

## PREFACE

# The Auction Will Set You Free

The nineteenth-century liberal was a radical, both in the etymological sense of going to the root of the matter, and in the political sense of favoring major changes in social institutions. So too must be his modern heir.

—MILTON FRIEDMAN, *CAPITALISM AND FREEDOM*, 1961

The seed of this book was planted during a summer one of us spent in Rio de Janeiro. Rio is the most naturally beautiful city in the world. Lush tropical hills, which roll down to an island-laden bright blue bay, afford unrivaled views. Yet these same hills are covered with *favelas*, squalid jerry-rigged slums that lack basic sanitation and transportation.

Leblon, possibly the wealthiest neighborhood in all of Latin America, lies at the base of the hills. There your money can buy, at wildly inflated prices, the luxury watches and cars that are leading status symbols. Yet the citizens of Leblon don't dare wear their watches on the street, nor stop their cars at red lights at night, for fear of the violence looming from the favelas above. Rio is one of the most dangerous cities in the world.

*Cariocas*, as the people of Rio call themselves, are relaxed, kind, creative, and open. They perceive race more subtly than we do in the United States, with our sharp line between white

and black. Both countries have long histories of slavery, but in Brazil, everyone is of mixed heritage. Even so, variations in skin tone convey gradations of class, an omnipresent force in Brazilian society.

Economically, Brazil is the most unequal country in the Western hemisphere. While it overflows with natural abundance, a few families control much of its wealth and almost 10% of Brazilians live below the global poverty line. The last president was ejected for abusing her power, her predecessor is in jail for corruption, and corruption investigators are closing in on the current leader, whose approval rating is in single digits. He will probably be jailed by the time this book is published. Living standards in the country have stagnated for long periods. Entrepreneurship is sparse.

Why has this paradise fallen? How can its potential be fulfilled? The debate is familiar.

LEFT: The government should tax the rich to supply homes, medical care, and jobs for the poor.

RIGHT: Yes, and you end up with Venezuela or Zimbabwe. The government needs to privatize state-owned industries, enforce property rights, lower taxes, and reduce regulation. Get the economy going, and inequality will take care of itself.

TECHNOCRATIC MIDDLE: We need an economy carefully regulated by internationally trained experts, targeted interventions that have been carefully tested by randomized controlled trials, and political reform that protects human rights.

People in rich countries, where inequality is rising, will recognize Brazil in their own countries. In the rich countries, economies are also stagnating and political conflict and corruption are on the rise. The long-standing belief that a “devel-

*oping* country” like Brazil will eventually end up as a “*developed* country” like the United States is under scrutiny, and people are beginning to wonder if things are moving in reverse. Meanwhile, the standard prescriptions for reform are the same as they have been for the last half century: increase taxes and redistribute; strengthen markets and privatize; or improve governance and expertise.

In Rio, these prescriptions are palpably stale. Poverty, tight and concentrated control of land, and political conflict seem to be intimately linked. Wealth redistribution has made few inroads on inequality. Improvement of property rights has not done much to foster development. Slum dwellers hang on to property that could instead be a public park, a nature preserve, or modern housing. Land in the city center, where favela dwellers could live decently and have access to public services, is monopolized by the wealthy, who are too fearful of crime to enjoy it. The same concentrated control of wealth that breeds inequality seems to corrupt politics and restrain business initiative: Brazil is in the bottom 10% of countries in terms of ease of creating a business, according to the World Bank.

The case of Rio demands an answer to the question: Is there no better way? Can this city not escape inequality, stagnation, and social conflict? Does Rio foreshadow the fate of New York, London, and Tokyo, except without the pleasures of samba and beaches?

### **Auctions as Radical Markets**

The problem stems from ideas, or rather the lack thereof. The arguments of both the Right and the Left had something to offer when they originated in the nineteenth and early twentieth centuries, but today their potential is spent. No longer bold reforms, they box us in. To open up our social possibilities, we

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must free our minds to radical redesigns. To get to the root of the problem, we must understand how our economic and political institutions work and use this knowledge to formulate a response, which is what we do in this book.

Our premise is that markets are, and for the medium term will remain, the best way of arranging a society. But while our society is supposed to be organized by competitive markets, we contend the most important markets are monopolized or entirely missing, and that by creating true competitive, open, and free markets, we can dramatically reduce inequality, increase prosperity, and heal the ideological and social rifts tearing our society apart.

Like those on the Right, we think that markets must be strengthened, expanded, and purified. Yet we perceive a fatal flaw in the Right: it has been timid and unimaginative in its vision of the social changes necessary to make markets flourish. Many on the Right support Market Fundamentalism, an ideology they assume to have been proven in economic theory and historical experience. In reality, it is little more than a nostalgic commitment to an idealized version of markets as they existed in the Anglo-Saxon world in the nineteenth century. (We will use the term *capitalism* to refer to this idealized historical version of markets, in which governments focus on protecting private property and enforcing contracts.) We contrast Market Fundamentalism with Market Radicalism, which is our own commitment to understand, restructure, and improve markets at their very roots.

We share with the Left the idea that existing social arrangements generate unfair inequality and undermine collective action. But the Left's flaw has been its reliance on the discretionary power of government bureaucratic elites to fix social ills. Imagined by the Left to be benevolent, ideologically neutral, and committed to the public good, these elites are some-

times arbitrary, corrupt, incompetent, or, perceived that way whether they are or not, distrusted by the public. To harness the radicalism we believe is inherent in markets, we must decentralize power while spurring collective action.

The Radical Markets we envision are institutional arrangements that allow the fundamental principles of market allocation—free exchange disciplined by competition and open to all comers—to play out fully. An auction is the quintessential Radical Market. Because the rules of an auction require people to bid against each other, the object on the block winds up in the hands of the person who wants it most—with the caveat that differences in bids may represent differences in wealth as well as desire.

Although most people do not think of auctions outside the realm of estate sales, fine art, and fund-raisers, they are commonly conducted on the Internet, away from the public eye. But in what follows we will show how spreading them throughout our society could save Rio—and the world.

### **Rio for Sale: A Thought Experiment**

Suppose the entire city of Rio is perpetually up for auction. Imagine that every building, business, factory, and patch of hillside has a going price, and anyone who bids a price higher than the going price for an entity would take possession of it. Auctions might extend to some kinds of personal property like automobiles, or even to what is normally determined through the political process, like the amount of pollution that factories are permitted to discharge. Much of this book is devoted to figuring out how such a system might work.

As a thought experiment, however, let us assume for the moment that the auctions are conducted via smartphone apps that automatically bid based on default settings, eliminating

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most of the need for people to constantly calculate how much to offer. Laws ensure that the obvious sorts of disruptions don't occur (for example, coming home to find your apartment is no longer yours). Incentives are in place to care for and develop assets, and ensure that privacy and other values are also preserved. All of the revenue generated by this auction would be returned to citizens, equally, as a "social dividend," or used to fund public projects, which is how revenues from oil sales in Alaska and Norway are used.

Life under this auction would transform Rio's society and politics. First, people would think about their property differently. The stark distinction between owning a house and occupying a spot on the beach would erode. Private property would become public to a significant extent and the possessions of those around you would, in a sense, become partly yours.

In addition, perpetual auctioning would undo the tremendous misuse of lands and other resources. The highest bidder for the most scenic hillsides would never be someone planning to build rickety and dilapidated slums. The highest bidder for central city land would not be the developers of small, ritzy condos but the builders of skyscrapers for the new, vast middle class auctioning would create.

A third result would be the end of the primary source of economic inequality. Although at first blush you might assume that the auction would allow the rich to buy up everything of value, reflect for a moment. What do you mean by "the rich"? People who own lots of businesses, land, and so forth. But, if everything were up for auction all the time, no person would own such assets. Their benefits would flow equally to all. Chapter 1 explains how.

Fourth, the Rio auction system would limit corruption by taking many major political decisions away from politicians and

placing them in the hands of citizens. With an improved public life, crime would be reduced, street life would be restored, and the retreat into private communities would cease. Far from the usual image of markets substituting for and undermining the public sphere, Radical Markets would bolster trust in public life. Chapter 2 explains how an auction could organize politics.

### Radical Heroes

Our argument draws on an intellectual tradition that goes back to Adam Smith. Smith is frequently invoked by conservative thinkers these days, including Market Fundamentalists. But Smith was a radical—in the two ways highlighted by our epigraph that are crucial to our thinking. First, he dug deeply into the roots of economic organization and proposed theories that remain influential today. Second, he attacked the prevailing ideas and institutions of his day and presented a series of daring propositions and reforms. People regard these ideas as “conservative” today simply because they were so successful in reshaping policy and thinking at the time.

Market Fundamentalists draw a line from Smith to people like Friedrich Hayek, Milton Friedman, and George Stigler—mid-century conservative idols and Nobel laureates who took from Smith an idealized notion of markets based on private property. They put this vision to work in support of libertarian economics and politics. The Fundamentalists ignore those economists who share Smith’s radical spirit, such as Henry George, whose ideas helped launch the Progressive era and who may have been the most widely read economist of all time, but whose vision was lost in the Left-Right battles of the Cold War. George was more concerned about inequality than were

the conservative followers of Smith, and he recognized that private property could stand in the way of truly free markets. To remedy this problem, he proposed a tax scheme that would create a system of common ownership for land.

The most important “Georgist” economist, to whose memory we dedicate this book, is a mid-twentieth-century professor named William Spencer Vickrey. Vickrey, pictured in figure P.1, was the Master Yoda of the economics profession: silly, carefree, reclusive, absent-minded, and a fount of often inscrutable yet world-changing insights. He roller-skated from the train to class and wore his lunch on his shirts. He might wake from a nap in the middle of research workshops to comment, “This paper would benefit from . . . Henry George’s principle of taxing land values.” He mentioned George’s scheme so often that a colleague who was eulogizing him quipped, “I imagine by now he has mentioned it to God, too.”<sup>1</sup> Also aloof, arrogant, and private, Vickrey often failed to publish academic articles that contained his best ideas.

The inspirations of Vickrey’s research closely resembled ours. He focused during most of his career on the organization of cities and the tremendous waste of resources in most urban forms. He was particularly fascinated by cities in Latin America, where he advised governments on urban planning and taxation. In fact, it was while he was designing a fiscal system for Venezuela that he produced the paper that finally undermined his best efforts at ensuring his obscurity.

That paper was published in 1961. Its inspiring title, “Counterspeculation, Auctions and Competitive Sealed Tenders,” seemed to ensure permanent obscurity. But it was rediscovered a decade later. Vickrey’s paper was the first to study the power of auctions to solve major social problems, helped found a field





**FIGURE P.1:** William S. Vickrey (1914–1996), Nobel Laureate in Economics, father of mechanism design and quiet hero of our drama.

of economics called “mechanism design,” and earned him the Nobel Prize in 1996.

Vickrey’s ideas have transformed economic theory and had an impact on the real world. Governments around the world use auctions based on Vickrey’s ideas to sell licenses to use radio spectrum. Facebook, Google, and Bing use a system derived from Vickrey’s ideas to allocate advertising space on their web pages. Vickrey’s insights about urban planning and congestion pricing are slowly changing the face of cities, and they play an important role in the pricing policies of ride-hailing apps like Uber and Lyft.<sup>2</sup>

However, none of these applications reflects the ambition that sparked Vickrey’s work. When Vickrey won the Nobel Prize, he reportedly hoped to use the award as a “bully pulpit” to bring George’s transformative ideas and the radical potential

of mechanism design to a broader audience.<sup>3</sup> Yet Vickrey died of a heart attack three days after learning of his prize. Even had he lived, Vickrey may have struggled to inspire the public. In 1996, economies were booming around the world and a new era of global cooperation seemed to be dawning. No one wanted to tinker with success and Vickrey's approach faced daunting practical obstacles.

Today, however, the outlook for economic and political progress is no longer sunny, while, thanks to developments in economics and technology, the practical limits on Vickrey's approach can now be overcome. This book, therefore, tries to act as Vickrey's lost bully pulpit, fleshing out the vision he might have shared with the world had he survived.

Radical Markets