authorities to stimulate, direct, guide, or jump-start the economy, unemployment remains persistently higher than not 8 percent, but 9 percent. Because of "regime uncertainty," the prospects for significant job creation in the current "recovery" remain bleak (Theroux 2011).

The calls for urgent action, for somebody to be in charge, during this "national job emergency" continue. "[S]itting by passively is no longer acceptable. In fact, it constitutes cruel and unusual punishment of the American workforce" (Blinder 2011). Are such calls for additional action justified, or do policymakers have blinders on in regard to the ineffectiveness and counterproductiveness of the ongoing attempts to have take charge? Pierre Lemieux asks precisely this question: "[D]o we

John P. Cochran is a professor of economics at Metropolitan State College of Denver.

The Independent Review, v. 16, n. 4, Spring 2012, ISSN 1086–1653, Copyright © 2012, pp. 591–598.

need somebody in charge to control economic crisis?" (p. 155). He argues that the continuing call for action, for somebody to be in charge of recovery, rests on two hypotheses that are too often taken for granted: "[T]he economic crisis would occur without the authorities guiding hand," and "these authorities know how to manage the economic cycle" (p. 39). Supported by a blend of theory and historical evidence, Lemieux argues convincingly that having "somebody in charge" is not only *not* a solution, but most often (everywhere and always?) a factor in generating the crisis and in postponing or stifling recovery.

Lemieux's book *Somebody in Charge: A Solution to Recessions?* (New York: Palgrave Macmillan, 2011) is a very useful contribution to the literature on the recent financial meltdown, recession, and slow recovery. More important, the work considers the broader question of government's appropriate role in generating prosperity. Lemieux springboards from the analysis of current conditions to consider a much broader and in the long run much more important question: "A modern economy is an incredibly complex system. Can Authority manage it?" (p. 9).

This question of the government's role in determining the "causes of the wealth of nations" dates to the origins of economics or political economy as a discipline. According to Edward Prescott, "[S]tandards of living were more or less constant from the beginning of civilization until the industrial revolution [*sic*]; then something changed" (qtd. in Snowdon and Vane 2005, 354). Adam Smith was one of the first to come to a judgment of what had changed. The emerging prosperity in Great Britain began around 1700 (Skousen 2001, 15) and was proceeded and accompanied by a lessening of authoritarian control of economic activity. Smith observed in 1755, "Little else is requisite to carry a state to the highest degree of opulence from the lowest barbarism, but *peace, easy taxes, and a tolerable administration of justice; all the rest being brought about by the natural course of things*" (qtd. in Cannan 1976, xliii, emphasis added). Smith later elaborated:

> All systems of either preference or of restraint, therefore, being thus completely taken away, the obvious system of natural liberty establishes itself on its own accord. Every man, as long as he does not violate the laws of justice, is left perfectly free to pursue his own interest his own way, and bring forth both his industry and capital into competition with those of any other man, or order of men. The sovereign is completely discharged from a duty, attempting to perform which he must always be exposed to innumerable delusions, and for the proper performance of which no human wisdom or knowledge could ever be sufficient; the duty of superintending the industry of private people, and of directing it towards the employments most suitable to the interest of society. ([1776] 1976, 650–51)

The Smithian vision of prosperity tied to individual planning and initiative did not go unchallenged. The world was then, as now, not an unhampered market, but

a heavily interventionist (mercantilist) economy. Mixed economies have much in common with the free-economy ideal. They are based on the division of labor, exchange, and (nominally) private property. An interventionist economy does provide opportunities for production, exchange, and wealth creation, especially for the politically connected (Osterfeld 1992). Interventionist systems do create wealth—especially relative to nonmarket systems, which can function only at low subsistence levels for most of the population.

A mixed economy, however, is still a system of restraint and privilege, so freedom and wealth creation are limited relative to a less-restricted economy. But to those who would be in charge, the observed wealth creation is the consequence not of the enhanced liberty, but of the direction of economy by an authority, the *somebody in charge*.

Brink Lindsey (2002) has labeled the intellectual movement that supports planning and directing the economy in order to "harness individualism to the car of collectivism" (Lemieux, p. 63) the *industrial counterrevolution*. The consistent pattern of the critique of free markets (1) during periods of economic growth and expanding prosperity attributes that prosperity to elements of control—the "adults" in charge (Boettke 2011); (2) during a crisis defines the current interventionist system, whether it be mercantilism, state capitalism, or some other form of mixed economy, as a free-market economy and attributes the crisis to the market elements, not to the "preferences and restraints" of the existing controls that caused the crisis to develop; and (3) uses the crisis as a platform to expand control and give more power to the government for "superintending the industry of private people." Lemieux demonstrates how the recent financial crisis reinvigorated this "delusion" of good government, which sees the solution to any real or imagined crisis not in private initiative, but in more authority.

The financial crisis of 2007, which grew out of problems in the real economy that were the consequence of distorted mortgage, housing, and real-estate markets (p. 122), brought to a halt the most recent period of market-driven economic success based on liberalization. From 1980 to 2005, the authorities relaxed controls and adopted more market-friendly policies, and, as a result, economies expanded and living standards improved. Control was reduced, not eliminated. Andrei Shleifer describes the period "[b]etween 1980 and 2005" as one in which "the world embraced free market policies, living standards rose sharply, while life expectancy, educational attainment, and democracy improved and absolute poverty declined." He then asks, "Is this a coincidence?" After reviewing the competing claims of those who attribute the success to expanding economic liberty and those who attribute the success to authorities in charge, he concludes, "On strategy, economics got the right answer: free market policies, supported but not encumbered by the government, deliver growth and prosperity" (2009, 135).

Lindsey's 2002 book *Against the Dead Hand: The Uncertain Struggle for Global Capitalism* appeared near the end of this twenty-five-year era. He argues that the adoption of market-based reforms did not spring from broad acceptance of the

Smithian vision but was driven by "sheer pragmatism" (x). The effects of failed collectivist policies left many who would have preferred to be in charge with no alternative but to explore "market friendly alternatives." He warns that the reforms were too often "half-hearted, and therefore tentative and incomplete" (xi). The potential harm from the significant antimarket policies remaining in place was being ignored with the risk that needed continuing economic liberalization would be slowed or past reforms reversed. Lindsey's warning was prophetic. The prosperity being generated by worldwide liberalization was at first slowed by the 2000–2001 recession in the United States, then derailed or side-tracked by the current crisis.

The U.S. reforms were truly incomplete and were being reversed. Prior to the 2007–2009 recession, the U.S. system was an entrenched mixed economy with, as Lemieux puts it, "the line between politicians and bureaucrats on one hand and tightly regulated private companies on the other hand . . . blurred" (p. 82). The regulatory climate, from at least the mid- to late 1990s, was not pro-business, free market, or antiregulatory. In fact, the George W. Bush years were "one of the most regulation-heavy periods in American history," with an "American banking system and financial system that certainly *could not* be described as laissez-faire. It was tightly supervised and controlled by the authorities—in the spirit of the times" (p. 102, emphasis added). One major financial institution of central control was mostly unaffected by the liberalizations of the 1980s and actually ended the era with enhanced prestige and power—the Federal Reserve System (the Fed).

Once the crisis hit, many economists (pp. 83–102), pundits, and political opportunists such as the democratic majority on the Financial Crisis Inquiry Commission jumped to the conclusion that "the banks led us into the financial crisis" (Wallison 2011). According to this faulty representation of the events leading to crisis and recession, blame lies with a malfunctioning private sector, driven by unconstrained greed and supported by a laissez-faire ideology (Wallison 2011). However, this crisis was not one of capitalism, but of "regulated capitalism" (Friedman 2009). Lemieux debunks the "markets caused the problem" literature (see chapter 4, "The Laissez-Faire Scapegoat," and chapter 5, "The Crime Scene").

Lemieux systematically develops his case step by step. Building on Friedrich Hayek's work and using elements of public-choice theory, he establishes that insurmountable challenges confront efforts to control a complex system inhabited by "inconvenient individuals" (p. 27). Appealing to historical evidence of the success of liberalizing societies and of the failures and limited success of attempts at control, he demonstrates how a complex, prosperous society depends on markets and individual planning embedded in a proper institutional framework, not on centralized control. He concludes: "Authority is limited by its necessarily imperfect comprehension of the complexity of the world, the impossibility of obtaining the information necessary to plan in any 'rational' way, and the inconvenient individual. The impotence of Authority is most obvious in a [Hayekian] Great Society offering large and

growing opportunities to all. Authority can certainly try to be in charge by flexing its coercive muscles, but it will be at the cost of liberty and prosperity" (p. 38).

Lemieux next provides a crash course in modern macroeconomics (pp. 39–62). Keynesian theory is shown to be an error-filled diversion, "a theoretical basis to . . . old ideas, mending the old clothes of popular economics" (p. 49); it is "in many ways a primitive way of looking at society and the economy" (p. 56). Keynesian economics dominated the teaching of macroeconomics from the 1950s to the 1980s, but the first attempts to use the theory for policymaking resulted not in the end of the business cycle as predicted, but in the stagflation of the 1970s and early 1980s. Professional economists then engaged in a policy-effectiveness debate based on the revival of old non-Keynesian approaches to macroeconomics and the development of new ones, including a revival of the Austrian approach (pp. 123–31). Lemieux concludes: "First, it is not totally obvious that serious recessions would occur without government. At any rate, it must not simply be assumed. Second, the diversity of serious macroeconomic theories shows how uncertain is our knowledge of business cycle phenomena. . . . How pretentious it is for parties of politicians or committees of bureaucrats to claim they know how to prevent or dampen recessions!" (p. 62).

With this foundation established, Lemieux proceeds to make the case that the roots of the crisis lay not in greed and self-interest running amok in unhampered markets, but in the policy and regulatory structure that created and enabled the excessive leverage and risk taking. Responding to comments by Congressman Barney Frank (D–Mass.), a contributing architect of much of the institutional framework that misdirected economic activity onto unproductive and even destructive sidetracks, who asserted that "the subprime crisis demonstrates the serious negative economic and social consequences that result from too little regulation" (qtd. on p. 121), Lemieux writes: "It is difficult to be more wrong. A home market artificially stimulated by government and a residential mortgage market half nationalized had led a large number of people to buy houses they could not afford, contributing to a housing bubble and its unavoidable crash with widening financial consequences. There was somebody in charge: for decades, the government had been the main cheerleader, mover, and shaker in the housing market. It regularly bullied private sector participants into abiding by its regulations, defective research, and whims" (p. 121).

Lemieux concludes his examination of the "crime scene," the events of the mortgage-market-driven financial crisis of 2007, with a key insight: "It was a financial crisis only in a derived sense—in the sense that finance is tied to the real economy and reacts to it. . . . [P]roblems still originated in the real economy." And he makes a judgment: "All these problems did not come from a shortage of interventions by public authorities. There was somebody in charge, and that was precisely the problem" (p. 122).

In a section titled "Monetary Meddling" (pp. 123–31), Lemieux takes what appears to be a sidetrack but in reality pertains to an extremely important issue: the role of the central bank, the Federal Reserve System, which he examines in light of

Austrian business-cycle theory. The previous portrait of the "crime scene" remains incomplete without a thorough examination and appreciation of the enabling role that this major authority played in banking and financial markets.

Lemieux unfortunately appears to have been heavily influenced by David Henderson and Jeffrey Rogers Hummel (2008). Their analysis, if correct, would have left the Fed as "virtually alone" in being one institution in charge "not to have contributed to, or worsened the crisis" (p. 131). Use of George Selgin's (2008) response might have led to a more balanced assessment. However, based not on Austrian analysis, which is indispensable for a proper understanding of the nature of the crisis and the slowness of the recovery (Cochran 2010), but on the more traditional analysis by John B. Taylor (2009) and Charles W. Calomiris (2009), Lemieux does concede that "it is difficult to believe that the central bank had no influence at all on interest rates and on the housing bubble. The balance of the arguments suggest that the Fed did contribute to the low interest rates that made the housing bubble possible, although it was not the only factor" (p. 131). Garrison provides a much better summary of the Austrian view and a more realistic picture of the Fed's actual impact on the bubble and the crisis:

> The broader lesson in all this is one that gives us a greater appreciation of the perils of centralization and the merits of decentralization. The old Mises–Hayek theory of the business cycle, which looks beyond the simple two-dimensional metric of inflation and unemployment, allows us to understand how risk-related distortions in mortgage markets were leveraged by the Federal Reserve into an economywide unsustainable boom. Executive and legislative attempts to stabilize the economy after the bust have decreased rather than increased our confidence that the economy's problems can be fixed by centralized authority. (2009, 198–99)

Garrison has more recently been even more emphatic about the Fed's impact on the crisis. Without the Fed, the impact of the distortions in the housing market would still have been significant, but they would also have been much more limited. The fact that the "Greenspan Fed adopted a loose monetary stance in the wake of the dot.com bust and well into the century's first decade was a game changer. The accommodation freed the housing sector from having to draw investment funds from other sectors. It fueled an economywide boom—the housing bubble leveraged by practitioners of Modern Finance being the most dramatic aspect of it." And he concludes, "[T][he fact that the bubble was doubly artificial provided a strong hint about the difficulties inherent in the subsequent recovery" (2012, 449).

Lemieux is correct that the "authorities in charge messed up in more than one way" (p. 131), but he understates the role of a key player. The Fed messed up in a big way, generating back-to-back cycles driven by monetary excesses that "turbo-charged" misdirections of economic activity. The Fed's actions and expanding

power since the onset of the crisis are even more alarming. To criticize the Fed and the Treasury's response to the financial crisis, John Taylor has coined the term *mondustrial policy,* which describes "not a monetary framework," but "an intervention framework financed by money creation" (qtd. in Hilsenrath 2009). Hummel argues that the policy responses to the crisis "resulted in another Fed failure" and have "also resulted in a dramatic transformation of the Fed's role in the economy. [Ben] Bernanke has so expanded the Fed's discretionary actions beyond controlling the money stock that it has become a gigantic, financial central planner" (2011, 485–86).

Recognition of the Fed's new role reinforces Lemieux's conclusion that "[t]he causes and legacy of the economic crisis of 2007–2009 reveal a deeper underlying crisis, which is a crisis of authority" (p. 162). If this book were widely read in and out of classrooms, it might be very useful in awaking more of the public to the fact that we do *not* need somebody in charge. Instead, we need "Wicksteed's car of collectivism" to "be stored on a sidetrack" (p. 163).

References

Blinder, Alan S. 2011. Our National Jobs Emergency. *Wall Street Journal,* July 12.

Boettke, Peter. 2011. Tigers, Dragons, and the Spirit of Capitalism. *Coordination Problem* (March 23). Available at: http://www.coordinationproblem.org/2011/03/tigers-dragons-and-the-spirit-of-capitalism.html.

Calomiris, Charles W. 2009. The Subprime Turmoil: What's Old, What's New, and What's Next. *Journal of Structured Finance* 15, no. 1 (Spring): 6–52.

Cannan, Edwin. 1976. Editor's Introduction. In *An Inquiry into the Nature and Causes of the Wealth of Nations,* by Adam Smith, xxiii–lvi. Dunwoody, Ga.: Norman S. Berg.

Cato Institute. 2009. [Response to statement by President Barack Obama.] *Wall Street Journal,* February 9.

Cochran, John P. 2010. Capital in Disequilibrium: Understanding the "Great Recession" and Potential for Recovery. *Quarterly Journal of Austrian Economics* 13, no. 3: 42–63.

Friedman, Jeffrey. 2009. A Crisis of Politics, Not Economics: Complexity, Ignorance, and Policy Failure. *Critical Review* 21: 2–3, 127–83.

Garrison, Roger W. 2009. Interest-Rate Targeting during the Great Moderation. *Cato Journal* 29, no. 1: 187–200.

———. 2012. Alchemy Leveraged: The Federal Reserve and Modern Finance. *The Independent Review* 16, no. 3 (Winter): 435–51.

Henderson, David R., and Jeffrey Rogers Hummel. 2008. *Greenspan*'s *Monetary Policy in Retrospect: Discretion or Rules?* Cato Institute Briefing Papers no. 109. Washington, D.C.: Cato Institute. Available at: http://www.cato.org/pub_display.php?pub_id=9756.

Hilsenrath, Jon. 2009. Outspoken Fed Critic Taylor Coins "Mondustrial Policy." WSJ *Blogs* (January 5). Available at: http://blogs.wsj.com/economics/2009/01/05/the-feds-outspoken-critic/.

Hummel, Jeffrey Rogers. 2011. Ben Bernanke versus Milton Friedman: The Federal Reserve's Emergence as the U.S. Economy's Central Planner. *The Independent Review* 15, no. 1 (Spring): 485–518 .

Lemieux, Pierre. 2011. *Somebody in Charge: A Solution to Recessions?* New York: Palgrave Macmillan.

Lindsey, Brink. 2002. *Against the Dead Hand: The Uncertain Struggle for Global Capitalism*. New York: Wiley.

Osterfeld, David. 1992. *Prosperity versus Planning: How Government Stifles Economic Growth*. New York: Oxford University Press.

Selgin, George. 2008. Guilty as Charged. *Mises Daily,* November 7. Available at: http://mises.org/daily/3200.

Shleifer, Andrei. 2009. The Age of Milton Friedman. *Journal of Economic Literature* 47, no. 1: 123–35.

Skousen, Mark. 2001. *The Making of Modern Economics: The Lives and Ideas of the Great Thinkers*. Armonk, N.Y.: M. E. Sharpe.

Smith, Adam. [1776] 1976. *An Inquiry into the Nature and Causes of the Wealth of Nations*. Dunwoody, Ga.: Norman S. Berg.

Snowdon, Brian, and Howard R. Vane. 2005. *Modern Macroeconomics: Its Origins, Development, and Current State*. Cheltenham, UK: Edward Elgar.

Taylor, John B. 2009. *Getting Off Track: How Government Actions and Interventions Caused, Prolonged, and Worsened the Financial Crisis*. Stanford, Calif.: Hoover Institution Press.

Theroux, David. 2011. Robert Higgs on Why Government Is Prolonging the Economic Crisis. *The Beacon Blog,* March 17. Available at: http://blog.independent.org/2011/03/17/robert-higgs-on-why-government-is-prolonging-the-economic-crisis/.

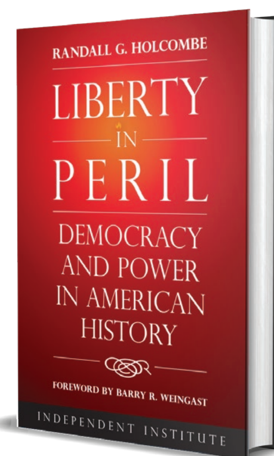
Wallison, Peter. 2011. Government-Sponsored Meltdown. *Wall Street Journal,* July 12.

SUBSCRIBE NOW AND RECEIVE A FREE BOOK!

"***The Independent Review*** does not accept pronouncements of government officials nor the conventional wisdom at face value."
—**JOHN R. MACARTHUR**, Publisher, *Harper's*

"***The Independent Review*** is excellent."
—**GARY BECKER**, Nobel Laureate in Economic Sciences

Subscribe to *The Independent Review* and receive a free book of your choice such as ***Liberty in Peril: Democracy and Power in American History***, by Randall G. Holcombe.



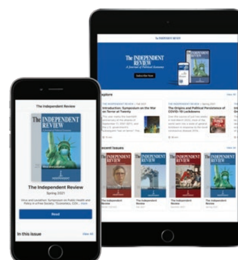
Thought-provoking and educational, *The Independent Review* is blazing the way toward informed debate. This quarterly journal offers leading-edge insights on today's most critical issues in economics, healthcare, education, the environment, energy, defense, law, history, political science, philosophy, and sociology.

Student? Educator? Journalist? Business or civic leader? Engaged citizen? This journal is for YOU!

Order today for more *FREE* book options

SUBSCRIBE

The Independent Review is now available digitally on mobile devices and tablets via the Apple/Android App Stores and Magzter. Subscriptions and single issues start at $2.99. **Learn More.**



INDEPENDENT INSTITUTE, 100 SWAN WAY, OAKLAND, CA 94621 • 1 (800) 927-8733 • ORDERS@INDEPENDENT.ORG