LMR

BUILDING THE 10%

JANUARY • 2019

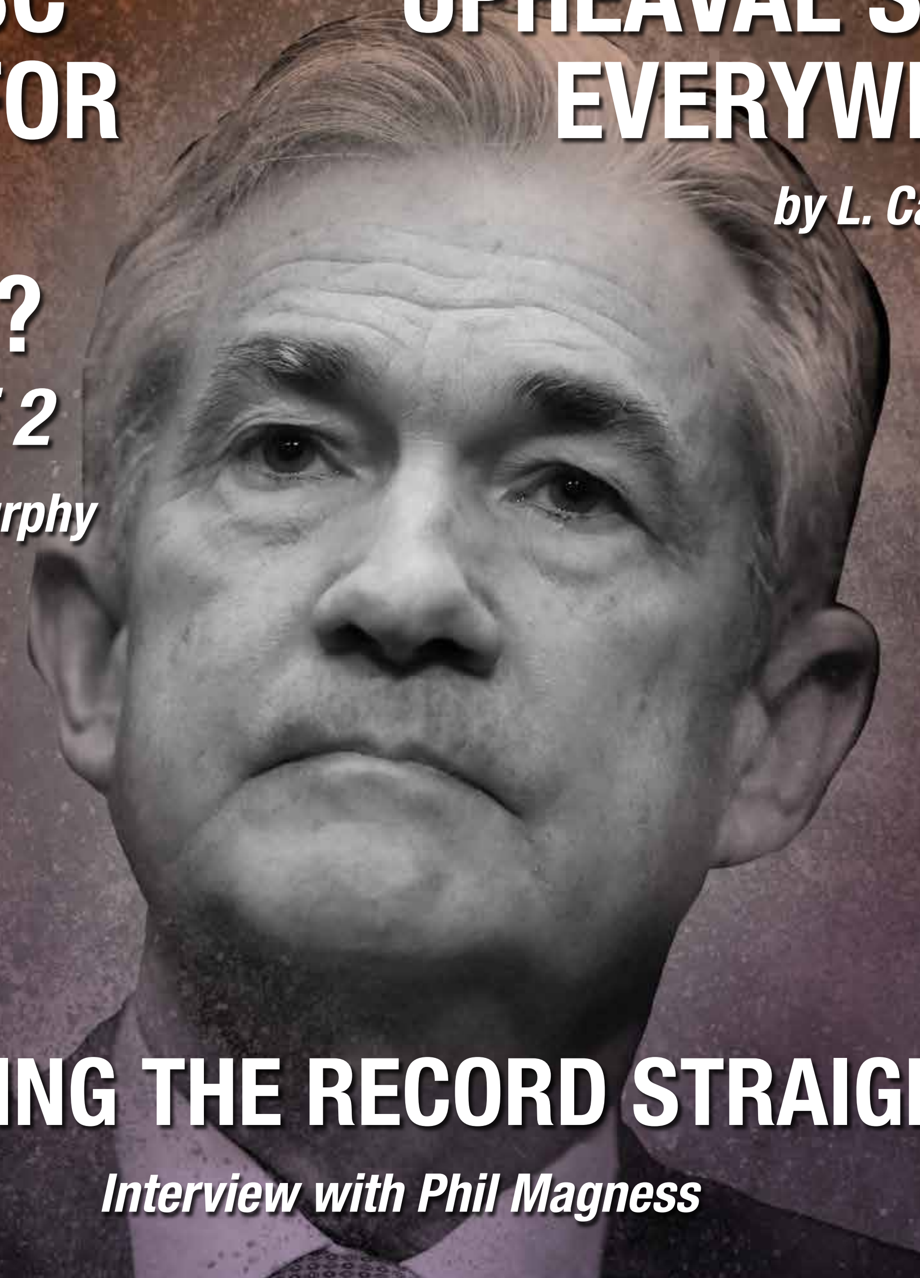
PULSE ON THE MARKET

Venezuela Gold Frozen

Uh Oh Ocasio

Fed Remittances Down

Powell Backing Off?



DOES IBC WORK FOR OLDER PEOPLE?

PART 2 OF 2

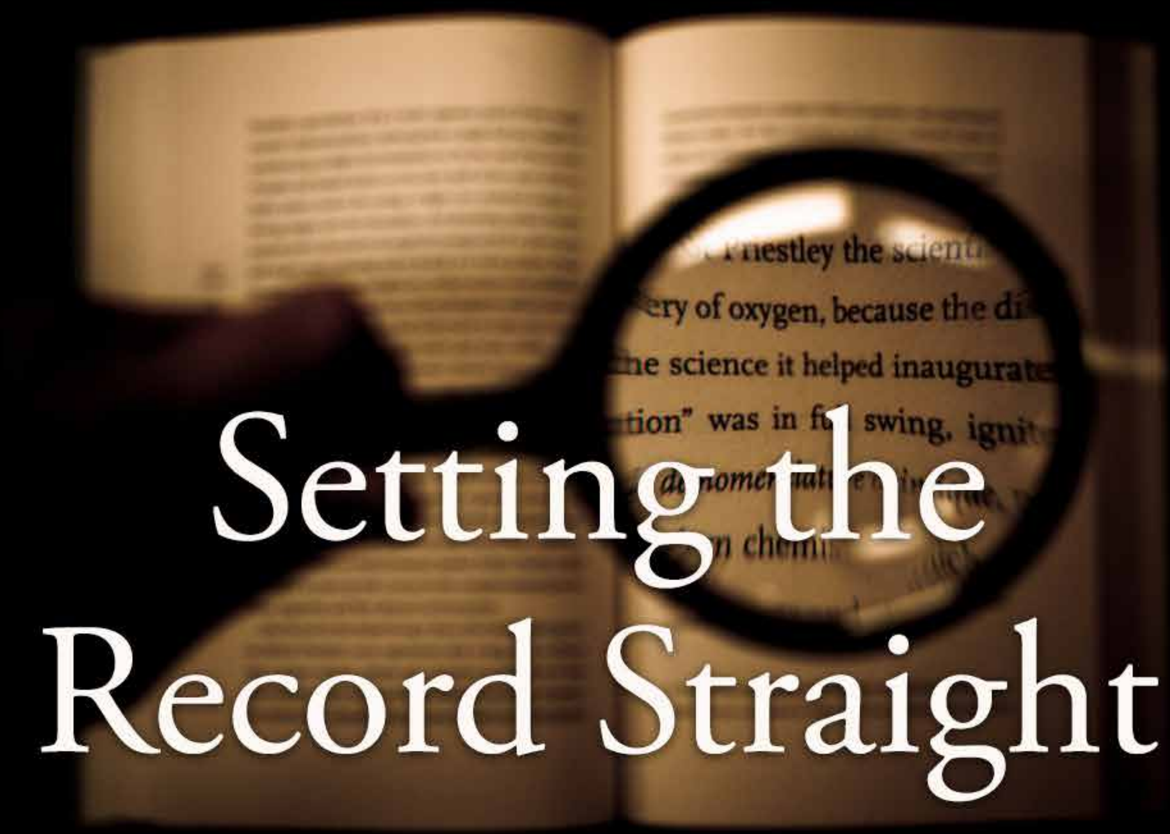
by Robert P. Murphy

UPHEAVAL SIGNS EVERYWHERE

by L. Carlos Lara

SETTING THE RECORD STRAIGHT

Interview with Phil Magness



Setting the Record Straight

Interview with Phil Magness

Phil Magness is a Senior Research Fellow at the American Institute for Economic Research. He is the author of numerous works on economic history, taxation, economic inequality, the history of slavery, and education policy in the United States.

Lara-Murphy Report: How did you discover Austrian economics?

Phil Magness: My first encounter with the Austrians was probably reading [Hayek's] *Road to Serfdom* in high school, although I was drawn to it primarily for its analysis of the interwar political collapse in Europe. That sparked an interest in reading more material by Hayek, which led me to Mises, and the rest is history.

LMR: You've written on a wide variety of topics, so we'll try to give our readers a sampling. Back in 2015, you and one of us (Murphy) co-authored a pretty popular article in the *Journal of Private Enterprise*,[1] which criticized the bestselling book by Thomas Piketty, *Capital in the Twenty-First Century*. Before that paper came out, the standard view among economists was along the lines of, "Well, there are some logical problems with Piketty's conceptual framework, but we can all agree he has made important contributions to our understanding of income and wealth inequality." Yet that was precisely what your paper challenged. Can you summarize some of the problems for our readers?

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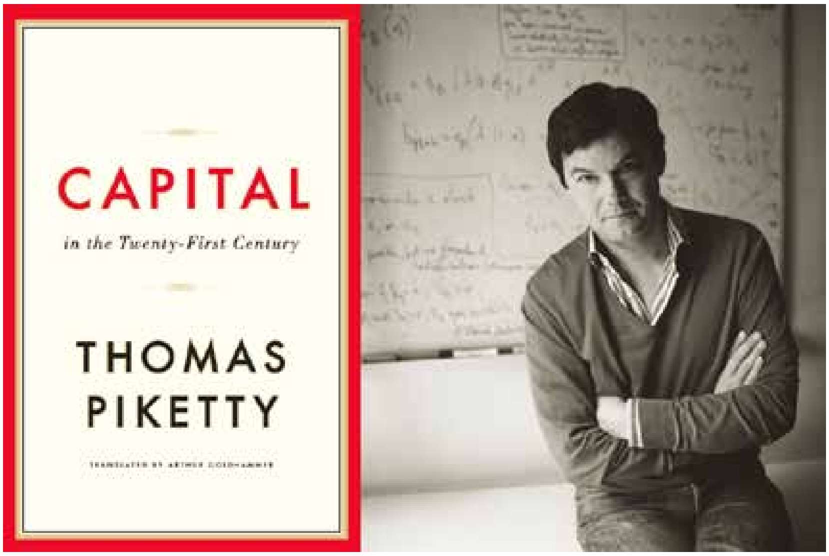

PM: Piketty's argument is premised upon there being a century-long U-shaped pattern in which inequality first declines in the wake of World War II, and then rebounds after 1980 with the Reagan tax cuts. He argues that this rebound coincides with the rise and decline of progressive income taxation, and notes that similar patterns occur in other developed countries (e.g. the UK under Thatcher). He then attempts to "measure" the long-term patterns in inequality through a couple of routes in ways that supposedly illustrate this thesis. The simplest measures are to take the income and wealth shares of the top of the distribution, e.g. the top "1 percent" of Occupy Wall Street ire. But he also attempts to measure the U.S. and world capital stock as a ratio to national or world income, which also produces a U.

The biggest problem is that on all 3 of Piketty's metrics, which supposedly demonstrate the U-curve pattern, he cuts corners on data assembly and does so in ways that seem to put a finger on the scale in favor of his arguments. So for example, when constructing his wealth distribution series, he actually swaps out different data sources across the 20th century and does so at points in history that are very convenient to his argument. When constructing his capital-to-income ratios for the world, he similarly brings in suspect data assumptions from the Soviet Union and other parts of the communist world at the mid-century mark (even though his book is allegedly about laws of "capitalism"). These in turn augment the magnitude of the mid-century trough. And most recently, I've been looking at Piketty's income inequality series for the U.S. as taken from income tax records. It turns out that he also makes a number of suspect "adjustments" here that cause him to overstate inequality at the two ends of the U-curve, and probably understate it at the mid-century trough.

LMR: Another one of your passions has been to defend the reputation of James Buchanan from the charges leveled by Nancy MacLean in her book, *Democracy in Chains.* Again, can you summarize the controversy for our readers?

PM: MacLean wrote a book entitled *Democracy in Chains,* which purports to trace the deep history of 1986 Nobel laureate James M. Buchanan and tie him into a massive conspiracy theory invoking the Koch Brothers, which she now asserts to be a threat to American democracy. A key part of her argument is an attempt to link Buchanan's formative work on Public Choice theory in the 1950s-60s to racial segregation. To this end, MacLean contended that Buchanan collaborated with the segregationist "Massive Resistance" movement in Virginia, and that he "learned the lessons" that would inform Public Choice theory from this experience of trying to fight school desegregation.

To bolster her case, MacLean also tries to claim that Buchanan drew intellectual inspiration from the 19th century pro-slavery politician John C. Calhoun (she calls Calhoun his "intellectual lodestar"), from the segregationist Agrarian Poet movement of the 1930s, and a host of other unsavory characters with serious baggage on issues of race. While she stops just short of calling Buchanan himself a racist, she draws on all these claimed ties to poison the well against him and to portray his economic ideas as being informed by and derivative of segregationist and pro-slavery political theory.

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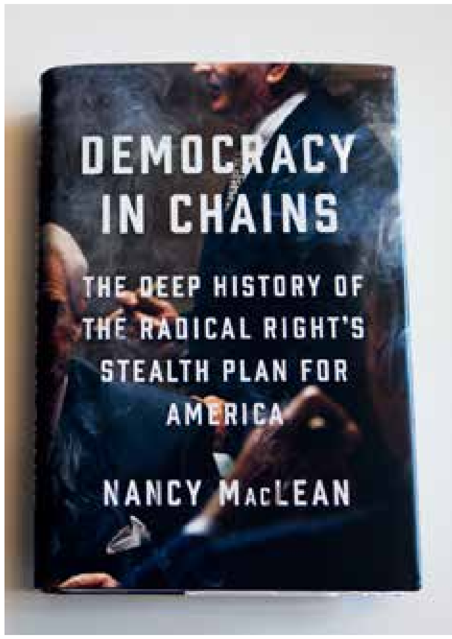

As a result, a number of intellectuals on the political left have credulously accepted and repeated her narrative as if it provided "proof" of these same racial motives.

The problem with MacLean's book however is that practically none of these claims has any truth to them. Some of them she simply makes up out of whole cloth. For example, John C. Calhoun—whom MacLean devotes most of her opening chapter to discussing—played exactly zero role in Buchanan's intellectual formation (a point that was confirmed over 40 years ago by Buchanan's co-author Gordon Tullock, who when asked about

Calhoun stated that neither he nor Buchanan had ever read him). The same is true of the Agrarian Poets—there's no evidence Buchanan drew upon or was meaningfully informed by any of their work.

To make her case that Buchanan allied with segregationists, MacLean grossly distorts a paper he wrote with Warren Nutter in 1959 advocating a school voucher system in Virginia. While MacLean depicts this paper as being in service to segregationist newspaper editor James J. Kilpatrick, it turns out her claimed link is premised upon a typo in another scholar's work that misidentified the location where Nutter and Buchanan's article was published. MacLean, unfortunately, takes this thesis and runs with it

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though, even offering imaginary conversations between Buchanan and the president of UVA in the 1950s to suggest that they were supposedly discussed strategies to resist *Brown v. Board of Education.*

It's all specious nonsense with little in the way of archival support, even though she claims otherwise in the book. So my work in this area has consisted of digging into the same archives as well as others that MacLean missed, and reconstructing what actually happened. It turns out the opposite of her narrative is true. Although Buchanan did not wade very deep into the desegregation issue at the time, he left several clues indicating that he actually opposed school segregation, such as an addendum to his school voucher paper from 1964 that stated that segregated schools should be barred from receiving voucher money. MacLean completely missed these clues, and instead created an imaginary counternarrative that thrusts Buchanan into the midst of segregationist politics. Unfortunately, she has responded to these corrections to her narrative by digging in, refusing to engage her critics, and spreading even wilder conspiracy theories about us. The whole mess has reflected poorly on the state of the history profession at the moment, though my strategy in response has been to research and document what actually happened in the hope that neutral parties can differentiate an evidence-based analysis from MacLean's partisan talking points.

"[T]he 1950s tax system had several large and intentional deductions, exemptions, and legal loopholes that allowed the wealthy to shelter their incomes from the high statutory tax burden."

LMR: As an economic historian, you have had plenty to say about the proposal from newly-elected Alexandria Ocasio-Cortez, calling for ~70% top marginal income tax rates. People like Paul Krugman defended her, saying that the best economic research supports such a high rate, and that anyway, we had even higher top income tax rates during the 1950s and 1960s, without the economy imploding. Are the right-wing critics just engaged in fear-mongering?

PM: I view the 70% tax rate endorsements from Krugman and the like as an indulgence in confirmation biases around their own political aspirations. Ocasio-Cortez is essentially trying to link her 70% tax proposal to the top marginal rates of the 1950s and 60s (which exceeded 70% and even 90% on the top earners at times) in order to make it politically palatable. Her claim is that the United States experienced prosperity in these years even though we had a highly progressive tax rate structure, and therefore we can repeat the experiment without succumbing to the obvious risks of a fiscal contraction caused by massive tax hikes.

The problem with this narrative is that it ignores a crucial fact of the mid-century tax system. Although the top marginal rates were extremely high (and also kicked in well below what we would consider "rich" income

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levels—e.g. the 50% rate took effect at only $16,000 in the 1950s, which would be considered an upper middle class income today), nobody actually paid these rates or anywhere close to them in their overall tax burdens. The reason is that the 1950s tax system had several large and intentional deductions, exemptions, and legal loopholes that allowed the wealthy to shelter their incomes from the high statutory tax burden. As a result, a rich person might face a statutory total tax burden in excess of 80% but only pay an effective tax rate on all income of about 40% due to the loopholes. Ocasio-Cortez completely omits this crucial fact from her analysis, and economists like Krugman—who should know better—seem content to pretend it isn't an issue.

LMR: Finally, your forthcoming book is *Cracks in the Ivory Tower*, due out in April. What do you have in store for us?

PM: *Cracks in the Ivory Tower*, which I co-authored with Georgetown philosopher Jason Brennan, is essentially a business ethics and economic analysis of the modern university system. We examine the moral failings of how universities operate, such as deceptive advertising to their students, over-promising benefits from degrees, permitting/encouraging cheating, diverting tuition resources to expenditures with questionable value, and of course the mess of academic hiring and PhD production.

Our overall argument is quite simple. Most higher ed commentators attribute these known problems to nefarious exogenous factors—to budget cuts, to the "corporatization" of universities, to "neoliberalism" and a host of similar bogeymen that are supposedly ruining higher ed. We illustrate instead that most of the problems being described are endogenous features of how higher ed operates due to perfectly mundane features of human self-interest responding to the incentives and institutional structures of university life.

For example, many faculty want to maximize their time for research, often on extremely niche subjects that interest them but few other people. This perfectly rational desire is often in tension though with their teaching obligations or with their department's ability to attract new majors. Administrators similarly want to maximize their own contributions to campus life, their own comforts, and their own legacies, which often means misallocating university resources to bureaucratic bloat in largely superfluous administrative offices, or to flashy building projects such as rock climbing walls, stadium scoreboards, and the notorious example of the "lazy river" pool complex on campus. The problem we highlight is that many of these rational but also economically and ethically questionable responses to the university incentive structure also transfer the bulk of their costs onto students and the taxpayers at large.

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1. Phil Magness and Robert P. Murphy, "Challenging the Empirical Contribution of Thomas Piketty's Capital in the Twenty-First Century," Journal of Private Enterprise, Spring 2015, available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2543012.