# Transaction Man: The Rise of the Deal and the Decline of the American Dream

### Lemann, Nicholas. 2019. *Transaction Man: The Rise of the Deal and the Decline of the American Dream.* Farrar, Straus and Giroux: New York. $28.00 306 pages

Nicholas Lemann has written an important book offering a plausible explanation as to why, despite the "macro" success of the American economy during recent years, many particular Americans feel they have been the victims of this "success." He is an adept story-teller, and has found paradigmatic tales of why a booming Dow Jones Industrial Average does not tell the entire story of recent US economic history. Furthermore, his fingering of the "culprits" in this crime is, I believe, largely accurate. And he even offers a good suggestion for an approach that might help to right our ship of state, namely, abandoning our reliance on a single, rationalistically arrived at, method for governing society, and returning to a more pluralistic, "competition-of-interest-groups" basis for achieving social order, in line with that suggested by, say, the authors of *The Federalist Papers*.

Nevertheless, despite my agreement in large with both Lemann's diagnosis of the cause of our recent social ailments, and with his prescription for curing them, I find this book problematic, as the author is far too "loosey-goosey" with the evidence he brings to bear for his case, and with his explanations of how various aspects of the situation he describes actually function. A bad argument for a true conclusion is still a bad argument, and it is especially encumbent on those who agree with the conclusion in question to reject bad arguments for it, lest the conclusion be dismissed solely on the basis of the badness of those particular arguments.

Lemann organizes his book into three major sections, based upon the three main ways American society was thought to be primarily organized by the most influential thinkers in each period. The first organizing principle, operative in the first half of the 20th century, held that it is institutions that matter most: the, the focus of social analysis, as well as that of legislation seeking to transform social conditions, should be aimed at institutions such as corporations, labor unions, political parties, and so on. Lemann’s paradigmatic figure for this section is Adolf Berle, an important advisor to FDR, and the author of *The Modern Corporation and Private Property*. Berle represented “clash of the titans liberalism,” Lemann’s colorful phrase for corporatists who welcomed giant corporations as levers that government could employ for social progress. The other strain of liberalism, “Middle Earth liberalism,” is represented here by Louis Brandies, Berle’s friend and future Supreme Court justice: this faction wanted to break up large corporations to reduce their power. (Given that anyone trying to argue that bankers might have inordinate influence on modern social affairs is usually accused of anti-semitism before they can finish their sentence, a point Lemann makes in passing is worth noting: one of the earliest, influential attacks on bankers' hidden control over economic life was *Other People's Money and How the Bankers Use It*, was penned by Brandeis... who was Jewish.)

But, as Lemann documents, from the 1970s onwards, largely under the influence of academic theories in economics and finance, a view gained ascendancy, one which held that the primary focus of policy should be on permitting any and all "voluntary" transactions, regardless of the effect of those transactions on existing social relations. The author makes Michael C. Jensen, the “transaction man,” the central figure of this section. The theoretical underpinning of this view was that freeing markets from all of the "artificial" restrictions that labor unions, domestic manufacturers, and other interest groups had bound them with would lead to greater "consumer utility." Of course, such analysis was far from "value-free" as its proponents suggested it was: in fact, it reduced the value of a human life to the value of what that human could consume during that life, and wiped out the fact that real people often are more concerned with what they can *contribute* to society than they are with what they can consume. A worker at a steel-manufacuring plant would likely see himself as an important factor in producing automobiles, refrigerators, ovens, and skyscrapers that other people would find useful; laid off, even if his "benefits" allowed him to buy a larger home entertainment system than when he had been employed, he would be more likely see his life as superflous to the society in which he lived. The primacy of "homo consumerus" is based on a false anthropology: we humans, in fact, deeply want to feel that our lives *matter* to others, and are not satisfied merely knowing that we got to consume lots of stuff during our allotted years.

Lemann himself sometimes falls prey to economistic thinking. For instance, he declares that "Economics and politics usually operate together as society's main organizing principles" (4). This sort of reductionism has been popular at least since Marx (and with many who are not Marxists), but it is not true: it is a shared understanding of the nature of reality that is a society's main organizing principle. Only for a society that has already decided that, say, self-interest is the guiding principle of life do economic factors exert as much influence as they do in ours.

But a much larger problem in this book is its casual use of "evidence," evidence for which, quite often, no reference is provided. For example, describing changes occurring in the Chicago neighborhood known as "Chicago Lawn" towards the end of the 20th century, Lemann characterizes the situation as "barely controlled chaos," with "panicked" whites selling and moving out, and "frightened" blacks (frightened by the decline of the neighborhood in which they had been living) buying and moving in. And what was the outcome of all of the panic, fear, and chaos? "In 1990 it was still just over half white; by 2000 it was just over half black" (7). Throughout this book we typically only get references for direct quotations: everything else, apparently, we should just take on faith. So I don't know the exact numbers Lemann was looking at when he wrote that passage, but it sure looks like he is saying that a neighborhood shifting from, say, 51% white, to 49% white, over *a ten-year period*, is "barely controlled chaos" and a result of "panic." He also claims that black buyers bought in at "prices far above what the fleeing whites had sold for" (7). I, for one, certainly wanted to see some evidence as to how "far above" these prices actually were, as Lemann's contention implies a significant obtuseness on the part of both the white sellers and the black buyers, who apparently were unable to check recent sale prices and realize they were being had. But no such evidence is provided.

In describing the milieu in which Jensen earned his PhD in the University of Chicago economics department, Lemann notes that "Friederich Hayek had moved to the university... in 1950" (102). True, but he had departed in 1962 for the University of Frieburg, and furthermore, the Chicago economics department had rejected Hayek as a member of their faculty, so that he wound up at the university's Committee on Social Thought. He also describes Milton Friedman as "the conservative economist," and as Hayek's protégé, both descriptions Friedman surely would have rejected.

Lemann continues by noting that economists Modigliani and Miller had argued "that the value of a company has nothing to do with the standard questions that professional investors had for years considered essential in deciding whether to buy a stock" (105). A few lines later, he cites Eugene Fama as holding that "well-functioning financial markets will set the price of a stock accurately" (105). He doesn't notice that these two ideas contradict each other: if "professional investors" were deciding whether to buy a stock consistently had "nothing to do with" the stock's actual value, then market prices for a stock would generally have been wildly inaccurate.

Arguing for Jensen's blindness to counter-evidence to his "efficient markets" theory, Lemann cites Keynes's example of the stock of ice companies trading higher in the summer than in the winter. (If this were true, it would suggest markets were "irrational," since winter investors ought to have foreseen that summer was coming in a few months, and vice-versa for summer investors.) But Lemann failed to investigate whether Keynes's bald declaration was true: Henry Hazlitt did do so, and in *The Failure of the New Economics*, he found that actual data on the few ice companies he could find trading on the stock market did not at all support Keynes's contention. He admitted that his thin evidence certainly did not *disprove* Keynes's contention, but noted that since Keynes had presented exactly *no* evidence for his contention, that the burden of proof now was firmly in Keynes's court.

As evidence of the evils stemming from the abundance of derivatives that were spawned during "The Time of Transaction Man" (the title of Lemann's fourth chapter), he mentions that "Enron... collapsed because of losses incurred from... derivatives trading" (171). But Professor of Law Frank Portnoy, testifying as an expert witness before the US Senate Committee on Governmental Affairs, asserted:

"How did Enron lose so much money?... the basic answer is now apparent: Enron was a derivatives trading firm; it made billions trading derivatives, but it lost billions on virtually everything else it did, including projects in fiber-optic bandwidth, retail gas and power, water systems, and even technology stocks. Enron used its expertise in derivatives to hide these losses."

It may be useful to note here that Portnoy was *highly* critical of Enron's use of derivatives, and of the lack of regulation on derivative trading in general. But even such a critic, who actually spent a large amount of time studying this case, did not try to claim that Enron folded because of *losses* in derivatives trading: no, the derivatives trading was the only part of the company making money. And Greg Kaza and I cited Portnoy in *Reason Magazine* in our 2004 article there (https://reason.com/2004/02/01/in-defense-of-derivatives-2/), so this fact was easily accesible from a popular magazine article. That Lemann, in 2019, is claiming that Enron fell due to *losses* from derivative trading leads me to suspect a serious lack of research on his part. On the other hand, perhaps he has some source that contradicts Portnoy... but since his citations are so minimal, how could this poor reviewer find out if this is so?

A couple of pages later, Lemann claims:

"if you place a bet on the future directional movement of the instrument by buying a derivative, and you're right, you can make a lot more money than if you owned the instrument itself. And what happens if you're wrong is similarly magnified..." (175)

This quote displays a fundamental misunderstanding of options. If I want to speculate that XCORP stock, which is currently at $100, will soon "go through the roof," I can buy, say, 100 shares of the stock for $10,000. Or, I can pay, perhaps, $500 on an option to purchase 100 shares of the stock at $110. If the stock goes to $0, if I bought the shares, I lose my entire $10,000. But if I bought the option contract, I lose only the $500 I paid for the option. Buying options is, most fundamentally, a way to *limit* one's downside when betting on a certain market outcome. The cost is that, if the stock does go up, my profit is $500 less than what it would have been otherwise (plus the fact that I don't gain from the rise from $100 to $110, in our example).

Of course, trading in derivatives *can* be very risky. For instance, *selling* "uncovered" puts is a famous way to achieve bankruptcy. But this is the opposite case of Lemann's: in buying a derivative, one only risks what one pays for it. It is selling derivatives, without a hedge against a movement against one's position, that is especially risky. It is quite surprising that an author who wishes to explain the risks involved in derivative trading to a popular audience does not seem to grasp this distinction.

The final major section of the book, called "Network Man," Lemann chooses as his paradigmatic representative Reid Hoffman, who was a key player in creating PayPal, and a co-founder of LinkedIn. Hoffman displays a sunny optimism about the ability of digital networks to improve everyone’s life, an optimism shaken by the 2016 presidential elections, and of which Lemann is skeptical. (The author makes another factual error here, claiming the Apple Computer has no living founders, killing off poor Steve Wozniak.)

In a brief Afterword, Lemann discusses the ideas of Arthur Bentley, a largely obscure figure who wrote a single important work, *The Process of Government*, which held that all politics is a matter of competing interest groups vying for benefits for their members. As such, the best we can do in establishing social order is to make sure no single interest can dominate all others: in short, we want a polycentric social order, with power widely distributed. This is an idea with merit; it is unfortunate that Lemann did not try to place Bentley's ideas in the larger context of other figures who thought along similar lines, such as James Madison, Alexander Hamilton, Vilfredo Pareto, Michael Oakeshott, Jane Jacobs, or James C. Scott, to cite just a few examples.

Lemann is an adept storyteller, and this talent vividly brings home the ways in which the "economic success" the United States has enjoyed in recent decades has been the success of a few at the expense of many others. As a result, this is a book well worth reading. Alas, if only Lemann had been more careful with his facts and assertions, it could have been an outstanding work, but due to its sloppiness, it falls short of that mark.