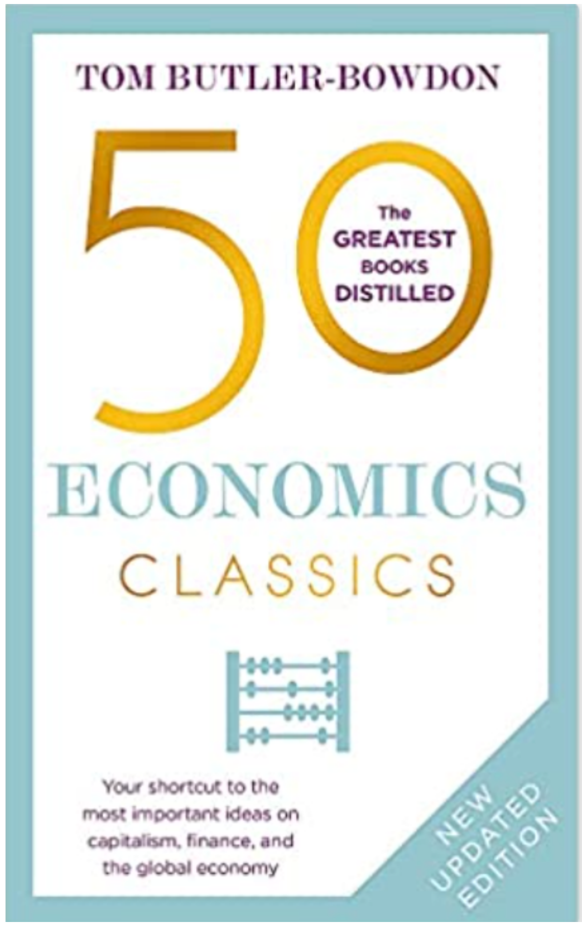

Bonus Bundle

John Bogle – *The Little Book of Common Sense Investing*

Andrew McAfee & Erik Brynjolfsson – *The Second Machine Age*

Paul Krugman – *The Conscience of a Liberal*

Thomas Schelling – *Micromotives and Macro Behavior*

Joseph Stiglitz – *The Euro*

The Little Book of Common Sense Investing

(2007)

John C Bogle

"Successful investing is all about common sense…Simple arithmetic suggests, and history confirms, that the winning strategy is to own all of the nation's publicly held businesses at very low cost. By doing so you are guaranteed to capture almost the entire return that they generated in the form of dividends and earning growth."

"[The] stock market is a giant distraction that causes investors to focus on transitory and volatile investment expectations rather than on what is really important – the gradual accumulation of the returns earned by corporate business."

In a nutshell

If you invest in the stock market, put your money in a fund that automatically owns a little bit of every company listed. Over time, it is a sure and almost worry-free way to accumulate wealth.

In a similar vein

Benjamin Graham *The Intelligent Investor*

Robert Shiller *Irrational Exuberance*

Paul Samuelson *Economics*

John Bogle is something of a financial maverick. He made his name as the founder, in 1976, of the first ever stock market index fund, the Vanguard 500, and grew Vanguard to be the second largest fund provider in the world, with over $3 trillion under management. In 1999 *Fortune* named him one of four "Giants of the 20th century" in the investing field, and in 2004, *Time* magazine included him as one of the "world's 100 most powerful and influential people".

So what is an index fund? Essentially baskets of all the major stocks listed in a certain market, they usually track an established index such as the Standard & Poor's 500 ('S&P 500', established 1926), composing the 500 largest corporations in America, or the Dow Jones Wilshire index, which takes in close to 5,000 stocks

Traditional index funds don't engage in 'trading', or buying and selling of stocks as regular managed funds do, but usually buy once and keep. This can make index funds seem very boring. However, the lack of trading excitement is easily made up for by their remarkably good long term records. Investing is really about common sense, and the basic arithmetic in support of index fund investing, Bogle asserts, is irresistible. They make the apparently complex world of finance simple, and the case for them is "compelling and unarguable", he says. As we would all like as much certainty as possible when investing in stocks, Bogle's book makes intriguing reading.

Who are you making rich?

For the average punter, Bogle says, the stock market is a loser's game. Why? Firstly, we have a misplaced faith in financial experts, who not only do no better, but often worse, than we collectively do ourselves; secondly, we do not realize the huge eroding effect on our funds of money managers' fees and the tax inefficiency of their way of operating. Those who *always* win are the "financial croupiers" – brokers, investment bankers, money managers etc. that rake in over $400 *billion* a year. As Bogle puts in, in a casino, 'the house always wins'.

Thanks to speculation, returns from the stock market itself vary greatly, much more so than the output of the economy itself, but the *costs* of investing stubbornly remain. You do not pay lower fees to your fund manager when he has a bad year or decade. We naturally like to think of the compounding increase in the value of stocks we hold, but we often don't understand the compounding of investment costs (fund joining and operating fees, taxes levied on transactions etc.). Mutual fund fees range from 0.9 per cent of assets to 3 per cent, with an average of 2.1 per cent. While these do not seem high at the beginning (1.5 per cent of $100,000, for instance, does not seem exorbitant), over time these costs can erode a potential fortune.

Bogle provides some further facts: Between 1980 and 2005 the US stock market averaged a return of 12.5 per cent per year. In the same period, the average mutual fund only returned 10 per cent, thanks to costs of 2.5 per cent. Index funds, in contrast, have costs averaging only 0.2 per cent. You can imagine what the difference in costs makes over the long run: in that 25-year period, a $10,000 investment in the S&P 500 directly, or an index fund tracking it, would have grown to $170,800. The same money in a managed mutual fund would have come to only $98,200. This huge difference is thanks in no small measure to the difference in costs.

But how does the actual performance of regular funds versus index funds compare? In the period 1995-2005, index funds returned a compound profit of 194 per cent, while managed mutual funds returned only 154 per cent. Again, a massive difference.

Stay still and prosper

You may think that your mutual fund is expertly turning over stocks frequently to make the most of your money, but in doing so it are also spending it, because each transaction has costs both in terms of taxes and management. You can be sure someone is getting paid a lot for calling the buys and sells. To justify their fees, fund managers have to be seen to be 'doing something', but as Warren Buffett has observed, "For investors as a whole, *returns decrease as motion increases*."

Because index funds invest automatically across the board, they do not need layers of analysts or managers. As they do not 'trade' but simply buy and hold, they avoid all the usual costs built up by frequent transactions. The longer you hold, the less risk there is, because you have left speculation (with all its costs and fluctuations of fortune) behind, and have become an *owner* of businesses. Bogle's recipe is very simple: "[Once] you have bought your stocks, get out of the casino and stay out".

Invest in capitalism, not the casino

Stock market investors can easily forget is that they are investing in the ingenuity, innovation and productive power of *companies*, which in America over the last 100 years have enjoyed a 9.5 per cent return on their capital. When this rate of return is compounded over many years, you get astounding results. Over a decade, a dollar invested becomes $2.48, over two decades $6.14, three decades $15.22, four decades $37.72, and over five decades $93.48 – from a single dollar. Of course, you have to adjust this for inflation, which significantly reduces the purchasing power of your money in decades hence, but over an investment span of 30 years, for example, an investment of $100,000 in corporate America through an index fund would still become worth over $660,000 in current real (spending power) terms.

Bogle notes that the gains of the stock market, measured over time, almost exactly match the gains made by American business itself. The average return on stocks is 9.6 per cent, while return on capital invested directly into businesses averages 9.5 per cent. He observes that, "in the long run, stock returns depend almost entirely on the reality of the investment returns earned by our corporations". The stock market may overvalue companies for as long as a decade, then the next decade might undervalue them. But just as Benjamin Graham pointed out, there is always 'reversion to the mean', with the underlying worth of the companies behind the stocks being revealed.

Bogle asserts that the stock market is a "giant distraction", Shakespeare's proverbial "tale told by an idiot, full of sound and fury, signifying nothing." Driven in the short term by emotions, thanks to this irrationality no one can ever know for sure which way it will turn, and it is a fool's game to try to guess. However, we *can* be surprisingly sure about the long term productivity of business, and by avoiding the game of 'picking winners' and simply investing in the whole stock market, we know we will reap the results of business growth. He recall's investor Benjamin Graham's analogy: "In the short run the stock market is a voting machine…(but) in the long run it is a weighing machine."

Bet on the numbers, not people

Bogle's question is, why are people paying *more* money for a way of investing that has *worse* returns?

Unfortunately, most of us do not know any better. We are advised to invest in managed funds under the illusion that there are some 'star funds' or 'star managers' that will earn us great returns. However, even when some funds do better than others, their performance is almost never maintained (just as you can't maintain a win on the horses forever). Great returns, as Burton Malkiel pointed out in *A Random Walk Down Wall Street*, are often sheer luck. We are stupid enough to invest based on past performance, which is not only no guarantee of future performance, but almost predicts future worse performance.

Fund managers are human, and get excited by the direction markets seem to be taking. Like anyone, they have a tendency to buy stocks at their peak and not buy them when they represent best value. There is none of this risk entailed in having a stake in an index fund that automatically tracks the market overall. In the long term, all gains and losses in the stock market are balanced, so if you invest in the game *overall*, you will win. As Bogle expresses it as, "Don't look for the needle – buy the haystack".

The secret's out

As the founder of the world's first index fund, Bogle of course has a vested interest in promoting them, but he supplies plenty of evidence (placed in boxes headed 'Don't take my word for it') from academics and major figures in the finance world to support his case. These include:

- Peter Lynch, legendary manager of the Fidelity Magellan Fund, noted in *Barron's* magazine that mutual fund performance was getting worse, and that "The public would be better off in an index fund".
- Mark Hulbert, editor of the *Hulbert Financial Digest*, wrote "You can outperform more than 80 per cent of your fellow investors over the next several decades simply by investing in an index fund – and doing nothing else."
- *The Economist* magazine noted that managed funds "charge their clients big fees for the privilege of losing their money".
- Warren Buffett's partner in Berkshire Hathaway, Charlie Munger, is quoted saying: "The poor guy in the general public is getting a terrible product from the professionals".

- Tyler Mathisen, editor of *Money* magazine, having been critical of 'boring' index funds like Bogle's, now admitted he was wrong: "Gunning for average is your best shot at finishing above average…Indexing should form the core of most investors' fund portfolios."

Final comments

Bogle describes the shift to put money in index funds as "a revolution", and for many years his strategy made him a lone voice. It was years before other index funds started up copying the Vanguard model, yet now there are around 580 in the United States alone. Some, ironically, are 'managed index funds', which mean that they choose stocks in only some industry sectors which pay more dividends or may grow quicker, and therefore try to beat the market. Bogle takes a dim view of them, as they significantly increase costs and risk compared to a traditional index fund. He also predicts that returns on stocks will be subdued in the years ahead, which is another reason to stick with traditional indexers, since managed funds will keep charging the same costs whether they do well or not.

With 18 chapters and over 200 pages, *The Little Book of Common Sense Investing* is not that little, and can seem repetitive - but in a way that affirms rather than annoys. Reading it is like having a fireside chat with one of the masters of investing, except that you may not be able to sleep having listened to his powerful message. His detractors, he notes, have said that the only thing going for him is his ability to state the obvious, but in a financial world of promotion and chicanery, perhaps putting our trust in the "relentless arithmetic" of index investing is the smartest thing we can do.

The Economist ("Index We Trust", June 2016) noted that Vanguard's investors now own around 5 per cent of every public company in the United States and around 1 per cent of every foreign public company (while Vanguard is dominant in the US, its model has been successfully copied overseas). Ben Johnson, of Morningstar, the fund research firm, notes that "In an industry with serious trust issues, Vanguard has proven an exception to the rule". The result is that, with more funds under management, it has been able to lower its already low fees significantly. Some finance academics worry that the increasing role of non-selective tracker or index funds means that the stock market loses its primary function of intelligent allocation of capital; money simply flows to existing companies, no questions asked. This may be true, but sorting out the good from the bad is not the job of the average small investor. Bogle's advice to avoid the complex and instead "profit from the magic of simplicity", remains sound.

John C Bogle

Born in 1929 in Verona, New Jersey, Bogle graduated from Blair Academy before attending Princeton University, where in 1951 he received an economics degree. After graduating he began working at the Wellington Management Company in Pennsylvania. He rose to become chairman of that company, and in 1974 left to start Vanguard.

Other books include *Common Sense on Mutual Funds* (1999), *John Bogle on Investing* (2000), and *The Battle for the Soul of Capitalism* (2005), which argues for higher ethical standards in American finance, Enough: True Measures of Money, Business, and Life (2010), and *The Clash of Cultures: Investment vs. Speculation* (2012).

See also *John Bogle and the Vanguard Experiment: One Man's Quest to Transform the Mutual Fund Industry*, by Robert Slater (1996), and *The Bogleheads' Guide To Investing* (2006) by Larimore, Lindauer and LeBoef. *The Little Book of Common Sense Investing Book* is dedicated to Paul Samuelson, the economist and Bogle's mentor at Princeton.

Bogle died in 2019.

The Second Machine Age

Work, Progress, and Prosperity in a Time of Brilliant Technologies

(2014)

Erik Brynjolfsson & Andrew McAfee

“Computers and other digital advances are doing for mental power – the ability to use our brains to understand and shape our environments - what the steam engine and its descendants did for muscle power.”

“Not only are the new technologies exponential, digital, and combinatorial, but most of the gains are still ahead of us. In the next twenty-four months, the planet will add more computer power than it did in all previous history. Over the next twenty-four years, the increase will likely be over a thousand-fold.”

In a nutshell

As the stock of human knowledge grows, so does our ability to create new wealth, but we can’t allow people to be left out of the benefits of technology and innovation.

In a similar vein

Gary Becker *Human Capital*

Peter Drucker *Innovation and Entrepreneurship*

Robert J Gordon *The Rise and Fall of American Growth*

Thomas Piketty *Capital in the Twenty-First Century*

Joseph Schumpeter *Capitalism, Socialism, and Democracy*

Do you ever feel like you are living in the future?

"Every day", the authors write in a new Preface to this book, "we come across examples of science fiction becoming reality", from the rise of drones in commerce and the rapid augmentation of artificial intelligence, to increasingly smart robots and 3D printing. It must have felt like this, they say, at the start of the Industrial Revolution. On the other hand, there are still millions of people who have simply stopped looking for work, or who are working in jobs way below their potential. We know rapid technological progress improves living standards, but we also know that many people's skills and education are preventing them from adjusting to, and prospering in, the new environment. What to do?

Brynjolfsson & McAfee, business economists at the Massachusetts Institute of Technology (MIT) are among the "techno-optimists" that Robert Gordon criticizes in his book *The Rise and Fall of American Growth* for overplaying the impact of the internet and information technology on living standards. Yet their bestseller, *The Second Machine Age*, subtitled "Work, Progress, and Prosperity in a Time of Brilliant Technologies", is far from naïve. They admit that advancing technological progress brings losers as well as winners, and see the human desire and need for work as forming one of the big debates of the future. *The Second Machine Age* is contemporary popular economics at its best, engaging us to think about the role of technology in our lives and in the world we are creating.

A new machine age

The early part of the book rests on an analysis by anthropologist Ian Morris (*Why The West Rules – For Now*), who highlighted that for most of human history, technological progress was "achingly slow, almost invisible". If technology is viewed as a line on a graph, we virtually flatlined for thousands of years. Then, 200 years ago, the Industrial Revolution (or what Brynjolfsson and McAfee call the "first machine age") meant that for the first time, technology – not politics, religion, or population – drove human progress. Humanity's new ability to generate and apply huge amounts of mechanical power changed everything.

Now, the authors say, we are in the second machine age, in which "Computers and other digital advances are doing for mental power… what the steam engine and its descendants did for muscle power." Surely, they reason, a huge boost to intellectual and data tools will be as important to humanity's advance as was the harnessing of physical power.

This idea that we are at an inflection point where digital and computer technologies will begin to make massive differences to our lives remains just a belief, but the authors point to rapid progress in a range of areas. For instance, in only 10 years, driverless cars have gone from being a science fiction concept that had terrible real results (DARPA's Grand Challenge for driverless cars in 2004 was dubbed

'Debacle in the Desert'), to being a safe technology almost ready to enter production. In 2004, speech recognition programs using natural language processing were pretty dire. Yet by 2014, millions of people were using Apple's Siri, the speaking personal assistant, and others like it, to get information quickly and organize their lives. Instant language translation was once the stuff of science fiction, now it is quickly becoming reality. In 2011, IBM's 'Watson' computer defeated the two greatest champs of the quiz show *Jeopardy!*, despite its often complex questions involving pattern recognition, puns, rhymes and general knowledge.

These innovations may just be a warm-up, the authors say. Genuinely useful Artificial Intelligence (AI) and the fact that most of the planet will be connected via a common digital network, will combine to have a more transformative effect on economic growth than the Industrial Revolution.

The innovation debate

"Innovation", wrote Joseph Schumpeter wrote in 1930, "is the outstanding fact in the economic history of capitalist society." But what *kind* of innovation? Brynjolfsson and McAfee consider the argument of Robert Gordon (*The Rise and Fall of American Growth*) and Tyler Cowen (*The Great Stagnation*) that most of America's "low hanging fruit" in terms of invention and innovation have been plucked, and that a new technological plateau accounts for the slower economic growth in rich countries. As great as information and communications technology (ICT) is in bringing us a lot more information and cheap entertainment, it is not really making our economies richer, and the benefits have largely already been worked out.

In 1987, Nobel-winning economist Robert Solow famously said, "We see the computer age everywhere, except in the productivity statistics". In fact, Brynjolfsson and McAfee note, there always seems to be a substantial lag between the introduction of a technology and it increasing productivity across the economy. For example, despite the introduction of electricity to American factories in the 1890s, it did not produce a labor productivity surge for another twenty years. Initially, factories simply replaced steam engines with electricity plant, and maintained the existing layout and processes. Not surprisingly, there wasn't much increase in productivity. In the 1980s ICT was still a small part of the economy, and not until the 1990s were there big productivity improvements thanks to its use. "General purpose technologies" such as electricity and ICT, to play out successfully, must be combined with *new business processes*. ICT, for example, has had the biggest effect when used alongside business process innovation such as lean manufacturing, or management concepts such as Total Quality Management and Six Sigma.

Where Gordon and Cowen imagine innovations as things that are created and used up, or plucked and eaten, Brynjolfsson and McAfee argue that "innovation is not coming up with something big and new, but instead recombining things that already exist". They mention Kary Mullis, who won a Nobel in chemistry for developing the polymerase chain reaction (or PCR) technique for replicating DNA sequences. When the idea came to him on an evening drive, he dismissed it because it seemed too easy;

it simply involved combining existing steps and techniques in biochemistry to create a new, valuable process. In *The Nature of Technology*, Brian Arthur argued that this kind of recombinant innovation is more the rule than the exception.

ICT allows for the radical combination and recombination of ideas, just as the innovations of printing, the library, and universal education did. The driverless car, for instance, is a combination of the traditional car with cheap sensors, computerized maps and GPS systems. The World Wide Web was a combination of a much older TCP/IP data transmission network, a new programming language (HTML) that governed the display of text and images and allowed hyperlinks, and the browser. Each was an innovation I their own right, but put together the effect was revolutionary. Brynjolfsson's and McAfee's point is that "Each development becomes a building block for future innovations. Progress doesn't run out; it accumulates." Spurred by recombinant innovations following in the wake of the initial advances in computing power in the 1970s, there are decades of growth ahead of us.

Technology and inequality

Until 1973, a growing economy was like the tide raising all boats, with wages growing across the board. Since then, incomes in the United States and most developed countries have jumped for 10 to 20 per cent of the population with advanced skills and education, and fallen or stagnated for the rest.

Why exactly has income inequality increased? While routine tasks are increasingly automated, leaving more less skilled people out of a job, work such as big data analytics and rapid product development have only increased the need for people with reasoning, creative or design skills, who are likely to have more education and training in the first place. The most valuable resource in the 21st century is not therefore capital, but highly augmented and skilled people who can extract the greatest gains from technology. If a CEO can make only one decision which increases a company's earnings by 10 per cent, it is worth paying her a lot. If a software programmer can make a programme that is slightly better than the competition, the software can sweep the market. A sportsperson can make fantastic sums simply because millions will pay to watch him on TV or online.

It could be argued that such an economic environment is fair, because those who have the most positive impact on society are rewarded. Is it a problem if a few people that create things which bring a lot of benefit get fabulously wealthy, if we all gain from their creation? And does widening inequality matter so much, if there is an increasing bounty of low cost or free goods and services? After all, if even the poor can afford once-incredible inventions like a smartphone and a laptop, then everyone has a high level of well-being compared to people 30 or 40 years ago.

The authors do not buy these arguments, for the simple reason that many people are not just losing out in relative terms, but seeing absolute falls in income at the same time as technology races forward. Yes, the internet is very cheap, and consumer goods continue to fall in price, but some things have become much more expensive. Housing, health care and college tuition are each significantly more costly than they used to be, growing by 50 per cent between 1990 and 2008 compared to a 20 per cent rise in family income. Forty per cent of people are "financially fragile", defined as the inability to cover an unexpected expense of $2,000 without going into debt. This might not be so bad if there was a lot of social mobility, but America – the so-called land of opportunity – has lower social mobility than the Scandinavian countries, and is about the same as Britain and Italy, Europe's least socially mobile states.

The authors agree with Daron Acemoglu and James Robinson (*Why Nations Fail* – see commentary in *50 Politics Classics*) that economic inequality leads to the richest in society "capturing" government to further their own interests, which means less opportunities for others. Rising inequality leads to stagnation and decline which not even the democratizing power of technology can cancel out.

Job prospects in the second machine age

The usual remedy put forth for "technological unemployment" is to provide a "universal wage", "guaranteed income" or "basic income" (a regular transfer payment from government to all citizens, not means-tested), which will ensure that people still have enough money to be consumers and to keep the economy going even if not working. Thomas Paine, Bertrand Russell and even Martin Luther King were in favour, as were economists John Kenneth Galbraith and Paul Samuelson. Contemporary commentators Martin Ford (*Rise of the Robots*) and Paul Mason (*Postcapitalism*) also support the idea.

Brynjolfsson and McAfee are opposed, however, for the simple reason that work provides many psychological benefits (a sense of purpose, pride, and order) beyond earning a living. Joblessness, rather than poverty on its own, is the cause of many social ills. Instead of a universal wage, the authors look to where humans can retain an edge over machines. Picasso said of computers: "But they are useless. They can only give you answers". Computers don't yet know how to ask better questions or do anything that goes beyond the framework of their programming. "We've never seen a truly creative machine, or an entrepreneurial one, or an innovative one", Brynjolfsson and McAfee write. "We've seen software that could create lines of English text that rhymed, but not that could write a true poem. Programs that can write clean prose are amazing achievements, but we've not seen one yet that can figure out what to write about next." It the *combination* of human ideation and creativity, and superior computer data-crunching, that offers the most exciting advances in all areas. In a 2012 *Wired* article, futurist Kevin Kelly asserted that "You'll be paid in the future based on how well you work with robots". In a world of cheap and plentiful data, there is a premium placed on being able to use and interpret that data – and that's where we humans can excel. For clues to the future, it is worth recalling what happened to work in the Industrial Revolution. With the advent of motorized agricultural machinery, millions of farm workers were put out of a job, but new technological industries in the cities absorbed their labor power.

That covers "white-collar" occupations; what about more physical work? Moravec's Paradox (after roboticist Hans Moravec) is the surprising fact that computers can do high-level reasoning without huge effort, but the simplest sensorimotor skill needs massive computational power. As things stand, it is extremely hard to give robots the perception and mobility that even toddlers have. You can buy robot vacuum cleaners, but "none of them is going to straighten the magazines on a coffee table", Brynjolfsson and McAfee note. For the foreseeable future, cleaners, cooks, electricians, plumbers and hairdressers are secure in their jobs.

Final comments

Oxford University researchers Frey and Osborne ("The Future of Employment", 2013) have predicted that up to 47% of current US jobs will be automated in the next 20 years (including many white collar ones) due to machine learning and robotics. This may turn out to be an exaggeration. A 2016 study by the Centre for European Economic Research noted that many jobs involve *bundles* of tasks, only some of which can be automated. If you factor in the variety of tasks most jobs require, and the human interaction aspects, it turns out that only 9% of jobs are at risk of automation, not 47%.

In 1930, Keynes imagined a time when the "economic problem" was solved, when prosperity provided for everyone to have a house, transport, and money for education, travel and entertainment. In this society, people might only work 15 hours a week. Keynes failed to see that human wants are endless, creating unlimited markets for goods and services. As what we demand becomes ever more sophisticated – compare a Ford Model T to a Tesla car – so much more thought, design, analysis and engineering is required. Coming up with new ideas, complex communication of ideas, and understanding things within a larger context, are where humans still have a distinct advantage.

Erik Brynjolfsson & Andrew McAfee

Born in 1962, Brynjolfsson has a Masters degree in applied mathematics and decision sciences from Harvard University, and a PhD in managerial economics from the MIT Sloan School of Management. His doctoral thesis was on the effect of technology on work. He is a professor at Stanford University and directs the Digital Economy Lab at the Stanford Institute for Human-Centered AI.

Born in 1967, McAfee has degrees in engineering and management from MIT, and did his PhD at Harvard Business School. He taught at Harvard Business School from 1999 to 2009, and has since been a research scientist at the Center for Digital Business at MIT, and a fellow at Harvard's Berkman Center for Internet and Society. He is a columnist for the *Financial Times* and writes a popular blog.

Brynjolfsson and McAfee are also the authors of the digital book *Race Against The Machine: How the Digital Revolution is Accelerating Innovation, Driving Productivity, and Irreversibly Transforming Business and the Economy* (2011).

The Conscience of a Liberal

(2007)

Paul Krugman

"The New Deal did more than create a middle-class society. It also brought America closer to its democratic ideals, by giving working Americans real political power and ending the dominant position of the wealthy elite… Liberalism, in other words, isn't just about the welfare state: It's also about democracy and the rule of law."

"Yet where the Great Depression lives on in our memory, the Great Compression has been largely forgotten. The achievement of a middle-class society, which once seemed an impossible dream, came to be taken for granted. Now we live in a second Gilded Age, as the middle-class society of the postwar era rapidly vanishes…But the story of the Great Compression is a powerful antidote to fatalism, a demonstration that political reform can create a more equitable distribution of income – and, in the process, create a healthier climate for democracy.

In a nutshell

Growing inequality is not simply the result of technological change or globalization, but is the product of political values and decisions which can be reversed.

In a similar vein

Robert G Gordon *The Rise and Fall of American Growth*

JM Keynes *The General Theory of Employment, Interest, and Money*

Naomi Klein *The Shock Doctrine*

Hyman Minsky *Stabilizing An Unstable Economy*

Thomas Piketty *Capital in the Twenty-First Century*

Paul Krugman is something of a superstar economist, holding forth in popular columns for *The New York Times*. Yet many of the issues he writes on today – an ideological hijacking of politics, protecting the welfare state, the role of unions, the role of race in America, the best ways to create economic growth – were explored in greater depth in *The Conscience of a Liberal*.

The title is a play on Barry Goldwater's 1963 *The Conscience of a Conservative*, a manifesto for the 'New Right' of American politics which marked the beginning of the end of Republican-Democrat bipartisanship on many issues. Goldwater ran unsuccessfully against Lyndon B Johnson in the presidential race of 1964, but many of his ideas would be taken up by Ronald Reagan, who became the personable face for policies which once would have been considered extreme. With *The Conscience of a Liberal*, Krugman sought to do for the center-left what Goldwater had done for the right - except that, as explained below, Krugman does not consider his views left-wing at all, but mainstream.

Krugman lays much of the blame for America's problems on a political and economic ideology that by its nature increases inequality. This is in stark contrast to the post-war decades, he recalls, when there existed a political consensus that sought to bring prosperity for all.

The not so good old days

Krugman goes to some length to remind the reader what America was like before Roosevelt's New Deal, in the period 1870s to 1930s. He describes it as "a land of vast inequality in wealth and power, in which a nominally democratic political system failed to represent the economic interests of the majority." Both the Republicans and Democrats were uninterested in the "little man" but rather existed to protect established interests. The wealthy bankrolled the campaigns of candidates they liked, proportionately to a much greater extent than today, electoral fraud was common, and there was a lot of labor unrest. Capitalists were prepared to do anything to prevent organized labor getting the upper hand, including the hire of armed mobs like the infamous Pinkerton Detectives.

There was also a strong anti-government ideology. Taxation was evil, the market was always right, and centralized government was painted as a European plague. True, living standards were rising - Krugman admits that there was a "a vast improvement in the quality of life" in many areas in this period (see Gordon commentary for details), yet most American lives were marked by economic insecurity. If you fell ill, were disabled or lost your job, or if you grew old without children to support you, you would face poverty. There was no safety net, because taxation was very low: the wealthy paid only 1 per cent of income compared to 20 per cent today. In this "Gilded Age", as historians call it, it was "a very good time to be rich", and a very bad time to be poor.

So why, Krugman asks, wasn't there a lot more political demand to help the worse-off? One reason was political disenfranchisement. In 1910, fourteen per cent of adult males were not eligible to vote because they were non-naturalized immigrants, and of course Southern blacks were disenfranchised by Jim Crow laws. The result: a quarter of the population, pretty much the poorest quarter, were cut out of the political process.

One of Krugman's main points is that "Middle-class societies don't emerge automatically as an economy matures, they have to be *created* through political action." It was only the election of Franklin Delano Roosevelt (FDR), in the depths of the Great Depression, and his "New Deal" that made America less unequal. In the 1920s, some states had set up proto-social insurance programs, such as support for widowed mothers, and pensions, but these were often voted out in courts. FDR's Social Security Act of 1935 provided for federal unemployment and old age insurance, and because there was such a strong suspicion of government, went out of his way to make sure that New Deal programs, such as the Works Progress Administration, were free from corruption and run well. The New Deal, Krugman argues, "brought America closer to its democratic ideals, by giving working Americans real political power and ending the dominant position of the wealthy elite".

Truman got his upset victory in 1948 because he campaigned on the fear that Thomas Dewey and the Republican Congress would reverse FDR's New Deal achievements. Truman's successor Eisenhower knew that unemployment insurance, Social Security, labor laws and the like were part of the American scene and did not try to water them down.

The Great Compression

In the post-war era, a new affluence flooded America. The massive inequality, and political polarisation of the 1920s seemed a thing of the past. The majority could afford to live decently, with their own home and car, and stable jobs, all of which provided "a new sense of dignity amongst ordinary Americans". In the 1920s, workers lived in fear of their bosses. Now they had decent pay, safe conditions, health and employment insurance. That wages and conditions were good for the average person could be traced back to FDR's Fair Labor Relations Act of 1935, which supported the right of workers to self-organize and for the strengthening of unions. The class consciousness of the 1920s was gone, because the rich were few and far between. One family might have a Chevy and another a Cadillac, but "there were no big differences in where people could go and what they could do", Krugman writes. Why were there much fewer rich people? In a word, taxation. In the 1920s there had never been more than a 24 per cent tax on income. This got ramped up under Roosevelt, and stayed high into the 1950s and 1960s to pay for welfare provision and the Cold War.

Standard economic theory, Krugman notes, says that you can't mess with the laws of supply and demand, and any attempt to narrow pay differences would be counterproductive. High taxes on profits would destroy incentives and collapse business investment, big increases in wages would lead to mass unemployment. But the fact is, none of this happened – unparalleled government intervention coincided with an economic boom that lasted until the oil shocks of the 1970s.

Supply-side (i.e. tax cutting) economists find this so disturbing, Krugman notes, that they have tried to rewrite history, or just ignore that it happened. Prosperity began with Ronald Reagan. But income growth during the Reagan, Bush and Clinton administrations did not come close to that enjoyed from World War Two to the mid-1970s. Krugman's point is that while the Great Depression still looms large in the collective memory, the "Great Compression" (when America created a great middle class and rapidly decreased inequality) is now forgotten.

A new Gilded Age?

Krugman admits that America is much more productive and richer than it was in the early 1970s. What ended was the sense that prosperity was *widely shared*. Average income (the income of the nation, divided by the number of its people) has gone up and up, but this is thanks to a huge increase in the wealth of the rich, skewing the numbers. The more telling measure is median income, the income of people who are neither very rich or very poor but in the middle. Adjusted for inflation, the median income of adult males in their 30s and 40s is 12 per cent lower than it was in 1973. The drop explains why in so many families both parents are having to work, and why people generally work for longer hours than they did a generation ago.

Today, there is much talk of the Millennials being the first generation to be poorer than their parents. "The point is", Krugman writes, "that the typical American family hasn't made clear progress in the last thirtysomething years. And that's not normal." He refers to research by Thomas Piketty and Emanuel Saez showing the similarity of income and wealth distribution between the 1920s and today. In the 1920s, the highest-income 10 per cent of the US population had 43.6 per cent of the total wealth. In 2005 it was 44.3 per cent. In the 1920s, the highest-income 1 per cent of the population had 17.3 per cent of total income. In 2005 it was 17.4 per cent. In 2015, the top 1 per cent was taking 19 per cent of total income, and the top 10 per cent almost 46 per cent.

Why have the earnings of the top 1 per cent pulled away from the top earning 10 per cent? The safe answer, which economists favor but which there is little evidence for, is that technological change increases the rewards going to the highly skilled. It side-steps what may be the real cause: what Krugman calls "institutions, norms, and political power."

In 1969, one of America's highest-paid workers, Charles Johnson, CEO of General Motors, received $795,000, which raised eyebrows, even though he ran America's largest company. At the time, the average salary of GM workers was $9,000, the equivalent of $40,000 in today's money, and had excellent benefits. Today, Wal-Mart is America's biggest employer. In 2014 Doug McMillon, its CEO, received $25 million. Adjusted for inflation, it was five times what Johnson got in a year. As for Walmart employees, they get around half what GM employees did forty years ago, and benefits are meagre. In Krugman's mind, non-unionized Wal-mart is indicative of what has happened since the 1970s.

The Great Compression has been replaced by a Great Divergence of incomes that many feel has returned America to a new Gilded Age of inequality, and some of this can be attributed to the decline of unions thanks to a well-funded right-wing crusade against them. The Republican party's antagonism, and hardball tactics by big business, resulted in a massive drop in unionized workers, from 30 per cent of the workforce in 1960, to 11 per cent today. By way of comparison, Canada remains above 30 per cent unionized, and has much greater equality of income. Growing income inequality in America, therefore, had little to do with technological change, but a lot to do with political change.

The politics of inequality

For Krugman it is no accident that right wing conservatives took over the Republican party in the mid-1970s, and the well-documented increase in inequality began in the early 1980s: "polarizing political change came first, and rising economic inequality followed". But if that is true, why did Americans elect George W Bush, who embodied the new kind of conservatism, twice? One of the features of the new Republicans, Krugman says, is the use of national security issues as distractions to what is happening in the economy. Bush would probably not have been reelected were it not for 9/11, and the subsequent Iraq War boosted his appeal until it became clear that it was based on false premises. Bush also tried (and failed) to privatize Social Security, a ploy consistent with the new kind of Republican party that exploited race issues for electoral gain. The civil rights movement of the 1960s and 1970s created a "white backlash", Krugman says, which became focused on opposition to universal health care and the welfare state, of which black Americans are sizeable beneficiaries.

Most the think tanks of the last 20 years which have become influential in policy-making are funded by wealthy conservative families like the Koch brothers and their foundations. They greatly outnumber left and centrist think tanks, and provide lucrative post-office jobs for politicians who lean right. Despite the increased intellectual influence of the right, thanks to money, Krugman cites data showing Americans shifting to the left on a number of issues. Americans are much more likely to call themselves 'conservative' and 'moderate' than 'liberal', but actual poll data shows how misleading these labels are. When 'moderates' (who always form the biggest bloc of voters) were questioned about specific policy issues, their answers were almost the same as people who described themselves as 'liberal'. The US is not in fact a conservative nation, or even a centre-right one. It is centre-left. This new political reality has been driven partly by immigration. Most new immigrants are Hispanic or Asian, and feel no connection with the anti-state ideology of New Conservatism; and being non-white, they are instinctively repelled by the apparent whiteness of the Republican Party and its apparent willingness to exploit "white backlash" in the service of winning power. Krugman was not surprised to see how Donald Trump brilliantly exploited resentments over class and race, and anxieties over security and America's place in the world, to win the Republican nomination from a predominantly white Republican voter base.

Final comments

Given the image that many non-Americans have of the US as a haven for right-wingers who are willing to let the levers of government grind to a halt to make an ideological point, Krugman's notion that the US is inherently progressive takes some convincing. And yet, Obama's election in 2008 and election in 2012, and Hillary Clinton's winning of the presidency in 2016, suggests Krugman was right that America "is ready for a new progressive political agenda". The enactment of the "Obamacare" universal health insurance regime was perhaps the best evidence of this.

Krugman is convincing when he argues that it is only politics which can take the lead in reducing economic inequality, with all its bad effects. When he describes himself as "liberal", Krugman means he is in favour of civil liberties, democracy and the rule of law. He observes that it always seems to be liberals who are trying to enfranchise citizens (though voting drives and the like) and conservatives who are trying to stop people voting, because their white voter base is shrinking. The word "wealth" conveys particularity and possession, whereas "prosperity" suggests things being better for all. Throughout history, wealth has arisen on its own, whereas prosperity, evenly shared, has always required political action.

Paul Krugman

Krugman was born in 1953 and grew up on Long Island, New York. His father worked in insurance and his paternal grandparents emigrated from Russia in the 1920s. He won a place to Yale University, and went on to do a PhD in economics at MIT (1977). In the early 1980s he was an assistant professor at both universities, becoming a full professor at MIT in 1984. From 2000 to 2015 he was at Princeton University, and is currently professor of economics at the Graduate Center of the City of New York, as well as writing a column for *The New York Times*.

Krugman's 2008 Nobel Prize for Economics was awarded for his work on "new trade theory", which was an evolution on Ricardo's theory of comparative advantage, and "new economic geography", or how production is organized across the globe; he is also known for his work on income inequality, macroeconomics, and currency crises. In 2007-08, Krugman was among the most prominent economists urging Keynesian stimulus to revive the US economy, instead of austerity measures. "The Conscience of a Liberal" is also the title of his *New York Times* blog on political and economic matters.

Popular books include *Arguing With Zombies: Economics, Politics, and the Fight For A Better Future* (2020), *End This Depression Now!* (2012), *The Return of Depression Economics and the Crisis of 2008* (1999), *The Great Unraveling* (2003), *The Age of Diminished Expectations* (1990), plus many academic works including *Macroeconomics* with Robin Wells (Fifth Edition, 2017).

Micromotives and Macrobehavior

(1978)

Thomas C Schelling

"A good part of social organization – of what we call society – consists of institutional arrangements to overcome these divergences between perceived individual interest and some larger collective bargain."

"What we are dealing with is the frequent divergence between what people are individually motivated to do and what they might like to accomplish together".

"With people, we can get carried away with our image of goal-seeking and problem solving. We can forget that people pursue misguided goals or don't know they goals, and that they enjoy or suffer subconscious processes that deceive them about their goals."

In a nutshell

Individuals can make decisions that are rational for them, but which lead to negative outcomes for society.

In a similar vein

Friedrich Hayek *The Use of Knowledge in Society*

Steven Levitt & Stephen Dubner *Freakonomics*

Ellinor Ostrom *Governing The Commons*

Richard Thaler *The Making of Behavioral Economics*

Long before contemporary authors such as Malcom Gladwell, Stephen Levitt or Tim Harford created a new genre of "popular economics", picking up on the strange and interesting in the discipline for the fascination of the average reader, there was Thomas Schelling.

Schelling won a Nobel for Economics in 2005 (shared with Israeli-American mathematician Robert Aumann) "for having enhanced our understanding of conflict and cooperation through game-theoretic analysis". In books such as *The Strategy of Conflict* (1960) and *Arms and Influence* (1966) he delved into the calculus of influence and deterrence that was part of the Cold War nuclear era. Conversations Schelling had with director Stanley Kubrick and the novelist Peter George led to the film *Dr Strangelove or: How I Learned to Stop Worrying and Love the Bomb* (1964).

Micromotives and Macrobehavior was Schelling's application of game theory principles to everyday life. He defines game theory, pioneered by the mathematician John Nash, as "the study of how rational individuals make choices when the better choice among two possibilities, or the best choice among several possibilities, depends on the choices that others will make or are making." In other words, the fact that decisions are made in light of other people's decisions, who in turn make decisions in the light of what others do. His phrase "micromotives and macrobehavior" was simply the relationship between how individuals act and how "people" behave as an aggregate. A decision I make may be rational, but if many others make the same kind of decision, the overall result can be very inefficient or even damaging. In the book, Schelling provides examples of informal American segregation (according to neighbourhood, school, and social clubs) that came about even if people were not being consciously racist.

In the perfectly competitive markets theorized by economists, millions of individuals acting on their own has a good collective outcome, an equilibrium. If too many people drive polluting cars and they become too expensive, for instance, there is a shift to bus transport which benefits society at large. But in the real world, Schelling noted, the decisions one person makes may be good for them, but not so good for the community. Fishermen keep on fishing even as stocks are depleted, parents throw wet wipes down the toilet, bankers keep lending even in a house price bubble. In each case, an "equilibrium" may result (fish-free seas, clogged sewers, overpriced housing), but it is not one that is beneficial for the mass.

Where shall I sit?

The book starts with a famous analysis of seating patterns, provoked by an experience Schelling had as a visiting speaker. As he was about to go on stage to deliver his talk, he was perplexed by the fact that, although the auditorium seemed mostly packed, the first dozen rows were empty. They were not reserved, so why wasn't anyone sitting in them?

Schelling later looked into the many possible reasons for the empty rows at the front, including the desire to avoid embarrassment or exposure by having to sit in the very front row, wanting to sit near others, or simply a preference to nearer the back to make a quick exit. It seemed that people like to sit near others, but not *too* near them (leaving at least one empty chair between you and the next stranger). What was clear to Schelling is that our seating preferences are not only to do with rational things like comfort or having a good view of the stage, but are formed by the psychology of the situation. No one sat in the first couple of rows out of fear of being isolated if the rows behind them did not fill up. Seating decisions, then, were based on *where people thought other people* would sit.

Schelling's point is that the goals or choices people make in their own interests do not necessarily lead to a positive outcome for the group, crowd or community overall. In the case of the auditorium, individual choices led to a poor distribution of seating: empty seats despite the crowd. "How well each does for himself in adapting to his social environment", Schelling writes, "is not the same thing as how satisfactory a social environment they collectively create for themselves."

Economists believe in "equilibrium", or the idea that phenomena, particularly markets, are self-balancing and lead to optimal results. But in Schelling's mind equilibrium is neither good nor bad, but simply the state of things when the dust has settled. "The body of a hanged man is in equilibrium when it finally stops swinging", he writes, "but nobody is doing to insist that the man is all right."

Economists' approval of equilibrium in national economies has often led to tragic outcomes, for that equilibrium could be a state of constant high inflation, or high unemployment, or sluggish growth. In the auditorium example, an economist would call it equilibrium if the people were so distributed that no one can be bothered to move seats. But that doesn't mean it is close to an ideal distribution. In an economy, my decision to stop spending may be very rational, given my circumstances, but if millions of others take the same course, a depression may result. No one ever *wants* unemployment or a stock market crash or a bank failure, and yet they frequently happen.

Schelling also discusses the idea, popularized by Garret Hardin, of the "tragedy of the commons", in which overgrazing results in environmental ruin, even though it was rational for each herder to graze his animals. By the same principle, it doesn't matter so much if we as an individual drop a wrapper, or have polluting exhaust, or hoard something during a shortage, but if large number of people start doing it you get a damaging collective outcome. If everyone decides to go to the beach, or take to the highway, the experience is no longer pleasurable or efficient. My micromotive leads to our negative macrobehavior.

Critical mass

A model fits the criterion of simplicity, Schelling says, if it not only shows how mechanical and physical systems work, but seems to describe social and human phenomena too. In nuclear energy production, there is a point when the process "goes critical", that is when the fission of the nuclear material becomes self-sustaining. This idea of achieving a "critical mass" (Malcolm Gladwell called them "tipping points") is seen in the rise of social and political movements, the spread of clothing fashions and diseases, the naming of first names of children and the adoption of new words.

Schelling tells of the phenomenon of the "dying seminar". A group of academic colleagues have some passionate shared interest, and resolve to create a seminar around it. The first couple of seminars are well-attended, but by the third or fourth attendance drops to half. The interest is still there, but somehow the momentum slows; there was no critical mass. Schelling's point is that an event can "die" even if there were satisfied participants.

With any event, there may be half a dozen people who will only come if ten people go, another ten will come only if twenty people go, and another twenty people who will only go if there are fifty people booked in. What matters is if the event is perceived as "a thing" that has a momentum of its own, and that *other people* are enthused about.

Schelling saw examples of critical mass every day, from the traffic intersection where pedestrians were willing to go against the lights only if a whole crowd doing so, to the exit of a professor on the last day of class: sometimes, a few claps leads to a round of applause; other times, the early claps peter out and there is embarrassed silence. In short, people do something when they see that it is "what everybody else is doing". Schelling's paradoxical observation is that we cannot presume that an outcome is preferred, even if it is universally chosen. Daylight saving, imperial measurement, the QWERTY keyboard – these are examples of things we go along with because others go along with it, not necessarily because they are the "best".

Segregation despite laws

Schelling became famous for his analysis of segregation, specifically his wish to find out what *individual* choices and incentives led to *collective* segregation.

He observed the phenomenon of "tipping", a subcategory of the critical mass phenomenon, in neighborhoods and public schools in terms of race. One or two minority families move into an area, which compels some members of the formerly homogenous (let's say white) population to leave. Their departure creates room for more minority families to move in, prompting more "majority" families to depart. So the process snowballs until it is no longer a "white neighbourhood". Schelling's point is not that all those who left were racist, but that people begin to leave simply because they fear that others' leaving will mean the value of their home will drop. People do not wait until some actual point of toleration is breached, but act in the expectation or fear that it will in the future. In the 1960s, the principle (later popularized by Malcolm Gladwell in *The Tipping Point*) was seen to operate in public schools, college fraternities, country clubs, and even beaches and parks. Yet informal segregation, Schelling noted, has continued long after legal segregation has outlawed, and indeed happens even if people are not consciously racist.

For example, a black person may find it more to their liking to attend a predominantly "black" church, but by becoming involved in that church may also use some of its services, such as an accommodation listing. Thus a communication system develops that reinforces community and separateness. The same is true for "white" churches and their communication systems. There may be no policy of segregation, but it happens anyway as people tend to prefer living in sub-worlds that give them a feeling of familiarity. College professors tend to group together in particular suburbs relating to the type of house they can afford on their similar incomes, but they also like knowing that they live in an area with people of similar mind and background. This is no more "discrimination" than white churches are consciously segregationist. In America, Schelling says, many people still "unconsciously rely on skin color as an index of poverty", which is itself based a belief that black people are usually poorer than whites. Or, or they may simply believe that this is what others believe, and use other people's beliefs as a guide for what is true.

People who can afford to live in the best area of a city generally do so, and if it is a society in which whites are generally richer than blacks, it will mean that the said area becomes mostly white without anyone designing it to be so. Yet Schelling also notes that people generally wish to avoid having minority status, so even if they have the money to live in the best area, members of a minority will not live there. In this way, without anyone really intending it, the segregation of a suburb can be compounded to the point where there is complete segregation. Alarmingly, such complete segregation becomes a "stable equilibrium" that proves resistant to change.

Schelling's point is that phenomena like racial segregation often just come about even though it serves no positive purpose. Indeed, segregation restricts choices and opportunities at the individual level. It may seem to benefit some people, but does nothing to advance society as a whole, brings no "social efficiency". A good hostess, he notes, will be sure to mix up the sexes equally at the dinner table, otherwise men and women naturally cluster because they feel more comfortable with their own sex. Yet some men will be bored by the conservation of other men, and some women quickly tired of female talk. What is "natural", therefore, is not necessarily good. To make the party a success, the host has to disturb natural patterns. In the same way, Schelling says, people don't necessarily like living in an all-white or all-black area, but if they have to choose between being in a minority or being in a majority, they will choose the latter.

Final comments

Markets, Schelling notes, are generally good at taking individual people's self-serving decisions and integrating them into a greater whole that results in a pretty good allocation of resources, but thanks to human psychology and imperfect or asymmetric information (others have more information than we do, and use it to their advantage), there are plenty of market failures too.

Schelling discusses George Akerlof's well-known 1970 article, "The Market for 'Lemons'", which said that because used car buyers don't know which cars on the market are good ones and which are “lemons”, the information deficit brings down the price of used cars generally. It is only warranties from dealers, and other certification, that keeps the used car market from dwindling to nothing. There are plenty of other markets where there is unequal information. Because a lot of people may try to hide health issues to get life insurance, insurance companies have to charge higher premiums to cover the human equivalent of “lemons”. As a result, healthier people who have long-life genes won’t bother buying a policy, and so the life insurance market becomes increasingly useless for people who want to insure against unexpected death, which is its purpose in the first place.

When economists say people are “rational” and “self-seeking”, they tend to mean it in a good way, yet it stands to reason that in any market or society in which there is plenty of dishonesty, suspicion, and wilful obscuration, the decisions that individuals make can lead to a poor collective result. Societies are not simply big markets but rather structures for upholding moral values. As citizens we are expected to live up to such norms for good reason.

Thomas C Schelling

Schelling was born in 1921 and grew up in San Diego, California.

He first studied economics at the University of California, Berkeley, and took his PhD from Harvard University in 1951. He worked on the Marshall Plan after the war, then as an adviser in the Truman administration. In 1958 he became a professor of economics at Harvard University, and for two decades from 1969 taught at Harvard’s Kennedy School of Government.

Schelling was professor emeritus at the School of Public Policy, University of Maryland, until his death in 2016.

The Euro

And its threat to the future of Europe

(2016)

Joseph Stiglitz

"It is hard for an economic federation to work if the different members of the federation have different views of the laws of economics – and there are fundamental differences in conceptions about how the economy works among the countries of the Eurozone that were present even at the time of the creation of the euro, but which were papered over."

"The story that it was flaws in Greece that had brought on the euro crisis *might* be convincing if Greece were the only country in the Eurozone with difficulties. But it is not. Ireland, Spain, Portugal, Cyprus, and now even Finland, France, and Italy face severe difficulties. With so many countries facing problems, once cannot help but suspect that the problem lies elsewhere."

"Many within Europe will be saddened by the death of the euro. This is not the end of the world: currencies come and go. The euro is just a 17-year-old experiment, poorly designed and engineered not to work. There is so much more to the European project, the vision of an integrated Europe, than a monetary arrangement… it is better to abandon the euro to save Europe and the European project."

In a nutshell

Currencies are meant to create independence and facilitate growth. For many European nations, the euro has achieved the opposite.

In a similar vein

Liaquat Ahamed *Lords of Finance*

Niall Ferguson *The Ascent of Money*

Thomas Piketty *Capital in the Twenty-First Century*

Michael Porter *The Competitive Advantage of Nations*

The project of "Europe" as a single political entity began modestly, out of the ashes of World War Two.

In 1950, France's Minister of Foreign Affairs, Robert Schuman, who had been advised by French diplomat and political economist Jean Monnet, proposed that all French and German production of coal and steel come under a single authority. The European Coal and Steel Community, established two years later, was the first concrete step towards continental union, recognizing that peace and prosperity could not happen if the age-old military opponents, France and Germany, remained in opposition. Thus, right from the start, economic integration was used to advance a political agenda of a united Europe. In 1957, the Treaty of Rome established the European Economic Community involving France, Germany, Italy, Belgium, Netherlands and Luxembourg, declaring a determination "to lay the foundations of an ever closer union among the peoples of Europe". The United Kingdom would sign up only after a referendum in 1975, but the motivation was advantageous trading terms from joining the "Common Market" (the predecessor to today's Single Market), rather than enthusiasm for being part of a super-state in the making.

On paper, a single European currency seemed another sensible step towards "ever closer union", increasing economic performance and furthering political and social cohesion. The Maastricht Treaty of 1992 set out the path for the launch of a single currency, the "euro", but it was 2002 before actual euro notes and coins started circulating. In *The Euro*, Nobel Prize winning American economist Joseph Stiglitz argues that, in contrast to the more cautious early days of the European Community, the move towards a single currency was a mistake: poorly thought out, hasty, and ideologically-driven.

Stiglitz is a well-known critic of laissez-faire globalization (*Globalization and its Discontents*, 2002) and wealth concentration (*The Great Divide*, 2015; *The Price of Inequality*, 2012), so it is fascinating that he would write a book that challenges the left-liberal consensus that the euro is a good thing. In his Introduction, Stiglitz likens himself to de Tocqueville, the Frenchman whose famous study of the United States was insightful precisely because he was an outsider.

Why should we care about the euro? With a population of 507 million, Europe's economy is roughly the same size as that of the United States, so in a very globalized world its economic success matters - to everyone.

Flawed at birth

When the euro was launched, things seemed to go well. As expected, capital flowed from the richer, core members to the "peripheral" ones (including Spain, Greece, Portugal and Ireland) and they grew rapidly because of plentiful loans at low interest rates. The vaunted equalizing effect was working.

Unfortunately, it did not last. The same countries would later see equally quick withdrawals of capital and credit, and plunges into recession. Instead of the expected convergence was a transfer of capital and talented people to the rich, growing countries, who then had more resources to invest to increase their advantages. The periphery fell increasingly behind and into further debt. Rather than achieving political integration and prosperity, the euro has driven wedges through Europe: the rich North and the irresponsible South.

Why, then, did Europe voluntarily don the straightjacket of the euro, a fixed currency which would inevitably make life tough for at least some of its members? The argument went that a united Europe would be more influential and powerful on the world stage, and to do this is should have a single currency, just as the United States does. But as Stiglitz notes, the American states may be very diverse in terms of wealth, population, and industry, but at least they have a common language and set of political institutions. Europe's linguistic and cultural barriers are much greater, and its political institutions much weaker and less "owned" by citizens. A person from South Dakota thinks of themselves as American first. Does a Frenchman think of himself as "European" first?

There was also an argument that closer economic integration, including a single currency, brings rising living standards, because producers are able to effect increasing economies of scale (it's cheaper to produce larger numbers of a product for a bigger market), and you get comparative advantage (countries focus on producing what they are relatively best at). But Europe already had free movement of goods, capital and labor through the EU; having the euro did not affect this reality. Moreover, there is a fundamental mismatch between the EU's policy of "subsidiarity", which devolves powers and responsibilities to the member states as much as possible, and which means that the EU's budget is only 1 per cent of the Eurozone's GDP (compared to the US central government's 20 per cent of GDP) – and the push towards economic integration symbolized by the euro.

While the euro throws all states into the pot as if they are the same, there are yawning differences. For instance, the low-debt, low-deficit model that underpins the currency is a reflection of German attitudes to financial rectitude, particularly the horror of inflation. Yet it is perfectly legitimate for other countries to want to prioritize employment over inflation. But if you have a single currency and a central bank, how do you set interest rates: to prevent inflation at all costs, or to prevent unemployment at all costs? Different countries may also wasn't varying exchange rates to control their balance of trade. A nation that imports more than it exports may want a lower value currency in order to help its exporting industries prosper. Yet the centralization of monetary policy through the European Central Bank has meant that countries have to adhere to strict fiscal (ie taxation and spending regimes) and monetary policy, making it all but impossible to navigate their way out of recessions and financial crises.

The book is also an opportunity to for Stiglitz to lance the idea that markets, left to their own devices, are efficient. The experience of the Eurozone is the perfect case study of markets, instead of moving towards equilibrium in the wake of economic dips and shocks, becoming more extreme. With financial liberalization and a single currency, the countries of the Eurozone have not converged economically through the power of markets, they have diverged. This is because free markets see allocation of money and resources to where the returns are greatest and safest, and unless proactive policies are adopted, there is little chance that poorer nations will be able to catch up. The euro was built on a belief in perfect markets, Stiglitz says, when it should have been based on market failures, imperfections, and the need for adjustments.

A dismal decade

The easiest way to consider the performance of the Eurozone, Stiglitz says, is to compare it to that of European countries that do not use the euro. In 2015, the non-Eurozone had grown by 8.1 per cent since 2007, compared to growth of only *0.6 per cent* in the Eurozone. And this excludes the growth of non-euro Poland (28 per cent) and Romania (12 per cent).

In the same 2007-2015 period, the United States grew by 10 per cent. The GDP of eleven Eurozone countries is still not back to 2007 levels, before the euro crisis hit, and in several countries, such as Greece, the crisis has been worse than the Great Depression.

Germany has been the 'star' in the Eurozone, but even it has had growth of only 0.8 per cent a year since 2007; hardly stellar compared to the rest of the world, and even that very modest growth has not been evenly shared. From 1992 to 2010 the proportion of income going to the top 1 per cent in Germany increased 24 per cent, and incomes for large sections of the population has been stagnant in the last 10 years.

The euro has seen the weaker countries in the eurozone become weaker, and the stronger countries stronger. Inequality has also increased within countries. How? High unemployment hurts those most at the bottom of the economic pile by creating households with no wage-earner, and those that are earning see their income fall due to downward pressure on salaries. The euro's limitations on economic growth have also led to government austerity programs which hurt the existing poor and middle-income people the most. This wonderful single currency, designed to turbocharge European markets, and increase wealth and social mobility, achieved the opposite, helping to fuel the rise of far-right and xenophobic parties.

The need to preserve organizational, human and social capital provides a compelling case for countercyclical economic policy which can keep an economy moving, keep people in jobs and companies afloat. What actually has happened in Greece is the destruction of such capital thanks to austerity measures, forced upon it by the "troika" of the International Monetary Fund, the European Central Bank and the European Commission. It became more important to stick to a certain debt or deficit level, in order to stay a member of the Eurozone, than it was to preserve jobs, companies, and communities. If such desperate choices must arise, Stiglitz asks, what really is the point of the euro? Such dilemmas are reminiscent of those faced by countries in the 1920s and 1930s deciding whether to reduce unemployment or to face the ignominy of coming of the Gold Standard.

Nothing conveys the terrible weakness of Europe's economy, Stiglitz says, as the way small improvements are trumpeted as the signs of recovery. When Spain's unemployment rate fell, in 2016, to 20 per cent (from 26 per cent in 2013), was it really cause for great celebration, particularly given that so many young Spaniards have left the country looking for work elsewhere? Spain's GDP remains over 5 per cent less than what it was in 2007, and if the euro stays unreformed there is little scope for the poorer nations to grow quicker. Europe's lost decade could well turn into its lost quarter century.

Fixing the euro…and the alternatives

The euro was a mistake, Stiglitz says, but "The European project is too important to be destroyed by the euro." He offers intriguing alternatives to the currency - either reform of the institutions that govern the Eurozone, or a move back towards national sovereignty over monetary and fiscal powers. Either more Europe, or less, but not the failed halfway house that currently exists, in which countries have the appearance of being sovereign, but in the economic areas where it matters most, are not.

Stiglitz proposes a set of modest structural reforms, such as a full banking union, a bank deposit security scheme and the mutualization of debt, that could bring the convergence of economies that the euro promised on but did not deliver, and which would increase solidarity. But there is a catch: most of them would involve some diminution of national power and sovereignty, so could be politically difficult. The possible ways forward:

1. Muddling through i.e. "doing the minimum to keep the Eurozone together but not enough to restore it to prosperity".

2. Divorce. Not reversion to a patchwork of 19 different currencies, but a transition to two, three or four currency blocks – for instance, a smaller Eurozone including countries that have a lot of economic and political similarity, or having two Eurozones, North and South.

3. A "flexible euro", in which each country has its own form of euro that takes account of national differences and priorities.

Divorce is actually a sound option, Stiglitz says, that could be done without high costs and even have benefits, certainly with lower economics costs than muddling through. It would be much better for Greece, which has been poorly treated by European bodies and Germany, giving it back full democracy. Greece could issue a new electronic currency, the "Greek-euro", which would be lower in value than the Euro, to correct trade imbalances and make its economy stronger. As well as making it more attractive to tourists, Greece could become the "Sunbelt of Europe", attracting retirees and businesses that are electronically based and could be located anywhere.

Another option is simply for Germany (and some other rich, Northern countries) to leave the euro as it stands. The resulting lower value of the euro would restore many countries' trade imbalances without them having to resort to recessions or the suppression of imports. Meantime Germany's trade surplus would be pared back and it would have to use other measures to stimulate its economy, like increasing wages and government spending.

Final comments

The lesson of the euro is that seeking economic integration before there is real political integration is a mistake. The single currency was driven into being on the assumption that just because you have freer movement of goods and services across borders, it will automatically benefit all the countries involved. Yet as these countries were very unequal in the first place, the absence of some trade barriers and national protections actually made them more vulnerable than before. The resistance to ratifying trade deals like the Trans-Pacific Partnership and the Transatlantic Trade and Investment Partnership are further evidence of this.

One former EU Council president called British PM David Cameron's decision to have the Brexit vote as "the worse policy decision in decades". In Stiglitz's mind, such views only confirm the antipathy towards democracy amongst EU elites. At nearly every opportunity in the last 15 years, when they have had the chance, Europe's voters have rejected the euro, the European Union, and the European constitution. For Stiglitz, the Brexit vote was the outcome of an ideological agenda which had put financial interests and trade liberalization above the interests of citizens and workers. Inspired by Brexit, the Visegrad countries may yet form a breakaway faction within the EU that rejects ever closer union and insists on the importance of national and cultural identity. Meantime, the elites of Germany, France, Italy, Sweden (and large sections of their electorates, it must be said) are committed to the idea of a liberal Europe. It would be a tragedy if, in the end, the only thing uniting EU member states was a currency that was no longer fit for purpose.

Roger Bootle's *The Trouble With Europe* carries many of the same arguments as Stiglitz's book, but from a British perspective. Both are required reading if you still believe in the "European project", but question the very institutions that have created it.

Joseph E Stiglitz

Stiglitz was born in 1943 in Gary, Indiana. His mother was a schoolteacher and his father an insurance salesman.

He attended Amherst College, and obtained his PhD in economics at the Massachusetts Institute of Technology. After a four-year stint as a research fellow at the University of Cambridge, he began a teaching and research career that included periods at Yale, Princeton, Oxford and Stanford universities. Since 2001 he has been a professor at Columbia University in New York, and is chief economist at a think tank, the Roosevelt Institute.

Stiglitz was on President Clinton's Council of Economic Advisers in the 1990s, before becoming Chief Economist at the World Bank. He was awarded the Nobel Prize in Economics in 2001 along with George Akerlof and Michael Spence for their work on markets with asymmetric information. He has been an adviser to several European centrist and centre-left parties and governments,

Books include *Globalization and Its Discontents* (2002), *Making Globalization Work* (2006), *The Three Trillion Dollar War* (2008, on Iraq), *The Price of Inequality* (2012), *Creating A Learning Society* (2015), *The Great Divide: Unequal Societies and What We Can Do About Them* (2015), and *People, Power and Profits: Progressive Capitalism for an Age of Discontent* (2020).

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