Introducing "Freedomnomics"

Freedomnomics: Why the Free Market Works and Other Half-Baked Theories Don't. By John R. Lott, Jr., Ph.D., Washington, D.C., Regnery Publishing, Inc., 2007, 194 pp., $67.99/hardback.

In his book *Freedomnomics*, author John R. Lott, Jr., explains why he believes that the free market works best by giving rein, not to government, but to the most efficient, productive, and creative aspects of our society. Lott and his supporters search for solutions in the theories advanced by Adam Smith and Milton Friedman, men they consider "prominent advocates for economic freedom" and among the greatest economists of the 18th and 20th centuries, respectively. *Freedomnomics* was published in 2007 and was written in part as a rebuttal to the very popular book *Freakonomics*, written by Steven D. Levitt and Stephen J. Dubner (New York: William Morrow, 2005). The book *Freedomnomics* is controversial, but has received praise, especially in conservative circles, as a welcome antidote "to the oversimplifications and shortcomings of *Freakonomics*."

In the body of the book, Lott compares and contrasts his application of economic principles with those of Levitt and Dubner in *Freakonomic*s, using Hurricane Katrina as the first of many examples. After Katrina, U.S. Senate hearings were convened to question oil company executives about the steep rise in oil prices; because gas prices began rising even before Katrina had actually hit, there were accusations of price gouging. Lott attempts to make the case that the prehurricane price increases were for economic reasons instead. Knowing that there would soon be shortages and higher prices, consumers filled up their tanks and speculators bought oil, believing they could profit by selling it later at a higher price. The greater-than-expected prehurricane demand led, of course, to higher prices. Oil company executives reasoned similarly; they knew they could raise prices in advance of the storm so that consumers would purchase less than they otherwise would and the oil companies could sell more at a later date, when the price was higher. Per Lott, the rise in gas prices prior to the hurricane resulted in a surprising beneficial effect: it kept the overall posthurricane price hike lower than it otherwise would have been, by decreasing the amount of gasoline used prior to the hurricane and thus increasing the supply post hurricane. Unfortunately, in Lott's view, many U.S. senators preferred nonmarket solutions to the problem, including price controls, a practice he felt had already been proved a failure when it was tried in the 1970s.

In a similar vein, Lott believes there is a common misperception that powerful companies will intentionally engage in predatory pricing, in which they temporarily lower their prices in order to eliminate competitors. Even if they are able to shut down the competition, he contends, these companies will then be forced to raise their prices above the marked-down price in order to recoup their losses. The higher prices would then lure new competitors into the market, forcing the companies to once again lower their prices, a repetitive cycle that he feels makes no economic sense. In Lott's view, company owners shy away from predatory pricing because they believe that any economic benefits to be gained by it are short term and highly questionable.

Senior citizens on limited budgets often make lunch at a local restaurant their main meal of the day. They do so because prices are less than at dinner and they don't mind the slightly smaller portions. Some have been led to question why lunch prices fail to rise as a result of this additional demand and have suggested price discrimination as a factor. Lott suggests an alternative answer. He theorizes that dinnertime patrons tend to linger considerably longer over their meals than lunchtime patrons, preventing the restaurant from serving other customers at the same table. Although restaurants make much of their profit on the sale of beverages and charge particularly high prices for coffee, tea, and wine (because they are menu items people tend to linger over the longest), the extended stays generate less profit than new customers would. Hence, Lott justifies the higher prices as a "rental" cost of the table.

The authors of *Freakonomics* make the claim that a new car loses considerable market value once it is driven off the lot, concluding that the only person who would logically want to resell a newly purchased car is someone who found it to be a "lemon." Lott disputes this for several reasons. First, the owner could have the original manufacturer do an inspection of the car to confirm its brand-new condition at a fairly small cost, and this certification should satisfy any potential buyer. Second, most cars come with a warranty that is assumable by the new owner. Third, Lott did an analysis of certified used cars in the Philadelphia area with fewer than 5,000 miles on them and found that the average price was just 3 percent less than the new-car manufacturer's suggested retail price. Finally, if the "lemon" thesis of *Freakonomics* were true, he reasons, then the prices for a certified "new" used car should not differ much from one that is a year old. But Lott found that there actually was a significant difference of 14 percent.

Lott devotes an entire chapter to "Reputations." In it, he makes the case that the importance of a company's reputation is often underestimated by analysts, legislators, and the general public, resulting in instances of excessive penalties for companies convicted of fraud. He feels this situation has led to a misconception among the public in general, and the authors of *Freakonomics* in particular, that corporate fraud is rampant but usually goes undetected. Per Lott, for Levitt and Dubner to state that something can be both undetected and rampant leaves an intelligent person to question how they would know that. Lott does cite statistics which show that in the late 1980s the average fine levied on a company convicted of fraud was much less than the penalties meted out to companies convicted of environmental pollution crimes; however, he contends that the difference can be explained by indirect effects related to the loss of reputation. Consumers don't often reject a company's product on the basis of environmental crimes the company has committed, but they will either stop purchasing or demand a lower price from companies that sell products that don't live up to expectations. In Lott's view, when declining sales, earnings, and stock prices are factored into the average total penalty on a company convicted of fraud, that penalty frequently turns out to be considerably greater than the penalty imposed on environmental violators.

Lott also takes issue with the position taken in *Freakonomics* that the Supreme Court's 1973 decision in *Roe v. Wade* legalizing abortion was a primary reason for the decline in crime rates during the 1990s. Levitt and Dubner claim that the children who were never born because they were aborted would have been much more likely than average to be perpetrators of crimes. Lott disputes this hypothesis, using the principle that if something becomes less "costly," people will engage in it more often. Applying the principle here shows that, when abortion became legal, women (and men) suddenly had a relatively inexpensive and safe option to end a pregnancy—an option that they didn't have before; consequently, people were more likely to engage in premarital sex and less likely to use contraceptives. This in turn led to a sharp increase in unplanned pregnancies and a jump in both out-of-wedlock children and crime. If the arguments in *Freakonomics* were correct, he reasons, then criminality among those individuals born after 1973 should have been the most greatly reduced; however, just the opposite was true: the rate began falling first for those who had been born prior to 1973. Canada's crime rate also declined in the 1990s. But because abortion wasn't legal there until 1988, the lower crime rate wasn't a result of that decision, given that those who were never born would have been too young to be criminals when the decline in the crime rate occurred. Some other reasons for the decline in the crime rate, says Lott, are the rescinding of the ban on the use of the death penalty, greater arrest and conviction rates, and right-to-carry gun laws.

Finally, *Freedomnomics* offers a different explanation for the expansion in the size and reach of the federal government in the past almost 100 years. Until World War I, the U.S. federal government typically consumed about 2 to 3 percent of the nation's GDP. The common view is that government began to grow rapidly when President Franklin Delano Roosevelt implemented the New Deal, but nonmilitary federal spending actually began trending upward during the 1920s. Lott attributes that trend to the granting of women's suffrage. In Lott's view, since being granted the right to vote, women have tended to vote in greater numbers for progressive and Democratic candidates, who they view as more likely to call for government intervention to solve problems, and less likely to vote for the private sector solutions generally preferred by the Republican Party. Women also tend to be more risk averse than men; hence, they tend to be stronger supporters of Medicare, Social Security, and education expenditures, and less in favor of welfare reform such as was legislated in 1996. Lott looks at what happened in individual states, many of which had granted women suffrage prior to passage of the 19th Amendment. He finds that state governments grew significantly after women were enfranchised, reversing a downward trend that had occurred in 4 of the 5 years prior to enfranchisement.

Like *Freakonomics*, *Freedomnomics* is an easily read and entertaining book that applies economic principles to our daily lives and does not require an economics background to be understood; however, as the reader of this review can surmise, the latter takes a view diametrically opposed to the former. For readers open to such a view, I definitely recommend *Freedomnomics*.

—Ronald Johnson
Office of Prices and Living Conditions
Bureau of Labor Statistics