BRIEFLY NOTED

Privatizing Disaster Relief

BY IKE BRANNON

Natural disasters have become more frequent in the United States over the last 15 years. They have also become more costly: from 2014 to 2018, the United States averaged 13 natural disasters per year that did more than $1 billion in damage.

This is happening for several reasons. For starters, the United States adds to its wealth each year, especially when it comes to housing, and that means more wealth is vulnerable to loss in a disaster. Last year the nation added nearly 1.5 million units to its housing stock and home prices nationwide climbed an average of 8.5%. Hence, any random hurricane, flood, tornado, wildfire, or mudslide can damage more—and more valuable—property.

Another reason is that people are locating to disaster-prone areas. Florida (subject to floods and hurricanes), Texas (which recently suffered through a record cold snap that may have done over $100 billion in damage to the state's economy), and California (subject to floods, wildfires, earthquakes, and mudslides) have seen plenty of disasters in the last decade. These are the three most populous states in the country.

Moreover, some 127 million Americans—40% percent of the national population—live in coastal counties. If they comprised a nation unto itself, these coastal counties would rank third in the world in gross domestic product, behind only China and the United States as a whole, according to the National Ocean Service. In fact, population density is over five times greater in coastal shoreline counties than the U.S. average. Coastal communities face such natural disaster risks as high-tide flooding, hurricanes, sea-level rise, erosion, and climate change.

The federal government has not done much to preemptively mitigate such disasters or encourage residents of such places to take mitigation steps on their own. The National Flood Insurance Program, which effectively subsidizes the risk of living by flood-prone bodies of water—especially for high-income people—has exacerbated the costs of coastal disasters for residents and the government. (See "The Flood Insurance Fix," Winter 2011; "The Unintended Effects of Government-Subsidized Weather Insurance," Fall 2015.)

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Government failure / Federal disaster management authorities have a well-documented track record of inefficiency and mismanagement. A 2019 report by the Government Accountability Office (GAO) found that the federal government struggles in its efforts to help communities recover from disasters. Among the problems are that recovery efforts tend to be complicated, difficult to execute, and slow to gear-up.

The report also highlighted problems engendered by the ad hoc nature of disaster recovery block grants, especially those that come from the Department of Housing and Urban Development (HUD). The last-minute funding results in a lack of adequately trained staff and an over-reliance on those few who do have relevant expertise and training, which leads to burnout and higher staff turnover. The GAO made several recommendations to correct those shortcomings in the future but, it noted in a subsequent report, most of its proposals have not been adopted.

Another problem pointed out by the GAO is that the lead agency for disaster relief, the Federal Emergency Management Agency (FEMA) is often guilty of poor advanced planning, which begets bureaucratic infighting among other federal agencies and state and local governments that try to fill the void. That further slows disaster response. For instance, one of the first steps following most disasters is to remove debris, but a primary complaint by those affected by disasters is that it can be especially difficult to get assistance for debris removal.

Private administration / The poor track record of government disaster response has some policymakers experimenting with using private entities to manage relief efforts. This idea had its origins in the wake of Hurricane Katrina, when then-governor Haley Barbour of Mississippi hired the accounting firm Horne to oversee billions of dollars in federal disaster recovery funds. His idea was to have the firm apply accounting, auditing, and business management disciplines to disaster oversight.

The experience proved highly successful in terms of taxpayer savings. The Disaster Recovery Division of the Mississippi Development Authority reported that the cost of administering disaster recovery programs, including housing, was held below what was authorized by HUD, while the rate of fraud was kept below 0.1%. In the years since, Horne and other consulting firms have created a robust private-sector disaster-relief industry.

The use of private contractors lessens the problems created by FEMA's lack of experienced administrative staff, engendered by the ad hoc nature of disaster relief.

When Congress allocates disaster money, it generally gives FEMA wide discretion in how it allocates the funds, encumbered only by some broad strictures, if at all. The agency also decides how to distribute the funds across the affected states, a politically sensitive task. It, of course, has an incentive to ensure that the allocation is proportional to the damage, but more

money tends to flow to places that prove to be more competent in disaster recovery by speedily clearing debris and working with insurance companies so that rebuilding can proceed. In some ways this is an efficient outcome: if a state's bureaucracy struggles to spend the money allocated to it, there is little reason to give it more. However, this can lead to disparities across states that are politically untenable in the long run.

A major concern for states and localities is that they will undergo an audit after a disaster and be required to return disaster relief funds found to have been misappropriated. The fear of this occurring results in state and local governments being excessively cautious in distributing funds, which slows recovery efforts. For example, a South Carolina resident whose home was heavily damaged by Hurricane Dorian in 2019 was not permitted to access federal relief funds because he had delinquent municipal trash fees, and the local government administrator was unsure whether that rendered the household ineligible. (It didn't).

PARKERDEEN/GETTY IMAGES

Sometimes a state simply has little relevant experience in administering aid and has little choice but to resort to a private contractor. In 2020, California set aside $2.6 billion of COVID-19 relief funds to provide rental assistance for low-income households, but it had no existing program that would make it easy to identify those who might be eligible for the subsidy. To solve the problem, the state hired Horne, the same firm that Mississippi hired in the wake of Hurricane Katrina, and the firm constructed a website that explains the program and its eligibility rules and that uses geolocation to route applicants to the correct city, county, or state websites. (That complexity was the result of some localities' insistence that they administer their own rent-relief programs.)

Agility and responsiveness / The use of private contractors lessens the problems created by FEMA's lack of experienced administrative staff, engendered by the ad hoc nature of disaster relief budgeting. FEMA cannot quickly expand the hiring of trained staff when a disaster begins: the federal government needs months to go through the process of posting a job, screening applicants, interviewing finalists, making offers, and bringing new hires onboard. Private disaster management companies can move with much greater haste. The major competitors in the disaster contracting field tend to be accounting or consulting firms such as Civix, AAE-Com, KPMG, and Deloitte. Such firms can reallocate employees from other sectors of the business for short intervals during particularly acute crises.

What's more, FEMA cannot lay off workers during a slow disaster season because of employment protections granted to government workers. Private contractors are not bound by such inflexibility, enhancing their efficiency. And in a year with relatively few serious disasters, the government could simply do without hiring a disaster consultancy altogether.

Outcomes / In an ideal world, government would play a minimal role in the provision of disaster relief: businesses and households would purchase insurance sufficient to cover any potential losses from any calamity, and the role of the state would be limited to the rehabilitation of public properties.

We are far from that world, however, and moral hazard abounds. For instance, though the National Flood Insurance Program caps residential coverage at $250,000 for the structure and $100,000 for contents (non-residential coverage has higher caps), it still crowds out the private market for such insurance. This government support in the aftermath of previous disasters has undoubtedly led businesses, individuals, and governments to do less preparation than they otherwise would because of the anticipation of government support should a disaster occur.

As Nobel economics laureates Ed Prescott and Finn Kydland have sagely observed, if we can't prevent people from making bad decisions in the first place, the government apparently cannot abandon them to their own devices. The question, then, is how to help them in the most efficient manner? Contracting out the administration of emergency rebuilding services to the private sector, but funded by the government, appears to be the cost-effective second-best solution for a country where the number and cost of natural disasters are growing steadily. R

BRIEFLY NOTED

In Defense of Internet Data

BY THOMAS M. LENARD

The January 6 attack on the U.S. Capitol has exacerbated the current dystopian view of the internet, leading to policy recommendations that strike at the heart of the digital economy. For example, the American Economic Liberties Project (AELP), an "anti-monopoly" group, recommends banning targeted advertising by communications platforms, arguing that the January 6 riot was to a large extent caused by the business models of Facebook, Twitter, and other social media platforms. The fundamental problem, according to the AELP, is that these "monopolists make billions from promoting misinformation, conspiracy theories, and violence."

The AELP is not alone. In a February 11 *New York Times* column, Cornell economist Robert Frank labeled the targeted advertising business model of firms like Facebook and Google a "profound threat to the nation's political and social stability." To address the problem, he recommends abandoning the advertising-based model in favor of a subscription-based model. The CEO of German media conglomerate Axel Springer has proposed prohibiting the commercial use of private data. In a January 29 *New York Times* op-ed, Harvard Business School professor Shoshanna Zuboff also alleges a connection between the activities of internet platforms and "Donald Trump's attempted coup." Echoing the theme of her 2019 book *The Age of Surveillance Capitalism*, she asserts that gathering and using information on people's internet browsing habits is fundamentally incompatible with democracy. (See "The Tech Giants Are Out to Get You," Summer 2019.)

There is little question that groups involved in the January 6 riot used social media to communicate and recruit converts. But the implication that, but for the availability of these platforms, events like this would not occur indicates a lack of historical perspective. There are, unfortunately, all too many examples of mob violence that predate the invention of social media, from the Reign of Terror during the French Revolution, to the Tulsa race riots, to Kristallnacht, to name only a few. The notion that internet platforms are responsible for such events today when such events occurred in the past is far-fetched.

Even aside from the events of January 6, it is frequently asserted that the internet, and particularly social media, are major causes of polarization in the United States. However, research on "affective polarization"—defined as the extent to which citizens feel more negatively toward other political parties than their own—by economists Levi Boxell and Mathew Gentzkow at Stanford and Jesse Shapiro at Brown suggests otherwise. They found that even though polarization had increased more in the United States than in other developed countries, internet and broadband penetration increased in all the sample countries and, indeed, rose faster in countries where polarization fell. They identify factors more distinctive to the United States—such as changing party composition, growing racial divisions, and partisan cable news—as more likely causes of increased polarization.

For most users, who are not engaged in socially destructive activities, advertising-supported platforms such as Facebook and Google provide great value. These platforms are intermediaries between marketers who want to reach consumers and consumers who want content and spend time on the platform and see ads generated by recommendation engines. The advertising revenues pay for the content enjoyed by consumers and for improvements in the platforms themselves. Economist David S. Evans has conservatively estimated that the value of these digital ecosystems to U.S. consumers exceeds $1 trillion annually.

The creative use of data is the basis for the success of many of this century's great internet companies—predominantly American companies—whose revenue is primarily derived from targeted advertising. The popularity of platforms like Facebook and Google, in turn, drives demand for broadband adoption and the devices used to access that content, including mobile handsets, wearables, and laptops produced by companies like Apple and Microsoft.

The ad-based models make it simple for billions of users to access digital content. Moving to a subscription-based model would adversely affect lower-income consumers who would have to pay for a range of services like search and email they now receive free in exchange for their data. Raising the cost of content on the internet by eliminating the advertising model and mandating paywalls on the most popular sites online would induce some consumers to disconnect—a particularly unfortunate consequence during a national effort to reduce the digital divide.

Misinformation is a serious problem that the platforms are struggling with, but the suggested remedy to change the ad-based content model is likely to instill deeper damage to social welfare than advocates appear to recognize. *R*

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Antitrust and 'Big Pharma'

BY THOMAS GRENNES

The COVID pandemic continues to be a major global crisis. Reformers have observed that crises are opportunities for major reform, and they should not be wasted. Accordingly, some policymakers are calling for more aggressive antitrust action against large pharmaceutical companies. Rebecca Kelly Slaughter, acting head of the Federal Trade Commission, has complained of "skyrocketing drug prices and ongoing concerns about anticompetitive conduct in the industry." Such actions may have superficial appeal, but they are likely to have unintended negative effects that would make a bad situation worse.

Intellectual property rights and research / New products cannot be produced or distributed until they are invented. This has been illustrated by the rapid invention of COVID vaccines by BioNTech/Pfizer, Moderna, Johnson & Johnson, and others. The vaccines were the result of efforts by talented scientists who could not work without compensation and firms that would not have invested resources without the hope of returns on that investment.

The purpose of patent and copyright laws is to encourage the development of useful new ideas. Legal intellectual property rights are important for established pharmaceutical companies like Pfizer that have ongoing research, as well as for startup companies like BioNTech that are testing potentially breakthrough ideas.

Ozlem Tureci, co-founder of BioNTech, has emphasized the importance of being able to hire outstanding scientists from many countries, but her firm could not have attracted those scientists without paying them competitive salaries. Patent protection for pharmaceuticals is vital to that research, especially at a time when new varieties of viruses are widely expected to emerge. Moreover, Tureci believes the research that produced the COVID vaccine will have valuable future applications, including fighting cancer. Without protection for their intellectual property, firms not doing research could use the new ideas without compensating their producers, which would eliminate the payoff to research. By excluding "free riders," patents provide an incentive to spend on research.

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Big Pharma / Populists oppose big businesses because they tend to equate "bigness" with market power. However, firm size is not a reliable indicator of monopoly. The technology of an industry may be subject to economies of scale in production, and the average firm in the industry may be larger than a typical firm in other industries. If there are enough big firms in the industry, no single firm may have the power to keep prices above cost.

The optimal size of a firm varies with the product being produced. Firms specializing in research on viruses may have a different optimal size than one specializing in producing a vaccine. Four firms dominate the world vaccine market: GlaxoSmithKline, Merck, Sanofi, and Pfizer. In 2020 they earned 90% of the vaccine revenue, according to the magazine *Fortune*.

If policymakers are concerned about market power, there is a much better way to limit it than imposing size limits on firms. Reductions in the cost of transportation and communication have reduced a natural trade barrier and brought on an era of globalization. There is ample evidence that the most effective constraint on market power by domestic firms is to allow foreign firms to enter the domestic market without tariffs, import quotas, or discriminatory licensing.

In the U.S. pharmaceuticals market, domestic firms Pfizer, Moderna, and Johnson & Johnson have been approved for distribution of COVID vaccines. Novavax and Gilead are also developing COVID vaccines and are expected to seek approval. If that is not enough competition, there are also prominent foreign companies that are distributing their vaccines all over the world that could enter the United States. In essence, one already has: the first developer of a COVID vaccine was the German-based BioNTech, which then partnered with Pfizer to produce its invention, making the partnership the first and largest supplier of vaccine in the country. There are other private foreign companies, such as AstraZeneca and Fujifilm Diosynth, as well as government-owned companies such as Russia's Sputnik V and China's Sinovac Biotech, whose vaccines are being sold all over the world. Discontent in the European Union over COVID policy has caused some member countries, especially Hungary, to look to Sputnik V. In Hong Kong, both Sinovac and the Western products are available, with consumers demonstrating a preference for Western vaccines.

The potential of these companies to sell in the United States limits prices domestic firms can charge. But to make the threat of imports credible requires no tariffs, quotas, or other limits on imports. Free trade is a simple and effective antitrust policy. However, nationalism is one reason some countries are unwilling to rely on trade to provide a vaccine. Some countries, such as the United States, have restricted vaccine exports, including exports to neighboring Canada.

Big and Small Pharma / As opposed to Big Pharma, firms such as BioNTech can be described as "Small Pharma." They have produced some of the major pharmaceutical innovations.

BioNTech was founded in 2008 by Tureci and her husband and fellow scientist Ugur Sahin, whose families migrated from Turkey to Mainz, Germany. BioNTech's prior research had involved a variety of vaccines, especially related to cancer. When the pandemic shocked the world,

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the owners saw the opportunity to apply their discoveries to a COVID vaccine.

They were successful researchers, but they lacked the ability to produce, test, and market their vaccine. They outsourced testing to a Chinese firm, Fosun Pharma, and they established their partnership with Pfizer to handle production as well as secure government approval and do marketing. This partnering between Big and Small Pharma is not unique. Similar deals have been struck on a variety of other products. Interestingly, of the Big Four Pharma firms, none were able to develop a COVID vaccine on their own.

Restraint of trade? / The cooperation between BioNTech and Pfizer is not the sort of activity that antitrust authorities have viewed as a "conspiracy to restrain trade." A more accurate description of their cooperation would be a division of labor in which Pfizer outsourced research to BioNTech to develop a specific COVID vaccine. Pfizer did some clinical trials, obtained government approval, and began production. Pfizer has substantially increased production by boosting its capacity and using that capacity 24 hours a day, seven days a week.

Science writer Matt Ridley has distinguished between inventions and innovation that converts inventions into practical and affordable goods for people to use. The collaboration between BioNTech and Pfizer largely accomplished the conversion from invention to innovation. Getting the vaccine into the arms of millions of Americans also required some favorable government regulation.

However, the vertical relationship between the supplier of research, BioNTech, and the buyer of research, Pfizer, is the kind of arrangement the Biden administration's newly reconfigured Federal Trade Commission is scrutinizing as a possible violation of antitrust laws. The FTC just announced a suit to block life science firm Illumina's planned acquisition of one of its suppliers, Grail. Grail is developing an early-stage cancer detection test. The two companies are not in a horizontal relationship in which they compete head-to-head. Opposition to vertical mergers on antitrust grounds has been rare, and there has only been one litigated challenge in the last 40 years. If the FTC had objected to the vertical cooperation by BioNTech and Pfizer, it would have been extremely harmful to the rapid development of the COVID vaccine and its distribution in the United States.

The nature of the COVID pandemic made a rapid response by pharmaceutical companies important. This included cooperation by companies that might be viewed by aggressive antitrust authorities as anticompetitive. Not only did BioNTech work with Pfizer, it formed a coalition of 13 companies that would use their facilities to produce the BioNTech vaccine. Likewise, Johnson & Johnson is working with Merck to produce J&J's vaccine after Merck gave up its own effort to create a vaccine.

A favorable interpretation of the cooperation that resulted in a rapid response to the negative COVID shock is that it saved lives and reduced suffering by slowing the spread of the virus around the world. It also reduced the economic losses of output from lockdowns of businesses, schools, and other institutions. Regulation elsewhere, such as in the EU, has been less nimble and rapid. Problems in evaluating AstraZeneca have contributed to the EU vaccinating fewer people per capita than the United States in the same time period.

Conclusion / Research is essential to developing new technology that raises living standards around the world. New technology can also prevent negative shocks like COVID from destroying lives and reducing health. Avoiding damages from new viruses will require new vaccines. Weakening intellectual property rights would reduce the research and technological innovation that would produce new vaccines, not to mention other goods.

Bigness of companies is not a reliable measure of monopoly power and allowing regulators to impose size limits on firms could be economically wasteful. Breaking up large firms and blocking vertical mergers could prevent firms from reaching economically optimal size. Free trade would be a much more effective antitrust policy than punishing firms for their size. R

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The Problem with Politicizing Corporations

BY PIERRE LEMIEUX

In his 1973 book *Capitalism and the Permissive Society*, the late *Financial Times* columnist Samuel Brittan observed that "businessmen can usually be relied upon to defend the indefensible aspects of their activities while giving in to their collectivist opponents on all essentials."

The corporate political positions that have become fashionable of late contribute to a dangerous trend that undermines the separation between economic and political power. Note that "power" has a different meaning in the two cases—corporations cannot send anybody to jail—but the difference shrinks when corporations become less distinguishable from the state.

Of course, private corporations—as "private" implies—should be free, through their executives, directors, and ultimately shareholders' assemblies, to determine corporate positions on any issue, express their political opinions, and peacefully act upon them. One would think that the diversity of their shareholders' and their customers' political opinions would check this politicization, but the principle remains valid. Contrary to what some activists on both ends (and elsewhere) of the political spectrum think, free speech is important. But we also have the right, following Brittan and other classical liberal thinkers, to tell corporate officers and shareholders that they are often being naively caught in debates they don't understand and that they are acting against their own interest and that of their customers.

New voting laws / In April, more than 300 corporations, their chief executive officers, and other executives issued with great fanfare a statement against proposed and recently enacted changes in state voting laws, most notably in Georgia. The merit and intent of these changes are debatable, with reasonable and not-so-reasonable arguments being offered both for and against them.

It is noteworthy that these laws are pushed by Republican state governments and that, as pointed out by the *New York Times*, two-thirds of Georgia absentee ballots were cast for Democratic presidential candidate Joe Biden. There is room for thinking that these "publicly minded" politicians are indirectly trying to target the voters who don't vote for the "right" candidates. The issue is partisan and related to Republican Donald Trump's baseless claims of election fraud after his humiliating defeat in the 2020 presidential election. On the other hand, it's doubtful the changes will have much effect on election outcomes, even in especially tight Georgia.

So, should corporations and CEOs get involved in this issue?

The April declaration began: "We stand for democracy. A government of the people, by the people" (strangely omitting "for the people," the third leg of the consecrated formula). The short declaration implies that "the right to vote for all of us" is currently in peril. "We all should feel a responsibility," it states, "to oppose any discriminatory legislation or measures that restrict or prevent any eligible voter from having an equal and fair opportunity to cast a ballot."

Corporate officers and shareholders are often naively caught in debates they don't understand and act against their own interests and that of their customers.

But what exactly is "an equal and fair opportunity to cast a ballot"? Obviously, it implies that no violence is used to prevent certain voters from voting, but this goal was reached decades ago. If the goal is for every voter to bear the exact same cost in terms of time and information gathering, it is unrealistic and superfluous: Individuals who earn more have a higher opportunity cost of voting. It takes time not only to go to the voting booth—and to queue there—or even to fill and return the absentee ballot, but also and more importantly to obtain and understand the candidates' platforms (or lack thereof) so as to not vote blind. The cost of voting is thus, and it cannot be otherwise ceteris paribus, higher for a middle-class voter—and higher still for a wealthy voter—than for a low-income or unemployed person.

"Who in their right mind would say that they want legislation that will limit people's ability to vote?" asked one of the main coordinators of the statement, Kenneth Chenault, former CEO of American Express. But there will always be limits on people's ability to vote, so the question is, in what degree? Should people be paid to vote and brought to the polling place in limousines? There is a good argument that somebody who does not want to spend any effort voting (like one-third of the American electorate) should not be pushed too hard to vote. More radically, Georgetown University philosopher Jason Brennan has presented a serious argument that uninformed voters should not vote. (See "Power to the Knowers!" Spring 2017.)

There is a good chance that our progressive CEOs haven't thought much about these issues. They are too busy and focused on their and their companies' self-interest. Or, as Brittan wrote, "Businessmen are paid to operate the system rather than understand or expound it."

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Walmart is one company that did not sign the statement. Its CEO, Doug McMillon, wisely declared, "We are not in the business of partisan politics." Harvey Golub, another former American Express CEO, correctly argued that "at the end of the day, corporations and the idea of capitalism will be in lower repute" from such involvement. "We're under no illusions that big business is a reliable friend of capitalism," noted an April 15 editorial in the *Wall Street Journal*.

Discriminating against customers / The April declaration is only one example of a general politicization of corporations. Many firms now try to push their professed political opinions on their customers. Facebook and Twitter have erased posts or marked them controversial, notably about the COVID pandemic and what "the science" says—but never mind what economic science says. They have deleted accounts. Although they may have had good reasons to do so in certain cases, their so-called "community standards" appear to be what they and their friends in the tech sector consider politically acceptable opinions; they are following the standards of one specific community or faction within society.

The phenomenon is fascinating. Corporations proudly take a stand against some of their customers' political opinions. Many explicitly advertise their woke conversion. Former diplomat Dave Seminara wrote in the *Wall Street Journal:*

> When I look around my house, I see many products from woke companies that want me to know how strongly they disagree with me on pretty much every issue of the day. … It doesn't seem like too much to ask that the businesses I patronize refrain from actively and loudly despising me.

PayPal certainly has—and should have—the right to prevent its customers from using their accounts to purchase guns or ammunition, a right protected (against government) by the Second Amendment of the Constitution. I would also defend the company's right to discriminate against its customers who exercise their First Amendment rights. But I would recommend that PayPal's executives read Brittan's book as well as Milton Friedman's 1962 *Capitalism and Freedom* to appreciate the importance of separating politics from the market. It's urgent.

This politicization of business contributes to alienating a sizeable part of the American public from "the community." This discrimination is not a recipe for social peace nor, of course, for liberty.

The supposed corporate goal of "meeting the needs of society"—as some say to justify this trend—is impossible as long as not all the individuals in society have the same needs and preferences. The only thing we can hope for—and it is the secret of prosperity—is that free and competitive businesses try to meet the demands of their customers.

The politicization of business contributes to alienating a sizeable part of the American public from "the community," which does not contribute to social peace or liberty.

Separation of politics and economics / One major advantage of the separation of economic and political power is that their union facilitates government authoritarianism. As long as businesses offer their goods and services to whomever is willing to pay the market price, and as long as they hire the talents they want at the market rate, individuals who disagree with majority opinions and government preaching are free to earn a living and live as they want.

Your fuel oil delivery man is not interested in your political opinions but only in your check. That is not a bug but a feature of capitalism. Friedman emphasized the idea that political freedom in the sense of individual rights is only possible if the economy is free from government and politics.

In many ways, the benefits of economic freedom were illustrated *a contrario* by the Jim Crow era. Subjected to government discrimination, black people would have been even more oppressed if free enterprise—businesses selling them food, motel accommodation, manufactured goods, etc.—had been more generally prevented from serving their needs. Railroads in the South were willing to serve blacks as well as whites until state governments forced them to segregate their cars. *The Negro Motorist Green-Book*, which was published annually from 1936 to 1967, informed black travelers where they would be welcome in hotels, restaurants, gas stations, or even public beaches and picnic places, instead of being harassed and humiliated (or worse). Imagine if all private businesses had been state corporations!

In *Capitalism and Freedom*, Friedman taught us that, all else equal, a private business in a free and competitive market will discriminate less than a government or public organization. This idea was reinforced by Gary Becker, also a Nobel economics laureate, who explained that a competitive private business must generally pay the cost of its discrimination against customers in the form of lower sales and against employees in the form of higher labor costs. In contrast, a public organization passes on the cost of its discrimination to the taxpayer. The majority of taxpayers or a winning minority among them may be happy to finance the discrimination they like, but dissenting taxpayers are forced to pay for it. In other words, an existing "taste for discrimination" (in Becker's terms) in the public is better enforced by government than by competitive businesses.

In his 2019 book *A Republic of Equals*, economist Jonathan Rothwell estimates that without various "barriers to free exchange" approved, promoted, and enforced by governments in the United States, "inequality in income would fall by half." The real estate market is a case in point. From the 1920s through the

New Deal and until the 1960s, the federal government actively encouraged housing discrimination against blacks by building or financing segregated housing and promoting segregated zoning guidelines, notably through "red-lining"—that is, the Federal Housing Administration giving poor credit ratings to non-segregated neighborhoods. (See "The One-Percenter State," Spring 2020.)

Courting the mob / Some people seem to believe that "nice" governments, together with politicized and obedient corporations, can do a lot of good—although many of the same people continuously criticize governments and corporations as they operate in reality. But even if Nirvana were within reach, social currents can shift suddenly, and politicized corporations may in the future support very different political ideas. Popular fads change with time, and it is always useful to have free businesses that will continue to cater to minorities even if the government does not.

Another tragic aspect of the current evolution is that today's corporations that support current popular causes probably do so in the vain hope and tragic illusion of avoiding more criticism, regulation, and control. It is far more likely that the opposite will happen. Once firms are perceived as pursuing "public" missions, they will be regulated as the effective extensions of government that they will have become. They will lose their economic freedom, just like their customers. *R*

On the Minimum Wage, Both Sides Have Their Economics Wrong

BY RICHARD B. MCKENZIE

The Biden administration has proposed raising the federal hourly minimum wage in annual steps from $7.25 to $15 by 2025. Supporters and critics of this idea have staked out their usual policy positions on the labor-market effects of raising the wage. Yet both sides are misguided in their assessments because they misunderstand the economics of labor markets for menial/low-wage workers. Their big mistake is their conclusion that the proposed increase will make a substantial majority of covered workers better off. The opposite is more likely, mainly because covered workers will lose employer-based and government-based benefits that can be expected to largely offset their money-wage gains.

Standard positions / Critics of minimum wage hikes have pointed to the mountain of econometric studies undertaken over the last half-century that show tens if not hundreds of thousands of job losses among covered low-wage workers from even a modest—say, 10%—minimum wage increase.

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In making their statistical arguments, critics have inadvertently fortified proponents' case. Proponents have realized that the critics' estimated job losses across scores of studies are only a small percentage of the covered jobs—no more than 3%—with many studies reporting losses of under 1%. This has enabled minimum wage proponents to stress that for a 10% wage hike, more than 97% of the covered workers (which can easily be in the millions) will not only keep their jobs but get a raise.

Accordingly, the Congressional Budget Office (CBO) reported in early 2021 that the Biden proposal will give a pay raise to 27 million covered workers while killing off 1.4 million low-wage jobs, which represents only 5% of the total covered jobs. Given the proposed 107% minimum wage increase, this is in line with the findings of past studies.

The proponents can then ask the obvious policy question: How else can the federal government give so many low-wage workers an income boost and raise so many out of poverty (nearly a million Americans, according to the CBO) with so little economic damage? Good point—but only if the proponents have their labor-market economics right.

Increased work demands, cut benefits / Unfortunately, many minimum wage proponents and critics alike have long misconstrued how competitive low-wage labor markets work under wage mandates. Both sides seem to understand that those workers receive low wages because of competitive labor-market pressures they face. But both sides also seem to overlook the fact that those competitive pressures on both workers and employers don't evaporate with mandated wage hikes. The pressures are simply redirected toward non-money forms of worker compensation.

As economists have conventionally argued, a minimum wage hike will price some low-wage workers out of the market, while attracting relatively more productive workers to the covered labor markets. The result? The emergence of a "labor-market surplus," which gives employers an ability to replace less-productive workers with automated equipment and processes and with the more productive workers attracted to the covered labor market (increasing job losses among original workers in the covered markets).

Employers need not stop there. With more job applicants than jobs, employers

BRIEFLY NOTED

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can do what comes naturally, especially under competitive product and labor-market pressures: cut or eliminate whatever fringe benefits they provide (say, discounts on merchandise, full-time work, training, minimal health benefits, flexible scheduling, working conditions, and on-the-job treatment). In addition, employers can increase work demands on covered workers, speeding up their assembly lines or otherwise requiring more output per hour for continued employment. With the emergence of the labor-market surplus, workers must concede because they can be easily replaced. Moreover, as noted, employers will be pressed by competitors to check their labor costs in whatever ways they can to stay competitive on the prices of their products.

Econometric studies have found the predicted effects: Workers covered by the hikes are provided less on-the-job training and health-care coverage, worse working conditions, and fewer opportunities for full-time jobs. Many employees have been asked to do the same work in fewer hours and with fewer coworkers. This means that the job-loss percentages have been minor, but not because the demand for low-wage workers is "inelastic," as some minimum wage proponents and opponents have contended. Rather, employers have been able to largely offset modest money-wage hikes through reductions in the cost of fringe benefits and with increased revenues from greater work demands and greater worker productivity than otherwise.

That is, a $1 per hour money-wage increase might only lead to, say, a 10¢ increase in employers' total labor cost per hour. On balance, jobs will still be lost, but only by a small percentage, in line *not* with the increase in the minimum-*money*-wage increase, but with the modest increase in employers' net labor costs per hour.

And it should be noted that claims that low-wage workers' labor-market demand is highly "inelastic" is problematic at best. A highly inelastic demand means that employers must have few substitutes for low-wage workers. The fact is that low-wage workers earn what they do because (in addition to low-wage workers being relatively unproductive), employers have many substitutes—not the least of which are more productive workers at higher market wages, automated machines and processes, and outsourced production to other firms in lower-wage areas of the country and world.

Lost compensation / Moreover, with a money-wage increase, many retained workers are, on balance, made worse off by forced wage hikes, contrary to what both proponents and critics suggest. Employers provide fringe benefits for a simple reason: they attract more workers at lower labor costs from added benefits and relaxed work demands than would be the case with a commensurate money-wage increase. Also, their workers value the benefits and relaxed work demands more than any resulting money-wage-rate loss that can be expected when jobs are made more attractive. More attractive jobs can lead to an influx of added workers who will drive the money-wage-rate down. If that were not the case, employers would not offer the fringes or lower work demands in the first place.

With an increase in the minimum-money-wage and resulting reduced fringes and greater work demands, the analysis reverses: the value of workers' lost fringes and the lost value from greater work demands will be greater than their mandated money-wage hike. (For example, a $1 minimum wage hike can lead to $1.10 in lost non-money compensation.).

Econometric studies have uncovered these types of worker loss. North Carolina State University labor economist Walter Wessels found that with a 10% increase in the minimum wage, workers experience a 12% reduction in the overall value of their total compensation packages. In addition, if a minimum wage hike truly made workers better off on balance, then the "quit rate" among covered workers should fall, but Wessel found that it increased.

Increased taxes and reduced government benefits / The foregoing conventional lines of minimum wage analysis overlook the fact that many low-wage workers receive various combinations of government welfare benefits that are "means tested," or tied to their earned income. This means that hikes in workers' money income from a higher minimum wage can be expected to lower their welfare benefits—to a surprising extent!

If the federal minimum wage is raised from $7.25 to $15 an hour (meaning that annual income will rise from $15,080 to $31,200 for the typical full-time worker), those workers will pay more in income and sales taxes, and lose a variety of welfare benefits such as food stamps, child-care subsidies, health care, and rental assistance (among many other programs). Craig Richardson of Winston-Salem State University estimates that the so-called "implicit marginal tax rate" for welfare recipients earning less than $38,000 annually can be as high as 95%, which means that for each additional $1,000 in money income from a higher minimum wage, low-wage workers can lose as much as $950 in welfare benefits. Even worse, those implicit tax rates can spike to 1,400% (the so-called "welfare cliff") when an individual's annual earnings rise above $43,000.

Richardson recently developed an online "Social Benefits Calculator" (www.forsythfutures.org/benefits-calculator-intro/) to compute welfare benefit losses from money-income increases for North Carolina residents. Using that calculator, he estimated the effects Biden's proposed minimum wage increase would have for a single mother with two children. If she works full time, her annual money income would rise by $16,120 but she would lose $11,502 in annual welfare benefits and her taxes would rise by $3,178. Her net gain in total annual benefits (added money income minus lost welfare benefits and added taxes) would be just $1,435. Her implicit marginal tax rate on the added minimum wage income would be 91.1%. Her reduced benefits and higher taxes would mean that her hourly $7.75 minimum wage increase would largely evaporate, falling to just 69¢, which would surely dampen her incentive to take a minimum wage job even at $15 an hour.

Backers of the $15 federal minimum wage stress how much low-income families with members now making the current wage of $7.25 need and deserve a pay raise. Ironically, the proposed wage would do very little to increase the net spendable incomes of many low-income families with multiple streams of welfare benefits. The increase would, however, increase the spendable incomes of much-higher-income families that are not eligible for welfare programs, with members (say, teenagers) who would receive the proposed $15 an hour.

The proposed increase would do little to raise the net spendable incomes of many low-wage families but would boost the incomes of much-higher-income families.

Conclusion / The Biden administration's envisioned doubling of the minimum wage over four years would be far above the "modest" increases of the past, which have been the subject of previous econometric work. This means that the job losses from the Biden proposal could be substantially greater than what was experienced in the past, given that employers may not be able to lower fringe benefits and raise work demands enough to offset a substantial portion of the minimum wage increase.

My University of California, Irvine colleagues David Neumark and Peter Shirley have estimated that Biden's proposal could reduce covered jobs by 16%. But don't count on the reduction being that large. Past marginal increases in the minimum wage may not apply to Biden's proposed "structural" increase.

Also, given that the federal minimum wage has not risen since 2009, employers of low-wage workers could have, in the interim, been adding benefits and reducing work demands (in many unnoticed ways) to attract and retain workers and remain competitive in their labor markets. Those workers' non-money-wage gains could now be reversed when the minimum wage goes to $15 an hour, lowering the net predicted job losses but also leaving retained workers less well off (and maybe worse off) than proponents and critics now imagine. This is especially true for many low-wage workers who have been able to tap several welfare programs because of their low incomes.

Finally, this should dampen the enthusiasm of those who see the proposed hike as a way to get low-wage workers off "the dole." Because of the high implicit marginal tax rates, many current welfare recipients will be little better off because of the increase. And as the CBO has recognized, a $15 minimum wage can drive up the labor costs and prices in health care and childcare, causing many American low-wage and high-wage workers to lose health care and childcare benefits. *R*

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