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## Paralysis

**P**EOPLE OFTEN REMEMBER THE PAST with exaggerated fondness. Sometimes, however, important aspects of life really were better in the old days. During the three decades following World War II, for example, incomes were rising rapidly and at about the same rate—almost 3 percent a year—for people at all income levels. We had an economically vibrant middle class. Existing roads and bridges were well maintained, and impressive new infrastructure was being added each year. We cheered when President John F. Kennedy urged, “Ask not what your country can do for you, ask what you can do for your country.” We were sure we could win the race to put a man on the moon. We were optimistic.

No longer. The economy has grown much more slowly during the intervening decades, and only those at the top of the income ladder have enjoyed significant earnings gains. CEOs of large U.S. corporations, for example, saw their pay increase tenfold over this period, while the inflation-adjusted hourly wages of their workers actually fell. The middle class is awash in debt.

Proposals to build desperately needed new infrastructure, such as high-speed rail systems or a smart electric grid, consistently fail in Congress, and existing infrastructure has been steadily falling into disrepair. Rich and poor alike now endure crumbling roads and unsafe bridges. Water supply and sewage systems fail regularly. Countless schools are in shambles. Many Americans live in the shadow of poorly maintained dams that could collapse

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at any moment. Funding has been cut for programs to lock down poorly guarded nuclear materials in the former Soviet Union.

More troubling, our political system seems almost completely paralyzed, even in the face of these genuinely urgent problems. This paralysis often stems from a seemingly willful ignorance of the basic facts and logic that govern human behavior.

A case in point is our failure to deal with the stubborn unemployment spawned by the financial crisis of 2008. As John Maynard Keynes explained during the Great Depression, economies mired in deep downturns seldom recover quickly on their own.<sup>1</sup> Consumers won't lead the way, he argued, because they're burdened with debt and fearful of losing their jobs, if they haven't already lost them. Nor will business investment spark recovery, because most firms already have more than enough capacity to produce what people want to buy. Government, Keynes concluded, is the only actor with both the ability and the motive to stimulate spending sufficiently to put people back to work.

Each new day of widespread unemployment is like a plane that takes off with many empty seats. In each case, an opportunity to produce something of value is lost forever. There was no good reason for failing to take every possible step to avoid such waste. Yet critics of economic stimulus were quick to denounce government spending itself as wasteful, even as a host of useful projects cried out for attention. According to the Nevada State Department of Transportation, for example, a worn 10-mile stretch of Interstate 80 would cost \$6 million to restore if the work were done today; but if we postpone action for just two years, weather and traffic will eat more deeply into the roadbed, and those same repairs will cost \$30 million.<sup>2</sup>

During the depths of the downturn, the workers and equipment necessary to do the work were sitting idle. And with considerable slack in markets worldwide, the required materials were available at unusually low prices. Interest rates for the money to finance these projects were near record lows. These were tasks that should have been tackled immediately, quite independently of the need for additional economic stimulus. Yet because of the profound ignorance that strangles our current political conversation, government could not act.

Stimulus opponents cited fear of deficits as a reason for inaction, but deficits are a long-run problem. No one argued that we could put off maintaining our infrastructure forever. Doing it right away meant doing it more cheaply, which meant smaller deficits in the long run, not bigger ones. Deficits must be dealt with, yes, but the time for doing so is when the economy has fully recovered.

The same leaders who cite concerns over deficits to explain their opposition to additional economic stimulus also voted to cut the enforcement budget of the Internal Revenue Service. Yet credible evidence says that each dollar cut from that budget causes tax revenue to fall by \$10, for a net increase in the deficit of \$9! That such cuts could be approved by the House of Representatives suggests that we're becoming, in the coinage of one pundit, an ignoramitocracy—a country in which ignorance-driven political paralysis prevents us from grappling with even our most pressing problems.

The same leaders voted to cut nutritional support for low-income women with small children by more than \$1 billion and to reduce the Clean Water State Revolving Fund by \$700 million. Those programs exist not only to help people in need, but also to prevent costly problems down the road. Cutting them will make future deficits larger, not smaller.

The same leaders also failed even to mention their deficit concerns when they opposed the scheduled expiration of the George W. Bush tax cuts for the wealthiest Americans in 2010. Because many of the wealthy already have more money than they can spend in their lifetimes, extending those tax cuts provided little economic stimulus. Letting them expire would have freed up revenue that could have been used for far more effective stimulus measures—such as grants to the states that could have prevented massive layoffs of teachers, police, and firefighters. Yet, as senate minority leader Mitch McConnell said without apparent irony in a CNN interview, “Raising taxes in the middle of a recession is not a good idea.”<sup>3</sup>

A less immediate concern, but perhaps the most troubling one, is our political system's indifference, even hostility, to increasingly pessimistic scientific estimates of the pace of global warming. Climate change skeptics often base their case for inaction on the fact that the science underlying calls for change is so inexact. But our most distinguished scientists are them-

selves quick to acknowledge the uncertainty inherent in their projections. Temperature increases could of course be smaller than expected—but they could also be substantially larger, and quite possibly catastrophic. Given the range of possible temperature increases and their respective probabilities of occurring, uncertainty is actually the strongest possible case for action.

The most recent simulations by MIT's respected Integrated Global Systems Model, for example, estimate a 10 percent chance that the average global surface temperature will rise by more than 12°F by 2095.<sup>4</sup> An increase of that magnitude would spell the end of life on Earth as we know it. That threat could be eliminated by simple policy measures like a steep tax on carbon dioxide emissions. If it were phased in gradually, we could adapt to such a tax without painful sacrifices.

Any rational political process would address this problem with dispatch. But House leaders in charge of energy policy stubbornly deny that there's even a problem. Seasoned congressional observers say there's virtually no chance that meaningful climate legislation could win passage in the U.S. Senate anytime soon. In an ignoramitocracy, such legislation is apparently politically unthinkable.

### How Did We Get Here?

It's prudent to be skeptical of unitary explanations. Yet it would be a mistake to downplay the importance of a powerful meme that has become entrenched in the public mind during the past three decades—namely that government is the source of all ills. Libertarians, who have always been vigilant against the misuse of government power, have been among the major propagators of this meme. And although those with formal ties to the Libertarian Party remain small in number, their influence on public discourse has been large and growing.

That influence has stemmed in large part from the enormous sums of money they've spent to spread the message that government is the problem. In a widely cited ten-thousand-word article published in the *New Yorker*, for instance, Jane Mayer traced how the multimillionaire libertarians Charles

and David Koch, owners of Koch Industries, have donated more than \$100 million in recent years to far-right-wing think tanks, organizers of the Tea Party, and other groups whose mission is to promulgate that message.<sup>5</sup>

Notwithstanding its claim to be fair and balanced, Rupert Murdoch's Fox News Channel has also worked tirelessly to promote the same message. Pre-dating these efforts were substantial grants in support of right-wing think tanks by the billionaire Richard Mellon Scaife, owner of the *Pittsburgh Tribune-Review* and an heir to the Mellon fortune. Earlier still, the John M. Olin Foundation had distributed almost \$400 million to conservative think tanks, media outlets, and law and economics programs at leading universities, all with the aim of spreading the beliefs that government is the problem and unfettered markets are the solution.

In total, these investments have been extraordinarily effective in fostering an inchoate but pervasive sense of anger that has made it all but impossible for government to act. Libertarians are correct, of course, that waste in government has a long and troubling history. And we can be grateful for their vigilance against the erosion of personal liberties and misuse of public funds. But does the fact that government is imperfect mean that complete policy paralysis is what most Americans really want? Markets, after all, aren't perfect either, and there are many important tasks that only government is well suited to perform. National defense is an obvious example, as are the construction and maintenance of public infrastructure. The definition and enforcement of property rights are also the province of government.

Government plays a prominent role in the economic and social life of every successful society. Countries whose citizens have the most favorable opinions of their governments tend also to be ones with the best public goods and services, the lowest levels of perceived corruption, and the highest per-capita incomes. In contrast, those with the weakest governments—think Haiti, Somalia, or Sudan—typically have poorly functioning markets, extremely low per-capita incomes, high levels of crime and violence, and citizens who regard their governments as ineffectual and corrupt. If forced to choose, most Americans would prefer to live in New Zealand than in Haiti.

Differences in the quality and scope of their respective governments are not the only reasons they'd make that choice. But they're important reasons.

The fact that many activities are best carried out collectively means that government must levy taxes to pay for them. Libertarians and other anti-government activists often decry mandatory taxation as theft, but no government could function if forced to rely exclusively on voluntary contributions. Without mandatory taxation, there could be no government. With no government, there would be no army, and without an army, your country would eventually be invaded by some other country that has an army. And when the dust settled, you'd be paying mandatory taxes to that country's government.

If there's no realistic alternative to living under a government with the power to levy mandatory taxes, our best option is to try to create one that will deliver the most value for our money. We must take seriously the question of how government institutions should be designed and monitored. We should have far-reaching conversations about what public services we want and how to pay for them. Yet we are doing none of those things at the moment.

This is clearly not how things should be in a resource-rich nation with the most educated and productive workforce on the planet. The good news is that it would actually be easy to move past our current gridlock. That's because it's the result not of irreconcilable differences in values but of a simple but profound misunderstanding about how competition works.

### **Why the Invisible Hand Often Breaks Down**

Without question, Adam Smith's invisible hand was a genuinely groundbreaking insight. Producers rush to introduce improved product designs and cost-saving innovations for the sole purpose of capturing market share and profits from their rivals. In the short run, these steps work just as the producers had hoped. But rival firms are quick to mimic the innovations, and the resulting competition quickly causes prices to fall in line with the new, lower costs. In the end, Smith argued, consumers are the ultimate beneficiaries of all this churning.

But many of Smith's modern disciples believe he made the much bolder claim that markets *always* harness individual self-interest to produce the greatest good for society as a whole. Smith's own account, however, was far more circumspect. He wrote, for example, that the profit-seeking business owner "intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention. *Nor is it always the worse for the society that it was not part of it* [emphasis added]."<sup>6</sup>

Smith never believed that the invisible hand guaranteed good outcomes in all circumstances. His skepticism was on full display, for example, when he wrote, "People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices."<sup>7</sup> To him, what was remarkable was that self-interested actions often led to socially benign outcomes.<sup>8</sup>

Like Smith, modern progressive critics of the market system tend to attribute its failings to conspiracies to restrain competition. But competition was much more easily restrained in Smith's day than it is now. The real challenge to the invisible hand is rooted in the very logic of the competitive process itself.

Charles Darwin was one of the first to perceive the underlying problem clearly. One of his central insights was that natural selection favors traits and behaviors primarily according to their effect on individual organisms, not larger groups.<sup>9</sup> Sometimes individual and group interests coincide, he recognized, and in such cases we often get invisible hand-like results. A mutation that codes for keener eyesight in one particular hawk, for example, serves the interests of that individual, but its inevitable spread also makes hawks as a species more successful.

In other cases, however, mutations that help the individual prove quite harmful to the larger group. This is in fact the expected result for mutations that confer advantage in head-to-head competition among members of the same species. Male body mass is a case in point. Most vertebrate species are polygynous, meaning that males take more than one mate if they can. The qualifier is important, because when some take multiple mates, others get none. The latter don't pass their genes along, making them the ultimate

losers in Darwinian terms. So it's no surprise that males often battle furiously for access to mates. Size matters in those battles, and hence the evolutionary arms races that produce larger males.

Elephant seals are an extreme but instructive example.<sup>10</sup> Bulls of the species often weigh almost six thousand pounds, more than five times as much as females and almost as much as a Lincoln Navigator SUV. During the mating season, pairs of mature bulls battle one another ferociously for hours on end, until one finally trudges off in defeat, bloodied and exhausted. The victor claims near-exclusive sexual access to a harem that may number as many as a hundred cows. But while being larger than his rival makes an individual bull more likely to prevail in such battles, prodigious size is a clear handicap for bulls as a group, making them far more vulnerable to sharks and other predators.

Given an opportunity to vote on a proposal to reduce every animal's weight by half, bulls would have every reason to favor it. Since it's relative size, not absolute size, that matters in battle, the change would not affect the outcome of any given head-to-head contest, but it would reduce each animal's risk of being eaten by sharks. There's no practical way, of course, that elephant seals could implement such a proposal. Nor could any bull solve this problem unilaterally, since a bull that weighed much less than others would never win a mate.

Similar conflicts pervade human interactions when individual rewards depend on relative performance. Their essence is nicely captured in a celebrated example by the economist Thomas Schelling.<sup>11</sup> Schelling noted that hockey players who are free to choose for themselves invariably skate without helmets, yet when they're permitted to vote on the matter, they support rules that require them. If helmets are so great, he wondered, why don't players just wear them? Why do they need a rule?

His answer began with the observation that skating without a helmet confers a small competitive edge—perhaps by enabling players to see or hear a little better, or perhaps by enabling them to intimidate their opponents. The immediate lure of gaining a competitive edge trumps more abstract concerns about the possibility of injury, so players eagerly embrace the additional risk. The rub, of course, is that when every player skates without a helmet, no one gains a competitive advantage—hence the attraction of the rule.



As Schelling's diagnosis makes clear, the problem confronting hockey players has nothing to do with imperfect information, lack of self-control, or poor cognitive skills—shortcomings that are often cited as grounds for government intervention.<sup>12</sup> And it clearly does not stem from exploitation or any insufficiency of competition. Rather, it's a garden-variety collective action problem. Players favor helmet rules because that's the only way they're able to play under reasonably safe conditions. A simple nudge—say, a sign in the locker room reminding players that helmets reduce the risk of serious injury—just won't solve their problem. They need a mandate.

What about the libertarian's complaint that helmet rules deprive individuals of the right to choose? This objection is akin to objecting that a military arms control agreement robs the signatories of their right to choose for themselves how much to spend on bombs. Of course, but that's the whole point of such agreements! Parties who confront a collective action problem often realize that the only way to get what they want is to constrain their own ability to do as they please.

As John Stuart Mill argued in *On Liberty*, it's permissible to constrain an individual's freedom of action only when there's no less intrusive way to prevent undue harm to others.<sup>13</sup> The hockey helmet rule appears to meet this test. By skating without a helmet, a player imposes harm on rival players by making them less likely to win the game, an outcome that really matters to them. If the helmet rule itself somehow imposed even greater harm, it wouldn't be justified. But that's a simple practical question, not a matter of deep philosophical principle.

Rewards that depend on relative performance spawn collective action problems that can cause markets to fail. For instance, the same wedge that separates individual and group interests in Darwinian arms races also helps explain why the invisible hand might not automatically lead to the best possible levels of safety in the workplace. The traditional invisible-hand account begins with the observation that, all other factors the same, riskier jobs tend to pay more, for two reasons. Because of the money employers save by not installing additional safety equipment, they can pay more; and because workers like safety, they will choose safer jobs unless riskier jobs do, in fact, pay more. According to the standard invisible-hand narrative, the fact that a

worker is willing to accept lower safety for higher wages implies that the extra income was sufficient compensation for the decrement in safety. But that account rests on the assumption that extra income is valued only for the additional absolute consumption it makes possible. When a worker gets a higher wage, however, there is also a second important benefit. He is able to consume more in absolute terms, yes—but he is also able to consume more relative to others.

Most parents, for example, want to send their children to the best possible schools. Some workers might thus decide to accept a riskier job at a higher wage because that would enable them to meet the monthly payments on a house in a better school district. But other workers are in the same boat, and school quality is an inherently relative concept. So if other workers also traded safety for higher wages, the ultimate outcome would be merely to bid up the prices of houses in better school districts. Everyone would end up with less safety, yet no one would achieve the goal that made that trade seem acceptable in the first place. As in a military arms race, when all parties build more arms, none is any more secure than before.

Workers confronting these incentives might well prefer an alternative state of the world in which all enjoyed greater safety, even at the expense of all having lower wages. But workers can control only their own job choices, not the choices of others. If any individual worker accepted a safer job while others didn't, that worker would be forced to send her children to inferior schools. To get the outcome they desire, workers must act in unison. Again, a mere nudge won't do. Merely knowing that individual actions are self-canceling doesn't eliminate the incentive to take those actions.

### Shallow Thinking about Freedom

As a high school student, when I first read Mill's passage that preventing harm to others was the only legitimate reason for restricting individual liberty, I enthusiastically agreed with it. I still do. Although Mill was no libertarian, libertarians are often quick to cite his harm principle approvingly.<sup>14</sup> But the list of restrictions of liberty that can be persuasively defended in its name is far longer than libertarians and other antigovernment activists commonly suppose.

Because the strongest objections to the kinds of policies needed to put our economy back on track have come from libertarians and others on the political right, their arguments merit careful scrutiny. Unlike most critics on the left, I will grant the libertarians' most important basic assumptions about the world—that markets are competitive, that people are rational, and that the state must meet a heavy burden of proof before restraining any individual citizen's liberty of action. Although there are reasons to question each assumption, the internal contradictions of the libertarian framework emerge clearly even if we accept these assumptions uncritically.

The fatal flaw in that framework stems from an observation that is itself completely uncontroversial—namely that in many important domains of life, performance is graded on the curve. A professional tennis player's earnings, for example, depend not on how well she plays in absolute terms, but on how well she plays relative to others on the tour. The dependence of reward on rank eliminates any presumption of harmony between individual and collective interests, and with it, the foundation of the libertarian's case for a completely unfettered market system.

But antigovernment activists are not the only ones who have failed to understand the logic that governs market exchange. Many beliefs long cherished by progressive thinkers are also at odds with that logic. Although many of the shortcomings that progressives have identified in our economic and political system are real, they're often wrong about the causes of those shortcomings, and therefore often wrong about how best to counteract them.

Many critics on the left, for example, attribute market failure to insufficient competition. But the problem is in fact a fundamental property of competition itself. Markets are more competitive now than they've ever been, yet that fact has done little to narrow the scope of market failure and much to exaggerate it.

### Indirect Harm

The specific issue on which my libertarian friends and I are quickest to part company concerns how we think about what constitutes harm to others. We all agree that it's legitimate for government to restrain people from stealing

others' property or from committing violence against them. The difficult cases involve more indirect forms of harm.

For example, although a sprinter who consumes anabolic steroids may make no physical contact with his closest rival, he nonetheless imposes heavy costs on him. The rival can either abstain from taking steroids, thereby losing the race and forfeiting any return on his substantial investment of time and effort, or he can restore the competitive balance by consuming steroids himself, thereby courting serious long-term health risks. Either way, the original sprinter's action will have caused him far greater harm than if he had been physically assaulted or had his bicycle stolen.

Yet many self-described libertarians insist that it should be a sprinter's right to take performance-enhancing drugs if he chooses. But why should that right trump the right of others to escape the resulting harm? Why should harm be discounted merely because it is indirect?

If Mill's harm principle is to have any coherent meaning, indirect forms of harm must count. My conception of what constitutes harm to others may strike some as expansive. But it's one that even libertarians will find difficult to challenge in their own terms. We'll see that even if libertarians had complete freedom to join others in forming any sort of society they pleased, they'd find compelling reasons for joining one that gave indirect harm equal footing with direct harm. Confusion about this point sometimes arises because indirect harm is often harder to measure than direct harm. But direct harm is sometimes hard to measure, too, and in those cases there's usually no debate about whether it should count.

The bottom line is that if one adopts any reasonable conception of what constitutes harm to others, the regulatory apparatus of the modern industrial state—in concept if not in every detail—becomes completely consistent with—and is indeed even required by—Mill's harm principle.

### **Governing with a Lighter Touch**

The fact that our political debate has been shackled by false beliefs has prevented us from grappling with serious problems. But if we can abandon

those beliefs, many of our problems turn out to be far less daunting than they appear.

Burgeoning government deficits, for example, are hardly the insurmountable hurdle they often seem. Reduced spending alone clearly can't eliminate them. With baby-boomer retirements looming and the electorate unwilling to embrace large cuts in Social Security and Medicare, we must also raise additional revenue. The good news is that doing so will not require difficult sacrifices from anyone. But it will require a Congress that is willing to redesign tax policy from the ground up. Although Tea Partiers and others decry taxes of all kinds, many levies actually make the country richer, not poorer. The way forward lies in greater reliance on these kinds of taxes.

A tax on any activity not only generates revenue but also discourages the activity. The second effect, of course, underlies the claim that taxes inhibit economic growth. That's often true of taxes on useful activities, a primary source of current tax revenue. Job creation, for example, is discouraged by the payroll tax, and investment is discouraged by the income tax, which is also a tax on savings.

But the reverse is true when we tax activities that cause harm to others. By entering a congested highway, we increase delays that in turn cost others thousands of dollars—even though entering those highways may save us only negligible time when compared with alternatives. In buying a heavy vehicle, we put the lives of others at risk, even though a lighter one might have served us almost as well.

Taxes levied on harmful activities kill two birds with one stone. They generate desperately needed revenue while discouraging behaviors whose costs greatly outweigh their benefits.

Antigovernment activists reliably denounce such taxes as “social engineering”—attempts to “control our behavior, steer our choices, and change the way we live our lives.”<sup>15</sup> Gasoline taxes aimed at discouraging dependence on foreign oil, for example, invariably elicit this accusation.

But it's a vacuous complaint, because virtually every law and regulation constitutes social engineering. Laws against homicide and theft? Because they aim to control our behavior, steer our choices, and change the way we

live our lives, they're social engineering. So are noise ordinances, speed limits, even stop signs and traffic lights. Social engineering is inescapable, simply because narrow self-interest would otherwise lead people to cause unacceptable harm to others. Only a committed anarchist could favor a world without social engineering.

If outright prohibitions are an acceptable way to discourage harmful behavior, why can't taxes be used for the same purpose? Taxes are, in fact, a far cheaper and less coercive way to curtail such behavior than laws or prescriptive regulations. That's because taxes concentrate harm reduction in the hands of those who can alter their behavior most easily.

When we tax pollution, for instance, polluters with the cheapest ways to reduce emissions rush to adopt them, thereby avoiding the tax. Similarly, when we tax vehicles by weight, those who can get by most easily with a lighter vehicle will buy one. Others find it cheaper to pay the tax.

The list of behaviors that cause undue harm to others is long. When we drink heavily, we increase the likelihood that others will die in accidents. When we smoke, we cause others to suffer tobacco-related illnesses. When we emit carbon dioxide into the atmosphere, we increase the damage from greater climate volatility.

Every dollar raised by taxing harmful activities is one dollar less that we must raise by taxing useful ones. The resulting revenue would enable us to reduce not only the federal deficit, but also the highly regressive payroll tax. And cutting that tax would stimulate hiring and help low-income families meet the burden of new taxes on harmful activities.

Wasteful government spending, of course, should be cut whenever possible. Military spending and subsidies to oil companies have dodged recent budget cuts, as did the notoriously inefficient ethanol subsidy program. These and other outlays merit closer scrutiny, to be sure.

But again, poorly conceived spending reductions often do more harm than good. Postponing highway repairs actually increases future deficits, because costs escalate so rapidly when maintenance is deferred.

Taxing harmful activities is the best way to raise the revenue essential for reducing deficits. Only someone who thinks that people have a right to

cause undue harm to others could object that such taxes violate anyone's rights. And because such taxes make the national economic pie bigger, it makes little sense to object that we can't afford them.

The new taxes should be phased in only after the economy is back at full employment. But even with federal taxes at their lowest level since the 1950s, we're unlikely to summon the political will to take that step until leaders stop insisting that all taxes are evil.

Shifting tax policy in this way would place additional resources at our disposal. Without having to sacrifice anything we value, we could generate more than enough revenue to eliminate government debt and refurbish long-neglected public infrastructure.

That's a bold claim. But as we'll see, it follows directly from logic and evidence that most of us already accept. The good news, in short, is that there's an enormous pot of free money available to any society that can bring itself to think more clearly about, and deal more intelligently with, activities that cause undue harm to others.