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The Housing Construction Morass

BY IKE BRANNON

It is hard to say objectively how much society should invest in housing. Economists do not conceptualize a standard ratio of housing units to population. Such a metric—if it existed—would crucially depend on family sizes, and family size depends on the cost and availability of housing, so there is an interdependence at work.

For instance, in places where housing is costly, children leave home at later ages, divorced couples are more likely to cohabitate, and grandmothers are more likely to live with their offspring. As our economy grows wealthier, we spend money on an increasing variety of goods, and one of those is more housing: in essence, we use our affluence to get away from our family.

However, it is hard to look at the post–Great Recession economy and not conclude that something is amiss in the housing market, and that our aggregate output of housing may be suboptimal. In the last dozen years, we have built much less new housing than in the decades before the 2008 housing market collapse. In fact, we have to go back to 1966, when the U.S. population was two-thirds what it is today, to find a year when we were adding as little new housing to our economy outside of a recession as has occurred each year since the Great Recession.

The depth and length of the decline in housing construction in the last dozen years cannot merely be attributed to a snap-back to conditions prior to the housing investment bubble in the early 2000s or a dissipation of residential construction overhang. In the last decade, the average number of new housing starts has averaged just two-thirds of the 1992–2007 average.

In other words, a fundamental change occurred after 2008 that has created a new regime for housing construction. It is worth investigating the factors that have caused this change.

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Constraining supply / There are myriad hurdles that have added to the cost and difficulty of building a new home. First, people are increasingly moving to places where it is costly to create new housing. In most cases, local government regulations create barriers to construction, and these locales show little interest in making anything other than cosmetic reforms. Of course, politicians in major metropolitan areas love to talk about reducing economic inequality and improving their low-income constituents' access to affordable housing. But talk is cheap and housing is not.

Locales show little interest in anything but cosmetic reform, though politicians love to talk about improving affordable housing. Talk is cheap and housing is not.

State governments could remove those local obstacles, but they seldom do. For instance, California's modest recent attempt to override local zoning rules to allow dense housing near mass transit stops, SB 827, suffered an ignominious political death in committee. Congress has shown little appetite for involving itself in this battle as well.

The regulatory costs of constructing a new home have increased quite a bit over the past decade. The National Association of Home Builders estimates regulatory compliance costs constitute one-fourth of the cost of a new home. For instance, the Obama administration increased the energy efficiency requirements for new homes, raising their construction costs, although supporters argue that such mandated investments are cost-effective for homeowners in the long run. Attempts to reform a dysfunctional flood insurance program by forcing more homeowners to pay something close to an actuarially fair premium also boosted home construction costs slightly, although Congress quickly rescinded most of those reforms under pressure from (wealthy) constituents

Obtaining financing for new homes became more difficult immediately after the financial crisis. Banks worried that selling their loans could be problematic after the government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac were put in conservatorship and felt compelled to be strict about the loans they obtained. Nonconforming loans (that is, loans that exceed the maximum size the GSEs will purchase) became even more difficult to obtain for a time, although that market eventually returned to normal. Credit standards to obtain conforming loans remain somewhat elevated to this day.

The limbo of Fannie and Freddie has exacerbated the financing issues, and it is unclear whether it will get resolved anytime soon. Their regulator, the Federal Home Financing Agency, has proposed a rule that would end the "net worth sweep" of sending the GSEs' profits to the U.S. Treasury and instead allow each to accumulate capital to better withstand a downturn. Many believe that this would increase the availability of mortgage financing for more middle-class and first-time homebuyers.

The federal government does little to encourage homeownership, although it does forgo a lot of tax revenue from a select group of homeowners ostensibly to do so. Deductions for mortgage interest and state and local taxes only confer benefits to those taxpayers who are wealthy enough to itemize, which is now just 10% of the population. Before the Tax Cuts and Jobs Act of 2017 increased the standard deduction, 30% of taxpayers availed themselves of those deductions, but—again—those truly on the cusp of affording a home did not benefit because they were unlikely to itemize. Besides, economists believe that these tax breaks are already capitalized into the prices of homes, resulting in no net incentive for homebuying.

Numerous states operate GSEs of their own that provide modest subsidies targeted to middle-income, first-time homebuyers. For instance, the Wisconsin Housing and Economic Development authority offers first-time homebuyers with an income under about $95,000 (it varies slightly across counties) and a credit score above 610 a rate-competitive mortgage with reduced fees.

Democratic presidential nominee Joe Biden has proposed a $15,000 tax credit for first-time homebuyers. The Obama administration implemented a $7,500 credit for 2009 as part of its effort to stabilize the housing market following the bubble collapse. The Obama measure's efficacy remains a matter of debate: the nearly frozen credit markets at the time and the moribund economy confounded its effect.

The cost of building fewer homes / The decline in new housing construction hurts our economy in two ways. For starters, home construction has traditionally been a key source of jobs for semi-skilled men. The National Federation of Independent Business estimates that each new home adds roughly three jobs to the economy.

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Before the pandemic, there were 7 million men aged 25–54 who were not participating in the labor market despite the low unemployment rate. Few in that cohort were in school, retired, or disabled. The dearth of homebuilding has no doubt contributed to this labor force participation decline.

The lack of home construction further reduces employment in this cohort by limiting the migration of workers to new locales where jobs are available. Before the pandemic, a disproportionate number of new jobs were in major metropolitan areas along the coasts, where housing costs are high mainly because local regulations inhibit construction.

Persistent high housing costs deter some job seekers from moving to those hot job markets. Instead, they pursue lower-productivity—and thus lower-wage—jobs in cities with more reasonable housing costs or remain unemployed (or underemployed) in their present community. Chang-Tai Hsieh and Enrico Morretti have estimated that gross domestic product would be nearly 9% higher if we merely allowed plentiful new housing to be built in New York and San Francisco/San Jose. ("Housing Constraints and Spatial Misallocation," *American Economic Journal: Macroeconomics* 11[2]: 1–39 [2019].)

The National Association of Home Builders found that housing contributed 4.5–5.9% of GDP each year between 1980 and 2007. Since the Great Recession, that proportion has been 2.5–3.4%, or more than 1 percentage point less than at any point during the previous quarter century. If we were to include the displacement effect from reduced home construction, that number would be even higher.

Improving upon the status quo / It is unlikely that the federal government will override these state and local building regulations. And there is no reason to think that places like California, New York City, or San Francisco will pursue serious reform on their own. Federal lawmakers' desire to repeal the caps for the deductibility of state and local taxes and mortgage interest—making those tax provisions more regressive—as well as continuing transferring GSE profits to the Treasury manifest a disinterest in taking practical steps to incentivize homeownership. Political fights about housing these days often devolve into issues that have little to do with creating new housing.

Some aver that the pandemic may change people's work habits and preferences in favor of telecommuting and workplace decentralization, and that more skilled workers and young families will be able to find professional success and family stability in smaller, less expensive

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communities. But it is hard to forecast preferences in a post-COVID-19 world. People still moved to London after the Great Plague, after all.

The skyrocketing public debt may soon force a future president and Congress to end deductions for mortgage interest and state and local taxes. Were that to happen, it is likely that lawmakers would provide some modest alternative to encourage homeownership, provided it cost a fraction of the revenue lost to the deductions. It would not be hard to create a new incentive that would improve upon the status quo. A modest credit for first-time homebuyers would be the likely alternative, perhaps limited to states and localities that do not overly restrict development.

Reform of Fannie Mae and Freddie Mac could also modestly increase homeownership if they do emerge from conservatorship with more freedom. Of course, the GSEs' determination to please both shareholders and political masters is what forced them into conservatorship in 2008, an occurrence that remains fresh in the minds of many politicians. That memory may preclude serious reform.

Many of the arguments typically trotted out in support of measures to encourage housing—people who own homes are more civic minded, save more money, and invest more in their community—tend to conflate cause and effect. However, a market where a variety of government forces have conspired to significantly inhibit home construction does impose a cost on society.

The ultimate cost of a perpetually reduced level of new home construction is that young families will spend more of their income on a home, wait longer before becoming homeowners—and having children—and a higher proportion will find it financially or practically impossible to move to high-productivity, higher-cost communities. While there may be an argument for geographically diversifying America's skilled workforce, doing so by keeping home prices high is undoubtedly not a cost-efficient way to achieve that goal. *R*

OSHA Shaming and the Rule of Law

BY ARTHUR G. SAPPER

Cass Sunstein, a Harvard law professor and former official in the Obama administration, recently endorsed the Occupational Safety and Health Administration's policy of "regulation by shaming"—castigating employers in news releases. He urged the Trump administration to fully reinstate it after having relaxed (but not fully abandoned) it from the days of the Obama administration. His sole reason was that a recent statistical study of injury rates showed that the policy "worked."

Yet, Sunstein failed to consider two important questions: Is the policy lawful? And is it moral? The answer to both is no. Instead, the policy undermines the rule of law, the foundation of civilized society.

Regulation by shaming / During the Obama administration, OSHA greatly increased the frequency and intensity of a tactic the agency, without much thought, had used for many years: castigating in press releases employers to whom it had issued citations. The press release would recite with embellishment the citation's allegations, putting the employer through a paper perp walk. It would disparage the employer, often using harsh words not found in the citation and featuring derogatory quotations from OSHA officials. One press release accused a company of having "created a culture that values production and profit over workers safety." Another, after announcing the issuance of citations for non-willful, non-serious *paperwork* violations, accused the employer of "blatant disregard" of regulations; years later, a court dismissed all the charges.

Nearly every OSHA press release uses misleading terminology. For example, many use terms suggestive of criminality, such as "fines" instead of "civil penalties," the term used in the law. Often, they emphasize that violations were alleged to be "serious," a term that in OSHA parlance has a specialized sense so broad as to be nearly meaningless. Nearly all imply that guilt has already been determined. Instead of saying that OSHA was making "allegations," they would speak of "violations" or state that OSHA had made "findings" or had "found" or "determined" something. Similarly, instead of saying that civil penalties had been "proposed" (the term used in the law), they would say that the employer had been "penalized," or "fined," or "ordered to pay" penalties. Only at their end would they dimly allude to the employer's right to contest, and even then in a misleading way: it would say the employer could contest the "findings."

It gets worse. Sometimes, press releases would make allegations or refer to events not in the citation, and thus that the employer had no way to challenge in court. Press releases have stated that violations were not only "willful" (which can be challenged) but "egregious" (which cannot). Some have announced that OSHA had placed the employer on its list of "Severe Violators," a scarlet letter invented by OSHA that, again, lacks any recognized legal channel by which it can be challenged. Some releases have claimed that alleged violations were the cause of a particular injury; one headline stated, "Training could have prevented … [the] worker's death." As OSHA well knows, causation may never be tried or determined in court because it is not a necessary element of an OSHA violation. Press releases have even

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mentioned that the employer had been issued not a citation but a so-called "hazard alert letter," which, unlike a citation, cannot be contested in court.

Some press releases have attempted to smear the innocent by implying guilt through association. For example, they have referred not merely to the cited employer, but to its corporate parent ("Smith Steel, part of the Smith Family of Companies") even though the parent had not been issued the citation. (All names here are fictitious substitutes.) They have libeled customers of cited employers, suggesting that their demanding supply requirements were responsible for injuries. One release stated that the production targets of two named customers were "so high" that a manufacturer "cut corners on safety, at the expense of workers' lives and limbs." The customers cannot legally challenge these claims because they had not received citations.

Press releases have also sometimes attempted to damage the employer's business, stating that, for example, "Its products are sold under the Acme, Sentry, Prima, and Facto brands to laundromats." One release's headline stated, "OSHA finds multiple safety issues at plant which supplies major auto brands"; the body of the release identified by name the charged employer's customers. Some press releases have appealed to popular biases, such as those against foreign corporations. One news release stated, "Based in Ireland, Smith provides food and beverage products to consumers in 140 countries."

Some press releases resort to demagoguery. Some have touted the number of times that a company has been inspected, as if to imply wrongdoing from the number of inspections. This is almost always misleading, as the inspection rate may just reflect the employer's size; for example, one headline stated that a company "has been inspected 42 times since 2007." That employer not only had almost 900 locations around the country but, of the 42 inspections mentioned, 20 did not result in citations. Some releases mention that the employer required OSHA to obtain an inspection warrant, ignoring that employers have a constitutional right to do so. Often, releases make lurid appeals to emotion. "John Doe's first day at work was also his last."; "Joan Smith was making plans for her wedding when ...."; "If Jones Corporation had not ignored the maritime industry's most dangerous hazard, Jim Page might be alive today."

Though OSHA has long engaged in this practice, the Obama administration supercharged it, even giving it a name: "regulation by shaming." It seems hard to believe that a government official could be so brazen as to openly label such a policy, but that's what then-head of OSHA David Michaels did. In a "vision statement," he asserted that "'regulation by shaming' may be the most effective means for OSHA to encourage elimination of life-threatening hazards." In a speech to OSHA employees, he maintained that "we will continue to practice 'regulation by shaming' ... by issuing news releases that name employers [and] expose their failings." He also called press releases a law "enforcement" technique, one of the "arrows in our quiver." "I am a big fan of shaming," he crowed.

It was thus no surprise that Michaels allowed himself to be quoted in press releases, such as saying that one employer's action "shows a complete disregard for worker safety." Nor did he shy from demagoguery; one press release began with his citing the "146 workers [who] died in the Triangle Shirtwaist Factory fire." And in a 2013 speech, he claimed that OSHA will name in press releases persons it deems "responsible" for violations even if OSHA lacks authority to prosecute them.

One former high OSHA official told me that neither he nor other OSHA officials with whom he worked on press releases had ever considered the lawfulness or morality of their actions. That shows.

What's wrong with being effective? / Sunstein assures us that regulation by shaming is effective. He may be right. Corporations consider their good names a corporate asset, a key to customer good will and therefore sales. So, regulation by shaming may well be as effective as he claims—but then, policemen routinely clubbing street corner denizens with nightsticks may well be effective in deterring loitering.

In a civilized society, however, we don't let policemen decide whom to punish, no matter how effective that might be. In a society governed by law, punishment comes after trial, not before. The accused first has the right to be heard and present evidence, and the facts are found at trial before a neutral and detached judge. It is that judge, not the prosecutor, who decides on punishment, and the judge is confined to selecting from among those punishments authorized by law. But Congress never authorized the use of adverse publicity as an OSHA sanction, not even by the specialized impartial adjudicative tribunal it established to rule on citations. The only sanctions it authorized were monetary and injunctive, and OSHA's only role was to *propose* those sanctions, not impose them.

There are civilized countries that have imposed public shaming as a punishment, and Sunstein and OSHA may profit by their example. English statutes once permitted courts to order publication of the names of those convicted of selling adulterated drugs, food, or drink, or violating a weights and measures law. Note the word "convicted."

Sunstein recently stated, however, that agencies should engage in regulation by shaming "not to add to existing punishments, but to reduce the likelihood of future violations by others." That is double-talk. The very definition of "punishment" includes the imposition of "shame ... for ... violation[s]," according to *Webster's Third International Dictionary*. The imposition of adverse consequences to discourage conduct is a "sanction" under the federal Administrative Procedure Act, which requires that an agency must have been given legal authority to inflict it. The former high OSHA official to whom I spoke about OSHA press releases went right to the heart of the matter: "Of course they were intended to punish."

Courts have had little trouble seeing

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through similar verbal smoke screens. A federal court called one agency's campaign of "public shaming of banks" "regulation through coercive power." A Texas court barred an agency from imposing the label "hazardous employer" as "designed to … coerce" and "deter," "a stick to compel private employers to change their behavior." So, let us have no more pious sophistries about how a campaign of regulation by shaming is not a form of punishment. Let us have agencies do what they expect employers to do: obey the law.

That would not be difficult. The Administrative Conference of the United States recommended back in 1973 that "all adverse agency publicity should be factual in content and accurate in description. Disparaging terminology should be avoided." There are agencies that do just that in their press releases. There is no reason why OSHA could not issue strictly factual press releases describing in neutral language the allegations of a citation or informing the public of information about dangerous equipment or chemicals without disparaging the manufacturer.

Why doesn't OSHA stop? / The Trump administration cut back on the harshness and frequency of punitive press releases, but they are still being issued. And if a Democrat captures the White House this fall, the old policy will likely come roaring back; union officials and others, such as Sunstein, are already urging just that.

Complaints about regulation by shaming have gone nearly unheeded. OSHA officials and their lawyers have steadfastly refused to comment on it, even when the policy is called illegal and immoral to their faces. OSHA's lawyers evidently believe that there is no clear way by which a press release can be legally challenged. The situation very much calls to mind the observation by the great legal scholar Leon Green in his 1954 article "Public Destruction of Private Reputation—A Remedy": "There is nothing so calculated to make officials and other men disdainful of the rights of their fellow men as the absence of accountability." R

Facilitating Interstate Telemedicine

BY SHIRLEY SVORNY

COVID-related concerns have led to a sharp climb in the use of telemedicine. Increased investment in telemedicine-related equipment, discovery of its convenience, and familiarity with its process make it all but certain that telemedicine will play a permanent, substantive role in U.S. health care going forward. Yet, state licensing laws impose a barrier to the practice of telemedicine across state lines. Imagine building a highway system throughout the country and then not letting anyone use it for interstate travel.

In the United States, for licensing and reimbursement, state laws define the site of care of a physician–patient interaction as being at the location of the patient. This means that physicians may not offer telemedicine services to patients in other states without a license to practice in those states. Many physicians are deterred by the time and expense involved in gaining those additional licenses and because it is challenging to adhere to multiple state-specific regulations and policies.

This limits access to care. This is especially true in rural communities, for patients with rare diseases who would benefit from access to specialists in other states, and for patients with serious illnesses who are too poor or fragile to travel.

In the wake of COVID-19, 18 states have waived restrictions on the cross-state practice of telemedicine. These waivers apply to out-of-state physicians and other clinicians in good standing in their home states, but the waivers are to last only for the duration of the pandemic. Most of the remaining states have also adopted temporary waivers, but they require out-of-state physicians to register (eight states), apply for a temporary medical license or permit (17 states), or have an association with an in-state provider (five states). To accommodate those actions, the Centers for Medicare and Medicaid Services temporarily waived requirements that out-of-state practitioners be licensed in the state where they are providing services.

On June 19, Senators Marsha Blackburn (R–TN) and Ted Cruz (R–TX) introduced a bill that would allow licensed providers to use telehealth to treat patients in any state based on their home state license—ending 180 days after the end of the national emergency. In Missouri, Gov. Mike Parson justified his state's decision to temporarily allow out-of-state physicians to offer care in Missouri on the basis that it is important to "provide as much access to care as possible for the sake of all Missourians." The irony is that it is *always* important to provide as much cost-effective access to care as possible.

Moving telemedicine forward / The telemedicine lobby hopes to garner support for legislation that would make the current temporary COVID-19-related Medicare telemedicine waivers permanent. Its primary interest is in cementing the waivers that allow payment for services provided to patients in their home and to expand coverage to beneficiaries outside rural areas.

Taxpayers have invested heavily in telemedicine. The Federal Communications Commission Rural Health Care Program allocates a half-billion dollars annually to support telecommunications and broadband services. The Federal Office of Rural Health Policy funds telemedicine-related technical assistance programs and research

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grants. The Coronavirus Aid, Relief and Economic Security Act included $200 million to reimburse costs of connected care services put in place in response to the COVID-19 pandemic.

Policymaking and license portability / When it comes to medical licensing, disorganized and disinterested voters have been no match for the physician and hospital lobbies. State-level barriers to the cross-state practice of telemedicine reflect this imbalance. When telemedicine is precluded and patients' only option is to travel to access care, local providers face less competition. Also, restrictions on interstate telemedicine give local providers increased leverage in negotiating payments with health insurers.

It is not uncommon for government actions to impede innovation and competition. Consider the regulations and restrictions placed on Uber and Lyft as a result of lobbying efforts by existing taxi companies.

Pushback against license portability also comes from state medical boards. The groups' national association, the Federation of State Medical Boards, proposed a move to license portability, but its member boards opposed it. Medical boards generate revenues when physicians are forced to seek multiple licenses, but that is surely not a good enough reason to derail a significant increase in access to care. How odd that these taxpayer-funded state agencies oppose an efficient means of providing health care.

With COVID-19, the number of deaths is posted daily on multiple media outlets. This may make it harder for legislators to acquiesce to self-interested efforts to limit access to care. When media outlets reported on "fatal waits" at Veterans Administration hospitals in 2018, the VA chose to set aside state licensing laws, allowing any VA doctor to provide care in any state.

A prescription for Congress / Congress can promote interstate telemedicine by establishing the site of care of a physician–patient interaction as that of the physician rather than the patient. Physicians would be allowed to provide care based on their home-state license to any patient across the country via telemedicine. Many patients already drive or fly to another state to get care, so this would be just another form of these doctor–patient interstate relationships.

Congress took a somewhat similar action when it eliminated restrictions on interstate banking in 1994. The Riegle–Neal Interstate Banking and Branching Efficiency Act invalidated state laws that precluded interstate activity. The elimination of barriers led to gains in banking efficiency, employment growth, and economic growth. Similarly, increased competition resulting from access to distant telemedicine providers will improve the efficiency of the health care sector.

It is imperative that Congress act quickly to do this. Continued uncertainty will deter investments in telemedicine. Economists have made this point about uncertainty and investment in general. Twenty-nine senators signed a June 15 letter authored by Brian Schatz (D–HI) that points out that continued investment in telemedicine requires a clear statement that indicates the long-term potential.

The train has left the station / Consulting firm McKinsey and Co. expects telemedicine to be huge post-COVID-19. They offer a cautionary caveat that "actions taken by healthcare leaders today will determine if the full potential of telehealth is realized after the crisis has passed." So true.

State licensing requirements are nearly identical. In the United States, oversight by hospitals, malpractice insurers, health insurers, and other (liable) providers offers ongoing protection for patients. Congressional action to define the site of care as that of the physician would result in access to care that existing state laws preclude. *R*

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Eliminating Rebates in Medicare Part D Will Not Reduce Drug Prices

BY ERIC V. SCHLECHT

On July 24, President Trump issued four executive orders intended to reduce drug prices. One of them targets pharmacy benefit managers (PBMs) by prohibiting drug company rebates arranged by PBMs representing insurers under Medicare Part D. The order is the latest step in a years-long battle between the Trump administration and PBMs.

The Trump administration believes PBMs are unnecessary and costly middlemen between pharmaceutical companies and consumers. This belief reflects a common fallacy and risks doing more harm than good to consumers and the public fisc. Moreover, by narrowly focusing on PBMs, the administration ignores the large structural problems that are driving up drug prices. In fact, PBMs not only add value by negotiating lower prices for health care providers, they also play an integral role in constraining government expenditures under Medicare Part D.

Part D's perverse incentive / PBMs foster free-market competition within Medicare Part D by negotiating with drug companies. The goal of these negotiations is explicitly to reduce the net price paid for pharmaceuticals by program enrollees and the government. PBMs also do this for the privately insured, thereby helping health plan sponsors and their beneficiaries save money.

In its current form, Medicare Part D seems almost as if it were designed to encourage high list prices for brand-name drugs. Part D consists of four payment stages for enrollees:

- The deductible stage, in which beneficiaries pay 100% of the cost of drugs. The deductible is currently capped at $435, although some plans provide a lower amount or even a $0 deductible.
- The "initial coverage" stage, in which insurers pay for some of the costs of covered drugs. Depending on the plan, patients pay a copayment (a set amount per drug) or coinsurance (a percentage of the cost of drugs).
- The "coverage gap" stage, during which the drug plan is responsible for only 5% of brand-name drug costs and the patients and drug manufacturers shoulder the remainder of the costs (more on that below).
- Finally, there is the "catastrophic coverage" stage. Once a patient's out-of-pocket costs reach a certain threshold ($6,350 in 2020), the government pays 80% of covered brand-name drug costs, the drug plan pays 15%, and the patient pays only 5%.

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Obviously, drug makers have an incentive to reduce their liability in the coverage gap stage. They do this by charging high prices, thereby hastening patients' move to the catastrophic coverage stage in which the government pays nearly the entire amount for their full-price drugs for the rest of the year, regardless of how expensive the drugs in question are.

PBMs improve this problematic structure by protecting patients from these exploitative moves by drug makers. In large part, PBMs work to negotiate rebates that the pharmaceutical companies provide on their list prices to PBMs and insurers. In other words, the list price for drugs may be high, but insurers are often not responsible for the full cost of Part D drugs because they receive rebates on their payments. Those rebate savings are passed onto Medicare Part D patients in the form of lower premiums.

Thus, eliminating the rebates does nothing to reduce Medicare Part D's incentive to drug makers to raise drug prices. The goal of the pharmaceutical companies is still to get patients to the catastrophic coverage phase as fast as possible. Eliminating rebates only

Drug makers have an incentive to charge high prices in the "coverage gap" stage, hastening patients' move to the "catastrophic coverage" stage.

raises premiums, which is something that the Congressional Budget Office has recognized and the Centers for Medicare & Medicaid Services' actuarial analysis of the proposed order has acknowledged.

Blaming the middleman / The larger problem with the administration's order is that its rationale—and the heated rhetoric that accompanied it—is predicated on a fundamentally false assertion that PBMs are a primary cause of high prescription drug prices and that reducing PBMs' ability to operate will magically reduce consumer costs. Only drug companies set the prices for their drugs.

The instinct to blame middlemen is common. But PBMs exist because they deliver value to health plan sponsors such as insurers, unions, and employers and their beneficiaries. PBMs negotiate lower drug prices and provide other useful services such as incentivizing the use of generic drugs and managing high-cost specialty medications, among other things. And they retain nearly none of the money from the rebates that the administration seeks to target to achieve these outcomes.

A 2019 Government Accountability Office report found that PBMs pass through 99.6% of the negotiated rebates to Part D plan sponsors, who use them to lower costs for beneficiaries and the federal government. As a result, tying the hands of PBMs would reduce one of the few effective tools to constrain prices.

If the administration truly wishes to rein in drug costs for seniors, it should work with Congress to restructure the Medicare Part D design to eliminate the perverse incentives that encourage drug companies to push prices higher. Instead of trying to eliminate PBM "middlemen," it should empower them. *R*

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Logic, Economics, and Protectionist Nationalists

BY PIERRE LEMIEUX

On July 1, three Republican lieutenant governors published in *The Hill* an op-ed celebrating the implementation of the United States–Mexico–Canada Agreement (USMCA). The agreement replaced the former North American Free Trade Agreement (NAFTA) and is basically a North American imitation of the free-trade-handicapped, trade-union-friendly, and environment-cheesy Trans-Pacific Partnership that President Trump previously eschewed. (See "Is NAFTA 2.0 Better than Nothing?" Winter 2018–2019.)

Barely a month later, Trump unilaterally reimposed tariffs on some aluminum imported from Canada.

Export plague / For the authors and ghost writers of the *Hill* piece, the only benefit of "free trade" is that it promotes U.S. exports. The USMCA, the authors glowingly wrote, will "increase U.S. annual agricultural exports by $2.2 billion." This crowing claim comes just a few lines after the statement that "agriculture is what puts food on the table, literally and metaphorically." They better take their "metaphorically" very literally because exported agricultural products actually take food *away* from American tables in order to feed foreigners. If agricultural products were not exported, they would flood the American market, push food prices down, and fill national stomachs. But logic is not the protectionist nationalists' strong point.

Neither is their economics. By definition, exports use national resources to produce goods (say, wheat) and services (such as a university education or foreign tourists' accommodation) to be consumed by foreigners. If these goods and services were not consumed by foreigners, they would be consumed by domestic consumers, or the resources used to make them would be released to produce other goods and services that domestic consumers want or inputs that domestic producers could use. You would think that a rational nationalist would consider exports a plague.

Now, consider imports, which by definition use foreign resources to produce goods and services for the benefit of domestic consumers or producers. You would think a nationalist would glowingly welcome imports. (With a bit of mischievousness, one can imagine a national protectionist politician exclaiming, "Let's have our cars manufactured by those Mexican criminals. Mexico will pay!")

Consumers through the wringer / Why do protectionist nationalists believe the exact contrary? Why do they favor exports and blame imports? One reason is that nationalism is typically an emotional creed that cares little for reasoned analysis. Closely related is the fact that economic freedom, which includes the freedom to import, reduces the power and glory of the national state, which is not agreeable either to the left or the right.

Another reason is that the political dice are loaded in favor of national exporters against national consumers. The interests of producers (workers, executives, and capitalists) win over the quantitively more important but more diluted interests of consumers. Consider the example of the tariffs on foreign washing machines decreed by the Trump administration in January 2018.

These tariffs cost about $1.5 billion in higher prices to the 8–10 million American households who buy a washing machine in an average year. This protectionist measure created 1,800 jobs in America (and, of course, boosted the wealth of investors in the domestic washing machine sector). The consumers' cost per job created is thus more than $800,000 per year. The producers will lobby politicians for such protection because each producer has much at stake: a job or profits. Households will do little, and will even ignore the issue, because each one is losing less than $100 when buying a washing machine every 10 years. (Data are from "The Production

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Relocation and Price Effects of US Trade Policy: The Case of Washing Machines," by Aaron Flaaen, Ali Hortaçsu, and Felix Tintelnot, *American Economic Review* 110(7): 2103–2127 [2020]. See also "Putting 97 Million Households through the Wringer," Spring 2018.)

It is a testimony to both the bias of the political process and the brotherhood of the Democratic Party and the Republican Party (especially under Trump) that Whirlpool, a domestic manufacturer of washing machines (and the only one that is domiciled in the United States), had similarly obtained two (less stringent) protectionist actions under Barack Obama, in 2012 and 2016. To quote Obama in another context, he declared in his first address to Congress in 2009: "New plug-in hybrids roll off our assembly lines, but they will run on batteries made in Korea. Well, I do not accept a future where the jobs and industries of tomorrow take root beyond our borders. … It is time for America to lead again."

A related reason for the incoherence of protectionist nationalism is that job creation in exports or in import substitution (producing goods domestically that were previously imported) are visible and provide great photo-op opportunities to politicians, while changes in consumer welfare are more difficult to identify immediately.

Link between imports and exports / Looking at this from an individualist—as opposed to a nationalist-collectivist—viewpoint helps us understand why Americans benefit from international trade. Why do Americans export? In a free society (without government subsidies), it is because they want to increase their sales and sell at good prices on the world market. And they are able to sell on the world market because they are among the most productive producers in certain industries where America has a comparative advantage.

American export activities are closely related to imports into America, even if neither exporters nor importers are aware of it. The foreign customer of an American exporter will have to obtain dollars to pay for his purchases. These dollars come through the foreign exchange market from some other Americans who have imported something from the same foreign land or who have invested there. Or the dollars could have come from a third country that trades with the other two. A country can only export if it imports an equivalent value from the rest of the word (or invests an equivalent value there). Thus, increasing American exports means, one way or another, today or tomorrow, increasing imports into America.

Of course, saying that "a country" imports or exports is a figure of speech. In a free country, only individuals or their private companies import or export. Under tyranny, the government does it (although the government is also composed of individuals).

Protectionist nationalists seem to also ignore why Americans import from abroad. The answer parallels the answer to the question of why they export. Individual Americans, directly or through middlemen, import because they get a good deal, which means that they get a better price or better quality (each one according to his individual evaluation) than they would get at home. They import from countries that, for the product in question, have a comparative advantage over the United States.

Since Americans freely import and expert when it is in their interests to do so, free trade must be in the interest of "the United States."

Since Americans freely import and export when it is in their interests to do so, free trade—unhampered by their own government in both exports and imports—must be in the interest of "the United States." Foreign governments, it is true, can interfere in "our" exports, but our own government interfering with "our" imports just multiplies the damage.

Of course, like domestic competition or technological change (or pandemics, for that matter), international competition often creates disruptions. But the nationalists should understand that "the country" cannot progress and prosper without disruptions. Moreover, if exports are assumed to be good for each individual country, imports must be, too, because total world imports are necessarily equal to total world exports.

A coherent nationalist would understand that the main purpose of exports is to buy imports, as James Mill explained in his *Elements of Political Economy* (original edition in 1821):

> The benefit which is derived from exchanging one commodity for another, arises, in all cases, from the commodity *received*, not from the commodity given. When one country exchanges … with another, the whole of its advantage consists in the commodities *imported*. …
>
> This seems to be so very nearly a self-evident proposition, as to be hardly capable of being rendered more clear by illustration; and yet it is so little in harmony with current and vulgar opinions.

In summary, here is what the three Republican lieutenant governors do not understand: Americans *work for foreigners* by exporting what they do relatively better than foreigners; and foreigners *work for Americans* by producing and exporting to America what they do relatively better than Americans. By exchanging their products, both groups get more to consume, just like, say, butchers and plumbers in domestic trade. In terms that a coherent nationalist might better understand, America uses "its" national resources to produce goods and services for foreigners because "it" benefits from the use of foreign resources producing things for "itself." And do not forget that the American importer is as much an American as the American exporter and equally worthy of the nationalist's love.

Clearing the incoherence of protectionist nationalism destroys the justification for both export glorification and protectionism. R

Instead of PPP, How About a Credit Lifeline?

BY VERONIQUE DE RUGY

In the throes of the COVID-19 crisis, politicians are doing what politicians do: enact government spending programs based on habitual ideas for "relief." Case in point: the Payroll Protection Program (PPP), Congress's predictable attempt to help small businesses that are experiencing a severe cash crunch and loss of income because of the pandemic.

Legislators had two goals in mind when they created the PPP: help small firms by giving them needed liquidity while also creating incentives for firms to avoid employee layoffs. The latter was to be achieved by offering to convert each loan into a grant if the recipient business retained its workers for two months.

This attempt to preserve the ecosystem of small businesses has merit, in theory. First, it would allow workers to stay connected to their employers, mitigating the financial and psychological hardship of joblessness. Second, by allowing most small businesses to survive, PPP would make it easier for workers who did lose their jobs to find new ones when the economy finally reopens.

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Flawed from the start / Unfortunately, the PPP's design was flawed and counterproductive. That is the inevitable result of policymakers' inability to think creatively and realistically about both the task and the nature of the agencies in charge of administrating the relief.

Like most government relief programs, the PPP is based on the assumption that this recession resembles previous downturns. The program focuses first on injecting liquidity into the capital market to stock up banks so they can lend to businesses. However, there was no liquidity crisis in the financial sector this time around. The epicenter of the crisis was in the nonfinancial sector, with firms and individuals facing a lack of liquidity not because of an inability to borrow, but because firms had lost their consumers and individuals had lost their jobs.

Congress also thought that it was a good idea to turn over responsibility for administering PPP to the Small Business Administration (SBA), an agency with a track record for *failing* at helping small businesses in previous emergencies. But even if the SBA were the most efficient agency in the world, the idea was bound to fail simply because of the scale of the task at hand. As I wrote in a recent piece for *Reason*:

> In a normal year, the agency makes about 60,000 loans totaling $30 billion. Of that amount, $2 billion are disaster loans and $23.2 billion are 7(a) loans. Under [the PPP], the SBA had to process more than 10 times its annual load in the span of a few weeks, responding to each application within a three-day window, with very little guidance from Congress about how to proceed.

Adding to the high probability of failure is that, like most government programs, the loan/grant design of the PPP is a one-size-fits-all model, making it hard to serve every firm in need. Yet the application process was complicated and tedious enough to create nightmares for many borrowers.

In addition, the two original goals set by legislators ended up being at odds with one another. The program imposed restrictive conditions on how borrowing firms could spend the money and specified how many employees the firms had to keep on the payroll to receive loan forgiveness. These restrictions made it harder for some firms to survive, while passing a large tab on to taxpayers.

Finally, because the PPP provided an opportunity to get free money to companies independently of their needs, many larger firms—some that still qualified as small and others that did not—with little or no liquidity issues decided nevertheless to take advantage of the loan opportunity. The consequences were predictable. The gold rush to get a loan created long lines and waiting periods for borrowers with pressing needs. It made accountability and oversight nearly impossible. And it created outrage when the public learned that the companies that received the biggest loans were large and well-connected.

A better lifeline / Assuming that it is a proper role of the federal government to help firms survive during the pandemic, there is a better way to achieve that goal. According to the SBA, in the United States there are 28 million businesses—99.9% of all firms—with fewer than 500 employees. Of those, 81% have no employees; they are sole proprietors and for tax purposes do not exist as businesses in the eyes of the federal government. They also have no Federal Employer Identification Number. To help these many diverse firms in different industries, geographic locations, and markets requires that eligibility be as flexible and as wide as possible.

Toward that end, economist Arnold Kling has suggested giving every individual and business with a bank account a credit line in the form of low-cost overdraft protection. This would be backed by the government, thereby taking the risk burden from the bank. Money borrowed under this initiative would have to be repaid, but the loan could be used for any purpose, a feature that simultaneously reduces the exposure of taxpayers because it eliminates the need for detailed oversight on how the funds are spent. The line of credit would enable borrowers to continue meeting their obligations, including rent and utility bills, despite short-term losses of income.

In our recent paper, "A Government-Backed Line of Credit Would Help Small Businesses More than Current Relief Efforts," Kling and I explain in detail how this proposal would work. First, regulators, including the Federal Deposit Insurance Corporation, could require every bank to participate and calculate for each bank account the revenue stream that went into the account as deposits for the months of January and February 2020. The owner of the account would then be eligible for a credit line allowing the account owner to overdraw the account by that amount, at an annual interest rate of 1%, to be assessed on the amount of the outstanding overdraft each month. For instance, a small business with $200,000 in receipts deposited over those two months would be eligible for a $200,000 line of credit. Likewise, an individual who got four paychecks of $1,000 each over those two months would be eligible for a line of credit of $4,000.

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Repayment of the line of credit to the banks by individuals and small businesses would be due in June 2022. Beyond that point, Treasury would remit any unpaid balances to the banks and assume responsibility for collecting from the holders of delinquent accounts. The compliance costs would be relatively low because banks would only have to write computer code to calculate the size of the credit line to which each checking account is entitled, track the overdrafts and interest accruals, report to borrowers on bank statements, and report to the Treasury on accounts that default in June 2022.

The proposal has some features that make it a better alternative to the PPP.

It is simple in design and implementation. It does not require the federal government to write rules about forbearance for all types of contracts. It does not involve the creation of any elaborate new government program or the expansion of existing ones. And it does not put beneficiaries at the mercy of bureaucracies unable to properly and effectively administer new programs.

And it is universal. Everyone gets a line of credit: small and large businesses, 3,000-employee and no-employee firms, companies and individuals. The result is no arbitrary exclusion of thousands of businesses—like commercial cleaners, home-repair companies, and hair salons—simply because of the way the SBA or the banks interpret the legislation. It also takes away the incentives for members of Congress to cater to special interests—farmers, Native American tribes, "green" firms—by requiring that a certain share of the funds be allocated to them.

In addition, this approach is flexible. People can use their credit lines to pay their rent, mortgages, car notes, employees, and other bills. Companies can use the funds to reorganize their businesses, invest in health measures for their customers and employees, and pay their workers. Better yet, it allows firms to adapt to new circumstances that are inevitable in a dynamic economy, rather than rewarding individuals and businesses to remain as they were prior to the crisis. There are businesses trying to ramp up hiring even while others are laying off workers. Public policies should allow individuals to respond flexibly to new constraints and opportunities, rather than condition aid (as the PPP does) on businesses' retention of workers regardless of how much those workers are needed.

Those who do not want to go into debt or who believe they have better options do not have to use this line of credit. Those who think they may need to borrow money later do not have to rush to banks out of fear that government funds will be exhausted.

The success of the proposal, however, rests on a nonnegotiable feature: borrowers must repay their loans. It is the repayment requirement that allows this solution to be both simple, universal, and flexible. It also assures that the cost to future taxpayers will be low. The government is not obligated to bail out every single person or every single business. Taxpayers only have to make good on the loans that go into default. But if incentives to repay are strong enough, the default rate would be quite low and, hence, the taxpayer costs would be minimal compared to the costs of the hundreds of billions of dollars spent on PPP.

Looking at this proposal from a pure libertarian angle, it can be criticized as more technocratic and costly than government doing nothing. Also, it is not a cure for the economic harm caused by shutdowns that last many months because there is no cure for such a shutdown. However, this proposal does provide a quick and workable solution for those in financial distress now while limiting the intrusiveness and cumbersomeness of government today and the costs to taxpayers tomorrow. *R*

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The Consistency of EPA Benefit–Cost Analysis

BY IKE BRANNON

The notion that rules promulgated by federal government agencies should only be approved if it can be shown their benefits outweigh their costs—which Executive Order 12866 has required since 1981—is not terribly objectionable. However, once in office, denizens in both parties have chafed at this constraint and gone to great lengths to get around it in order to achieve both short-term and long-term political objectives. Evading its strictures has proven to be rather easy.

In a rare act of regulatory self-restraint, the Environmental Protection Agency recently issued a proposed rule that would limit the flexibility the agency has shown when conducting benefit–cost analysis of proposed rules under the Clean Air Act. Among other provisions, the rule would formalize the analysis process, following the Office of Management and Budget's Circular A-4 and the EPA's own Guidelines for Preparing Economic Analyses. It would also prohibit the inclusion of co-benefits when determining a rule's net benefits, thereby avoiding the double-counting problem that infamously influenced the Obama administration's Mercury and Air Toxics Standards.

This regulatory reform would force the EPA to adhere to a set of standards that—it is hoped—would not change much across administrations. The intention is to depoliticize the agency's actions and focus its efforts on promulgating rules that indisputably benefit the country.

Preemptive caving / The mechanism within the federal government that produces and analyzes benefit–cost analyses—namely, the executive-branch agencies themselves and the Office of Information and Regulatory Affairs (OIRA)—can work only if all of the entities involved are guided by the same set of rules and are operating with a clear and consistent understanding of the process. Unfortunately, this is not always the case.

For instance, while the executive order mandates that agencies provide to OIRA a benefit–cost analysis for any proposed rule with an economic effect that exceeds $100 million, agencies tend to discover numerous proposed rules that appear to have an effect just below that threshold, making them immune to OIRA review. Research by Sam Batkins has found considerable evidence of this behavior.

Another problem is that the agencies typically perform the benefit–cost analysis on their own proposed rules, which creates a form of moral hazard. Agency staffers have a vested interest in their proposed rule passing muster, as their careers are advanced by achieving greater regulatory oversight. That puts the staff economists tasked with performing the benefit–cost analysis in a difficult position. The implicit understanding is that their analysis should validate the rule regardless of the underlying reality.

This moral hazard means that the quality of benefit–cost analysis can vary greatly across administrations. Members of a pro-regulatory administration will often work with the EPA to effectively let it know that they will pressure OIRA to be less critical of any benefit–cost analysis, which invariably leads to less rigorous work. The phrase OIRA staffers like to use to describe this strategy is "preemptive caving."

Less-than-rigorous benefit–cost analysis can occur in administrations distracted by other exigencies as well, I have observed. In the aftermath of 9/11, OIRA—where I

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worked at the time— received an EPA analysis that had the first part of its printed title, "ENGINEERING ANALYSIS," crossed out and "COST-BENEFIT" scribbled in pen above it. Needless to say, my colleagues and I found it to be of marginal value, but we were unable to delay the rule to conduct a more thorough analysis.

Reform ideas / Arguably the most important environmental legislation passed in the last three decades is the 1990 Amendments to the Clean Air Act. One reason for its effectiveness is that Congress worked for years in a bipartisan fashion to reach a broad consensus on its content, and that has resulted in a vastly improved environment. The most important rules that came from the legislation—and that the act clearly delineated—ended up with benefits that substantially outweighed the compliance and enforcement costs.

However, in recent years there have been rules engendered by the act that may not have been cost-effective. The act has been stretched to cover climate change as well as other perceived environmental exigencies that its authors did not conceive of when it was created three decades ago. We should have a process in place that ensures critical scrutiny of all regulatory proposals before they are enacted, and I fear that the current system does not achieve that.

One solution to this lacuna that would lessen the moral hazard and improve the analysis of regulatory proposals would take the responsibility for benefit–cost analysis from the agencies and give it to a new entity altogether. That would (partially) insulate analysis from the systemic pressures that exist when doing such tasks within the agency itself.

Such a reform has thus far failed to receive much support. Regulatory agencies will never be keen to surrender the modicum of leverage and budget that such a change would entail. Congress has failed to evince much enthusiasm for such a change as well.

Congress does have the ability to withdraw rules it does not like, using the Congressional Review Act. But that requires a majority in both the House and Senate, and is subject to veto by the president. And it applies only to rules published within 60 days of Congress adjourning *sine die*, so it is a very imperfect instrument.

However, the EPA's proposal to standardize its benefit–cost analysis would constitute an acceptable compromise that achieves part of what would be gained from separating the analysis from the rulemaking. It would also strengthen the quality of these analyses in both Republican and Democratic administrations.

While it is a Republican administration that is enacting this rule (albeit a bit late in its tenure), it is worth noting that Cass Sunstein, a former OIRA administrator for the Obama administration and someone who has published a great deal of research on benefit–cost analysis, has written in support of the idea. According to Sunstein, EPA Administrator Andrew Wheeler's 2019 guidance on the rule constitutes "an important memorandum that makes perfect sense."

Congress worked for years to reach a broad consensus on the 1990 Clean Air Act Amendments, and that has resulted in an improved environment.

After spending a decade working for OIRA, an executive branch agency, and three different congressional committees, I have observed firsthand that power tends to accrete from the legislative branch to the executive branch year by year, regardless of administration. This trend is worrisome and serves to degrade the quality of our government.

One reason I enthusiastically support the EPA's proposed rule is that it represents one small step toward limiting that accretion. Few agencies initiate steps that limit their discretion; usually it is the opposite. I hope that this constraint will force administrations with ambitious agendas to seek congressional cooperation rather than scheme to subvert the legislative branch by getting creative with rulemaking and ignoring benefit–cost analyses when they do not comport with their agenda.

George Mason economist Garett Jones has received a lot of attention for his recent book *10% Less Democracy*. (See "Slightly Less Democracy Means Slightly More Freedom," Summer 2020.) In it, he suggests that we take some decisions that we currently leave to elected officials and put them in the hands of government-employed experts who work on the involved issues. Writ small, this suggests that cities hire instead of vote for coroners; at the federal level it would have agencies show greater deference to the independent regulatory agencies and give them the power to enforce and adjudicate issues that are too complex or minor for Congress and its elected officials to delve into.

What Jones advocates would not simply give the EPA carte blanche to do what its pro-environmental apparatchiks desire. He calls for clearly delineated rules within which the agency would work and that could not be manipulated or set aside by administrations that find them inconvenient or interfering with their agenda, as has often been the case in the past.

Having an executive branch more engaged with Congress would ultimately lead to a government that voters would have more faith in and lead to outcomes that a greater proportion of its citizenry would approve. I think now is a propitious time to accomplish such a thing. *R*

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