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Inside:
MATT RIDLEY on innovation

From the **Institute of Economic Affairs**

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WELCOME

As autumn approaches and shadows lengthen, memories of **England's exploits** at this summer's **World Cup** will soon begin to fade.

But football itself – and the Premier League in particular – will continue to be **firmly in the public eye**. As transfer fees reach **stratospheric levels**, so do **players' salaries**.

So, in our cover story, we ask: are today's players **outrageously overpaid**? Or rightfully **reaping the rewards** of the most popular game on the planet? Find out more on page 16.

And just as our football attracts **talent from around the globe**, so does **EA**.

This edition features some of the **world's finest writers on economics**. From the US, **Steve Landsburg** gives us an extract from his latest book, *Can You Outsmart an Economist?* Find out if you can on page 34!

Also from the States, **Don Boudreaux** demonstrates the power of veto (page 38), and on page 10 **Michael Munger** roots out the **rent seekers**, in the second of two articles we feature on Public Choice.

Elsewhere, Kurdish-Swedish author **Nima Sanandaji** focuses on the potentially **damaging side effects** of economic sanctions. And from here in the UK, **Matt Ridley** – renowned author of *The Rational Optimist* and *The Evolution of Everything* – previews his upcoming IEA lecture on **how and why innovation happens** (page 4).

And we're delighted to feature **new writing talent** too. On page 32, sixth former **Allison Chia** contributes her first article (From Black Wednesday to Brexit) to **EA**.

I hope this **eclectic mix** makes for **stimulating** – and perhaps **surprising** – reading. **Enjoy**.

Jamie Whyte
Editor
September 2018

PS: In case you've missed them, all previous editions of **EA** are available for free download at **www.iea.org.uk/eamagazine**.

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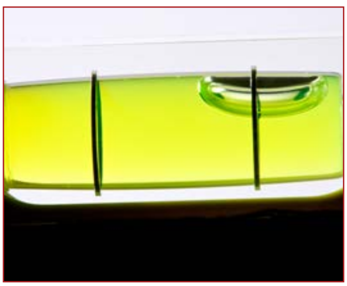
CONTENTS



Editor Jamie Whyte
Creative Director Glynn Brailsford
Design Marian Hutchinson
Editorial Adviser Richard Wellings

IEA
2 Lord North Street Westminster SW1P 3LB
020 7799 8900 **www.iea.org.uk**

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HOW MANY LIGHT BULBS does it take to CHANGE THE WORLD?

Acclaimed author MATT RIDLEY previews his forthcoming IEA lecture…

As Friedrich Hayek knew all too well, innovation is the source of most, if not all, prosperity.

A new tool, a new rule or a new idea is what makes people better able to fulfill their needs and their wishes as they go through life.

I'm sitting at a table, dressed in cotton clothes, using a Microsoft programme and employing the English language to write this article – four ways in which my life is made better by things that people invented: an object, a processed plant, some software and a cultural phenomenon.

What is innovation and why does it happen to us and not to rabbits or rocks?

There was a time when it did not happen: Homo erectus, our ancestor, used roughly the same design of stone tool – the Acheulian hand axe – for more than a million years with little change. The habit of innovation had to be invented.

23 DIFFERENT PEOPLE INVENTED THE LIGHT BULB INDEPENDENTLY IN THE SAME DECADE

The key seems to have been exchange: once human beings started exchanging ideas as well as objects, they began recombining them in novel ways.

Cut people off from exchange networks and they not only stop innovating, they sometimes go backwards and disinnovate.

Here are ten things about innovation that might surprise you:

Mostly it happens by a sort of recombination, very like the way genetic change happens through the rearrangement of genetic sequences.
Every technology is a combination of other technologies, every idea a combination of other ideas. The pencil that lies on my desk is an improbable combination of wood and graphite to produce a new function.

Innovation is an evolutionary, incremental process.
The English language is a man-made thing, but there was no founder, and nor is anybody in charge.

We are far too ready to worship heroic inventors, and forget just how gradual and team-like invention nearly always is.

Did you know that 23 different people invented the light bulb independently in the same decade?

The technology was ripe to be invented and it was inevitable it would be. That's why patent disputes accompany most discoveries and innovations.

You cannot invent things before they are ready to be invented.
Powered flight had to wait for engines. Computing software had to wait for programmable computers, which had to wait for integrated circuits, which had to wait for semiconductors.

It is surprisingly hard to think of things that could have been invented decades before they were. Even wheeled suitcases came at about the right time as airports expanded.

It's also surprisingly hard to plan, predict or stimulate innovation.
Forcing it to happen is hard. Steve Jobs took a gamble on the idea that making computers more user-friendly would generate novel features and make a successful business.

But when Elizabeth Holmes tried to emulate his approach with blood diagnostic tests, assuming that innovation would arrive if she demanded it, she ended up presiding over an infamous fraud called Theranos.

Innovation is not necessarily speeding up.
I've lived through spectacular changes in communication and computing, but relatively little change in transport – the personal gyrocopters and routine space travel I was promised as a child never arrived.

My grandparents had the opposite experience, being born before the car or the aeroplane, and dying after men landed on the moon, but seeing little change in telephones, telegraphs and typewriters during their lives.

Innovation helps people diversify as consumers while specialising as producers.
Compared with animals, or with subsistence farmers, most people can exchange a few hours of highly specialised production – a "job" – for a cornucopia of different foods, goods, experiences, entertainments and travel.

Innovation that does not cut the cost of acquiring things usually fails. Wind turbines are a good example.

Innovation is as much the mother as the daughter of science.
The steam engine led to thermodynamics not vice versa. Social media, the mobile phone, drones, block chain – all owe little to academic discoveries. Sure, government funding of science does lead to innovation too, but it's a two-way street. And as scientists often discover, the invention gets you only 5% of the way. Much of innovation is turning an idea into an affordable and useful product.

Innovation does not lead to unemployment.
Quite the reverse. Ever since the first threshing machines on farms, people have worried that automation costs jobs.

Instead it creates them by freeing people and capital to seek out new ways for people to employ each other.

True, we have ended up with more leisure, but it has been equitably shared: most people spend half their life now in education or retirement, and in the other half spend only 20% of their time actually at work – not counting sleep, weekends and lunch hours.

There are huge vested interests ranged against innovation.
Big companies and public agencies do their best to protect their rent-seeking opportunities.

Intellectual property, occupational licensing and government favouritism also do much to keep innovators out.

As long ago as 1679 William Petty pointed out that "when a new invention is first propounded, in the beginning every man objects and the poor inventor runs the gauntloop of all petulant wits."

Everybody knows innovation is generally a good thing and yet lots of people fear it.
The dairy farmers of America got margarine banned in several states. The hansom cab operators of London tried to get the umbrella banned (and later, Uber). Canal owners campaigned against railways.

Today the precautionary principle is used by some activists to prevent life-saving new technologies like genetically modified food or electronic cigarettes, even when these are demonstrably safer and better than existing technologies.

INNOVATION IS THE CRUCIAL INGREDIENT OF MODERN SOCIETY

In short, innovation is the crucial ingredient of modern society, yet economists struggle to explain it.

Most, including Friedrich Hayek, assumed it to be an "exogenous" force that lands like manna from heaven upon a fortunate country.

Some, like Paul Romer, argued that it is itself a product of economic activity.

Nobody really knows how it happens, which is rather wonderful, I think •

Matt Ridley
www.mattridley.co.uk

Matt Ridley's books have sold over a million copies, been translated into 31 languages and won several awards. His books include *The Rational Optimist* and *The Evolution of Everything*.

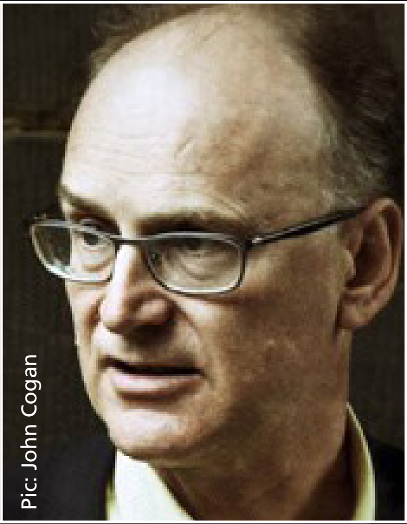
His TED talk "When Ideas Have Sex" has been viewed more than two million times.

As Viscount Ridley, he was elected to the House of Lords in February 2013 and served on the science and technology select committee 2014-2017.

Matt worked for *The Economist* for nine years as science editor, Washington correspondent and American editor.

He will give this year's IEA Hayek Memorial Lecture at Church House, Westminster, on November 14.

To attend, email **events@iea.org.uk**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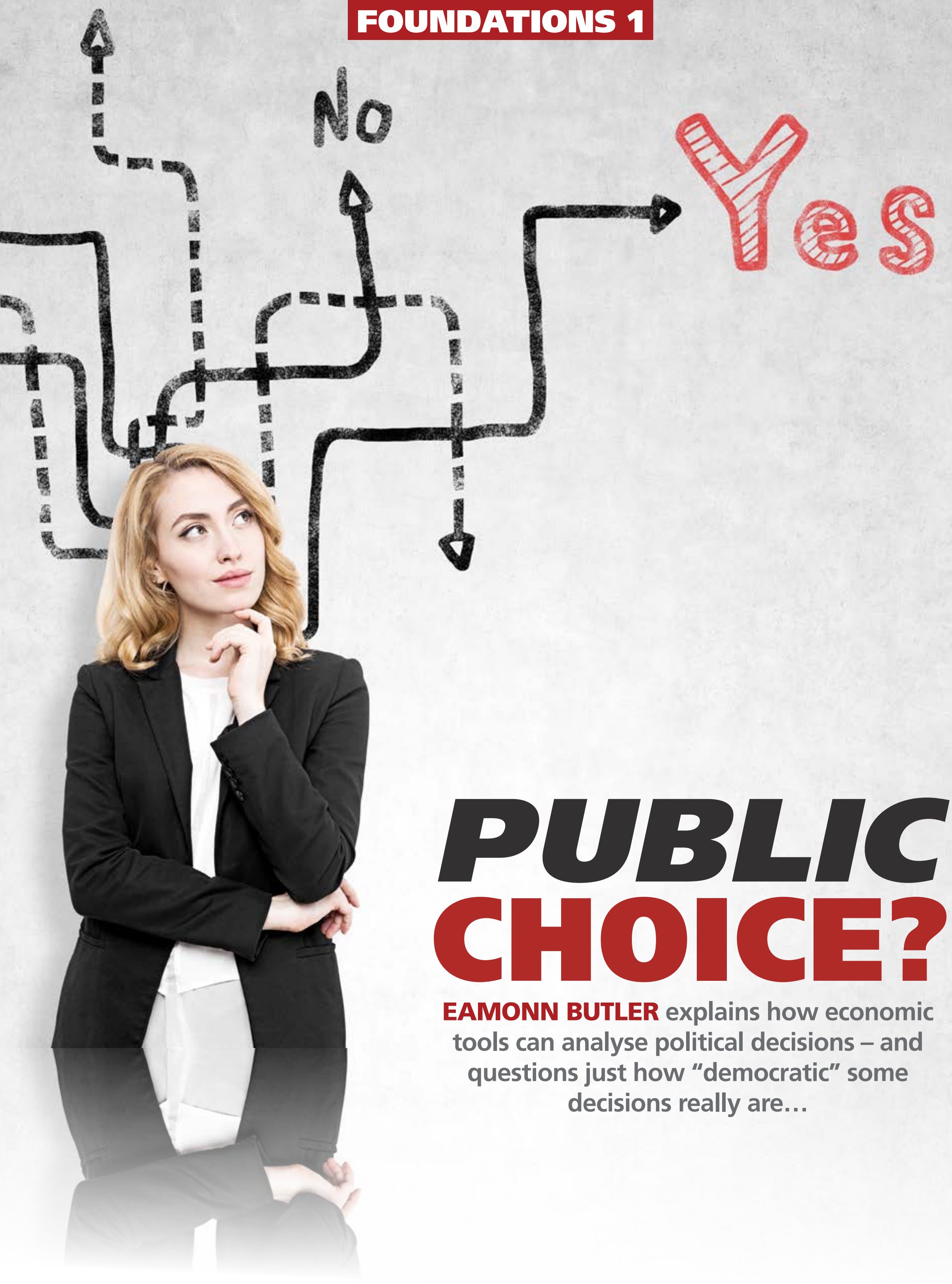

PUBLIC CHOICE?

EAMONN BUTLER explains how economic tools can analyse political decisions – and questions just how "democratic" some decisions really are…

Will the view from the next hill be worth the effort of climbing it? Should you spend time learning the guitar?

Though no money is involved, these are still economic choices: decisions about how much resource (e.g. time and effort) to spend in pursuit of something we value.

To help us analyse and make such choices, economists have developed some simple but useful tools.

They include ideas such as *cost* – the value of what you give up in trying reach your end goal – and *benefit*, the value you gain from achieving it.

Likewise, *profit* is the difference in value between what you give up and what you gain – though if the view was disappointing or you find the guitar too difficult, it might equally be your loss.

It is instructive to use these tools to analyse how political decisions are made.

That is exactly what the Public Choice School of economists does, and what James M. Buchanan won the 1986 Nobel Economics Prize for.

These economists note that when making private choices, the individual feels both the costs (trudging up the hill) and the benefits (the glorious view).

In political decisions, such as whether London Airport should be expanded, the people who benefit (e.g. air travellers) are not the same people who bear the costs (e.g. taxpayers and those whose homes are bulldozed).

Yet minorities are often forced to accept the decisions of the majority. This means that in "democratic" decisions, the majority can exploit the minority – voting themselves benefits but imposing the costs on others.

The "welfare economists" of the twentieth century forgot this.

They assumed that public decision-making was perfectly rational. Once the economists had worked out the costs and benefits of a project (such as an airport expansion), the politicians could be left to follow their advice.

But politicians have their own private interests that distort their decisions – as do the citizens who elect them and the officials who implement the laws. Choices made democratically are not necessarily the best choices.

The trouble starts with elections. Elections are regarded as measures of the public interest. In fact, they are competitions between competing private interests.

There is no way to reconcile those who want a bigger airport with those who want quiet skies, those who want lower taxes, or those who want the money spent on defence instead. These conflicting private interests cannot be summed into any sensible single measure of 'public interest'.

Also, different systems produce different results.

Under majority voting, if 51% of the voters want airport expansion, the other 49% have to accept it. But if a two-thirds majority is required, the expansionists might have to modify their proposals to get them through. The lower the majority required, the easier it is for the majority to exploit the minority.

That is why Buchanan favoured a near-unanimity rule for decisions on things, such as taxation, where it is very easy to impose costs on minorities (like "the wealthy" or "land owners").

Another issue is "rent seeking". Small groups with very strong interests come to dominate the election process.

Farmers, for example, might benefit greatly from public subsidies or protection against foreign producers. That might mean higher costs for taxpayers and customers, but not high enough to get them campaigning against it.

THIS PURSUIT OF THE "MEDIAN VOTER" MEANS ALL PARTIES TEND TO BUNCH AT THE CENTRE – LEAVING NON-CENTRIST ELECTORS LARGELY UNREPRESENTED

So the lobby groups are vocal, focused and politically organised, while ordinary people are not. Unsurprisingly, therefore, political candidates pander to the noisy few rather than the "silent majority".

People complain about the silent majority's apathy. But look at it again in terms of costs and benefits.

The chance of your vote actually making a difference in an election is tens of millions to one. So why bother studying the candidates and the issues? Your "rational ignorance" makes perfect sense.

Once they have bagged the

votes of the lobby groups, politicians' best chance of picking up more votes, say the Public Choice theorists, is to adopt policies that appeal to the large mass of voters in the centre. That also leaves them some hope of picking up voters on either side.

But this pursuit of the "median voter" means that all parties tend to bunch at the centre, leaving non-centrist electors largely unrepresented.

When elected, politicians may well resort to vote-trading (or "logrolling") to get their own policies through the legislature.

They agree to support measures that other legislators favour strongly in return for those legislators' support on their own preferred projects: "you vote for my measures and I'll vote for yours".

But the result is that more laws are passed than anyone really wants.

Government growth is also promoted by the self-interest of civil servants.

WHAT'S MISSING IN THIS PROCESS IS THE VOICE OF THE PUBLIC

They are likely to pursue the security and status of a large department with a big budget, and so talk legislators into expanding the rules and regulations that they administer.

Again, what is missing in this process is the voice of the public who have to pay for these measures and who suffer their effects.

Issues like these are why many Public Choice theorists argue for strong constitutional restraints on the political process.

They worry that electoral majorities – often dominated by coalitions of highly motivated vested interest groups – may use their numbers to exploit under-represented minorities or even the ignored masses.

Such issues should also warn us that the answer to "market failure" is not always government intervention, as many mainstream economists assume.

A streetwise economist is painfully aware that *government* failure is even worse•

Eamonn Butler
Director
Adam Smith Institute
eamonn@adamsmith.org

The real cost of RENT SEEKING

In the second of our articles on Public Choice, MICHAEL MUNGER explains why there's no such thing as free money

"I don't know if we should stay in this business".

The "business" the Charlotte N.C. city official was referring to was applying for grants from the Department of Housing and Urban Development (HUD), the federal agency charged with increasing home ownership.

Twenty-five years ago, when I had this conversation, I didn't understand what he meant. Why would a city official think twice about getting free money to help local citizens?

The answer is one of the lessons of public choice: free money isn't free.

In fact, you have to pay for free money twice: first you have to collect the money through taxation. Then you have to pay for the money again, because the benefits are dissipated by what economists call "rent-seeking".

Robert Tollison, a leading public choice economist defines rent-seeking as "the expenditure of scarce resources to capture an artificially created transfer".

FREE MONEY ISN'T FREE – IN FACT, YOU HAVE TO PAY FOR FREE MONEY TWICE

The city official told me that his office employed 15 people whose sole jobs were to identify and win federal grants. Their total salaries, and the staff and utilities required to support them, exceeded one quarter of the federal funds they had secured in grants the previous year.

It seems like a pretty good deal to spend only 25 cents to win a dollar. But if you think about all the other cities doing the same thing, you realise that this system of distributing grants has some perverse costs.

And the costs were climbing. Other cities around the nation, in the mid-1990s, had begun to get better at the HUD-grant game.

At first, Charlotte had been able to win grants with a relatively short proposal and some supporting documents. But as time passed, the amount of effort and resources required to win was increasing.

Not only was Charlotte

spending more city tax dollars just to win grants funded by federal tax dollars, but Charlotte was winning less often. With the same thing surely occurring in other cities chasing the same money, this "free money" was getting expensive.

In my classes, I ask students to play a game that I call a Tullock lottery, after one of the inventors of the concept of rent-seeking, Gordon Tullock.

The lottery works as follows: I offer to auction off $100 to the student who bids the most. The catch is that each bidder must put the bid money in an envelope, and I keep all of the bid money no matter who wins.

So, if you put $30 in an envelope and somebody else bids $31, you lose both the prize and the bid. When I run this game with students I can sometimes make $50 or more, even after paying off the prize.

Take a walk along K Street in Washington, D.C. where many of the political lobbying firms have their offices. It is lined with tall buildings, peopled by men and women with excellent educations and a desire to make lots of money and achieve great things.

What are those buildings, those people? They are nothing more than bids in the political version of a Tullock lottery.

The cost of maintaining a D.C. office with a staff and lights and lobbying professionals is the offer to politicians. If someone else bids more and the firm doesn't win that tax provision or defence bid or road contract, it doesn't get its bid back. The money is gone. It is thrown into the maw of bad political competition.

Who benefits from that system? Is it the contractors, all those companies and organisations with offices on K Street? Not really.

Playing a rent-seeking game like this means those firms spend just about all they expect to win. It is true that some firms get large contracts and big cheques, but all the players would be better off overall if they could avoid playing the game to begin with.

THE RULES OF OUR POLITICAL SYSTEM HAVE CREATED THIS DESTRUCTIVE KIND OF POLITICAL COMPETITION

My students ask why anyone would play this sort of game. The answer is that the rules of our political system have created this destructive kind of political competition. When so much government money is available to the highest bidder, playing this lottery begins to look enticing.

When politicians set up a rent-seeking contest, they are gambling not with their own money but with money they have collected from taxation.

To simulate the real world of rent-seeking more closely, I would need to amend my classroom exercise.

First, collect $10 from each student. Next, run the auction, giving the students a chance to buy their money back. I'm not sure what would happen, but this procedure would give you the "pay for it twice" aspect that real political rent-seeking games exhibit. And I wouldn't be surprised if some students just stayed home sick that day, as a way to avoid playing the game at all.

What did Charlotte decide? Did they drop out of the game? Of course not.

True, spending city money to win pretty much the same amount of federal money makes little sense economically. But it makes a lot of sense politically.

As long as politicians are able to claim credit for bringing new federal spending to their state, district, or city, it doesn't matter that each dollar "won" actually cost 30 cents, or even $1.20. On 1 August, 2005, a story was published in the *Charlotte Observer*:

"WASHINGTON, DC – Senator Richard Burr today announced $8,329,494 in United States Department of Housing and Urban Development (HUD) grants for the City of Charlotte. The funds will expand affordable housing and emergency shelter to the homeless and sick and extend homeownership opportunities to low-income and minority households".

Homeless, sick, low-income, and minority households? Who could object to that? Besides, it's free money! Isn't it? •

Michael Munger
Professor of Political Science
Duke University
North Carolina
munger@duke.edu

SHELL SHOCK

STEVE DAVIES on the dangers of false comparisons – and why you should always compare eggs with eggs

The collective public conversation is full of debates about whether some institution or practice, or even the entire social and economic system, is good or bad, functional or dysfunctional. Above all, there are arguments about whether things judged to be bad can be improved.

This by itself is a good thing. It is only by holding ways of doing things up to judgment and suggesting improvements that any change for the better can happen. (This, by the way, is a very modern way of thinking, which was rare before the modern age).

Yet debates of this kind are often unproductive. Things that are flawed but functional are too often cast aside and replaced by things that do not work as well.

The main reason is the malign influence of the Nirvana Fallacy. It has been around for a long time but was first clearly identified and given its name in 1969, in a famous paper by the UCLA economist Harold Demsetz.

The essence of the fallacy is this. One of the participants in an argument compares the existing real-world institution or practice that is being discussed to an ideal, imaginary and perfect alternative rather than to an alternative that actually exists or might realistically come to exist.

In other words, the actual is compared to the ideal. The actual real-life case is then criticised because it fails to measure up to the ideal alternative.

The problem is that you are not comparing like with like. It can be perfectly appropriate to compare two utopias or supposedly ideal states of affairs where everything works as intended (in political philosophy for example). This can help to clarify differences of principle or foundational assumption.

But when looking at the real world and trying to make sense of it, you must compare the actual with the actual. Only then can you make accurate judgments about which of the two real world examples works better, or is better, at reaching an agreed goal (such as the reduction of poverty).

Demsetz described this approach as "comparative institutional analysis". What you should not do is compare the imperfect or second-best real-world situation with an ideal and perfect but imaginary alternative. That is, you should not compare messy real-world options with Nirvana.

There are many examples of this fallacy, particularly where debates about economic institutions are concerned.

The most obvious are cases where the real world of predominantly capitalist or free-market mixed economies are contrasted with an ideal alternative economic and political order.

One very common phenomenon is to compare capitalism and its consequences and effects to an ideal socialist world. The question you should always ask when this happens is: "compared to what?".

For example, criticisms of the wages and employment practices in sweatshops usually assume that the alternative is high wage employment with the kinds of working conditions and regulations found in developed economies.

In the real world, that is not actually an alternative. The actual alternative is something like scratching a living on a refuse dump, or being a prostitute or street criminal, or living as a subsistence farmer.

There are equally annoying people on the free-market side. They compare a social democracy or mixed economy to an ideal laissez-faire capitalist economy with minimal government where everything works perfectly. This is just as bad an argument.

In both these cases, real world examples are dismissed with the airy remark "oh that's not real socialism/capitalism". This makes proper debate and comparison impossible.

What you need to do is compare cases that are either both in existence or are realistic and feasible.

The 'comparative institutional analysis' approach would compare current capitalism with 'really existing socialism' or different kinds of mixed economy with each other, or a realistic picture of a market economy with actual social democratic ones.

WHEN LOOKING AT THE REAL WORLD AND TRYING TO MAKE SENSE OF IT, YOU MUST COMPARE THE ACTUAL WITH THE ACTUAL

In fact, the Nirvana fallacy has come to corrupt economics in general.

In most school and university courses, the reality of market economies is compared to the ideal alternative of perfect equilibrium, with departures from that described as "failures".

What is needed is to compare actual institutional solutions to real world challenges and see which ones work best (or least badly).

The fallacy also happens in everyday life, when you compare your actual partner or job or home to a perfect alternative rather than to an actually plausible one.

The results of this error can be bad at a personal level but, at the societal or policy level, they can be catastrophic.

As Voltaire observed, the perfect is the enemy of the good. This is something to bear in mind in both academic debate and personal life•

Dr Stephen Davies
Head of Education
Institute of Economic Affairs
sdavies@iea.org.uk

NIMA SANANDAJI on the potentially damaging side effects of economic sanctions

The practice of economic sanctions is not new. 2,400 years ago Athens declared a trade embargo on the neighbouring city state of Megara, strangling the city's trade.

But it is in the modern age that sanctions have become a popular tool of foreign policy. So, do sanctions work?

Extensive research has been carried out on the outcome and impact of economic sanctions, with different claims over their results.

The Oxford Reference encyclopedia has this to write about sanctions: "There is considerable disagreement over their effectiveness. Critics point out that they are easily evaded and often inflict more pain on those they are designed to help than on the governments they are meant to influence".

In some instances, sanctions seem to have achieved their goals.

The sanctions against apartheid governments in Rhodesia and South Africa for example put pressure on racist systems already strained by popular uprising, speeding up the fall of these states.

India has cut off trade to its smaller neighbour Nepal, creating a shortage of necessary goods, and by doing so forced Nepal to adopt certain policies.

But these are the rare cases that defy the rule. Often, people and businesses in sanctioned countries feel betrayed by the world, and instead turn towards supporting their governments when the rest of the world cuts off trade links.

The sanctions against Russia have for example made the Russian people much more supportive of the Putin administration. When goods stopped flowing to Russia through international trade, the state made deals with powerful oligarchs to produce various goods.

And so Russia, which previously had ambitious free-market aspirations (for example via a low and flat tax rate), was pushed towards a more centrally planned model with crony capitalism.

This has benefited the political class and hurt the country as a whole, while also making Russia much more hostile to the West. Western consumers and businesses similarly are hurt since the option to trade with Russia is cut off.

In a recent study, I look at the "friendly fire effect" of economic sanctions.

Essentially all Western economies except Switzerland and Israel are taking part in the sanctions against Russia.

One might imagine that this would allow these two non-sanctioning countries to massively increase their trade with Russia – after all, when Russia is cut off from trading with the rest of Europe, why not turn to Switzerland?

SANCTIONS NOT ONLY LIMIT THE ECONOMIC WELL-BEING OF PEOPLE ... BUT ALSO REDUCE ECONOMIC AND CIVIL LIBERTIES

As it turns out, however, the economies that choose not to participate in the sanctions also experience a massive drop in exports.

This is because world trade happens through so called global value chains – in which companies in places such as Switzerland, Israel, Russia, the UK and the US work together to produce certain goods.

Cutting out a country from this global chain means everybody else in the chain will have difficulties trading. This means the economic costs of sanctions are bigger than one might otherwise believe.

One must also consider that sanctions not only limit the economic well-being of people in the targeted country (in some cases leading to malnourishment or even starvation), but also reduce economic and civil liberties.

By doing so, they undermine the peaceful exchange which breeds global prosperity and peaceful relations.

The researchers Dursun Peksen and Cooper Drury have used a time-series cross-national dataset of sanctions over the period 1972 to 2000 to study the effectiveness of sanctions in reaching their goals.

The authors find "both the immediate and longer-term effects of economic sanctions significantly reduce the level of democratic freedoms in the target."

One illustrative example is the sanctions enacted against North Korea. Cutting off the country from trade made the planned economy last longer than it would otherwise have done.

Fortunately, there have been some openings for North Korea to trade with China and to a limited degree also South Korea. Gradually the North Korean state has incorporated some elements of free markets into its economic model.

North Korea is still an authoritarian and brutal state, but the shift towards a market economy is nonetheless positive – it has, for example, reduced starvation.

Recently, North and South Korea signed the Panmunjom Declaration for Peace, Prosperity and Unification of the Korean Peninsula. This historic document represents a move towards peace in one of the longest global conflicts; a conflict which could result in nuclear war.

An important part of the deal between the two Korean states is about fostering trade links. As the sanctions are replaced with trade, peaceful relations follow.

Sanctions are not always the wrong policy, but they should be used very cautiously.

Often, it makes more sense to encourage free exchange. Linking the world together in advanced global value chains is the best strategy for peace and prosperity. In the end, either goods will cross borders, or armies will•

Nima Sanandaji
President, European Centre for Entrepreneurship and Policy Reform
nima@sanandaji.se

FOR MORE

This article is based on the forthcoming IEA report *Blocking Progress* by Dr. Nima Sanandaji.

Download it for free at **www.iea.org.uk/research**

Nima is a Kurdish-Swedish author of 25 books.

He is currently touring with his new book *The Birthplace of Capitalism – The Middle East.*

NET PROFIT

Are footballers worth the money?
MARK LITTLEWOOD on the rise of **player power**

This summer's scintillating World Cup thrilled millions around the world.

We witnessed jaw-dropping technical skills, pulsating penalty shoot-outs and the emergence of a new generation of superstars headed by the likes of Kylian Mbappe.

A.Ricardo/Shutterstock.com

But the World Cup isn't just a feast of football. It's a global shop window where even half-decent players can add millions to their transfer value – and their take-home pay.

And that inevitably rekindles a very modern-day debate: are footballers worth it?

Players' enormous salaries and transfer fees of hundreds of millions are variously described as obscene, absurd, ludicrous and even unsustainable.

Yet each year the amount of money spent is not merely sustained, it zooms upwards.

With new media platforms likely to bid against Sky and BT for the rights to televise live football, forcing up the fees top-flight clubs can demand of broadcasters, there is every reason to believe this trend will continue.

But far from being embarrassed about the riches associated with England's most adored export industry, we should be taking considerable pride in its success.

This should be particularly true of those who wish to see a substantial transfer of power away from the capitalist bosses and towards the employees upon whom their industry relies.

If you remain attracted to the dictum that the workers should receive the "full fruits of their labour", changes in the power structures of English football should be your stand-out example of the world you believe in.

For the story of the last fifty years has been how those who work as footballers have ensured that the economic gains in the industry have increasingly ended up with them – in wages and bonuses – rather than with club owners or even the "consumers" or fans of football.

The bonus pool shared out among England's 1966 World Cup winning team amounted to £376,000 in today's money. A decent centre-forward can now earn that in less than a fortnight.

The 1966 team captain, Bobby Moore, began his career on the equivalent today of £14,000 **a year**.

In the early 1980s, less than 20 years after his hat-trick

berm_teerawat/Shutterstock.com

against West Germany won the World Cup, Geoff Hurst was in an unemployment queue to claim his £25 dole cheque.

Other football heroes of the past were obliged to take second jobs just to make ends meet. Cyril Knowles, the Spurs full-back about whom the phrase "Nice one, Cyril" was coined, spent his summers working in a fish and chip shop in Pudsey.

FAR FROM BEING EMBARRASSED ABOUT THE RICHES ASSOCIATED WITH ENGLAND'S MOST ADORED EXPORT INDUSTRY, WE SHOULD TAKE CONSIDERABLE PRIDE IN ITS SUCCESS

Those who worked as footballers in the 1960s could not even aspire to a decent "work-life balance".

Contrast that with players like Neymar. When the Brazilian forward moved from Barcelona to the French super-club Paris Saint-Germain for a fee of nearly £200 million) he stood to earn around £250 million over the course of his five-year contract - probably amounting to a bit more than £20,000 for every minute he spends on the pitch.

For those who yearn for enhanced social mobility and

Alizada Studios/Shutterstock.com

better conditions for workers, Neymar's story should bring a tear to the eye.

Despite his father having three jobs, the family often had to rely on candlelight as they couldn't afford the regular electricity bill. The whole Neymar clan – including his grandparents – reportedly slept in the same tiny bedroom on a single mattress.

His huge new salary at PSG essentially amounted to a multimillion-pound transfer of wealth from the Qatari owners of the club to a working-class boy from the slums of Sao Paulo.

Modern trade union leaders must be studying this unparalleled advance of worker power in football with both fascination and envy.

In 1981, fewer than ten first division English footballers earned more than £175,000 a year. The average player now commands 15 times that.

It's not just that players have been carried on the wave of a footballing renaissance. They are not just benefiting from a bigger pie, they also command a much greater proportion of it.

In the 1980s, about 40 per cent of a club's income would be devoted to players' salaries; the figure now stands at about 70 per cent.

As a movement successfully agitating for greater worker power, Premier League footballers stand without equal in the modern era. So enormous has their success been in securing wage increases that it is increasingly impossible for clubs to make any sort of profit at all.

AS A MOVEMENT SUCCESSFULLY AGITATING FOR GREATER WORKER POWER, PREMIER LEAGUE FOOTBALLERS STAND WITHOUT EQUAL IN THE MODERN ERA

Player power has also given rise to a new and determined militancy. To the consternation of both the capitalist bosses and the fans, talented footballers are agitating for enhanced career opportunities.

That leads to stand-offs, no-shows and niggling 'injuries' as players seek to escape their current employment contracts to pursue their ambitions with much richer and more successful employers elsewhere.

The enormous improvement in footballers' working lives has also gone hand in hand with other great leaps forward in the game.

Hooliganism has largely been stamped out. Stadiums are enormously safer and more comfortable than just a couple of decades ago.

Racism hasn't been wholly removed from the game, but a third of all Premier League players are now from an ethnic minority background, compared with just 8 per cent in the highest echelons of British business and 10 per cent of top performers at the BBC.

It is hard, of course, not to envy highly skilled and superbly paid footballers.

But rather than wringing our hands about the riches now available in the beautiful game, we should be lauding Premier League football as a shining example of what a successful workers' revolution can look like ●

Mark Littlewood
Director General
Institute of Economic Affairs
mlittlewood@iea.org.uk

For his sins, Mark Littlewood is an avid Southampton fan.

This feature is based on an article he originally wrote for *The Times* Business section.

You can read his next column on Monday September 24 – and fortnightly thereafter.


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OFF THE RAILS

RICHARD WELLINGS on how government intervention has derailed Britain's trains

Britain's railways were privatised in the 1990s, but the policy is still controversial. A recent survey found that 60 per cent of the public would like to see the industry renationalised, a policy supported by the Labour Party.

The problems facing the rail sector - such as high subsidies, overcrowding, and unreliable services – are typically blamed on privatisation. In reality, though, many of these problems are the result of government intervention.

The infrastructure – tracks, signalling etc. – was renationalised in 2002 with the creation of Network Rail, a government-owned company. And Network Rail was largely responsible for many of the industry's recent crises, including the timetable debacles on Northern and Thameslink.

Moreover, the 'private-sector' train operators are very heavily regulated by the government. For example, many of their fares are subject to price controls, which cause overcrowding on peak-time services by artificially boosting demand.

But one of the most damaging interventions of all was the decision to impose an artificial structure on the industry. Several studies, including official government reports, have concluded that this created large inefficiencies, pushing up subsidies as a result.

Throughout railway history, the same firm almost always both owned the tracks and ran the trains – a structure known as vertical integration.

But the government adopted a 'separated' model during privatisation, with one firm owning the tracks and several different firms running the trains. It was hoped this approach would increase efficiency by stimulating competition between operators.

A broadly similar model was tried on the pioneering Stockton and Darlington railway, which opened in 1825. Coach companies operated horse-drawn trains and paid a toll to the track owners.

But the system quickly collapsed. If trains broke down, departed late or moved slowly, they would block the route and delay competitors.

The inflexibility of railway technology kept trains trapped on the rails and, unlike road vehicles, unable to drive around blockages.

High levels of interdependency meant decisions by one firm had significant effects on the others. Disputes arose about who was to blame for the problems and who should pay compensation. Fights frequently erupted between drivers.

ONE OF THE MOST DAMAGING INTERVENTIONS WAS THE IMPOSITION OF AN ARTIFICIAL STRUCTURE ON THE INDUSTRY

All this hassle wasted resources and reduced efficiency, so eventually the track owners decided to buy out the coach firms and run trains themselves.

After the railways were re-privatised in the 1990s, comparable problems emerged.

In order to manage disputes between the track owner and different operators, complex rules and contracts were introduced, along with government agencies to oversee them. Large numbers of consultants and officials joined the industry, at substantial cost.

Long-term investments also create costs for separated models. If firms want to upgrade a line to boost passenger numbers, then both track owners and train operators must be involved.

Extra fare revenues initially go to the operators, so they must agree to pay higher track charges in order to pay for the upgrade – otherwise there is little incentive to undertake the project.

Expensive new rolling stock might be required to improve the service, and the new vehicles might not be suitable for other routes, increasing the financial risks. A high degree of such 'asset specificity' increases the interdependency of track owners and train operators.

And what if the project hits problems? It might go over-budget or be finished late - or perhaps the planned outputs can't be achieved at acceptable cost. The complex contracts needed to cover such possibilities might involve protracted negotiations.

Investors also face the risk that if original specifications aren't met, payment from the train operators will be withheld or compensation demanded (as happened with the £9 billion upgrade of the West Coast Main Line, completed in 2008).

Freedom from contractual obligations might give an integrated firm more flexibility to adapt to changing circumstances.

Rail firms therefore face a trade-off. It is possible that separation will foster more competition, improving incentives for cost control and innovation. If efficiency is significantly higher under such a model, split ownership might be more profitable.

But separation could also bring efficiency losses.

DISPUTES AROSE ABOUT WHO WAS TO BLAME – AND FIGHTS FREQUENTLY ERUPTED BETWEEN DRIVERS

Economies of scale could be lost if tasks and assets are duplicated.

And 'transaction costs' could be higher – costs from dealing with separate firms, such as the complex and risky contracts outlined above.

Without state intervention, the rail industry could evolve according to market conditions. If firms thought separation would increase profits, then integrated companies could split up. If firms thought integration would increase profits, track owners could merge with train operators.

Major problems arise when governments decide to impose a particular structure on the industry, not allowing firms to merge or split up.

This risks setting an inefficient model in stone, raising costs for taxpayers and passengers, and in the process bringing privatisation into disrepute●

Richard Wellings
Deputy Research Director
Institute of Economic Affairs
rwellings@iea.org.uk

THiNK-ING TIME

In June we held our fourth – and largest – **THINK** conference in London.

More than 600 16 to 25-year-olds joined us at the Royal Geographical Society to hear some of the most exciting economists and thinkers from across the world.

Many attendees travelled impressive distances to explore new economic ideas, challenge views and forge friendships.

Highlights included best-selling authors **Tim Harford** and **Linda Yueh**; Deputy Editor of *The Economist*, **Tom Standage**; **Raj Chande** from the Behavioural Insights Team; and Nobel Prize Winner, **Professor Vernon Smith**.

You can watch videos of all the talks from **THINK** by visiting our YouTube channel: www.youtube.com/iealondon

LOOK OUT FOR THINK 2019 AT www.thinkiea.com!

HEADING TO READING (and more!)

Over the next nine months we will, once again, be visiting schools all across the country.

Sixth form A-Level and IB Economics students will have the chance to hear from top economists on topics as varied as "Robots and jobs: see it from an economist's point of view", "Is there such a thing as the gender pay gap?", and "Market failure and government failure: the case of healthcare".

These conferences are **FREE** to attend.

If you're interested in attending one or you would like to host a conference at your school, please contact Christiana Stewart-Lockhart: **cstewartlockhart@iea.org.uk.**

SCHEDULE

2018

Reading Blue Coat School	Thursday October 4
Loretto School, Edinburgh	Thursday November 8
Bromley High School, South London	Friday November 23

2019

Worth, West Sussex	Wednesday January 30
Pate's Grammar School, Cheltenham	Wednesday February 6
Tonbridge School, Kent	Monday March 11
New Hall School, Essex	Thursday March 21
Stowe, Buckinghamshire	March (TBC)

INTEND to INTERN?

SIXTH FORM INTERNSHIPS

If you're in Year 12 or 13 and are looking for work experience next summer then this is the perfect opportunity for you!

We provide a dedicated one-week internship at our offices in London especially for sixth formers.

There are 120 places in total across 3 different weeks in July. You'll be one of 40 interns on each wave of the programme and the week includes lectures, workshops, debates and discussions with expert economists.

To find out more visit **www.iea.org.uk/internships**. The deadline for 2019 applications is Friday March 29.

WHAT THEY SAY:

"I believe I've come out more knowledgeable and with friends from all over the country. I'd like to thank the IEA for the outstanding internship you provided."
– IEA sixth form intern, July 2018

"I've very much enjoyed this internship – it's been an invaluable experience I'll never forget." – IEA sixth form intern, July 2018

"It was a very informative and enjoyable experience; I met many like-minded people who I'm sure I will be friends with for life. I thoroughly enjoyed learning more about the IEA and gained invaluable knowledge from all the lectures."
– IEA sixth form intern, July 2018

SUMMER INTERNSHIPS

Each summer, the IEA welcomes nearly 80 undergraduate interns (two groups of 40) from around the world for a packed three-week programme of lectures, seminars, debates, discussions, events and social activities.

Each intern produces a supervised research project, chosen by themselves, and is mentored by one of the IEA's senior researchers.

Want to apply? If you are an undergraduate student and you're interested in learning about ideas, then this is the internship for you.

Visit www.iea.org/internships to find out more. The deadline for Summer 2019 applications is Friday March 29.

WELCOME MATT...

Our annual Hayek Lecture is fast approaching – and you're invited!

This year's lecture will be given by acclaimed author **MATT RIDLEY – see his article on page 4 for a sneak preview of his talk.**

The lecture is **FREE TO ATTEND** and will take place on **Wednesday November 14**, from 6.30pm to 8.15pm, at Church House, Westminster, London.

Places are limited – so email events@iea.org.uk as soon as possible if you'd like to attend one of **the highlights of the EA calendar.**


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GIG ECONOMY

This summer veteran rock star Paul Simon gave a concert in Hyde Park, the final time he will perform in the UK.

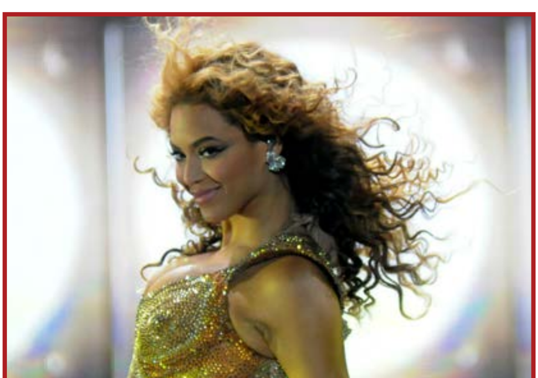
He famously came here first in the 1960s and has been back many times since, as part of a constant back-and-forth flow between American and British performers.

This is arguably a more significant 'special relationship' than many of the things our politicians go on about.

But it is probably not well known that, in addition to any normal visa requirements, a US (or Canadian, Australian, New Zealand, South African, Brazilian etc.) performer needs to have a Tier 5 (Temporary Worker – Creative and sporting) visa before he or she can perform.

This costs £244, or £854 if you are in a hurry and can't wait the three weeks or so that it takes to process these things. You need to get a 'Certificate of Sponsorship' from a 'licensed employer' and you may face a healthcare surcharge. It's a hassle, basically.

This has hit the news because the Home Office, in preparing for tighter security after Brexit, has discovered that for many years performers have been able to avoid this charge if they made landfall in Ireland, played a couple of gigs in Dublin, then moved on to the UK.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Things are now going to be toughened up.

Apparently Beyonce, for example, travels with an entourage of 250 and should have paid over £160,000 in visa fees. The Home Office needs the money. Kerr-ching.

All very well for the corporate behemoth that is Beyonce Inc, you may say.

But what about today's version of the young Paul Simon, who may simply have – in the words of a song he famously wrote on Warrington station – 'a suitcase and guitar in hand'?

Getting a Tier 5 visa is a complicated business and the expense is disproportionate to any likely benefit obtained.

Put another way, it's indirectly a tax on UK consumers of American music, comedy and drama.

LEN SHACKLETON SPOTLIGHTS A BACKDOOR TAX ON BRITAIN'S GIG-GOERS

EU performers are exempt, and thus it's cheaper to bring over a ballet from Berlin than one from Russia. Economists see this as trade diversion, a common feature of customs unions and free trade areas.

It's maybe a small thing. But when we eventually redraft our immigration rules, please let's make it easier for creatives to come to the UK. We should have the freest possible trade in entertainment – just as for other goods and services●

Len Shackleton
Professor of Economics
University of Buckingham
len.shackleton@buckingham.ac.uk

NORWAY or NO WAY?

Two IEA staffers go head-to-head on Brexit options

The so-called "Norway Option" – a form of Brexit under which the UK would leave the European Customs Union, but remain in the Single Market for the time being – is a bit like Michael Myers, the villain in the horror movie Halloween...

Every time you think it has finally been killed off, it pops up again. Like Myers, it just stubbornly refuses to die.

It died for the first time in January 2017, when Theresa May clearly ruled it out in her Lancaster House speech. But it did not remain dead for long.

The recent Chequers statement was supposed to kill it off for good – but it didn't.

It was advocated yet again by a number of relatively prominent commentators (most of them committed Brexiteers), including David Smith, Jeremy Warner, Philip Johnston, Tim Stanley, Nick Timothy, Paul Goodman, James Cartlidge MP and Rupert Darwall.

The IEA was divided on Brexit before the referendum, and while we all respect the result, we remain divided on the type of Brexit we want.

We asked two of our staff members, **JULIAN JESSOP** and **KRISTIAN NIEMIETZ**, for their take on the Norway Option (also known as the EEA).

Julian and Kristian are both liberal economists. They do not disagree on fundamental principles, and they do not have fundamentally different visions of what kind of country they want the UK to be.

But they differ on whether that vision is best achieved inside or outside of the European Economic Area (EEA)…

So which option would they choose: NORWAY or NO WAY?

NORWAY – says Dr. Kristian Niemietz, the IEA's Head of Health and Welfare

If the IEA had one tenth of the influence that a lot of our opponents think we have, I would probably back a Hard Brexit.

If we had a realistic chance of becoming a 'Singapore-on-Thames' outside of the Single Market, I would be on board.

But the truth is that we do not have anything like that influence. The Zeitgeist is very much against us. Britain is a country where free-market liberalism is an unpopular and politically unsuccessful fringe opinion.

Post-Brexit Britain will not be governed by people who believe in free markets. It will be governed by people who believe in a very large and a very activist state.

And that's just the Conservatives.

This is what we need to bear in mind when we compare different Brexit options. You cannot benchmark the EFTA/EEA Option or 'Norway Option' – safe, but admittedly not very exciting – against a hypothetical Singapore-on-steroids Hard Brexit.

You have to benchmark it against the kind of Hard Brexit that we are likely to get, not the kind that you would like to see.

This is why I cannot share the enthusiasm of some of my colleagues for a Hard Brexit. They talk about the opportunities of deregulation and liberalisation, as if all the domestic political constraints would simply evaporate on 29 March 2019.

They seem to believe that the act of leaving the European Union will magically turn Britain into a nation of Hayekians and Friedmanites.

As with most things, there are costs and benefits associated with leaving the Single Market. The problem is that while the costs are dead certain, the benefits are highly speculative.

More precisely, the benefits would only materialise if we adopted a really ambitious free-market reform agenda. (Spoiler alert: we won't.)

Let's talk about the costs. As you'll remember, before the Referendum, the vast majority of empirical assessments which tried to estimate the medium-term economic impact of Brexit concluded that it would make Britain poorer. This year, the government's own impact assessment concluded the same thing.

POST-BREXIT BRITAIN WILL BE GOVERNED BY PEOPLE WHO BELIEVE IN A VERY LARGE AND A VERY ACTIVIST STATE

It's important to note that this is not an argument against Brexit per se.

These models do not show the cost of leaving the EU as such. What they really show, in the main, is the cost of leaving the Single Market. The cost of leaving the EU, on its own, is trivial. Even the cost of leaving the Customs Union is not huge (as we can see in models which include an EEA Option). The part that really matters is the Single Market.

You could argue that economic modelling is unreliable, and that economic models have been wrong before. But the point is that they don't usually err so overwhelmingly in one direction.

You could also argue that these models have all been compiled by people who have a vested interest in staying in, or at least close to, the EU.

Or you could argue that the problem is not Brexit, but the fact that our own political class and civil servants do not believe in it.

But then, you would sound suspiciously like the "Real socialism has never been tried" crowd: real Brexit has never been tried.

Alternatively – you could just admit that the overwhelming evidence is against you, that you have been chasing a rainbow, and that a Hard Brexit is just not worth the gamble.

The Norway Option does not have to be a permanent arrangement. But for now, it is the safest, quickest and easiest way out•

Kristian Niemietz
Head of Health and Welfare
Institute of Economic Affairs
kniemietz@iea.org.uk

NO WAY – says Julian Jessop – IEA Chief Economist and Head of the IEA's Brexit Unit

The UK's departure from the EU is a once-in-a-lifetime opportunity to create a more flexible and dynamic economy and to lead the world again in free trade.

Like most investments, it involves costs, many of them upfront, as well as benefits, which may appear less certain and take longer to come through.

But the aim should be to maximise the potential upsides while minimising the downsides, rather than viewing the whole thing as a ghastly exercise in damage limitation.

THESE STUDIES CONSISTENTLY OVERSTATE THE LIKELY COSTS OF ADDITIONAL BARRIERS TO TRADE WITH THE EU

What does that mean in practice? In my view, this vision requires the UK to leave both the Single Market and the Customs Union, and not simply replicate them.

This would deliver the most scope to optimise regulations for the needs of our own economy and lower barriers to trade outside the EU.

This knocks out the Norway Option (which ties us to the Single Market), and other hybrids such as the Jersey option (which tie us to a customs union and continued regulatory alignment).

It's also hard to see how these alternative models respect the result of the 2016 referendum.

Yes, this only asked whether we should leave the European Union, without specifying the form that the future relationship should take.

But Leave campaigners were clear that this was "a vote to take control of our borders, laws and money". If they'd been asked, I'm sure they'd have included "trade policy" too.

Nonetheless, I don't believe these political arguments are enough. Remainers have a point when they argue that the 2016 vote was very close, and the politics could of course change.

I certainly wouldn't feel comfortable arguing that a large and sustained hit to the economy would be a "price worth paying" for a particular interpretation of sovereignty, or "the will of the people".

It is therefore important for Leave-supporting economists to make the case that our vision of Brexit would also leave people better off. I am happy to do so.

Most mainstream analysis suggests that the net effect will be more negative the further we diverge from the Single Market and the Customs Union.

But these studies also have one other thing in common: they consistently overstate the likely costs of additional barriers to trade with the EU, and underestimate the potential benefits.

We should also challenge the calls to maintain

"frictionless trade" with the EU.

Of course, we should listen to businesses (including those led by Leave supporters), but we should also question what they say.

So, what's the alternative? Labels are important here. I prefer something like "Clean Brexit", rather than "Hard Brexit" which implies something bad. (Indeed, its simply wrong to claim that the IEA, which has no corporate view, backs one form of Brexit over another.)

But if there is a consensus among Leave-supporting economists, myself included, it's probably in favour of a comprehensive free trade agreement with the EU, with streamlined customs arrangements and some form of mutual recognition covering both goods and services, following a transition period. Until recently this was government policy too.

An immediate exit on WTO terms is the fall back, and perhaps only a temporary one, if the EU won't play ball.

However, it would still be preferable to any option, Norwegian or otherwise, that locks the UK into Brexit in name only●

Julian Jessop
Chief Economist
and Head of the Brexit Unit
Institute of Economic Affairs
jjessop@iea.org.uk


EA
From the Institute of Economic Affairs
Issue 12 £3.75
Inside
MATT RIDLEY on innovation

LEVEL HEADED?

CHRISTOPHER SNOWDON critiques a new book on inequality in which the authors turn "speculative evidence" into "gospel truth"

One of the most talked about books of 2009 was *The Spirit Level* by the social epidemiologists Kate Pickett and Richard Wilkinson.

They have now released a sequel, *The Inner Level*, the theme and format of which is uncannily similar to the original.

A series of chapters make the case for income inequality causing a wide range of social ills before the authors round off with a rallying cry for "radical egalitarianism" and "economic democracy".

The Spirit Level relied on a succession of dubious scatterplots for evidence. The Inner Level has no shortage of similar graphs, but is more focused on explaining how inequality is supposed to cause so many problems.

At the heart of their explanation is the claim that "modern, free-market societies" cause status anxiety.

To keep up with the Joneses, people work ever longer hours and immerse themselves in consumerism. This, so the argument goes, leads to mental-health disorders and substance abuse which, in turn, lead to worse parenting. And so the cycle continues.

If you are predisposed to believe that "lack of confidence and a sense of insecurity have reached a level of intensity that makes them perhaps the most important limitation on levels of happiness and the quality of life throughout many rich societies" you are more likely to swallow what follows.

But if you have your doubts about whether "shyness" and "party anxiety" are bona fide mental disorders, you will want some evidence.

Or, at least, a coherent argument. The problem is that Wilkinson and Pickett are not very good at laying one out.

Unable to see a tangent without going off on it, they fill the book with mini-essays about everything from package holidays to psychopaths, the relevance of which is murky at best.

And yet the incoherence of the narrative serves a function. By disorientating the reader with a combination of science, folk wisdom, bald assertion and anecdote, they make the reader forget which of their claims are substantiated by credible research and which are hunches, guesses and wild extrapolations.

A common technique used here, as in *The Spirit Level*, is for a single piece of speculative evidence to be presented early on which has become gospel truth by the time they refer to it later.

This technique works in reverse, with the authors claiming they will prove something later in the book and then failing to do so. "We shall see in the course of this chapter and the next", they write, "that depression, psychotic symptoms, schizophrenia and narcissistic traits are all significantly more common in more unequal societies".

But we don't. They admit there are no internationally comparable figures for narcissism and they barely discuss depression, let alone compare prevalence in different countries, although they are able to find three studies in the literature that point to a relationship with inequality.

They devote a whole chapter to anxiety but there are no internationally comparable figures for this either, so they settle for the observation that anxiety and inequality have both risen in the US, albeit not at the same time.

From such empirical molehills, Wilkinson and Pickett build mountains. Through a one-sided interpretation of cherry-picked evidence, they paint an unremittingly gloomy picture of life in "less equal" nations.

British readers, at whom the book is principally aimed, are told they are either selfish and sociopathic, or depressed and subservient.

We are, supposedly, uncaring, unsharing, friendless hyper-consumerists, on the brink of mental illness if not clinically insane, who have retreated from society to admire ourselves in the mirror.

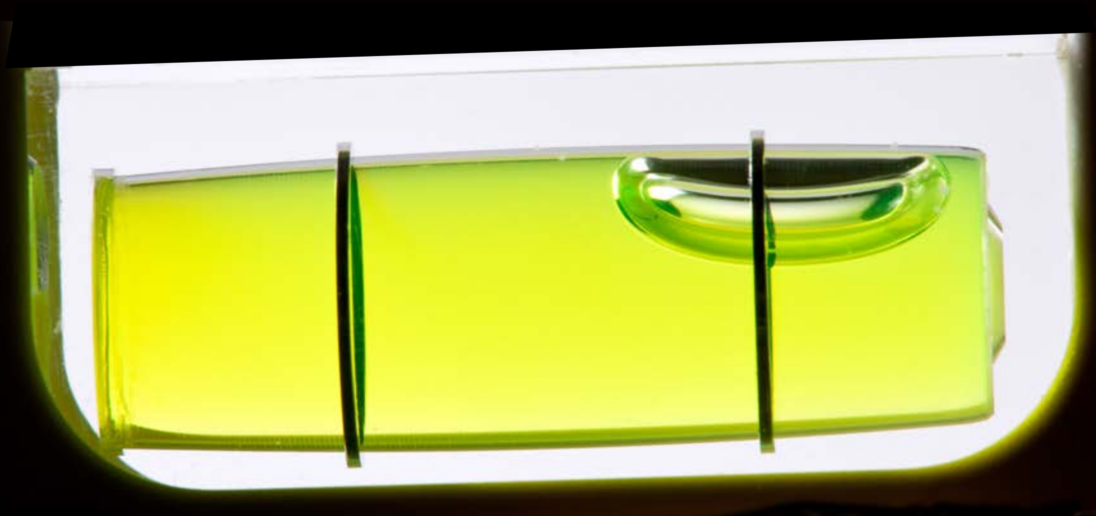
All because of income inequality! And yet the UK's Gini coefficient - the standard measure of inequality – is currently 0.32, making it indistinguishable from France and Japan (0.32) and much closer to the "most equal" country of Slovenia (0.26) than the "least equal" country South Africa (0.63).

If we look at wealth inequality – which Wilkinson and Pickett never do – the UK is well below the supposedly egalitarian nations of Denmark, Norway and Sweden.

THEY FILL THE BOOK WITH MINI-ESSAYS ABOUT EVERYTHING FROM PACKAGE HOLIDAYS TO PSYCHOPATHS – THE RELEVANCE OF WHICH IS MURKY AT BEST

What Wilkinson and Pickett present as an existential chasm between "more equal" and "less equal" countries amounts to a narcissism of minor differences between broadly similar capitalist societies•

Christopher Snowdon
Head of Lifestyle Economics
Institute of Economic Affairs
csnowdon@iea.org.uk



From BLACK WEDNESDAY to

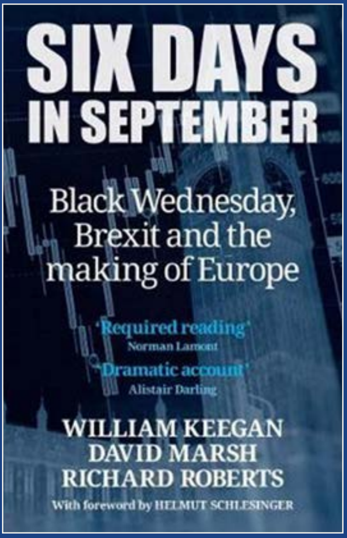
The Exchange Rate Mechanism (ERM), established in 1979, was a precursor to the euro.

Each member nation retained its own currency – the deutschmark, franc, lira, etc. – but agreed to hold their exchange rates within a narrow range.

This required governments to buy their national currency when its value approached the agreed lower bound and sell it when it approached the upper bound.

Six Days in September: Black Wednesday, Brexit and the Making of Europe, (by William Keegan, David Marsh and Richard Roberts), refers to the days in 1992 when Britain was forced out of the ERM.

Currency speculators (including George Soros) sold sterling in such massive quantities that the British government was incapable (except at unreasonable cost) of buying enough to hold its value above the lower bound required by membership of the ERM.



But the story of the book begins earlier, with Britain's 1990 entry to the ERM. And its story is yet to end, according to the authors, who argue that Brexit is ultimately a consequence of Britain's ill-judged entry to the ERM and poorly managed exit from it.

Six Days provides a compact and engaging behind-the-scenes account of the political drama and economic decisions that drew Britain into the ERM and that eventually forced it out on the September 16 1992.

Among the latter was the

reluctance of Germany's central bank, the Bundesbank, to support sterling. This, the authors contend, damaged the ongoing relationship between the UK and the rest of the EU.

But, as *Six Days* makes clear, no single decision accounts for Britain's departure from the ERM.

Beyond simple errors of judgement, it was the result of a complex web of differing and often competing national interests. France was concerned with expanding its economy, while Britain's goal was mainly reducing inflation. Germany, too, was interested in fighting inflation by maintaining a high interest rate.

Such competing economic interests made the ERM inherently unstable. The costs of staying within the parameters of the ERM were worthwhile for some countries but not for others, Britain's 15 years of uninterrupted economic growth following Black Wednesday being "exhibit number one".

The real value of *Six Days*, however, lies not in the economic analysis of the ERM but in the light it shines on what actually went on between the many important figures involved, and how they dealt with the trials thrown their way – or, equally often, failed to deal with them.

A COMPACT AND ENGAGING BEHIND-THE-SCENES ACCOUNT OF POLITICAL DRAMA AND ECONOMIC DECISIONS

It highlights the importance of trust between members of the same parliament, and the importance of getting the right messages across.

The public comment by Helmut Schlesinger, then president of the Bundesbank, that further ERM pressure was likely before September 20 sparked misunderstanding and decreased confidence in both consumers and businesses.

Whereas Britain's departure from the ERM was involuntary, Brexit is a still debated majority decision. Leaving the ERM turned out to be a blessing. Having an independent monetary policy contributed to lower inflation and sustained economic growth for Britain.

Could independence in commercial regulation and trade policy have a similar effect to independence in monetary policy?

Many say Brexit will be an economic calamity. Then again, that was a common response to Black Wednesday•

Allison Chia

STUDENT SPOTLIGHT

ALLISON CHIA is in the Upper Sixth at Headington School, Oxford. She submitted this review after reading previous editions of **EA**.

Allison is joint head of her school's Economic Magazine, where she also plans to launch an economics society.

If you're interested in writing an article for us, email: **eamag@iea.org.uk**

The HIDDEN TRUTH behind STATISTICS

What statistics tell you is rarely obvious, says author **STEVEN LANDSBURG**

When a university admits 46 percent of its male applicants and only 30 percent of its (equally qualified) female applicants, can we infer gender discrimination?

Several high-powered attorneys thought so, which is why they brought a suit against the University of California at Berkeley in 1973.

They managed to run up a lot of bills before someone observed that not a single one of Berkeley's individual departments appeared to be discriminating.

Instead, women were being disproportionately rejected because women were disproportionately applying to the most selective departments.

Here are the actual admissions statistics. See Table 1 below (The numbers are part of the public record, but the names of the departments are not, so they are referred to here simply as Departments A, B, C, D, E, and F).

As you can see, four out of six departments admitted women at a higher rate than men, and the other two (Departments C and E) admitted men at only a slightly higher rate than women.

When this was pointed out in court, the lawsuit against Berkeley collapsed – but not before a lot of lawyers had spoken a lot of nonsense.

The mistake those lawyers made was to focus on the aggregate statistics – that is, the numbers in the "total" column – without breaking things down.

That's what created the illusion of discrimination where none existed.

But exactly the same mistake can just as easily create the opposite illusion, by creating the illusion of nondiscrimination where discrimination does exist. For example:

JURY SELECTION: A political activist complains that African Americans are systematically underrepresented on American juries. An investigation reveals that exactly 25 percent of white Americans have served on juries and exactly 25 percent of African Americans have served on juries. Can we dismiss the activist's complaint?

SOLUTION: Not at all. Those aggregate statistics tell us practically nothing. Suppose, for example, that African Americans live primarily in cities, where it's very common to be called for jury duty, while White Americans live disproportionately in rural areas, where jury service is rare.

In that case, you'd expect to see a much bigger fraction of African Americans than White Americans serving on juries. If you don't see that bigger fraction, you're right to suspect discrimination – no matter what the aggregate statistics seem to show. Here's a concrete (though hypothetical) example: Table 2 tells us, for example, that there are 100 urban White Americans, 50 of whom have served on juries.

If you prefer a more realistic (though equally hypothetical) example, just tack a few zeroes onto all the numbers in the table, which won't affect the percentages. What you can see here is that even though 25 percent of African Americans and 25 percent of White Americans have served on juries, African Americans are apparently being discriminated against in both the urban and rural areas.

In the case of the Berkeley lawsuit, a focus on aggregate statistics created the illusion of discrimination where in fact there was none.

In the jury example, a focus on aggregate statistics creates the illusion that discrimination is absent when it is in fact pervasive.

	Urban	Rural	Total
White Americans	50/100 (50%)	50/300 (17%)	100/400 (25%)
African Americans	10/30 (33%)	0/10 (0%)	10/40 (25%)

Table 2

	Dept. A	Dept. B	Dept. C	Dept.D	Dept. E	Dept. F	Total
MEN	512/825 (62%)	353/560 (63%)	120/325 (37%)	138/417 (33%)	53/191 (28%)	16/272 (6%)	1192/2590 (46%)
WOMEN	89/108 (82%)	17/25 (68%)	202/593 (34%)	131/375 (35%)	94/393 (24%)	24/341 (7%)	557/1835 (30%)

Table 1

The moral, then, is not that discrimination is always either more or less a problem than it appears. The moral is to beware of aggregate statistics.

Here's another example, where aggregate statistics mislead in a slightly different way:

INCOME TRENDS: In a recent 25-year period, the median income of all American workers increased by a paltry 3 percent.

Over the same period, the median income of white male American workers increased by a much heftier 15 percent. Can you conclude that for at least one other demographic group (white females, nonwhite males, or nonwhite females), the increase must have been even less than 3 percent?

SOLUTION: You can conclude nothing of the kind. The period in question is 1980-2005. Here's what happened to median incomes (after correcting for inflation) for each demographic group over that period: (See Table 3)

That's right. White American males had 15 percent growth, and every other group had even larger growth - as high as 75 percent for White American women - even though the aggregate growth was only 3 percent.

That's possible partly because the sizes of the groups changed. In 1980 the median worker was a white man. By 2005, enough women had entered the workforce that the median worker was a woman.

	1980 Median	2005 Median	% Increase
All workers	25,000	25,700	3%
White men	30,700	35,200	15%
Nonwhite men	19,300	22,300	16%
White women	11,200	19,600	75%
Nonwhite women	10,200	16,500	62%

Table 3

Women do indeed earn less than men, which is why the income of the median worker came down. But that tells us exactly nothing about income growth for men, or for women, or for White Americans, or for nonwhites, or for anyone else.

Similarly, the average maths scores of seventeen-year-olds have dropped slightly over the past twenty years or so – even though the scores of the average White American student, the average African American student, and the average Hispanic student have all increased (by 1.3 percent, 12.6 percent, and 8.7 percent).

How can this be? It's simple: African Americans and Hispanics, who on average score lower than White Americans, now make up a larger percentage of the population. If you focus on the grim-looking aggregate statistic, you'll miss the fact that every group has improved.

ANIMAL FARM: A farmer keeps both goats and cows. Ten years ago, his median animal weighed 1,000 pounds. Then he adopted a new feeding technique, and today his median animal weighs 300 pounds. Should we conclude that his new feeding technique was a failure?

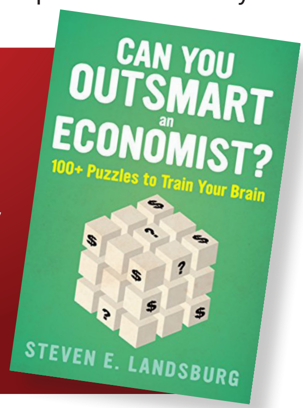
SOLUTION: Here's what I left out: Ten years ago, the farmer had ten 100-pound goats and twenty 1,000-pound cows. Today he has fifty 300-pound goats and forty 3,000-pound cows. His median goat and his median cow have both tripled in size – but his median animal, which used to be a 1,000-pound cow, is now a 300-pound goat.

An unscrupulous rival might point to that reduction as proof that the farmer's techniques have failed – when in fact they proved to be a great success for both the goats and the cows.

Likewise, an unscrupulous politician might point to the paltry 3 percent growth rate in median income as proof that the American economy wasn't working very well – when in fact it worked quite well for every demographic group•

This is an excerpt from Steven Landsburg's forthcoming book *Can You Outsmart an Economist? 100+ Puzzles to Train Your Brain* (Mariner Books, Boston, 2018).

Read more in the next edition of **EA.**

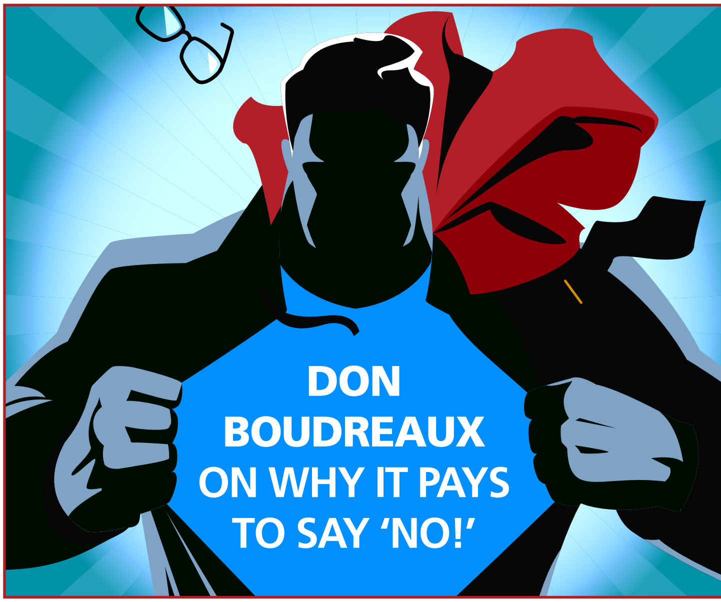


Steven Landsburg
Professor of Economics
Rochester University
steven@landsburg.com

SOUNDBITE

Robust and razor sharp views


How markets give you...
VETO POWER!



Are employers in free markets more powerful than workers? Are merchants more powerful than consumers? Many people answer "yes." I answer "no."

An essential component of a market economy is freedom of contract. And a key feature of freedom of contact is freedom not to contract — to say "no," which protects each adult from being made worse off by those who offer to deal with him or her.

If I don't like an automaker's price for a car, I don't buy that car. If I don't like a job offer, I reject that offer. By rejecting these offers, I'm not made better off, but nor am I made worse off.

My veto power requires merchants who want my business, or businesses that want me to work for them, to offer me deals that, in my judgment, improve my well-being.

This veto power of mine, in other words, gives me power to protect myself from even the largest, most profitable firms — and it gives them incentives to work to improve my well-being by offering deals that I judge attractive.

My veto power also means third parties are in no position to judge whatever contracts I enter into.

Suppose I accept a job at an hourly wage that a third party judges to be too low. That third party's judgment should be ignored.

My willingness to take that job means that, in my judgment, my well-being is improved by working at that job. I could have rejected the job offer.

But because I accepted it, I obviously believe that, however poor the job offer might be in some objective sense, it's better for me than my next-best alternative.

So, if the third party strips me of this job, he makes me worse off, regardless of his intentions.

It's a myth, therefore, that within markets, firms have power over consumers and workers.

Yet such power can be – and too often is – gained when firms conspire with government to diminish competition or to otherwise constrict individuals' options.

If, for example, domestic automakers persuade government to obstruct automobile imports, options that I and other consumers might have found more attractive than those offered by domestic automakers are made artificially unavailable.

I and other consumers become more likely to buy cars assembled domestically. And while those of us who then choose to buy domestically assembled cars are made better off compared to not buying them, we are made worse off compared to buying the imported cars we would have bought in the absence of the import restriction.

An under-appreciated danger of government action is that, unlike free markets, it frequently forces individuals into situations that make them worse off.

Minimum-wage legislation forces many low-skilled workers into the ranks of the unemployed by denying them the ability to offer to work at hourly wages below the legislated minimum.

They would prefer working at the lower pay to unemployment with no pay, but government arbitrarily strips them of this preferred option. Similarly, damage is inflicted on consumers who buy domestically produced goods "protected" by tariffs.

Any unjust power that firms have over individuals comes not from markets, but from government●

Don Boudreaux
Senior Fellow
Mercatus Center
George Mason University
Dboudrea.gmu-edu

This article first appeared in the Pittsburgh Tribune

The Great British RAKE OFF

Interest in the idea of a Universal Basic Income (UBI) is growing. A UBI involves citizens receiving an unconditional payment from the government in addition to any income received from elsewhere.

Current interest is linked to fears about widespread unemployment in the wake of coming automation, fears which are probably exaggerated.

But UBI is not really a new concept – it has its origins in the 18th century – and receives support for a variety of reasons.

The Labour Party sees it as a redistributive policy that also offers alternatives to capitalist employment: this is why Shadow Chancellor John McDonnell recently announced that he wants to see a pilot scheme in the Party's next election manifesto. The Green Party has seen it as a way of facilitating more sustainable lifestyles.

The political right has argued that it offers a simplified alternative to the complicated and bureaucratic welfare state - a variant of the negative income tax proposed by Milton Friedman.

In principle it could reduce or eliminate the 'poverty trap' associated with means-tested benefits.

If a UBI were implemented in the UK on a large scale, what would be the implications?

First, it would be expensive. Naïve schemes are often based on scrapping all existing welfare benefits and using the funds to provide a UBI. But this would not provide enough to live on.

In the UK, we spend about £250 billion a year on broadly-defined welfare benefits (including the state pension). The amount could be slightly higher or lower depending on eligibility criteria, but this sum would suggest a UBI of a little under £4000 per year.

However, 12 million people currently receive state pensions: the basic pension is well over £6000. Nearly 5 million people receive housing benefit, averaging about £5000 per year, while 2.5 million ill or disabled people on Employment and Support Allowance collectively cost about £45 billion in state support.

It would not be politically possible to deprive all these people of current entitlements, especially when a UBI scheme would give the same flat UBI to billionaires.

In order that no welfare recipients lose out significantly with a UBI, we would have to spend much more than we currently do on welfare – perhaps an extra £100 billion – or else cut back the UBI to a much lower level, when it would achieve very little.

A still more expensive option has been touted by ex-Labour leader Ed Miliband. His proposal for a UBI of £10,000 per year would cost £580 billion.

How would people react to this 'free' income? Economic theory tells us that a UBI would produce income effects and substitution effects, both of which suggest that labour supply would be reduced.

Provision of a non-work income is generally assumed to increase the demand for leisure (the income effect), while higher marginal tax rates needed to pay for the UBI) make an extra hour of work less attractive (the substitution effect).

If a UBI meant that large numbers of people would want to reduce or abandon paid work, the scheme could rapidly become unaffordable as the tax levied on those still working would have to rise further.

The argument that this could easily be avoided by 'robot taxes' or property levies, as people as varied as Bill Gates and Jeremy Corbyn have suggested, is optimistic to say the least.

What would the consequences be for immigration? If available to all residents, a UBI would hugely enhance incentives for people to move to the UK.

But if new immigrants were not entitled to the benefit immediately, there would then have to be a separate back-up means-tested system to prevent destitution.

There are other concerns. One is acceptability on moral grounds: is it right to oblige people by law to contribute taxes to support those who are under no reciprocal obligation to work or give anything back to the community? We have no experience of what such a society would be like in the long term.

Families or households, rather than individuals, are what we are generally concerned with when discussing poverty. But the UBI focuses on individuals.

There would be millions of pointless transfers: a single earner in a family would pay higher taxes so the state could pay their partner and children. Over time this could undermine the responsibility of people to their families and increase their dependence on the state.

LEN SHACKLETON SAYS UNIVERSAL BASIC INCOME COULD COST BILLIONS

If the scheme were popular, there might be a constant tendency for politicians to seek electoral support by offering higher levels of payment until the scheme became unsustainable.

Moreover, whatever idealists say, it is difficult to believe that these politicians would easily resist the temptation to impose particular patterns of behaviour as a precondition of receiving the UBI.

Bossy politicians who claim to know what is best for us are thick on the ground, and a substantial UBI would give them more leverage than they should perhaps have●

Len Shackleton
Professor of Economics
University of Buckingham
len.shackleton@buckingham.ac.uk

FURTHER READING

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CEREAL KILLERS

CHRISTOPHER SNOWDON on government efforts to impose "health by stealth"

Do Coco Pops seem less tasty than they used to be? Are chocolate bars getting smaller? Does the flavour of Ribena seem a bit… different?

You might have noticed that some of your favourite food and drinks are changing - but you may not realise that the government is responsible.

Starting in 2015, Public Health England (PHE) embarked on an ambitious and unprecedented plan to encourage food manufacturers to reduce the amount of sugar in their products by 20 per cent by 2020.

The scheme is technically voluntary but is backed up with the threat of legislation. "Britain needs to go on a diet," says PHE's chief executive, Duncan Selbie, and food reformulation is his way of doing it.

Although the sugar reduction scheme is supposed to be subtle and gradual – it is known as "health by stealth" – social media regularly erupts in fury when popular brands are altered without warning.

The reformulation of Coco Pops, which had 30 per cent of their sugar removed in the summer, is just the start of a radical shake up of the food supply.

Public Health England is now working on a similar programme to reduce fat, salt and calories "in a wider range of product categories and across all sectors, including the eating out of home sector." This includes "restaurants, pubs, takeaways and fast food restaurants, cinemas, cafes, sandwich and coffee shops".

The government's target of reducing calories in popular foods by 20 per cent by 2024 means that Kellogg's reformulation of Coco Pops will be in vain. Despite reducing sugar content by a third, a bowl of the cereal has only one less calorie than it did before.

No one is opposed to giving consumers healthier options, but the reformulation scheme is not about providing choice.

On the contrary, the aim is to remove full-sugar and full-calorie options altogether. PHE says that "it is important that action predominantly focuses on changing and reducing levels in the standard, everyday products that most people buy. Alternatives to the standard product, even after several years on the market, generally only account for a small proportion of sales and this is unlikely to change."

WILL PEOPLE REACT TO SHRINKING CHOCOLATE BARS BY EATING TWO INSTEAD OF ONE?

But why is it that low-sugar and low-fat brands are niche products? The simple answer is that most people do not want them and, given that the majority of us are not obese, it is difficult to argue that most people need them.

Even those who would benefit from losing weight could be making a rational decision when they choose the full-flavour brand if they find the reformulated version unpalatable.

Like so much of economics, it is a question of trade-offs. Some people are prepared to sacrifice taste for the benefits of consuming fewer calories. Others are not.

Millions of us do not need to worry about it at all and some people would benefit from consuming more calories. At the moment, we have the choice. The government's reformulation scheme aims to take that choice away and make the trade-offs for us on the flawed assumption that the whole country "needs to go on a diet".

The unintended consequences could be profound. Will people react to shrinking chocolate bars by eating two instead of one? Will consumers end up having to spend more money to meet their calorie requirements?

Taking a fifth of calories out of the food supply is a dazzlingly simple idea which is devilishly difficult to execute.

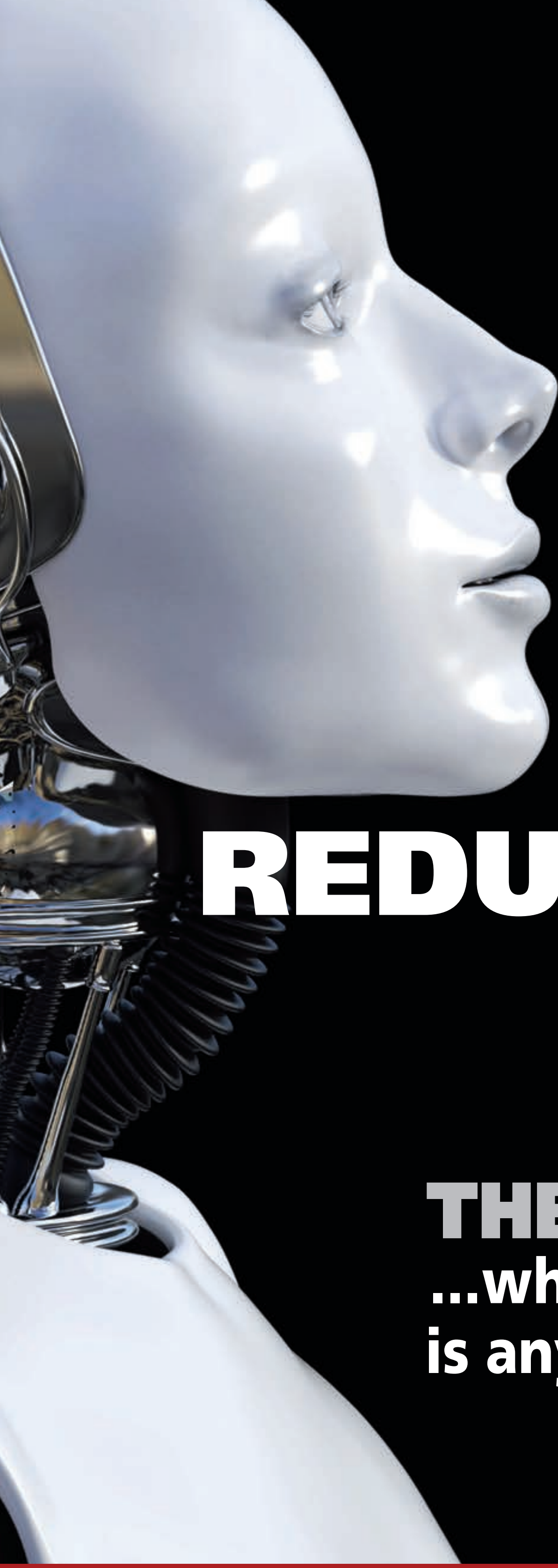
The prospect of being able to gorge on your favourite foods with impunity is appealing, but the idea that the food industry can magically take out a significant number of calories while leaving the deliciousness is the stuff of Willy Wonka.

Food companies, like chefs, do not put sugar, fat and salt in their products for fun. They do it because we like it. The proof is literally in the pudding. If it doesn't tickle our taste buds, we won't buy it.

For good evolutionary reasons, human beings are hard-wired to find calorific food tasty.

In practice, there are only two ways to reformulate a food product with fewer calories. You can make it smaller or you can make it taste worse. That is the trade-off. There is no third way, and arbitrary targets set by the government are not going to change that●

Christopher Snowdon
Head of Lifestyle Economics
Institute of Economic Affairs
csnowdon@iea.org.uk



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