

NEW ROLES FOR GOVERNMENT

The Nanny State

Interview with Dean Baker

A new book argues that we coddle the well-off in America. It's free markets for the rest of us. The author discusses the issues in this interview.

Q Your new book is about how the government is used to help the rich. Why was it necessary to write this book?

A. The debate on economic issues in the country has been very badly skewed. It has been framed as though conservatives want the market to be completely unfettered and are opposed to all forms of government intervention. Supposedly, you have liberals and progressives saying that we want the government to intervene to help people, to ensure security, to fight poverty, and to ensure health care, while the conservatives are demanding less government. The fact is that conservatives want and get all forms of government intervention. They simply do not own up to it, so in effect conservatives have been allowed to structure the rules to ensure that market outcomes lead to an upward redistribution of income. Then, in effect, they say, "This is the natural

DEAN BAKER is codirector of the Center for Economic and Policy Research. His newest book is The Conservative Nanny State: How the Wealthy Use the Government to Stay Rich and Get Richer (Washington, DC: Center for Economic and Policy Research, 2006; available at www.conservativenannystate.org).

workings of the market,” and they don’t want the rules questioned. That leaves a hollow debate because liberals have given away most of the store, and you end up quarreling over what often are relatively small things like tax policy and the earned income tax credit. These are important issues and good programs. But in the scheme of things, the market distribution of income is far more important than what you can hope to accomplish by tax or transfer policy.

Q Economists have been talking about a kind of corporate welfare state for some time, going back to John Kenneth Galbraith and earlier—military contracts, expensive tax breaks on high-level compensation, high-level health care plans and pension benefits, depreciation allowances. You have a somewhat different take on this.

A. I want to go behind these issues. A lot of people have spent a lot of time doing good work in those areas, but I want to ask, what are the rules that structure the market outcomes? I want to say, why is it that you have CEOs who can receive tens of millions of dollars in pay? Why do doctors get \$200,000 a year, and why are so many other people working for \$5.50 an hour? The conventional view is that that is just the market, and what I am trying to say in the book is, no, I can identify a whole set of policies where we could have structured them differently. Trade is an example that is hugely important. We usually have the argument over whether you support free trade. But that has not been what our trade policy has been about. It has been about allowing free trade in some areas, most importantly manufactured goods. But it has been absolutely opposed to having free trade in areas where you have higher-paid labor, specifically doctors, lawyers, accountants, economists.

Q Let me stop you there. How would free trade work in those areas?

A. To back up a second, getting free trade in manufacturing was not just a question of lowering tariffs. For example, the North American

Free Trade Agreement (NAFTA) was seen as opening up trade with Mexico, but our tariffs were already very low on imported goods from Mexico. They were not really keeping any goods out. NAFTA was about setting up rules so that manufacturing firms knew they could establish operations in Mexico and have a great deal of security in those operations, both in terms of being able to function there and in being able to ship their goods back to the United States without a problem. So for Mexico, that meant NAFTA imposed very tough rules against confiscation and nationalization, prohibitions on the Mexican government restricting the repatriation of profits to the United States—a whole set of rules on their operation in Mexico that gave U.S. investors security to open factories in Mexico. Then on the flip side, not only did they knock down the tariffs in the United States, but they also put up all these prohibitions that we cannot put up—say, safety restrictions that might have the effect of excluding imports from Mexico.

So we had to set up a whole regime to facilitate this flow of investment into manufacturing in Mexico so that we can have plants there that compete directly with manufacturing in the United States. To put that in the context of the professions, suppose our trade negotiators instead said, we want to make it easy for smart kids in Mexico to become doctors, lawyers, and other types of professionals in the United States. First, the negotiators could have standardized our licensing requirements. Not that we would have the same requirements as Mexico, but we would have a clear set of requirements that would be justified based on safety or quality so we would make sure the doctors are well educated and well trained to our standards. Then every student in Mexico would know that if they met these requirements, they could work as a doctor anywhere in the United States. Just as a kid growing up in Long Island would be able to do that. That would have been free trade in professional services, and it would have allowed for enormous gains—much, much larger than the gains for manufacturing.

Q. How do we get gains from that kind of free trade?

A. Exactly the same way we get them from manufacturing. In manu-

facturing the story is that we can get cars, clothes, whatever might be cheaper there, because people in Mexico will work for lower wages. It is cheaper to produce goods there than in the United States. Also, an awful lot of people in Mexico, India, China—pick your country—in principle would be willing to work as professionals in the United States at a fraction of the cost of our professionals. So, just to take a very simple example I mentioned in the book, if we paid the same for doctors in the United States as they do in Europe, it would save us \$80 billion a year in health care expenditures, almost a thousand dollars per family per year. If you carry that down the list, we would pay less for our university education if our university faculty and university presidents were paid more in line with what people and professionals in the developing world are paid. The same is the case with lawyers, and so on. We would have enormous savings—the exact same argument that is made for savings from trade in manufacturing—except this method would bring about greater equality in the distribution of income rather than greater inequality.

Q Do you object to the fact that the restrictions on immigration are unequal in this sense, or do you object to the fact that there are any direct or subtle restrictions on immigration at all? Should we be totally open to immigration in much the way it was in the late 1800s?

A. No, but we have been totally dishonest about the way it is open right now, so there is this pretense that somehow we have open borders. I do not think I used the phrase in the book, and I wish I had. We do not have an open border policy. Rather, we have a “die at the border” policy. If you are willing to risk death at the border and willing to work underground, then you can come to the United States and work in a restaurant or in a garment factory, whatever it might be. People are willing to take these risks. People coming from relatively desperate straits in Mexico and other developing countries will do that. But no doctor, no lawyer, no professional in the developing world is going to risk everything they have to try to work under the table.

So I would say, let us first be serious about what we have. We do not have free trade, we do not have free immigration, we have rules that are tilted to put workers at the bottom and in the middle in direct competition with workers in the developing world, and that has a very simple, predictable outcome. It lowers the wages for people in the middle and at the bottom. We could, and I would argue should, tilt our policies to have our professionals or higher-paid workers competing with people from the developing world. I would not favor open borders. That is absolutely nutty, because probably on the order of a few hundred million people would come to the United States in a very short period of time if we really had that policy. I do not believe that anyone who has ever really given it any thought would promote this policy. But, as I say, from the standpoint of workers in the United States and, in fact, from the standpoint of developing countries, it makes much more sense to have the competition focus at the top rather than the bottom.

Q Let us talk a little about Federal Reserve policy. How does the Fed support your thesis about a nanny state for the rich?

A. People fail to recognize that the Federal Reserve Board is acting as an agency of the government. It is an arm of the government, I should say. One of its main goals, and sometimes the only goal, is to control inflation. And the way in which they do that is by raising interest rates, slowing the economy and throwing people out of work. That is actually quite deliberate. The whole idea is that you control inflation by raising the unemployment rate, or at least preventing it from falling. That puts downward pressure on the wages of less-skilled workers. And we know the story here is that when we are raising the unemployment rate, it is not typically doctors or lawyers or CEOs who are losing their jobs, it is manufacturing workers, sales clerks, dishwashers—people at the middle and bottom of the wage distribution.

I have actually done some work on this with Jared Bernstein, and what we have found is that when you get low rates of unemployment, like what you had in the late 1990s, you had good wage growth up

and down the income distribution, including the very bottom. But when you had higher rates of unemployment, the only people who were getting wage gains consistently were those in the top 20 or 30 percent. So the mechanism of controlling inflation here is that we throw people out of work, we force people to lose their jobs or at least prevent them from getting jobs, and then we put downward pressure on the wages of those who are working. So, we should recognize that this Fed policy has important distributional implications and, secondly, that if this is the best way we can think of for controlling inflation, at the very least you could make a strong argument that we owe some compensation to the people who are losing their jobs to keep the inflation rate from getting too high.

Q. The Fed would say, of course, what is their alternative? These are the tools they have. What would be your answer to that?

A. Two points: One is, where do you draw the line at which you begin to tighten policy? There has been a big effort to tell us that everyone agrees there is an unemployment rate below which inflation will start to rise. That is simply not true. They always agreed back in the mid-1990s that you drew the line at 6 percent unemployment. As we now know, they were completely wrong. So the first question is, where do you draw the line?

Q Where do you draw the line for the unemployment rate?

A. My point is, we really do not understand the economy that well, no one does. Where you make the decision depends on how you view the relative cost of higher unemployment versus higher inflation. And as it stands now, this decision is made through a depoliticized process that is largely under the control of the banking community. As a result, they make a decision that is likely to be strongly prejudiced toward tolerating higher rates of unemployment in order to prevent inflation.

So that is the first point. The second point is that you can look to other mechanisms to control inflation. Now, these are all laughed at, scoffed at, in the economics profession today. But if you go back to

the 1950s and 1960s, we had wage price guidelines—at times we had controls. In Europe today, you still have centralized wage bargaining in many countries—Ireland, Netherlands, the Scandinavian countries—and there is actually a lot of research that shows that centralized wage bargaining is a successful mechanism for restraining inflation.

It is hard to talk about centralized wage bargaining in the United States because we do not have many unions. But the point is that it is helpful to try to look to alternatives. There are costs associated with such interferences with the market. But we have to recognize that there are also costs in raising the unemployment rate to keep the inflation rate under control. Maybe we could come up with a better way, maybe we cannot. The method that we have now is hugely costly. It is not only those who are unemployed. We are losing hundreds of billions of dollars in output a year if we have a 6 percent unemployment rate, whereas under another set of policies, we could have a 4 percent unemployment rate. So if we could find some sort of system that had guidelines, targets, whatever it might be that would allow us to get the unemployment rate lower and keep inflation from getting out of control, that is a direction of research that is certainly worth exploring. And you know that direction of research has unfortunately been largely cut off over the last quarter century.

Q Let me go on to a couple of other issues you raise. Why do CEOs make so much money these days?

A. I say in the book that CEOs are setting their own salaries because to a very large extent they control who sits on corporate boards and on the compensation committees that determine their pay. It is very difficult for the shareholders to organize to oppose that. The rules that most corporations operate under allow the management to count proxies that are not returned as being in management's favor, which means that unless you have some very determined opposition from some major shareholders, it is extremely difficult to overturn management's decisions, including decisions that allow for very high CEO pay.

We have to rewrite the rules. This is not really interference in the market because the government always sets rules for corporations. Corporations are creations of the government. Individuals can have partnerships, but the corporate status is something that comes from the government. There are already very extensive rules about corporate democracy and shareholder rights—rights of minority shareholders. You can easily set rules that could require CEO pay packages, or packages of top executives, to be periodically sent out for approval by shareholders, and that proxies that are not returned are not counted, so you have to get a majority of those who actually vote. We could make the process comparable to what we ordinarily would do in a democracy, which could probably go a long way. One reason it is very important to rein in those pay packages is not just that a small number of people walk off with these huge sums, but also that high CEO pay distorts pay scales for other sectors of the economy. So you have university presidents who also think they should get \$900,000 or a million a year, even executives of charities often get these huge pay packages. So it sets targets that go even beyond the corporate sector.

Q Let us talk about two other areas. You devote quite a bit of time to the copyright and patent law. How does that serve the rich as opposed to the rest of us?

A. Copyrights and patents obviously are ways to promote creative work and innovation, and they do that, but I argue in the book that they are very inefficient ways. They both have very high economic costs, so you have goods like software that, in principle, could be available free, and instead it is very costly. It also leads to situations where you have people like Bill Gates who get incredibly wealthy. If Bill Gates did not have the government enforcing his monopoly on Microsoft, I do not know what he would be doing for a living, but I am sure he would not have forty-eight billion dollars.

Q. Explain what you mean by enforcing his monopoly.

A. Copyrights are a government monopoly. That means that Bill Gates has his copyrights on Windows, and if I want to make Windows

available on the Web to anyone who wants to get it from me, he can have me arrested and thrown in jail. The government has given him complete control over the distribution of Windows so that the people who sell it have to get his permission to do so. So this is a government monopoly. We want to give people pecuniary incentives to develop software. Copyrights are also used for writing, music, books, patents in the case of prescription drugs. Obviously it's a way to finance research. But in the book and in other things that I've written, I said we can look to other ways to provide those incentives. I would argue that we can find ways that are more efficient and probably would not lead to the same concentration of wealth that we have seen through the copyright and patent system.

Q. What are some examples?

A. In the case of, say, pharmaceutical research, we already have an example right in front of our face: The government spends \$30 billion a year financing pharmaceutical, or I should say biomedical, research through the National Institutes of Health (NIH). By all accounts, that money is extremely well spent. They produce a lot of great breakthroughs. They do not typically carry drugs through their testing phases, although they sometimes do clinical tests, and, in fact, when they do clinical tests, they perform them at a fraction of the cost that the industry claims they incur. But the NIH has produced a number of great breakthroughs with its research spending. To my mind, I would like to see public research on pharmaceuticals expanded and actually have it focused on developing the drugs—actually bringing the drugs through the clinical testing process and the FDA approval process—and then simply having the patents for the new drugs put in the public domain so that, in effect, all new drugs are sold as generics. This would lead to manufacturers' competing to produce drugs at the lowest cost, given that they meet safety requirements.

Q But the private industry has produced great new drugs as well. We can cite abuses, but they have great new drugs.

A. They have, but the key issue here is how efficient are they, what

is the cost? And again, I'm looking at their own numbers. Their costs have been rising at the rate of over 11 percent a year for about the last fifteen, sixteen years, according to Joe DiMasi, the leading researcher on drug development costs. Development costs (basic research and clinical trials) are well over a billion dollars for each new drug, according to DiMasi. So this makes it incredibly expensive. On top of that, roughly two-thirds of the drugs that are approved are copycat drugs. This does not mean they are altogether worthless, but they are certainly not as valuable as breakthrough drugs. On top of that, you create the perverse incentives: When you have monopoly profits in the drug industry, you have incentives, say with Vioxx, to conceal negative effects. When you are making a fortune by selling the drugs, if you find evidence that your drug might not be entirely safe, perhaps less effective than it has been billed, you have an incentive to conceal that evidence. So patient finance and drug research can both be extremely inefficient and lead to bad medicine.

Q Let us talk about one last area, the bankruptcy laws, which have been changed recently. How did they serve the rich and not the rest of us?

A. The arguments around the new bankruptcy law are just a classic example of how we have turned logic on its head. They were a government intervention in favor of the lenders. In the past, most loans were tied to collateral. If the mortgage loan went bad, the lender took the house. Now, many loans are not tied to collateral. With the new bankruptcy law, creditors make bad loans and then, rather than just saying, we made a mistake, we messed up, we have to live with the consequences of our bad loans, they are running to the government to say, help us make these people pay up. We want you to go after them even if it means following them for what could be twenty years. We want the government to monitor their pay, find out if they have any money anywhere, and help us collect this for as long as it takes. That is a government intervention, and, what was really striking, not only is this stricter bankruptcy law a form of government intervention, it

also applies retroactively to debts incurred under the old bankruptcy law.

Q What policy changes would you recommend and in what order of priority?

A. First, a change in trade policy, which is hugely important. Trade has been a large component in the trend toward greater inequality. I would like to reverse that trend.

Second, the high price of medical care in the United States is largely due to the fact that our doctors are so highly paid—they earn twice as much as doctors in Europe. We cannot afford that. In addition, high and rising education costs are due in part to the fact that at least some of our faculty—I know there is low-paid faculty—are very well paid.

Third is a change in Federal Reserve policy. The low unemployment rate in the late 1990s had an enormous impact on improving the living standards of very large segments of the population. If we could maintain unemployment at around 4 percent, as it was in 2000, we would have a very, very different country.

And the fourth change would be in policy toward intellectual property, which is relevant most critically to prescription drugs. The cost of prescription drugs is going through the roof. In the United States there are a lot of people who will not be able to pay the patent-protected prices for prescription drugs. I would say that looking to an alternative mechanism for financing prescription drug research is very high on our list.

To order reprints, call 1-800-352-2210; outside the United States, call 717-632-3535.