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Book Review

The Great Reversal: How America Gave Up on Free Markets

Thomas Philippon
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Thomas Philippon, a French economist who teaches at New York University and advises both the US and French governments, likes the free market. He says:

> Economists like competition for several reasons. The first reason is that competition pushes prices down, since the most direct way for a company to increase its market share is to offer a lower price than its competitors…In a competitive market, firms seek to attract customers not only by reducing prices, but also by offering a wide menu of quality goods and services. Competition leads to more choices for consumers as businesses cater to different segments of the population and then try to differentiate their products from those of their competitors. (pp. 18–19)

Given the manifest superiority of competition as a way to allocate scarce resources, why don't we have a fully free market? Philippon knows the answer: "The lack of competition is explained largely

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by policy choices, influenced by lobbying and campaign finance contributions…[A]cross time, state, and industries, corporate lobbying and campaign finance contributions lead to barriers to entry and regulations that protect large incumbents" (p. 9). He discusses in great detail lobbying and the influence of money on politics. These ways of interfering with the free market help to explain the "great reversal." Most people think that America has a freer and more competitive economy than Europe, and for the most part this is right. In some goods and services, though, such as air travel and cell phone plans, Europe has a freer economy and lower-cost products than we do, and this latter fact is what he means by the "great reversal."

The way to proceed seems obvious. Government should stay out of the economy. In that way competition, unhindered by the "regulatory capture" of government agencies by entrenched interests, will be able to satisfy consumer demand.

Philippon unfortunately does not accept this simple view. As readers of the book will quickly discover, he is a convinced technocrat who cannot restrain his desire to "improve" the free market. To attempt to do this requires many technical tools, and he explains these with great enthusiasm. You will learn all you ever wanted to know about the Herfindahl-Hirschman index, Tobin's q and the fundamental law of investment, the North American Industry Classification System (NAICS) way of classifying industries, and other arcane matters.

What is the problem with the simple view? Sometimes, Philippon says, large firms take over too much of the market for their product, and the government needs to break them up. By no means does he think that large firms are always bad. To the contrary, they sometimes become large by giving consumers what they want:

> The growth of Walmart provides us with an example of efficient concentration. Its profit margins remain stable or even decline, and, most important, prices go down. Consumers benefit from Walmart's expansion. It is fair to debate and challenge Walmart's labor and management practices, but there is little doubt that Walmart has been good for US consumers. (p. 34)

Sometimes, though, concentration as Philippon measures it does not have such beneficial results. Why not? "If the industry is competitive, the price must equal the marginal production cost—the price to build one extra car or to produce one extra ounce of chocolate….[W]hen firms have market power[,] [t]he price is now above the marginal production cost" (pp. 27, 29). In this sad circumstance, "consumer surplus" is less than it could be. Hence the government might need to take corrective measures. As is usually the case with Philippon's presentation of his views, this requires qualification. It's often very hard to establish whether an industry is concentrated and, if it is, whether the concentration is "efficient."

From an Austrian perspective, we have to distinguish two cases. Is the industry concentrated because the government has granted certain firms special privileges that enable them to exclude or restrict competition? Then, there is indeed a reason to act. These measures must be repealed. Matters are different, though, if firms do not get special privileges from the government but simply fail to generate enough "consumer surplus." This is an artificial standard imposed on the free market, and Austrians reject it.

Philippon does not mention the Austrian view, but he does note a Chicago school position that is different from his own: "an idea from the Chicago School is that high concentration does not necessarily imply market power as long as the threat of entry is real, that is, as long as the market is contestable" (p. 87). This idea makes perfect sense, and it is difficult to understand why Philippon is more demanding.

Philippon also fails to confront another problem for his view, one that he himself recognizes. Suppose that he is right about concentration. How can the government remedy the situation, given the probability of regulatory capture by the very entrenched firms that he wishes to regulate? He has no answer to this, so far as concerns the US economy. He just hopes for the best.

He also embraces another idea at odds with the free market. He rightly notes that subsidies to particular businesses distort the market. If the government uses tax money to help a business, then the company's success isn't entirely a response to consumer preferences. Unfortunately, he takes "tax breaks" to be subsidies as well:

> Lobbying for lower taxes is fundamentally inefficient because tax breaks create distortions in the allocations of economic resources, and because

> someone else must then pay these taxes…You might think that lower taxes can have beneficial incentive effects….When economists advocate for lower taxes, we mean lower marginal tax rates on as broad a base as possible. The tax breaks obtained by lobbyists take the form of loopholes and rarely improve investment and hiring decisions. (p. 163)

Later in the book, Philippon condemns "corporate tax evasion, which is legal for the most part but costly and inefficient nonetheless." (p. 263)

Murray Rothbard brilliantly exposed the fallacy of this view in *Power and Market* ([1970] 2009, 1219–20):

> Many writers denounce tax exemptions and levy their fire at the tax-exempt, particularly those instrumental in obtaining the exemptions for themselves. These writers include those advocates of the free market who treat a tax exemption as a special privilege and attack it as equivalent to a subsidy and therefore inconsistent with the free market. Yet an exemption from taxation or any other burden is *not* equivalent to a subsidy. There is a key difference. In the latter case a man is receiving a special grant of privilege wrested from his fellowmen; in the former he is *escaping* a burden imposed on other men. Whereas the one is done at the expense of his fellowmen, the other is not. For in the former case, the grantee is participating in the acquisition of loot; in the latter, he escapes payment of tribute to the looters. To blame him for escaping is equivalent to blaming the slave for fleeing his master. It is clear that if a certain burden is unjust, blame should be levied, *not* on the man who escapes the burden, but on the man or men who impose it in the first place. If a tax is in fact unjust, and some are exempt from it, the hue and cry should not be to *extend the tax to everyone*, but on the contrary to *extend the exemption to everyone*. The exemption itself cannot be considered unjust unless the tax or other burden is first established as *just*.

Despite these problems, Philippon does have some good suggestions. He attacks occupational licensing with great force:

> Geographic mobility has been declining for thirty years in the US. Workers are less likely to move between states and metropolitan areas than they were in the past. There are several plausible explanations for this trend. One of them is the steady increase in the number of workers whose occupations require some sort of license or certification… Licensing is always "officially" motivated by concerns for health, safety, and consumer protection. And sometimes it is legitimate. Often, however, it is the perfect way for incumbents to protect their rents.

> Indeed, they actively lobby for the extension of lobbying requirements because they understand that these are efficient barriers to entry. (p. 283)

Attempts to restrict entry range far beyond licensing:

> Entry in finance is also limited by heavy—and sometimes biased—regulations…Why did we get the bloated financial industry of today instead of the lean and efficient Walmart? As it turns out, Walmart applied for a banking license in 2005, but it was denied under—who would have guessed—heavy lobbying by bankers. (p. 216)

The Great Reversal should thus be read with caution. Philippon likes competition but, like many other technocrats, he thinks he can do better than the unhampered market economy. He cannot.

REFERENCES

Rothbard, Murray N. [1970] 2009. *Man, Economy, and State with Power and Market*. 2d ed. Auburn, Ala: Ludwig von Mises Institute.