The Commanding Heights: The Battle Between Government and the Marketplace that is Remaking the Modern World. By Daniel Yergin and Joseph Stanislaw. New York: Simon and Schuster, 1998

Daniel Yergin's and Joseph Stanislaw's *The Commanding Heights* strives for breadth and perspective on an issue crucial to Austrian economics: the relative power of markets and governments. The authors have produced a book that is fundamentally optimistic that markets will continue to be the driving force behind world events, and that price decision-making will eventually prevail over political decision-making. From their experience analyzing interventionist forays into energy markets, they offer a compelling account of market expansionism and how the command economy lost its reputation.

While covering a broad philosophical spectrum, the book irons over divisions within market theory, but it honors a core Austrian principle. However, in the end, a lack of theoretical rigor, a thin presentation of intellectual history, and too many concessions to the values and priorities of the opponents of market freedom compromise their account.

Yergin is the Pulitzer-prize winning author of *The Prize*, the tale of the petroleum industry. Stanislaw is a Paris-based advisor to global companies, managing director of Cambridge Energy Research Associates. The title of the book is from Lenin's famous 1922 phrase declaring that markets should be limited and that government should manage the top levels of the economy. But over the last seventy years, the authors argue, the desire and ability of states to command these heights has shriveled. The great statist tide has turned during the course of complex interplay between government failures and market innovations. Notably, the turn of the last twenty years owes its torque to the public's changing beliefs about the capacity of states to solve social and economic problems.

In the 1980s, the push against command economies accelerated. In some cases, advocates of free enterprise simply landed unexpectedly in the command posts as if dropped behind enemy lines. Margaret Thatcher, the central heroine of the book, was essentially a free-market rebel in her party and a radical in her country. Even in other parts of the world, including Africa and Latin America where classical-liberal traditions are absent, the high ground was seized not for another group of compassionate thugs, but for privatization and freer markets.

Parts of this book are quite powerful. The story of Deng Xiaoping is fascinating. Following the Chinese Revolution of 1911, he was sent to France for further schooling. There, he developed two lasting passions, croissants and communism. "It was Ho Chi Minh, later the leader of North Vietnam, who would tell him where in Paris to get the best croissants" (p. 192). In 1979, Deng initiated an extraordinary set of

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reforms on practical grounds: "It doesn't matter whether a cat is black or white as long as it catches mice" (p. 195). In his challenge to the ideologically entrenched in his party, he suggested that they set up special leftist zones, with planning, rationing, travel restrictions, and a ban on foreign investment. Though Deng started the undoing of Communist Party economic hegemony, the authors concede that it is far from clear how his legacy will play out. Yergin and Stanislaw avoid any probing dissection of Deng's "sacred principle of pragmatism" and what that could mean for China's future.

Another feature of the book is the dozens of anecdotes connected with statist hubris. The most startling story comes not from the Soviet Union, as one might expect, but from India, and it concerns the Hindustan Fertilizer Plant built between 1971 and 1979 with public funds. Civil servants bought machinery from nine countries with financing from export credits. For a dozen years, twelve hundred employees clocked in every day. But during that time, the plant never produced any fertilizer for sale. The machinery did not fit together; yet everyone pretended, for twelve years, that the plant was operating.

One of the book's strengths is the dozens of original interviews of the major players, including Yegor Gaidar of Russia, Albert Fujimori of Peru, and Lawrence Summers, now deputy secretary of the Treasury, and formerly at the International Monetary Fund. The most readable chapter concerns Keith Joseph, Great Britain's "Minister of Thought," and Thatcher, who could not have forged Britain's U-turn without him. It is vivid and captures the sense of isolation that market advocates felt in the early 70s. It is amazing today to remember that a public figure could be easily demonized and shamed for introducing the basic lessons of Adam Smith and the insights of Hayek and Mises.

Superficiality corrodes the authors' account of the role of Austrian economics. Hayek's life and work is surveyed in slightly more than four pages. Like the Chicago School, the Austrian contribution is measured by the actual influence on people close to politics. We learn that Thatcher waved Hayek's *The Constitution of Liberty* in front of her party's "wets." We get a brief, but passable, explanation of the calculation problem, and that should suffice as a resounding plug for Mises's *Socialism*. Mises is less softhearted and more hardheaded toward socialist values than are Yergin and Stanislaw.

There are problems that cut too deeply, mortally wounding *The Commanding Heights* as the final word on the Great Turn. The first serious problem is the frequent reliance on conventional wisdom that turns out not to be true. Did Keynes save capitalism from itself, or was that a cliché that the authors are presenting? Did mixed economies deliver the goods, or is that an oversimplification that people believed, rightly or wrongly? Were laws passed to limit manipulation by robber barons, or was that mere perception (the question itself smuggles hidden premises)? Was capitalism's association with depression and war economically justifiable? When the authors drift between describing social perception and explaining economic history, they raise ambiguities.

The second problem is their basic framework, stressing that the world has moved from an era where it was believed that markets fail, to one where it is more often believed that government fails. The main issue is failure. They use the term so generally that it pertains to either efficiency or equity concerns or both.

However, their conception of market success—never made explicit—resonates throughout their analysis. They believe, like many of the people who try to command the heights of the economy, that highly idealized competitive markets are the basis for analyzing real markets and for developing policies that will make real markets more like the ideal. Yergin and Stanislaw are far more Chicagoan than Austrian, far less inclined to follow the Misesian insight that the starting point of market analysis is the implication of human cognition and action, not mathematics.

Perfect competition is the foundation of their false ideal of market success. This is a preposterous theory made pernicious by its practice. There is no Wizard of Oz who has *special* market knowledge outside of those who are creating the market. The desire to grasp the levers and pulleys of the market to fix its allegedly inherent flaws is a gross pretense, almost always the expression of a desire for political discretion over economic outcomes. The standard of perfect competition and market success need not be met because it cannot be met.

The authors' failure to grasp the theoretical stakes leads them to a serious historical omission in *The Commanding Heights.* In another flagrant confusion of social perception, government propaganda, and tiddlywinks economics, they suggest that the Securities and Exchange Commission (SEC) was set up in the wake of the Depression to make the capital market work better (p. 52). Did it? Is there a difference between restoring confidence and artificially inducing overconfidence? We never find out. They are careful about recounting the SEC's origins, including the biography and personal foibles of its founder James Landis. But they don't follow through.

Fundamentally, the SEC regulates business speech to make the market *fair* for the little guy. Infatuated by the idea that no one stockholder should know more than any other, the SEC for years prevented them from meeting together. Then it enforced vigorously laws against people who knew more (the insiders) than others (the outsiders). It is immaterial to the SEC whether those insiders created that information. This agency made it a criminal act for a person who knows more than another to trade on that knowledge and make a profit. Thwarting efficiency in capital markets has its costs: the indiscriminate banning of insider trading; that is, using corporate property, is like a rule that forces corporations to toss money out of headquarters windows.

Yergin and Stansilaw note that change accelerated during the 1980s, but they do not even mention the farsighted and dominant agents of change: the leveraged buyout artists. In the eighties, entrepreneurs discovered gross bureaucratic inefficiencies in large firms. They found they could capture the value of underused assets by breaking apart diversified firms and consolidating lines of business. The leveraged buyouts (LBOs) inaugurated the era of "right-sizing" in the search for efficient organization. These entrepreneurs were unique in the world: there are no such dynamic corporate takeover markets in Europe and Asia. Entrepreneurs concentrated financial power and employed information that they themselves created to contest the incumbent management. LBO specialists like Kohlberg, Kravis, and Roberts used the innovative financing technique of high leverage with low-grade debt ("junk bonds") to buy underperforming firms. Entrepreneurs like T. Boone Pickens, using investment bank Drexel Burnham Lambert, could compete for the assets of a company by offering a stronger corporate vision.

Whose side was the SEC on? It fought the perfectly legitimate activities of the capital markets, tooth and nail. It helped to turn Drexel's star, Michael Milken, into a political prisoner. Nearly every step of the way, the agency undermined the power of financial markets and promoted the increased bureaucratization of markets. The SEC was spurred on by Congress, flanked on one side by U.S. Attorney Rudolph Guiliani and on the other by sundry state legislators beholden to corporations in their district. The SEC sided with established interests, the Fortune 500, and its key constituency, the New York Stock Exchange. While their rationale for penalizing Drexel was to keep the markets fair for the little guy, in fact, its laws were purely protectionist.

In the power vacuum created when markets sucked the air out of government agency purpose, the SEC became reinvigorated by a Congress that wanted to focus the public on the "pressing national problem" of the hostile takeover market. In the end, people were put in jail (Michael Milken) and legitimate techniques vilified (like hostile takeover arbitrage—Ivan Boesky) because they violated the policy of perfect competition. Milken and others made the market fall short of its false ideal, by tipping the playing field, by upsetting expectations, concentrating market power. In fact, Drexel, the most successful investment bank of the 1980s, was punished for undermining establishment interests.

The third problem is their conception of the mixed economy, and where the most significant lines between market and government are drawn. Their account of financial market power is weak and leaves far too much of importance out of the picture. Their oil monomania blinds them. In 1973 and 1974, petroleum problems were certainly important and headline worthy. But the 40-percent drop in the value of the stock market triggered huge changes in the way risks are managed in the private sector. That was a turning point in the shift from strong managerial discretion (such as that found in the bureaucratic management of the large conglomerates) to strong owners by the mid-80s. The rise in the power of financial markets is incomprehensible without an explanation of the takeover and restructuring movement in the United States.

The authors' summary analysis of how state corporations function and then fail is very good. But, here again they miss an opportunity. They fail to apply those lessons fully to U.S.-style corporations with their web of state protections (charter, subsidy, and regulation) and buoyant community support. Yergin and Stanislaw don't like state corporations, but they seem content to live with disturbing compromises in corporate governance. They adopt a very conventional posture: they dislike unpopular, centralized, bureaucratic management. But they don't strongly criticize popular, decentralized, *constituency* influence (stakeholders) over private corporate decisions.

Their whole argument against state-corporatism seems to collapse at the end when they start sounding like former Labor Secretary Robert Reich. Yergin and Stanislaw obsessed, as many others are, with the problems of income inequality. Indeed, that is one of their critical tests of the new, free economies: will they spread the goods around *fairly*? Since it can't be done centrally, how might it be done noncentrally? They are vaguely sympathetic to the European view that world capital markets should not be driven by the "Anglo-Saxon cult of shareholder value," which would further divide the haves from the have-nots. They take several potshots at financial analysts who look to see if quarterly requirements are met.

Either they do not find serious problems with the idea of expanding stakeholder power or they think that it is simply a political reality to which we must adapt. This is Deng's "principle of pragmatism" at work. The expansion of stakeholder power is simply a decentralized welfare-state program and is no less pernicious than the centralized federal expansion of rights and entitlements.

The fourth and last point is that they tell the story of the fight for economic freedom as bloodless. The fact is that some governments were not well-intentioned. In fact they were evil-intentioned. And where they were not explicitly venal, they were inspired by socialist values and it was those values that provided the bedrock of support for dictatorships all over the globe. No doubt there was interventionism that was public-spirited, yet naïve. But not nearly as much as they suggest.

The willingness to believe in the ideal of socialism can explain the massive self-blinding of the twentieth century. The horrors of dictatorships were evident—anyone could understand them. When Keith Joseph made speeches to students in the seventies, he was perceived as a Don Quixote. Exasperated, lonely, he would ask those students which countries ran their affairs better than Britain. The answers he got: Cuba, China, and Yugoslavia. Such staggering evasions of reality need a better explanation than the story recounted by Yergin and Stansilaw.

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