

## IN REVIEW

## The Solution to Expensive Housing Is More Housing

◆ REVIEW BY DAVID R. HENDERSON

Finally, a book by a *New York Times* reporter who understands the crucial link between restrictions on the supply of housing and the price of housing! *Golden Gates*, by economics reporter Conor Dougherty, is a tour de force. It's a rare book that mixes careful, nuanced reporting, painless economics lessons, interesting history of California, and pitch-perfect humor, but Dougherty has written one.

Dougherty, who was a housing reporter for the *Wall Street Journal* for a decade, must have learned a lot in that job. He knows and understands the economics literature on the connection between supply and price, as evidenced by his treatment of the pathbreaking work of Harvard's Ed Glaeser and Wharton's Joseph Gyourko. (See "Zoning's Steep Price," Fall 2002.) Furthermore, Dougherty understands that when more luxury housing is built, that frees up housing that is then sold to people slightly lower on the wealth scale, and on down. He also understands the negative consequences of rent control.

That's not to say that I agree with everything in the book. In particular, the author underplays both the bad consequences of rent control and the good that would result from massive housing deregulation. But those defects are way more than offset by his understanding of the harm done by restrictions on building.

**Activists and economists** / Early in the book, Dougherty introduces a number

of important players. First is a colorful character named Sonja Trauss, a teacher in the East Bay who dropped out of the doctoral economics program at Washington University in St. Louis, emerging with a master's degree. Trauss started San Francisco Bay Area Renters' Federation, an organization that favors allowing more housing to be built. She was an early advocate of YIMBY (Yes In My Back Yard), the opposite of NIMBY (Not In My Back Yard). As Dougherty puts it, "Sonja was for anything and everything, so long as it was built tall and fast and had people living in it." Trauss later became a full-time activist for the cause of more housing, and Dougherty tracks her movements carefully.

Trauss has a way with words and Dougherty has a keen ear for those words. She understands 19th-century writer Frédéric Bastiat's point about the unseen con-

sequences of government regulation. At a hearing in the East Bay city of Lafayette, she pointed out that many of the people who would be affected by a decision to allow more housing "don't know who they are yet" and that some of them are not even born. It's Bastiat's seen versus unseen.

The book also discusses Harvard labor economist Lawrence Katz. Few people probably know—I didn't—that when he graduated as Berkeley's top economics undergrad, Katz devoted his whole 1981 commencement speech to one of the main causes of the high price of housing in the Bay Area: restriction of supply. He pointed out something that few of his classmates

probably knew: just 10 years earlier, "California house prices were not much greater than the national median."

Another important player Dougherty introduces is Glaeser. He and Gyourko computed construction costs in various areas and then subtracted those costs from the price of a house to compute the value of the land on which building permits had been granted. Although Dougherty doesn't mention it, their clever check on their results was to compare prices of houses that were comparable, except that one sat on

more land than the other. The house with a quarter-acre of additional land sold for only about \$10,000–\$20,000 more, while a quarter-acre lot on which building was permitted often sold for around 10 times more. The increase in housing prices, therefore, was due not to a scarcity of land, but to a scarcity of building permits.

While many academics who come up with powerful results simply move on to the next interesting area, Glaeser believes in publicizing his results. Writes Dougherty, "He started blogging about housing costs and writing op-eds about housing costs and becoming the subject of various newspaper profiles where he called the advent of strict zoning the most important



*Golden Gates: Fighting for Housing in America*

By Conor Dougherty  
288 pp.; Penguin Press, 2020

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shift in the U.S. housing market since the adoption of the automobile.”

**Trickle-down housing supply** / As someone who, for over 40 years, has advocated cutting high marginal tax rates, I can attest that I have yet to see one of my allies advocate “trickle down” tax cuts. But one area where the term does apply is in housing. Many Californians oppose allowing people to build luxury houses because they think that won’t help people who can’t afford such luxury. They’re wrong. Dougherty quotes a software engineer and Trauss ally, Vincent Woo, who said at a 2016 San Francisco Board of Supervisors hearing:

If we don’t build units for people with money to go into, we all know what’s going to happen. They’re going to compete [for] the existing stock for middle income housing residents, and we know who’s going to win, the people with more money.

Allowing luxury units to be built, by contrast, would free up housing for people with less income. You don’t see a lot of low-income people driving new Cadillacs, but you do see some of them driving 10-year-old Cadillacs.

People who want to limit the supply of housing often try to limit a key resource in order to create a bottleneck. In the last few decades, this strategy has been applied to the supply of water. On the Monterey Peninsula, where I live, no-growthers and slow-growthers successfully pushed in the 1980s and 1990s to prevent a new dam from being built. They are now trying to prevent the local water utility, Cal-Am, from building a desalination plant. Dougherty discusses the bottleneck issue briefly, quoting a conservationist named Raymond Dasmann who advocated restricting the water supply and new housing. Although we sometimes (usually?) think of these no- and slow-growthers as left-liberals—because many of them are—Dougherty reminds us that left-liberals were not always that way. He points out that Pat Brown, the Demo-

cratic governor of California who lost to Ronald Reagan in 1966 when running for a third term, welcomed newcomers and wanted California’s population to grow. In 1960, Brown asked rhetorically: “What are we to do? Build barriers around California and say nobody else can come in because we don’t have enough water to go around?” In his 1965 book *The Destruction of California*, Dasmann’s answer was, in essence, “Yup.” That’s how many, many Californians would answer today. And that makes Dougherty pessimistic about the prospects for large increases in the supply of housing.

Dougherty also understands the enormous harm done by government “redevelopment” projects in the 1960s and 1970s. They “demolished black neighborhoods around the country” and “destroyed thousands of rooming houses and ‘cage hotels’ with single-occupant dwellings and shared bathrooms, removing a crucial supply of last-resort shelter.”

In one chapter, Dougherty discusses the heart-wrenching stories of Latinos living in San Mateo who barely managed to pay the rent and who then were faced with a huge rent increase that pushed them out of the area. One woman, Sister Christina Heltsley, who runs a Redwood, CA charity called the St. Francis Center, got creative, using some of the center’s funds and other money she raised to buy an improved apartment block and then let the apartments at a below-market rent to less-wealthy people. Dougherty comments that she “had in a sense removed [the apartments] from capitalism.” That’s false: Heltsley’s actions were a capitalist act. Capitalism allows, but does not require, people to sell or rent to the highest bidder.

**Power of prices** / In discussing the harm rent control does, Dougherty shows a solid understanding of the role of rent, and prices generally, in allocating resources to their highest-valued uses. He notes that

many people believe that “high prices mostly just exploit people who can’t pay them.” That’s wrong, he notes, because “prices have a big and vastly underappreciated role in society, which is to tell us what sorts of things we need more of.” He adds, “At the highest level, that’s what a market economy is.” The alternative to a market economy, he says flatly, is feudalism. He understands why economists across the spectrum tend to favor markets, writing, “Markets aren’t perfect, but they are mostly better than feudalism, which is why economists, even liberal ones, tend to look down on any policy that disrupts the message prices are trying to send.” Paren-

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thetically, I note that I have yet to meet an economist not living in a rent-controlled dwelling who favors rent control.

Dougherty writes that “various studies, meaning pretty much all of them, show that cities with strict price caps end up with less rental housing and higher rental prices.” The reason is that rent control reduces the incentive to build housing. Dougherty also discusses a well-known Stanford study that found that rent control in San Francisco “had probably accelerated gentrification, by pushing investors to flip affordable apartments into high-priced condos and co-ops.” He also notes that “rent control encourages people who are higher-income to park themselves in fixed-rate apartments long after they can afford to move out, and in the most egregious cases use their savings to buy second homes elsewhere.”

I noted at the start of this review that Dougherty sprinkles the narrative with humor. One good example is his discussion of a hearing in Lafayette at which an anti-housing activist named Michael Griffiths of a group called Save Lafayette professed that “nobody likes to get into

lawsuits.” Dougherty writes: “A council member later retorted that it wasn’t the city’s fault they were getting sued. This was presumably to remind Michael Griffiths of *Save Lafayette* that *Michael Griffiths of Save Lafayette* was currently the one suing them” (italics in original).

**Middle course** / Toward the end of the book, Dougherty tries to steer a middle course. He writes:

It’s a fraught leap from “the government is responsible for redlining and redevelopment” to “therefore socialism.” It seems equally fraught to believe that a capitalism that creates a business model on eviction and homelessness would make us all better off if it were allowed to run its course.

This last statement is strange, coming from someone who spent over 200 pages showing us that that last “fraught” statement is probably true. Throughout the book, Dougherty argues that allowing huge increases in housing would bring down house prices and rents, which would reduce evictions and homelessness.

It’s true that not *everyone* would be better off from liberalizing housing policies. In particular, the drop in housing prices would hurt older, wealthy homeowners. And if those homeowners were childless, they wouldn’t even be able to comfort themselves with the thought that at least their adult children would find living closer to home more affordable. But those homeowners, quite rightly, are not who he’s worried about.

Sticking to his middle course, Dougherty writes, “There’s no way to rectify a housing shortage other than to build housing, and there’s no way to take care of people whom the private market won’t take care of other than subsidies or rent control, or both.” Yet his own book shows the opposite of that last clause. If governments allowed huge increases in housing, the private market *would* take care of almost everyone, and rent controls and subsidies would not be necessary. Many more people would then be able to enter the golden gates. R

# What to Do about Unequal Ability?

◆ REVIEW BY GEORGE LEEF

**A**merica is in the grip of a tyranny. So says Harvard philosophy professor Michael Sandel in his latest book. This tyranny doesn’t have an individual tyrant, but instead is systemic. America’s economy, controlled by politicians of both leftist and rightist orientations, has allowed merit to trample all over people who come up

short in the skills that enable one to make it big in today’s world. People who are fortunate enough to have what it takes to earn degrees from elite colleges can parlay their advantages into “outsize” rewards, while those who weren’t so fortunate are left behind, suffering economically and emotionally in the wake of the winners.

**Unequal talent** / The key to Sandel’s argument is that no one deserves his or her attributes. He writes about those who gain admission to top schools:

While it is true that their admission reflects dedication and hard work, it cannot really be said that it is solely their own doing. What about the parents and teachers who helped them on their way? What about talents and gifts not wholly of their making? What about the good fortune to live in a society that cultivates and rewards the talents they happen to have?

These people, in short, were lucky to get their abilities and, in a well-governed polity, would have to share their good fortune with everyone else.

Luck has always been a problem for egalitarians, but Sandel claims that it has gotten much worse in America over the last 40 years. That is because, beginning with Ronald Reagan and continuing through the Bushes, Bill Clinton, and Barack Obama, presidents have allowed two evils to run rampant: globalization and financialization. Those phenomena have, according to Sandel, allowed a tiny

few with the right credentials and skills to reap prodigious rewards, while leading to stagnant wages and an “erosion of the dignity of work” for the vast majority.

Rather than governing for the benefit of the masses, our political leaders have embraced what the author calls “the rhetoric of rising.” That is, they have told Americans that they too can get ahead if they go to college, where they’ll get the right skills for success. Sandel correctly sees that such rhetoric gives people false hope. It’s good to have a Harvard professor arguing that we have oversold higher education—a point I’ll return to below.

First, however, I’d like to focus on the crux of his argument against the justice of our system. Egalitarians have long claimed that nature’s unequal distribution of talent is problematic. Sandel admits that he wants to have highly capable people serve him and concedes that life in a “sterile equality” would not be desirable, but he argues that America has allowed merit to go too far. Ordinary folks feel disrespected and disempowered, rightfully angry at the way society’s “winners” look down on them. Moreover, he contends, the rich are now able to cement their families’ elite status in getting their children into top schools, where they get the right credentials and make the right contacts. Thus, the old notion that America is a land of opportunity is no longer true. Things must change.

**Is equality ideal?** / That’s the gravamen of Sandel’s complaint. How persuasive is it? Not at all, in my estimation.

Begin with his central conviction that life should be fair—that inequality is not justified unless it can be shown to benefit the poor. Why should equality be set on a pedestal as the moral norm? In his essay “Egalitarianism as a Revolt Against Nature,” Murray Rothbard observed, “The goal of equality has for too long been treated uncritically and axiomatically as the ethical ideal.” Sandel certainly does that, but he makes no argument for it.

Most of us understand that nature isn’t egalitarian, that people differ greatly from each other over a wide

array of attributes, of which talent for making money is but one. Yet, that doesn’t crush us. The mediocre musician doesn’t despair over the existence of superstars making millions per concert. (OK, some might; but most don’t, at least not for long.) The writer struggling to get a novel published doesn’t rail against the unfairness of top novelists repeatedly making the best-seller charts. Intellectuals may brood over the morality of a few getting rich because of their undeserved talents, but most of us don’t. Nor do we see any reason to tamper with society so that those intellectuals might feel better. The book merely assumes that we all agree that equality is the ethical ideal.

What about Sandel’s more specific claim that America’s “losers” feel that they’re not just far less wealthy than the winners, but are the object of derision? He thinks that accounts for rising populism, but what is his evidence for it? Remarkably, he presents none. Readers are supposed to take his pronouncements *ex cathedra*.

Sandel does, however, delve into the famous dispute from the 1940s over whether high rewards in the market signal superior virtue for those who earn them. He presents F.A. Hayek’s case that market earnings have nothing to do with personal virtue, but he proceeds neither to show



***The Tyranny of Merit: What's Become of the Common Good?***

By Michael J. Sandel  
272 pp.; Farrar, Straus and Giroux, 2020

why Hayek was mistaken nor, more crucially for his case, that the Americans who he thinks are so unhappy with their lot in life think Hayek was mistaken. It would seem obvious that a book proclaiming a tyranny by the successful over the rest of society needs to show plenty of evidence on this score—condescending statements by the rich about the uselessness of the poor and statements by the poor that they lead miserable lives because they know that they’re stuck in a rut—but tyranny doesn’t.

The only proof Sandel offers for his claim that the

rich look down on the poor is an anecdote from a class he taught in China. The subject of organ sales came up and it was debated whether it was right for a rich person to be able to buy a kidney from a poor one. One student argued that it was because the rich person’s life must be important if he’s rich. Perhaps some Chinese look at things that way, but I doubt that many Americans would agree that wealth and virtue go hand

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in hand. Nothing in *The Tyranny of Merit* indicates that Sandel has actually spoken with the kinds of Americans—painters, delivery drivers, auto mechanics, etc.—who he assumes feel themselves victimized by the onslaught of merit.

In sum, Sandel’s case that there is something terribly wrong in America is singularly unpersuasive. Furthermore, the solutions he suggests are not appealing. He says that we should have a federal wage subsidy for low-wage workers so they’d understand that society values their efforts. It’s hard to

believe that such a governmental subsidy would convince, say, a grocery store cashier that society really does value her work. He also praises populist conservative groups that attack “market fundamentalism” by pushing for more trade restrictions. Even if we went full-bore protectionist, that would do little to bring back the lost manufacturing jobs that Sandel laments, and to whatever extent it did, there would be heavy off-setting losses for other poor people who’d have to pay more for many basic items.

**Education arms race** / Sandel does get one thing right: America’s obsession with higher education is a serious problem.

Because of the “rhetoric of rising” and rivers of federal student aid money, America has a glut of college graduates, all expecting “good jobs” that will put them comfortably into the middle class or above. We have also created a system that puts severe pressure on students to get top grades and participate in a host of extracurricular activities meant to impress college recruiters. This “arms race” to gain admission to one of our prestige colleges or universities is a needless strain on kids, not to mention a temptation for parents to go to enormous lengths, including fraud, to get them into one of those schools.

Kids who don’t have the intellectual talent or resources to play this game are left behind. Sandel rightly regards that as unfair. Unfortunately, his analysis of the college problem misses the key element: creden-

tial inflation. Because we have so many people with college degrees in the workforce, many employers have seen fit to use the possession of a degree as a screening mechanism to rule out those who don’t have college credentials. Therefore, people who lack those credentials are being crowded into the shrinking sectors of the labor market where college isn’t yet a requirement. Upward mobility for such workers is impeded by the artificial problem of credential inflation (along with other policy blunders such as occupational licensing



laws), not by the supposed condescension of meritocratic elitists.

Because Sandel doesn't grapple with the problem we have created for people without a college education, he doesn't see that the solution is to stop subsidizing college attendance and allow the market to find better means of training workers and assessing their ability. All he suggests is that elite colleges should admit students by lottery. He wants to see Harvard cull out those applicants who really don't seem able to handle the work (a practice to which the most fervent egalitarians would object) and then admit from the remaining pool by pure chance. While admission by lottery wouldn't do any harm and might start to

ratchet down the educational arms race, it wouldn't solve the real problem, which is that decades of federal subsidies have turned higher education into a credential-selling business.

Sandel concludes his book by writing, "The meritocratic conviction that people deserve whatever riches the market bestows on their talents makes solidarity an almost impossible project." In that assessment, the author projects his own egalitarianism into the minds of Americans who really don't seem to be upset over the fact that some people become much wealthier than others. He also ignores the sad historical record of nations that have turned away from liberty in favor of solidarity. R

of the "unelected shadow government" he describes in the book is Dr. Anthony Fauci, director of the National Institute of Allergy and Infectious Diseases, and that two of the federal agencies at the forefront of the response to the pandemic are the Centers for Disease Control and Prevention and the Food and Drug Administration. He faults both agencies for having "thwarted the creation of an efficient testing regime," saying that "they did not exercise [their] authority with any haste."

Those agencies are peopled with just some of the rule makers, enforcers, litigators and others who control much of the federal government and, through lawsuits, exert growing national authority over state and local government.

## Is the Center of Power in Washington Transforming?

◆ REVIEW BY VERN MCKINLEY

**S**peculation is rampant among Supreme Court watchers about how the elevation of Amy Coney Barrett, along with President Donald Trump's other two appointments, will affect the alignment of voting blocks of justices. One area of the law that this realignment could affect is the direction of federal governance through administrative law.

*The Unelected* is a historical, legal, and policy review of how far modern administrative law and the administrative state have strayed from a system amenable to a limited and accountable government reliant on enumerated powers and anchored checks and balances. The book was released well before Justice Ruth Bader Ginsburg's seat on the Court became one of the key political issues of the 2020 election, but it does not take much imagination to get a sense from the book that the new justices will have a substantial effect on regulated businesses, large and small alike.

Copland is director of legal policy at the Manhattan Institute and *The Unelected* is his first book. The title's reference is to "a host of unelected actors with government roles," drawing attention to how far the "modern

regulatory state," as Copland calls it, has come unhinged from the "accountability to the voting public" model embedded in the philosophy of the Founding Fathers and the Constitution.

I previously reviewed Peter Wallison's *Judicial Fortitude* ("Doing Damage to the Deference Doctrine," Summer 2019), which shares the same publisher as *The Unelected*, Encounter Books. Wallison applied similar scrutiny to the rise of the administrative/regulatory state, although Wallison and Copland take different approaches in their critiques.

**Meet the unelected** / Early on, Copland writes, "As this book goes to press, America is facing a viral pandemic at least as large as any we've seen in a hundred years." He notes that one of the members

**Missing elements** / The titles of some of the book's early chapters illustrate how this system came into being. "Legislating Without Congress" addresses the tendency of lawmakers to pass vague, "open-ended laws and leave the details to the unelected experts in the Executive Branch." This state of affairs has been in place since the Progressive Era, but Copland hints that it may be coming to a close with the shifting alignment of the Supreme Court. He cites the 2019 case of *Gundy v. United States* and a dissent penned by Justice Neil Gorsuch and joined by Chief Justice John Roberts and Justice Clarence Thomas as an indication of a reversion back to so-called nondelegation principles. Justice Samuel Alito concurred with the majority opinion, hinting that he might also reconsider the line of cases. (*Gundy* was argued before Justices Brett Kavanaugh and Coney Barrett joined the court.)

In the early chapters, Copland uses case studies to reveal the real-world effects of the administrative state. One particularly chilling account from the chapter "Legislating Without Congress" begins, "On Monday, February 7, 2011, Dr. Peter Gleason took his own life." Gleason had run afoul of the FDA's limitations on off-label drug prescriptions. Even though the drug he prescribed is legal, he was charged with engaging in interstate commerce of a misbranded drug. Ultimately, his license to

practice medicine was revoked. The rule Gleason was accused of violating was written by the FDA and not Congress, the accountable body.

The chapter “Administering Without the Executive” discusses the creation of administrative agencies headed by powerful directors who can stay in office well beyond the term of the appointing president. Among those agencies are the Consumer Financial Protection Bureau (CFPB) and the Federal Housing Finance Agency (FHFA). Copland debriefs the reader on the *Humphrey’s Executor* case that concerned a Federal Trade Commission member named William Humphrey who was originally appointed by President Calvin Coolidge and reappointed by Herbert Hoover. Franklin Roosevelt deemed Humphrey to not be adequately supportive of his New Deal agenda and wanted to remove him from the FTC. Humphrey died before the Supreme Court heard his case, but his estate took up the fight and won a favorable ruling, bolstering the sustainability of such holdover appointees.

A roughly similar issue has been playing

the judicial branch—to unelected agency officials. Unsurprisingly, those officials have acquired more power by stretching the plain meaning of the laws enacted by the Congress beyond recognition.

This trend is explained by Copland through a discussion of the early 1980s case *Chevron v. Natural Resources Defense Council*, with which observers of administrative law are very familiar. The ruling involved the level of judicial scrutiny that should be applied to agency interpretations of a statute. It grants “deference to administrative agencies ... when a statute’s terms are ambiguous.” The Supreme Court may reexamine *Chevron*’s core reasoning and Justices Roberts, Alito, and Thomas have indicated doubts about the longstanding doctrine. Given the timing of the book’s release, Copland could not engage in speculation about how Justice Coney Barrett might scrutinize this precedent, but he does make a connection between *Chevron* and Justice Gor-

such. Gorsuch penned a lower court ruling openly questioning the underlying basis for *Chevron* and, interestingly enough, his mother was the Environmental Protection Agency administrator whose decision came under scrutiny in the case.

The chapter “Regulating Without Rulemaking” explains how agencies can elude the formal rulemaking process and the open-hearing and notice-and-comment periods that accompany rulemaking by issuing proclamations through platforms such as “policy interpretations” and “guidance.” These softer pronouncements allow an agency to adjust an agency’s prior legal position. The Supreme Court has allowed this practice to proliferate through def-



**The Unelected: How an Unaccountable Elite Is Governing America**

By James R. Copland  
304 pp.; Encounter Books, 2020

erence to these agency interpretations of their own rules. Justice Thomas has stood out in challenging this practice as he argues that the “power both to craft and to interpret a regulation concentrates power in the executive.”

The last of the chapters with titles describing these seeming inconsistencies in the administrative law framework is “Lawyers Without Clients.” It traces the history of how lawyers initiate class-action cases that bring in handsome legal fees but are not in most cases initiated by wronged clients. As Copland explains, this category of lawsuits is “conceived by and

for the benefit of attorneys.” That theme carries forward for many of the remaining chapters that provide narratives on tort suits and awards, tobacco cases, securities shareholder and fraud litigation, and emerging climate change lawsuits. Copland delves deep into the intricacies of procedural matters in these chapters, taking me back to my days in civil procedure class in law school. Whereas some of the changes on the Supreme Court may advance the principles of limited government, a larger, more intrusive government may result from the momentum of these lawsuits.

**Conclusion /** *The Unelected* illustrates the difficulty of timing the release of a book to maximize the usefulness of the material presented. Prominent lamentations about “the deep state” will likely wane with Trump’s departure from D.C. Still, the topic is an important and enduring one. Although it is hard to say what is the perfect timing these days for a book on the evolving state of administrative law, this area of jurisprudence will surely be well trodden ground in the coming decades. The early signs in at least some aspects of administrative law point to a transformation not observed since the Progressive Era.

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### **The early stages in at least some aspects of administrative law point to a transformation not observed since the Progressive Era.**

out in recent years in *Seila Law*, involving the CFPB. Unfortunately, *The Unelected* went to press before the *Seila Law* case was fully litigated. In June 2020, the court determined that the structure of the CFPB violated the Constitution’s separation of powers, allowing for the president to remove the CFPB head. Also, after the book went to print, the Supreme Court heard another case along these lines, *Collins v. Mnuchin*, concerning the constitutionality of the structure of the FHFA.

The chapter “Judging Without the Judiciary” chronicles how

the courts have abdicated the interpretation of laws—the core function of

# Another Reason Why the West Is Rich

◆ REVIEW BY JANE SHAW STROUP

**T**hey never let up. They keep arriving—those big, popular books that you can't resist because they offer a single powerful explanation for the economic prosperity of the West. Jared Diamond pointed to geography, Douglass North and Robert Thomas to property rights, Joel Mokyr to technology, Dierdre McCloskey to bourgeois virtues, and Kenneth Pomeranz to coal and colonies.

Now we have another big, monocausal explanation for Western Europe's rise that is utterly different from the rest, although it has faint echoes of Max Weber. *The WEIRD People in the World*, by cultural psychologist Joseph Henrich, gives the credit for European prosperity to the Catholic Church. Why? Because the Church completely obliterated traditional kinship ties through increasingly rigid restrictions on whom one could marry.

The process started in 597 AD when a monk, Augustine of Canterbury, was trying to convert the Anglo-Saxons of England. He wrote to Pope Gregory I (now St. Gregory the Great), asking if some prevalent marriage customs would be allowed once the natives became Christian. The pope's reply was strict. He rejected marriage to close relatives or to close in-laws (in-laws are called "affines" by anthropologists). He banned the adoption of children. He prohibited concubines. (Divorce was already prohibited, based on Jesus's words in Scripture.)

Exactly why the pope gave these answers can be debated, but one effect of the practice was to reduce the number of heirs. And one result of fewer heirs was that more people bequeathed their wealth to the Church, motivated in part by the hope that such gifts could ease their way into heaven.

**Individual over clan** / To Henrich, the pope's instructions launched the Church's "Marriage and Family Program" (MFP), which ultimately destroyed the extended

family. He does not discuss the reasons for this policy, but he presents plenty of evidence for it. He includes a timeline of the steps, both local and centralized, that the Church took to eliminate marriages within one's "clan."

By 1063, the Synod of Rome (the assembly of bishops for Italy) prohibited marriages between all cousins up to sixth cousins. Certainly, that was extreme. Who is your sixth cousin? Someone who has the same great-great-great-great-great-grandparent. It is unlikely that you would know who such a relative is. And if you found a seventh cousin to marry, you had to be sure that he or she was not also an affine or a godparent. (The sixth-cousin "incest" rule was later relaxed to prohibit just third and closer cousins from marrying one another. While the rule was in force, the convenient "discovery" that one was married to a distant cousin could be reason for an annulment.)

The effect of the MFP, according to Henrich, was enormous. Without dependence on a broad collection of relatives and without obligations to them, people were forced to act on their own or with just a nuclear family (if they managed to form one). Thus, the MFP led people to create associations with non-relatives, launching medieval guilds, monasteries, and universities. They formed towns and cities. They entered into commercial and political relationships with strangers that would otherwise not even be considered. Towns and commerce grew and practices to ensure trustworthiness grew with them.

These people became individualistic, less willing to bend to authority, and more eager to develop distinctive personal characteristics and achievements because they were competing with others for wealth, prestige, and spouses. They became more "moral" (that is, they adopted a commitment to "impartial principles"). If they didn't follow those principles, they felt guilty. They even came up with a new collection of Christian sects, Protestantism, that emphasized individualism: Protestants wanted to have a personal relationship with God through the Bible. That led to an obligation to teach as many people to read as possible, which in turn spurred massive changes (reading even changes the brain, Henrich notes).

They also became more analytical, thinking in terms of abstract rules and separating things into categories. Most other cultures are more holistic; they look at relationships, how the parts of their surroundings fit together, says Henrich. Analytical thinking laid the foundation for law, science, and technology.

The process became unstoppable by 1500, maybe even earlier. As a result, Henrich says, people whose culture was formed by those Catholic Western Europeans are WEIRD. That is, their culture has primed them to be Western, Educated, Industrialized, Rich, and Democratic—utterly different from all other cultures.

**Kinship connectedness** / Henrich's 680-page argument is built upon an enormous amount of data, including psychological experiments, surveys, game theory, and historical and anthropological examples, as well as interpretations of this material. One reason the book is so long is that he has to explain and illustrate sometimes complicated experiments (and even with 680 pages, a magnifying glass will help you read graphs that are barely 2 inches by 2 inches).

One step in his argument involves measuring societies for their kinship connectedness. Henrich and his associates have developed a Kinship Intensity Index (KII) based on information from the Ethnographic Atlas, a database about cultures "prior to industrialization," built from information

gathered around 1900. Intense kinship cultures allow and encourage marriages between cousins, multiple wives, endogamous marriage (i.e., within the clan), and patrilineal or matrilineal inheritance. Low-intensity kinship cultures have minimal cousin marriages, monogamy, a wide choice in marriage, and bilateral inheritance. Unlike high-intensity kinship cultures, they have “neolocal” marriages: newly married couples readily leave their home to form their own nuclear marriage.

Examples of high-KII countries are Iran, Ghana, and Pakistan. Examples of countries that are low in kinship intensity are Sweden, England, the United States, and Australia.

Then, Henrich and his associates used a cache of psychological tests to identify personal characteristics.

Consider the Asch Conformity Experiment (devised in the 1950s). College students are shown three vertical lines of different lengths. They are also shown a “target” line that matches the length of one of the other three lines. The subjects are expected to say out loud which of the three lines

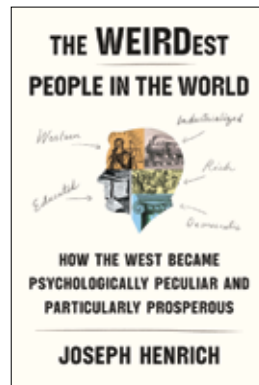
is the same length as the target line. This is an easy task and 98% of people who take it get it right when they are alone.

But in the experiment, several other “participants,” who really are test confederates, announce their answers before the individual taking the test speaks. They all give the same wrong answer. Will the student “correct” his or her answer to conform to the others’ (wrong) assessments, or will the student stick with what he or she believes to be the right answer?

These tests are taken by students from numerous countries. It turns out that about one-quarter of all students “conform” to the answers of the others. However, “WEIRD” students conform less. (In this example, Henrich doesn’t specify the countries that the WEIRD students come

from.) They give the wrong answer less often than those from other backgrounds. Students from Brazil, for example, go along with the wrong answer about 50% more often than the WEIRD students, and students from Zimbabwe give the wrong answer about 200% more often.

The Asch study is one of many, many measurements that Henrich uses. Another is the World Values Study. It asks people to describe themselves as more or less traditional and to say whether obedience is an important value to them or not. As you would expect, WEIRD people are less committed to tradition and obedience than others. Preference for tradition and obedience is correlated with heavily kinship-based societies.



*The WEIRDest People in the World: How the West Became Psychologically Peculiar and Particularly Prosperous*

By Joseph Henrich

680 pp.; Farrar, Straus and Giroux, 2020

are part of a culture that was in close contact with the Church between 500 and 1500 AD. In Europe, he did this by mapping the expansion of the Catholic Church during the period, using as his source the formation of bishoprics (which were often created when a chief or king converted to Christianity). That told him which parts of Europe had been affected by the MFP, and when.

Henrich also went beyond Europe. Using an existing “migration matrix,” he and his associates calculated an MFP level for each modern country in the world. If a large group of people had come to a country from a place that had contact with the Catholic Church in the 500–1500 AD period (e.g., the United States or Australia), that country would have a high MFP level. He writes:

The data show that the longer a country’s population was exposed to the Church the weaker its kin-based institutions.... In fact, of all the agricultural, ecological, climatic, geographic, and historical factors that we explored in trying to understand the global variation in kinship intensity, the biggest factor—though not the only—was historical exposure to the Church.

Henrich was even able to detect a difference between the effects of the Western Catholic Church, with its demanding marriage restrictions, and those of the Eastern Orthodox Church. The Church split in 1054. While the Eastern Church had marriage restrictions, they were less rigid than those of the Western Church (“MFP lite,” Henrich calls them). Those who descended from the Eastern Church’s culture are less WEIRD.

A similar exercise led him to find a cause-and-effect connection between the growth of Protestantism and greater literacy. Protestantism, he says, gave a “boost” to the MFP, moving the WEIRD characteristics to another level.

In 1517, Luther presented his Ninety-five Theses in Wittenberg (according to legend, nailed to the Cathedral door). Henrich was able to determine that Protestant influence spanned out (almost in ripples) from Wittenberg. Over 350 years later, in 1871, the number of Protestants in each Prussian county followed a pattern: the number decreased by about 10% for every 100 kilometers’ distance from Wittenberg. Henrich then correlated the level of Protestantism in each county (in 1871) with the level of literacy (also in 1871), obtaining what he calls “striking” results. “Not only do Prussian counties closer to Wittenberg have higher shares of Protestants, but those additional Protestants are associated with greater literacy and more schools.”

**Guilt and shame** / Speaking very broadly, Henrich says that WEIRD societies fear guilt, while kinship-intense societies fear shame. This is a point we have often heard before when comparing Western and East-



## IN REVIEW

ern societies. But why does it happen?

Henrich says that individualism leads WEIRD people to expect themselves and others to be consistent in all their relationships; those who don't are "two-faced" or dishonest. If WEIRD people act inconsistently, they experience "cognitive dissonance" and often engage in rationalizations to overcome feelings of guilt.

"Other populations," writes Henrich, "focus more on actions and outcomes over what's 'inside.'" Actions that might not especially bother a person internally (such as failing a test) may cause shame because of the reaction of kin; and because there are so many kin, and many kin are close to one another, the shame may be widespread and severe.

There are many other arguments,

graphs, claims, and descriptions in this book, including aspects of European history. For much of its history, Europe was involved in almost constant wars. But because of the presence of MFP, the wars spurred even more involvement in associations: religious, political, social, and work-oriented. Ultimately, the associations led to more "benign forms of intergroup competition," one of which was the market.

There is much more to be mined in the book—and, probably, debated. In the meanwhile, I consider much of what Henrich says to be persuasive. I'll put his book on my shelf along with Diamond's *Guns, Germs, and Steel* and North and Thomas's *The Rise of the Western World*, and wait for more to come. R

## Whose Body Is It Anyway?

◆ REVIEW BY DAVID R. HENDERSON

**W**hen I taught benefit-cost analysis at the Naval Postgraduate School, one of the first principles I explained was that, to do a good analysis, you need to consider the costs and benefits to the various people affected rather than taking as gospel the desires of policymakers. We studied both good and bad examples of benefit-cost analyses. In the bad ones, a common error was to leave out the gains to consumers when they consumed items that policymakers did not want them to. A typical case was alcoholic beverages; policymakers kept overlooking the enjoyment that consumers receive from a drink.

In his book *The Rediscovery of Tobacco: Smoking, Vaping, and the Creative Destruction of the Cigarette*, independent journalist (and one-time Cato staffer) Jacob Grier avoids that error. Not only does he consider the costs of cigarettes and other forms of tobacco to their users and to nonsmokers, but he also considers the benefits to users. In doing so, he makes a case for people's freedom to smoke or inhale what they want when it does not inflict harm on non-users. Along the way, he details how the antismoking movement has shown its disregard for the interests of smokers. He

also shows that the damage from secondhand and "thirdhand" smoke is often overstated and that the harm from e-cigarettes is overstated and the benefits understated. Although I am a dyed-in-the-wool nonsmoker and non-vaper and Grier did not persuade me to try these substances (nor did he attempt to change readers' minds), I learned a lot from this book. You could say that I "rediscovered tobacco."

**Health effects research** / One of the best parts of the book is Grier's discussion of the use of bad science to support anti-smoking policies. He tells the story of the apparent health effects of a June 2002 ban on smoking in workplaces, bars, restaurants, and casinos in Helena, MT. During the first six months of the ban, Helena's reported rate of heart attacks fell by 60%. Then, after a judge struck down the law,

the reported rate of heart attacks shot back up. Prominent antismoking activist Stanton Glantz of the University of California, San Francisco, with whom I debated the smoking bans in restaurants on the pages of *Econ Journal Watch*, touted those numbers in a press release as strong evidence that protecting people from secondhand smoke saves lives. The *New York Times* and the *Wall Street Journal* carried stories about the Helena experience and people advocating smoking bans seized on the heart attack findings to buttress their case.

Later studies with much larger sample sizes reached different conclusions. A study of a statewide ban in Colorado, for example, which had 5 million residents, found no effect on heart attacks. The study's authors explained that their own earlier studies had found a large effect. They noted that when you have a small population, as in their earlier studies, random fluctuations can cause the effect to appear large. Helena's population is 0.6% of Colorado's. Also, the authors noted, rates of heart attacks were falling and their previous studies had failed to account for that fact.

Grier notes an interesting difference in research methodologies between studies of the health effects on smokers in the 1940s and 1950s and the later studies of researchers on secondhand smoke. The earlier researchers had noticed a huge increase in deaths from lung cancer in the first half of the 20th century and wanted to figure out why. They established a clear relationship between smoking cigarettes and lung cancer. But, notes Grier, research on secondhand smoke "reversed that approach." He writes, "Scientists started out with a hypothesis—that secondhand smoke was causing lung cancer in nonsmokers—and took on the task of finding the bodies."

One place that researchers looked for bodies was Japanese households. Grier explains why: in the 1960s and 1970s, smoking by Japanese men was common whereas smoking by Japanese women was taboo. In a 1981 study in the *British Medical Journal* (now known as *BMJ*), Takeshi Hirayama reported that the risk of lung cancer for women married to smokers was

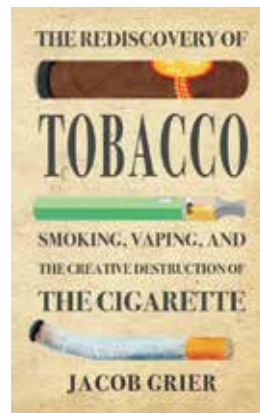
higher than the risk for women married to nonsmokers. Specifically, the risk for women married to men who smoked fewer than 20 cigarettes per day was 61% higher, and for women whose husbands were heavy smokers it was 108% higher. That sounds high and is high, but Grier puts it in perspective. He reports data from other studies that show the risk of lung cancer for smokers to be 1,400%–1,900% higher than the risk to nonsmokers. So, the risk from secondhand smoke for people who live in close quarters with smokers for years is substantial but a whole order of magnitude lower than the risk for smokers.

Moreover, a 2003 study in the *BMJ* by epidemiologists James Enstrom and Geoffrey Kabat using an American Cancer Society data set that spanned 39 years found no evidence that secondhand smoke increased the risk of lung cancer or coronary heart disease. Tobacco companies funded their final years of research, a fact that led many people to call Enstrom and Kabat shills for big tobacco. A *BMJ* editor pointed out, though, that of 140 written responses by readers, only 3%

(that means four responses) referred to data. Some sociologists who wrote about the controversy stated that the responses were evidence of “an authoritarian cult.” Georgetown University law professor Lawrence Gostin stated that research into secondhand smoke was not motivated by a crisis in public health, but rather by “the increasing intense secular value that smokers were becoming a public nuisance.”

Grier notes that the Centers for Disease Control claim that secondhand smoke kills 41,000 Americans per year. That would put it on a par with annual fatalities from traffic accidents. But is the CDC’s claim true? Grier points out that the World Health Organization estimates 13,200 annual deaths from secondhand smoke

for the United States, Canada, and Cuba combined. That would make the death rate for the United States less than 30% of the CDC’s estimate. Adding further doubt to the CDC’s numbers is the fact that the decline in the percentage of Americans who smoke and the increase in smoking bans over the last few decades should mean that the death rate from secondhand smoke is falling. And yet, writes Grier, “estimates are surprisingly sticky.”



***The Rediscovery of Tobacco: Smoking, Vaping, and the Creative Destruction of the Cigarette***

By Jacob Grier  
267 pp.; Jacob Grier, 2019

Antismoking activists, he notes, didn’t stop with secondhand smoke. They raised the ante by stirring up concern about “thirdhand smoke.” What’s that? Grier quotes a definition the *New York Times* posited in 2009: “the invisible yet toxic brew of gases and particles clinging to smokers’ hair and clothing, not to mention cushions and carpeting, that lingers long after secondhand smoke has cleared the room.” Grier comments that he does not know “if studies will ever successfully demonstrate that thirdhand smoke increases the risk of any particular disease, and, crucially neither do the researchers who have been promoting these fears to the

public for more than a decade.” This is awkward wording. He seems to be saying that the researchers have no evidence, but I wish he had stated his point more clearly.

He tells the interesting story of Boston University School of Public Health professor Michael Siegel, an epidemiologist trained at the CDC. In much of his research and public activism, Siegel had made the case for indoor smoking bans. But activists’ push for bans even in outdoor spaces was too much for him. In 2013, in an email to Grier, Siegel wrote that tobacco control “is now guided more by ideology and politics than by science.” He also suggested that one reason the debate is so lopsided is that the 1998 Master Settlement Agreement between big tobacco companies and

state attorneys general tied the hands of the tobacco companies. The companies are now forced to fund antismoking research. This, in the land of the free and the First Amendment.

***Sliding down the slippery slope*** / Although Grier is not an economist, he uses the public choice framework to explain why some cigar bars in Oregon (where he lives) are allowed and others are not. To be allowed to exist, cigar bars must document that they sold tobacco before 2006, don’t have more than 40 seats, must be licensed to sell liquor (not just beer and wine), and must have a humidor present. These rules, he notes, accomplish three goals: keep wealthier (and presumably more politically powerful) cigar smokers happy, allow a few businesses to stay in existence, and protect those businesses from other competition.

Grier also tells the story of a hypocritical Washington, DC city councilman named Jack Evans, who voted in favor of the city’s smoking ban but pushed through an exception that accommodates a cigar dinner held by the Friendly Sons of Saint Patrick, a charitable and social organization to which Evans belongs. Evans’s razor-sharp logic for the exception? “To eliminate cigars would be ludicrous.”

Libertarian critics of tough regulations often argue that they put us on a slippery slope to even more extreme regulations. Grier points out that the more extreme proponents of smoking regulations are doing this. He quotes one *Vox* writer’s proposal that indoor smoking be banned “*everywhere*—inside bars, restaurants, your home. Full stop” (italics in original). Grier responds, “The writers at *Vox* deserve a perverse sort of credit for gliding down the slippery slope that smoking ban opponents have long warned against.”

A standard idea in public health policy is that if a product causes harm, it should be regulated or banned. Those who advocate such an idea often claim the mantle of science. Grier points out the problem: “To treat the debate over smoking bans as entirely a question of science is to make a basic category error.” The science, even if

it weren't so sketchy, is simply an input. It cannot resolve issues of rights. Do waiters and waitresses have the right to work in bars and restaurants that allow smoking? Grier maintains that they do. He points out that the fatality rate for fishermen seeking

West Coast Dungeness crabs is almost 80 times higher than the average fatality rate for U.S. workers, but no one advocates not allowing fishermen to catch Dungeness crabs. I would also point out that when I discussed this issue in a class of military

officers years ago, one of my students, who had worked in a bar, said that even though she hated breathing cigarette smoke, it had been worth it to her because smokers tended to pay much bigger tips. That's the market at work.

## COMMENTARY

## Will We See Another Bumper Crop of Financial Crisis Books?

BY VERN MCKINLEY

**T**he Great Recession had its genesis in the market instability of late 2007. By the summer of 2008 it was clear the United States was not only in recession but also sliding into a financial crisis.

It did not take long for books chronicling the early phases of the financial crisis to appear. In March 2009, William Cohan's *House of Cards* (Doubleday) told the story of the March 2008 collapse of Bear Stearns. In July 2009, David Wessel's *In Fed We Trust* (Crown Business) engaged in a more ambitious effort, recounting the story of the full range of rescues during the financial crisis. A massive wave of financial crisis books followed in the ensuing decade, relating the events of the Great Recession or, seizing on the newfound interest in financial instability, telling the stories of historical financial crises.

**Are we facing a financial crisis?** / Switching gears to 2020, will we see a second wave of financial crisis books in the coming decade? To answer that, we should consider whether the 2020 COVID-19 recession includes a financial crisis.

Unlike U.S. recessions, which are officially identified by the National Bureau of Economic Research's lagged pronouncements of their lifecycle, there is no similar high-profile pronouncement of the existence, beginning, or end of a U.S. financial crisis. That said, the Federal Reserve Bank of St. Louis and the Treasury Department's Office of Financial Research do maintain financial system stress indices that pinpoint periods of financial instability. There was stress in the early months of 2020, but it waned by July. We will see if that remains the case or was only a respite.

A number of elements are considered prerequisites for a financial crisis:

- **A recession that has a duration well beyond a year.** Recessions in the post-World War II period have lasted less than one year on average. During the Great Recession the economy weathered an 18-month recession, and during the financial crisis of the 1980s the economy endured a 16-month recession. In comparison, the initial recession at the beginning of the

Great Depression lasted a staggering 43 months. We do not yet know the duration of the COVID recession or whether it will take a "double dip" form, but a financial crisis could result even if there is no lengthy economic downturn.

- **The failure or near failure of a significant number of financial institutions.** The Great Recession saw the outright failure of Lehman Brothers and near failure of Bear Stearns, AIG, Fannie Mae, Freddie Mac, and Citigroup, among hundreds of other, smaller institutions. Continental Illinois failed during the early 1980s along with over a thousand commercial banks and savings associations. The 1920s and early 1930s saw the failure of nearly half of the 30,000 banking institutions operating as of 1920.

Given the aggressive interventions by the Federal Reserve and Treasury Department in early 2020, only a handful of financial institutions failed in 2020, all of them tiny banks whose problems preceded the COVID-19 recession. No major banks have been seriously threatened. A *Wall Street Journal* article addressing the fate of banks during 2020 summarized the year nicely: "Wall Street banks have had a decent crisis so far." We'll see if that continues in 2021.

- **Contraction in the level of credit in the economy.** This indicator is usually measured as negative growth in bank net loans and leases. That happened in 1938, 1942–1943, 1991–1992, and 2009. We do not yet know if something similar is happening now; loan growth data for 2020 will be available in early 2021.

**Categorizing books in the aftermath of the Great Recession** / Another way to think about future books in the wake of 2020's financial instability is to consider what topics might be fruitful for research and what topics might have an interesting narrative that can hold readers' interest. Here are a few possibilities:

- **Journalistic stories telling of crisis interventions:** Wessel's book, mentioned above, falls into this category, but the best example is Andrew Ross Sorkin's *Too Big to Fail* (Penguin, 2010). It is a readable and riveting volume that traces through the full range of Fed, Treasury, and Federal Deposit Insurance Corporation

**Marlboro monopoly** / Grier also offers an interesting discussion of the Tobacco Control Act of 2009, which, he notes, other tobacco companies refer to as the “Marlboro Monopoly Act.” When the law passed, Philip Morris’s Marlboro brand

accounted for 40% of U.S. cigarette sales. The law exempted the menthol flavor, which Philip Morris uses, and forbade flavors used by competitors R.J. Reynolds and Brown & Williamson.

The law treats cigarettes like drugs, giv-

ing the Food and Drug Administration the power to say no to any new tobacco products. Cigarette companies must submit their applications to sell “substantially equivalent” products 90 days before they plan to sell. Of 3,500 substantial equiva-

interventions during the Great Recession. Others in this category include those that focus on the collapse of a single institution, such as *A Colossal Failure of Common Sense* (Crown Business, 2009) by Lawrence McDonald about Lehman Brothers. The dearth of failures during 2020 gives prospective authors little raw material to replicate Sorkin’s formula in *Too Big to Fail*.

■ **Insider memoirs:** Following the Great Recession, memoirs were written by each of the “big four” appointees who led financial authorities: Hank Paulson’s *On the Brink* (Business Plus, 2010); Sheila Bair’s *Bull by the Horns* (2012, Free Press); Timothy Geithner’s *Stress Test* (Crown, 2014); and Ben Bernanke’s *The Courage to Act* (Norton, 2015). During the crisis, those authors offered statements on what drove their decision-making, but the memoirs contained juicy details that were not previously public. For me, the strongest of the books is Bair’s, as she does not completely buy into the narrative that supported the massive bank bailouts.

Who would write similar books about today? Stephen Mnuchin and Jay Powell have been the most high-profile of the financial world insiders in the COVID era. Janet Yellen will have stories to tell if we have turbulence in 2021 and beyond. Another insider who might make a valuable contribution is Mark Calabria, former chief economist for Mike Pence and current director of the Federal Housing Finance Agency, conservator for Fannie Mae and Freddie Mac.

As with journalistic storytelling about the current situation, there may not be the same allure to these coming books because of the lack of gripping high-profile institution failures. The back-and-forth of negotiating the CARES Act or developing Fed lending facilities pale in comparison.

■ **Historical context reviews:** In the previous crisis, several books appeared that did not focus on the Great Recession, but either used it to draw attention to past crises or otherwise gave background on how the imbalances built up in the years before the crisis. Liaquat Ahamed’s *Lords of Finance* (Penguin 2009) and Bethany McLean and Joe Nocera’s *All the Devils Are Here* (Portfolio, 2010) are two examples.

I am aware of two planned books that would fall into this category. Jeanna Smialek of the *New York Times* is working on a historical review of the post-Alan Greenspan Fed, with much of the focus on 2020. It is to be published by Knopf Doubleday in 2022. Federal Reserve historian Peter Conti-Brown of Wharton and Sean Vanatta of the University of Glasgow are working on a book titled *The Banker’s Thumb*,

telling the history of U.S. bank supervision from the Civil War to the Trump era. It is to be released by Harvard University Press this year. A topic that might be ripe for a good case study would be a historical comparison of the disruptions to the financial sector during the 1918 and 2020 pandemics.

■ **Other categories:** This is a catch-all for several types of books. One would be a time series and related economic and financial analysis that draws upon available data and academic research. Carmen Reinhart and Kenneth Rogoff’s *This Time Is Different* (Princeton University Press, 2011) and Alan Blinder’s *After the Music Stopped* (Penguin, 2013) would be good examples of this genre from the last crisis.

Other types of books in this category would be character-driven, made-for-movie books like Michael Lewis’s *The Big Short* (Norton, 2010), Federal Reserve and central bank critiques like Nomi Prins’ *Collusion* (Bold Type Books, 2018) and Danielle DiMartino Booth’s *Fed Up* (Portfolio, 2017), and government reports like *The Financial Crisis Inquiry Commission Report*, which was developed by a congressionally created commission responsible for reporting on the causes of the Great Recession.

Unless he has retired, Lewis may be working on another book, but nothing has been announced yet. Same goes for the other authors in this category. Although a special congressional commission has not been appointed yet to probe federal policy decisions surrounding COVID, this would be advisable given the hurried (and some would say sloppy) process of putting together the 2020 CARES Act and the accompanying Fed interventions.

**Conclusion** / We could still descend into a prolonged financial crisis in 2021 and that may cause prospective authors to hesitate on announcing new book projects. The coming commercial real estate bust has not fully arrived. We do not yet know the duration of the economic downturn or the final body count for failed banks and other financial institutions, as all financial crises have their own unique traits.

For me, given the dearth of interesting storylines and institution failures, indications thus far are that the events of 2020 are not as fertile ground for a bounty of financial crisis books like what we saw in the wake of the Great Recession. There is also just not the same freshness to the topic that there was a decade ago. The paucity of upcoming titles bears that out. We will see if that changes.



lence applications submitted in the four years after the law took effect, the FDA, with over 100 employees reviewing them, had issued exactly zero rulings. In one case involving a small company, the FDA responded to an application by asking what the product's "heating source" was. This was a simple stalling tactic; Grier notes that it is well known that cigarettes are heated with fire. The law does seem pretty clearly aimed at limiting competition.

One of the most monstrous things the U.S. government has done concerning tobacco-related products is to hamper Americans' ability to get nicotine in less dangerous forms. Grier tells of snus (pronounced "snoose"), a variant of snuff that is popular in Sweden and Norway. Snus is much cleaner than chewing tobacco and has helped people in those two countries "achieve some of the world's lowest rates of smoking and smoking-related diseases." The smoking rates for all ages in Sweden have fallen to less than 8% for men and 10% for women. Although the FDA allows snus to be sold in the United States, it forbids snus companies from telling customers that their product is lower risk.

Similarly, even though millions of Americans have switched from dangerous cigarettes to much safer e-cigarettes, the FDA has hampered this new industry. Firms that want to introduce new e-cigarettes must get FDA permission, and permission is expensive to get. Also, the FDA forbids sellers of e-cigarettes to tell customers of their products' reduced risk compared to cigarettes even though, according to a report by the United Kingdom's Royal College of Physicians, the risk of long-term vaping is no more than 5% of the risk of smoking cigarettes. As one researcher put it in 1976, "People smoke for nicotine, but they die from the tar." E-cigarettes have no tar.

We often hear that America is the land of the free. Grier punctures that myth. He writes, "Despite its nominally libertarian ethos, the United States is poised to become one of the most restrictive countries in the world when it comes to smoking." We can only hope that his book will help make the United States less restrictive. R

# Populist Political Choices Are Meaningless

◆ REVIEW BY PIERRE LEMIEUX

**D**espite last fall's defeat of Donald Trump, populism in the United States is not dead. Perhaps next up for America is left-wing populism, which is more like the right-wing variety than many people realize. Hence, reviewing political scientist William Riker's classic *Liberalism Against Populism* is appropriate and urgent.

Published in 1982, the book is noteworthy both for its overview of social choice theory—a framework for analyzing how collective choices relate to individual preferences—and for the lessons it draws from the clash between populism and political liberalism.

Riker (1920–1993) was a professor of political science and department chairman at the University of Rochester. He pioneered what he called "positive political theory," based on rational choice, formal economic modeling, and empirically falsifiable statements. He led political scientists to discover economist Kenneth Arrow's seminal 1951 book *Social Choice and Individual Values*, which launched the modern theory of social choice. Riker was also involved with the economic theory of public choice, an overlapping but different research area, and was president of the Public Choice Society in 1966. About the time he published *Liberalism Against Populism*, he was president of the American Political Science Association.

Riker defined populism as embracing two propositions: First, the "will of the people" ought to be government policy. Second, "the people are free when their wishes are law." As for liberalism, he conceived it as any democratic system that does not attach any sacrosanct character to the will of the people. Riker's approach to liberal democracy is close to what F.A. Hayek described in *Law, Legislation, and Liberty*, vol. 3: *The Political Order of a Free People* (University of Chicago Press, 1979):

The true value of democracy is to serve as a sanitary precaution protecting us

against an abuse of power. It enables us to get rid of a government and try to replace it by a better one. Or, to put it differently, it is the only convention we have yet discovered to make peaceful change possible.

**Social choice and the imperfection of voting** / Which system is better, liberalism or populism? The theory of social choice is relevant to this question, Riker explains, because it analyzes how "tastes, preferences, or values of individual persons are amalgamated and summarized into the choice of a collective group or society." Social choice refers to the choices made through government—that is, *political* choices. The problem of populism, Riker argues, is that voting (elections and referenda)—or, for that matter, any other political aggregation of individual preferences—cannot reveal the will of the people or the content of the public interest, assuming that such things even exist.

Systems of voting and counting votes include majority voting, plurality voting, different methods of ranking candidates, and list voting in proportional representation systems. In the United States, one method of ranking candidates ("ranked-choice voting") is now used in some local elections and, in Maine, in state and federal elections, including for president. Two other states are considering adopting ranked-choice voting.

Different voting methods often produce different results. In fact, if you want a certain result from a given electorate, you can

often find some voting system that would produce it. For that reason, there is no “objective” way to democratically choose the best voting method.

In the presence of three or more alternatives (candidates or issues), all voting methods violate at least one of a few basic technical or democratic-fairness criteria. One is *monotonicity*, which means that if one voter changes his mind in favor of an alternative, other things being equal, the social choice (aggregation) function should produce a result that does not increase the chances of another alternative. *Undifferentiatedness* or *anonymity* means that votes cannot be distinguished from one another: all voters are equal and anonymous. *Neutrality* requires that the voting system not favor one alternative over others. It has been mathematically demonstrated that majority voting between two alternatives, where one alternative gets more than 50% of the vote, is “the *only* method that simultaneously satisfies the criteria of monotonicity, undifferentiatedness, and neutrality,” Riker notes. For example, if a primary is held to winnow a larger field to two, that would violate the neutrality criterion.

We must also consider the fundamental *Condorcet criterion* (named after 18th century French mathematician and philosopher Nicolas de Condorcet), which requires that the winner among many alternatives (opponents or proposals) be the one that would also win a pair-wise election against each of the other candidates. Problem is, a “Condorcet winner” does not always—

or even often—exist when more than two alternatives are being voted on. And when a Condorcet winner does exist, it may not actually be chosen because of the voting system. For instance, in the 1912 presidential election, Progressive Party candidate Theodore Roosevelt may have been a Condorcet winner against Democrat Woodrow Wilson and Republican William Taft, but Wilson won the election.

Social choice, Riker concludes, depends as much on aggregation methods and political institutions as it does on individual values and tastes. Since each voting method can be justified by one or more democratic criteria (methods that look fairer, for example, may ignore the Condorcet winner), we must face the fact that an election has no “true” winner.

The “paradox of voting,” discovered by Condorcet in the 18th century, lies in the observation that a Condorcet winner may not exist, leaving unstable cycles between

alternatives. Consider three voters,  $V_1$ ,  $V_2$ , and  $V_3$ , and three alternatives presented to those voters,  $X$ ,  $Y$ , and  $Z$ . Table 1, reproduced from Riker, gives the ordinal preferences of each voter.  $V_1$  prefer  $X$  to  $Y$  and  $Y$  to  $Z$ , which we can express symbolically as “ $XYZ$ .”  $V_2$  and  $V_3$  have different preferences but, by hypothesis, every individual’s preferences are transitive, that is, coherent or rational.  $V_1$ , who prefers  $X$  to  $Y$  and  $Y$  to  $Z$ , prefers  $X$  to  $Z$ .  $V_2$ , who prefers  $Y$  to  $Z$  and  $Z$  to  $X$ , prefers  $Y$  to  $X$ . And  $V_3$ , who prefers  $Z$  to  $X$  and  $X$  to  $Y$ , prefers  $Z$  to  $Y$ . (Note that, like elsewhere in this review, we are considering ordinal preferences—that is, the ranks that each voter assigns to alternatives—without any assumption about the intensity of the preferences of each nor any common metric to compare the voters’ preference scales.)

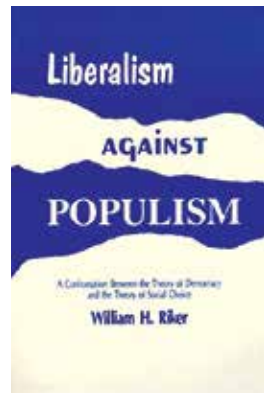
If the voters are asked to choose between  $X$  and  $Y$ ,  $V_1$  and  $V_3$  would vote for  $X$  because it is higher in their respective preferences;

the social choice would thus be  $X$ . If our three voters are asked instead (or later) to choose between  $Y$  and  $Z$ , the result of the vote would be  $Y$  because  $V_1$  and  $V_2$  would vote for  $Y$ ; the social choice would be  $Y$ . Now, if our three voters are asked to choose between  $Z$  and  $X$ , the majority,  $V_2$  and  $V_3$ , would vote for  $Z$ ; the social choice would be  $Z$ . So, we have social choices indicating that, “for society” (if we may talk this way),  $X$  is preferred to  $Y$ ,  $Y$  to  $Z$ , but  $Z$  to  $X$ . Despite all voters having transitive individual preferences, the social choice function reveals intransitive preferences.

The “social choice function” is the mechanism or procedure that translates individual preferences into social choices. This function is also called the “social welfare function” because, in welfare economics, a similar device was used to supposedly maximize social welfare. In a democracy, it is assumed that some method of voting constitutes the social choice function, either in elections, referenda, or plebiscites.

**Arrow’s Impossibility Theorem** / It is easy to modify the data of the simple example above in such a way that the paradox of voting disappears, although it gets difficult as the number of voters increases. Moreover, different mechanisms for making social choices and for voting exist. This is where Arrow’s work becomes crucial. He mathematically demonstrated that something similar to the voting paradox affects *all sorts* of social choices with more than two alternatives. The original demonstration appears in his book *Social Choice and Individual Values*. In simplified terms, Arrow’s Impossibility Theorem states that no method of aggregation (the social choice function) can satisfy all of the following conditions:

- **Axiom of collective rationality:** If society prefers alternative  $X$  to  $Y$  and alternative  $Y$  to  $Z$ , it will also prefer  $X$  to  $Z$ .
- **Condition 1** (Pareto condition): If all members of a society prefer  $X$  to  $Y$ , the social choice function (the voting mechanism) will choose  $X$ .
- **Condition 2** (unrestricted domain):



**Liberalism Against Populism: A Confrontation between the Theory of Democracy and the Theory of Social Choice**

By William H. Riker  
311 pp.; W.H. Freeman, 1982

**TABLE 1**  
**The Paradox of Voting**

$V_1$	$XYZ$
$V_2$	$YZX$
$V_3$	$ZXY$

## IN REVIEW

The preferences of individuals are not restricted to certain preferences that would produce certain desired results.

■ **Condition 3** (independence of irrelevant alternatives): Irrelevant alternatives don't affect a social choice. If society prefers  $X$  to  $Y$  and to  $Z$ , the disappearance of  $Z$  is not going to change the expressed preference of  $X$  to  $Y$ . This condition can be thought of as another requirement of collective rationality.

■ **Condition 4** (non-dictatorship): Between any two alternatives  $X$  and  $Y$ , it cannot be that one of them, say  $X$ , will necessarily be the social choice simply because a certain individual (the dictator) prefers  $X$  to  $Y$ .

Assuming that Conditions 1–3 are realized, Arrow's theorem implies that any social choice will be either dictatorial (violating Condition 4) or incoherent (violating the axiom of collective rationality). Incoherence leads to cycles:  $X$  would win against  $Y$ ,  $Y$  against  $Z$ ,  $Z$  against  $X$ ,  $X$  against  $Y$  again, and so forth. Social choices are either dictatorial or, as Riker puts it, "arbitrary nonsense." And this is true *whatever the method of aggregating individual preferences*.

One way to escape incoherence in social choice is to assume that the preferences of all individuals are "single-peaked"—a limitation of individual preferences that violates Condition 2. Single-peakedness means that if we place each individual's preferences for the different alternatives on an axis (imagine that these alternatives are different tax rates), each individual has only one utility peak: as he moves away from his ideal alternative, in one direction or another (more taxes or less), other alternatives become less and less attractive. (See "The Public Choice Revolution," Fall 2004.) To simplify (a bit too much): under single-peakedness, no individual prefers what others consider extremes: in the Vietnam War, for example, an individual's two most preferred alternatives cannot be to get out immediately or to carpet-bomb the country. Although voters have different opinions, they share a common attitude on what is reasonable.

Assuming single-peakedness saves the coherence of social choices, but at a cost. In an election, candidates will be motivated to move to the center of the political spectrum in order to gather the largest number of votes. As they move there, they gain more votes from the other side of the median than they lose from the side they are on. This "median voter theorem" means that only the median voter (or group of voters), who is exactly in the middle of the distribution of political preferences, will see his top-preferred alternative translated into a social choice. Political parties become difficult to distinguish because they all want to please the median voter. If there are no more incoherent cycles, that is because, in practice, all the alternatives have been arbitrarily reduced to a single one at the middle of the political spectrum.

In a large, diversified society, of course, single-peakedness is unrealistic. And as soon as many genuine alternatives are available to voters, incoherent social choices will raise their heads.

The dilemma between nonsense and dictatorship is not very attractive. Much of the research in social choice theory after Arrow's theorem has been to try to salvage a transitive social choice function, often by weakening Condition 3 on the independence of irrelevant alternatives. This and other solutions, however, end up violating Arrow's conditions.

As noted by Riker, another escape was proposed by James Buchanan, the 1986 Nobel economics laureate—an escape that negates the whole concept of a social choice function. Buchanan pointed out that it is anthropomorphism to expect that a group or a society, which is not an actual living and thinking creature, will show the same logical coherence as an individual. The search for a meaningful social choice function is thus necessarily a vain enterprise. For Buchanan, it is anyway preferable to have succeeding cycles of temporary domination by different majorities rather than a continuous exploitation of minorities by a stable majority. (See Buchanan's "Social Choice, Democracy, and Free Markets," *Journal of Political Economy* 62[2]: 114–123 [1954].)

The advantage of market choices is precisely that they are *individual* choices and do not aim at imposing a *social*—that is, political—choice on everybody. It makes no sense to say that the number of chocolate bars bought by individual consumers is incoherent with the quantity of beer they drink. On the market, every individual gets what he wants (within his budget constraint); not so in politics. From there ultimately comes the incoherence or dictatorship of social choices.

**Manipulation** / What we have seen thus far does not factor in voting manipulation, which can further undermine any procedure of social choice. One sort of manipulation is strategic voting—that is, voting against one's preferences in order to avoid a still worse outcome. This is common in Congress through vote trading, which according to Riker is "the most extreme version of strategic voting": I will vote for your pet project, which I don't like much or am indifferent about, in exchange for you voting for my pet project, which I absolutely want. This sort of horse trading can even lead to a set of decisions that is detrimental to everybody.

In general elections, major political parties try to crush out third parties by telling the latter's potential voters to vote strategically in order not to "waste" their votes. Strategic voting can also happen under proportional representation because voters may give their votes to a party more likely to participate in a governing coalition. However, as Riker admits, strategic voting is unlikely (I would say very unlikely) in all but small groups. In large elections, an individual voter has no practical influence on the result, which must be obvious to him if he does not suffer from cognitive limitations or is not a victim of propaganda. If this individual does not vote, the winner is extremely unlikely to be different because winners are not elected by a single pivotal vote.

Another legal method of voting manipulation is the control of the agenda by politicians or bureaucrats—that is, the process whereby voters are presented with only

some alternatives or in an order favorable to the manipulator. It has been shown that “manipulation can occur under *any* method of voting,” except if preferences are nearly identical across individuals. Voter manipulation can also occur in legislative assemblies. Riker gives the example of the 1902 rejection of the 17th Amendment (on the popular election of senators) by a Senate committee. He argues that an agenda manipulation suggested that no majority was forthcoming, which prevented the amendment from coming to the floor. (The 17th Amendment was adopted a decade later by a stronger coalition.) A laboratory experiment devised by Charles Plott and Michael Levine (“A Model of Agenda Influence on Committee Decisions,” *American Economic Review* 68[1]: 146–160 [1978]) and replicated by Riker suggests that the right partition of issues can lead voters to vote just like the agenda setter wants them to.

**Instability and discontent** / Even if a Condorcet winner exists, that alternative is unlikely to be chosen in elections. In policy space, “*anything* can happen,” Richard McKelvey and Norman Schofield argued (McKelvey, “Intransitivities in Multidimensional Voting and Some Implications for Agenda Control,” *Journal of Economic Theory* 12: 472–482 [1976]; Schofield, “Instability of Simple Dynamic Games,” *Review of Economic Studies* 45[3]: 575–594 [1978]). This instability explains the wide swings in political choices, such as Donald Trump’s election in 2016 and his policies. Four years later, his defeat and his reaction repeated the demonstration. The stability we otherwise observe is due to institutions that limit the choices submitted to majority rule.

It is not surprising that discontent is the hallmark of democratic politics. Not only are overruled minorities dissatisfied but, because the system very seldom reaches an equilibrium on a Condorcet winner, the current majority itself will soon be unhappy too. For politicians, the art of politics consists in profiting from that disorder, which can only intensify discontent. The more people expect from democracy, the more

dissatisfied they will be, as Anthony de Jasay argued in his 1985 book *The State*.

Furthermore, Riker observes, “losing in the market is a relatively mild kind of losing compared with losing in politics.” He gives the example of the losers from the adoption or increase of the minimum wage: they lose their access to the labor market because their low productivity has become too expensive and they are legally prevented from improving their lot by underbidding the more productive. So, he adds, the “dismal science” is political science, not economics.

Disequilibrium sometimes leads to revolution and civil war. Abraham Lincoln, who won with a plurality of about 40% of the votes in 1860, would have lost to Stephen Douglas or perhaps John Bell if other election methods had been used, Riker argues.

**Liberalism against populism** / We are now in a better position to understand why Riker believed that social choice theory destroyed the intellectual justifications of populism and reinforced liberal theory. Populism fails because there is no way to know what is the “will of the people”—if that term even makes sense—and what the results of an election mean. Riker writes, “We do not know and cannot know what the people want.” For the same reasons, “when people have to vote on which interpretation [of the public interest] is correct, then clearly the true public interest will not be revealed, without substantial unanimity.” No political alchemy or voting gadgetry (like, say, ranked-choice voting) can change that. “Populism fails, therefore, not because it is morally wrong, but because it is empty,” he concludes. Trump thought he represented the will of the people, but any other politician can claim the same (as Biden did in his inaugural address) because the will of the people is unascertainable.

The American political tradition has always been marred by “a strong strand of populism.” Riker wonders why, despite the “disasters with the ‘imperial’ presidencies of Johnson and Nixon,” people continue

to search for ways to increase the president’s power.

Liberalism, on the contrary, is consistent with the theory of social choice because it “does not demand much from voting.” Liberalism does not require the outcome of an election to make sense. Voting only provides the majority with “a way to get rid of rulers.” It is “a wholly negative kind of control.” Liberal democracy is humble: it is not popular rule “but an intermittent and sometimes random popular veto” that has some capability “to restrain official tyranny.”

Populism, writes Riker, “reinforces the normal arrogance of rulers with a built-in justification for tyranny, the contemporary version of the divine right of rulers.” Populism demands a rapid realization of the will of the people, which is constrained by liberal institutions. Riker found the main constraining institutions in elections, bicameralism, and decentralization—as well as, to a lesser extent, an independent judiciary. I would suggest that he underestimated the importance of the latter and neglected what De Jasay called “private force,” which is the presence of powerful private organizations that Leviathan does not dare to confront, although it is not clear if such organizations still exist.

Social choice theory persuaded Riker to abandon his populist intuitions. “It took me a score of years of reflection on [economist Duncan] Black’s and Arrow’s discoveries to reject the populism I had initially espoused,” he explains. Many scholars probably say, “Me too!”

Riker’s conclusions still stand, four decades after the publication of *Liberalism Against Populism*. But how and when can we expect the general public to understand the economic and mathematical underpinnings of social choice theory? Even the intelligent layman will struggle to follow the arguments, let alone the mathematical theorems. “The dissemination of a rather arcane theory is a task for generations,” Riker noted, in an Enlightenment sort of optimism. If this task is achievable, *Liberalism Against Populism* will have mightily contributed to it by educating many students of politics. R



## Working Papers ➦ BY PETER VAN DOREN AND IKE BRANNON

A SUMMARY OF RECENT PAPERS THAT MAY BE OF INTEREST TO *REGULATION*'S READERS.

### Nuclear Power

■ “Sources of Cost Overrun in Nuclear Power Plant Construction Call for a New Approach to Engineering Design,” by Philip Eash-Gates, Magdalena M. Klemun, Goksin Kavlak, et al. *Joule* 4(11): 2348–2373 (November 2020).

In theory, low-cost nuclear power has been the answer to many energy and environmental policy questions ever since the 1950s. In practice, its costs have increased inexorably. Why?

This paper documents the history of nuclear power plant construction in the United States and the increase in costs. From 1967 through 1978, 107 were built. Rather than costs going down over that time from learning by doing, plant costs more than doubled with each doubling of cumulative U.S. capacity. The problem was declining “materials deployment productivity”—that is, the amount of concrete and steel that workers put together per unit of time.

About 30% of the productivity reduction stems from nuclear regulatory safety concerns. According to the authors:

While our analysis identifies the rebar density in reinforced concrete as the most influential variable for cost decrease, changes to the amount and composition of containment concrete are constrained by safety regulations, most notably the requirement for containment structures to withstand commercial aircraft impacts. New plant designs with underground (embedded) reactors could allow for thinner containment walls. However, these designs are still under development and pose the risk of high excavation costs in areas or at sites with low productivity.

The sources of the other 70% of productivity slowdown were construction management and workflow issues, including lack of material and tool availability, overcrowded work areas, and scheduling conflicts between crews of different trades. Craft laborers, for example, were unproductive during 75% of scheduled working hours.

Plant builders attempted to address these problems by increasing the use of standardized prefabricated modules that could be shipped to site and installed. These were employed in later reactors, but whatever advantages they provided did not improve aggregate productivity.

Since the 1990s, two nuclear projects have begun construction, both two-reactor expansions of existing generating stations. The VC Summer project in South Carolina was abandoned in 2017 with sunk costs of \$9 billion, and the Vogtle project in Georgia is severely delayed. Current estimates place the total price of the Vogtle expansion at \$25 billion, almost twice as high as the initial estimate of \$14 billion, and costs are anticipated to rise further.

These problems are not unique to the United States. Projects

in Finland and France have also experienced cost escalation, cost overrun, and schedule delays, as I noted in a previous Working Papers column (Spring 2012).

This paper provides an important reality check for those who believe nuclear power is an essential component of any strategy to reduce greenhouse gas emissions. —**Peter Van Doren**

### Banking Fees

■ “Who Pays the Price? Overdraft Fee Ceilings and the Unbanked,” by Jennifer L. Dlugosz, Brian T. Melzer, and Donald P. Morgan. Working paper, November 2020.

Nearly 25% of low-income U.S. households are unbanked. Many observers believe that overdraft fees are the cause. In 2015, banks collected nearly \$12 billion in overdraft and bounced check fees, constituting nearly two-thirds of their deposit account fees. Sen. Corey Booker (D-NJ) has introduced legislation to limit such charges.

This paper examines a “natural experiment” in which a 2001 federal regulation relaxed the state-level overdraft fee limits that previously constrained nationally chartered banks in four states. During the late-1990s and early 2000s, Alaska, Illinois, Missouri, and Tennessee imposed caps on the overdraft and bounced check fees that banks could charge their residents. In 2001, the Office of the Comptroller of the Currency (OCC) issued a ruling that federal law preempted those state laws in the case of nationally chartered banks, which had roughly 50% deposit market share in the affected states.

In response to the OCC ruling, nationally chartered banks in those states increased their overdraft fees by about 10% but cut their returned check rates by 10% relative to other states. National banks increased the supply of overdraft credit once the fee limits were relaxed.

National banks also decreased the minimum deposit balance required to avoid a monthly maintenance fee in interest-bearing checking accounts in those states by between \$376 and \$538 from an average minimum balance of \$1,345. That is a decline of 28%–40%. There was no change in minimum required balances on non-interest checking accounts nor any change in monthly account maintenance fees. As a result, checking account ownership by low-income households rose by 4.8 percentage points in the affected states relative to other states following the preemption ruling, a more than 10% increase from a 44% baseline ownership rate. Those households above the bottom quintile in income showed no change in bank account ownership.

A relaxation in price controls increased the use of checking accounts among low-income households. —**P.V.D.**

# Research on the Minimum Wage and Employment

■ “Myth or Measurement: What Does the New Minimum Wage Research Say about Minimum Wages and Job Loss in the United States?” by David Neumark and Peter Shirley. NBER Working Paper no. 28388, January 2021.

There is a sense—abetted by the media—that economics is divided on the effect of a minimum wage on employment. It’s certainly an impression that many economists have tried to foster. For instance, an oft-cited 2015 survey by the University of Chicago’s Initiative on Global Markets found that one-fourth of economists surveyed (mostly elite ones with some political experience) reject the idea that a minimum wage increase would reduce jobs, while another 40% said its effect is uncertain.

In 1994, David Card and Alan Krueger published “Minimum Wages and Employment: A Case Study of the Fast-Food Industry in New Jersey and Pennsylvania” (*American Economic Review* 84[4]: 772–793). It purported to show that a minimum wage increase in New Jersey resulted in *higher* employment in chain fast-food restaurants as compared to the Pennsylvania communities directly across the border where the minimum wage was unchanged. The article triggered a flurry of new studies hoping to replicate its results.

David Neumark of the University of California, Irvine and William Wascher of the Federal Reserve Board of Governors reviewed Card and Krueger’s data (“Employment Effects of Minimum and Subminimum Wages: Panel Data on State Minimum Wage Laws,” *Industrial and Labor Relations Review* 46[1]: 55–81 [1992]) and found myriad data coding errors in Card and Krueger’s research that Neumark and Wascher’s own work suggested drove most of Card and Krueger’s counterintuitive results. Neumark and Wascher’s analysis using corrected data found that the New Jersey minimum wage increase did indeed reduce employment.

The competing papers cleaved the labor economist community, with liberal-leaning members embracing Card and Krueger’s work and conservative-leaning ones supporting Neumark and Wascher’s. This left the impression to many that the question is unsettled.

Since those studies appeared, there have been two increases in the federal minimum wage and a number of states and municipalities have raised their own minimum wage. The changes over time and differences across states create enough variation to ostensibly discern the effect an increase has on employment levels, and researchers have produced a raft of such analyses. Neumark has collected these studies and attempted an “analysis of analyses.”

There are two competing economic views that can cause economists to support the minimum wage. The first is to hold the perspective that increasing the wage does reduce employment, but only slightly. In this view, demand for unskilled labor is quite inelastic; it’s difficult to replace these occupations with capital or do without them altogether. Economists in this camp argue that

the societal benefits from wage increases for workers who keep their jobs after the increase more than outweigh the societal costs of those few who lose their jobs because of the increase.

The second view is that a minimum wage increase does not affect employment *at all*. This contention is at odds with neo-classical economics unless we assume that many minimum wage workers are in *monopsonistic* labor markets, where there is only one buyer of labor. Such labor markets were not uncommon a century ago, when company towns still existed and a community’s entire workforce was beholden to a single employer. However, it’s one thing to assert that these labor market conditions persist and another thing altogether to identify them. The (limited) research on this tends to look at labor markets by industry instead of community, a stratification that makes little sense when applied to low-skilled workers who presumably possess no industry-specific skills and tend to focus their job search in their own community.

Because a monopsonist employer must raise wages for everyone a little bit to entice the marginal worker to take a job (unless the employer has the power to wage-discriminate between existing and new workers), the marginal cost of that worker is much higher than his wage. Hence, the monopsonistic employer pays wages below the socially optimal rate and employs less than the socially optimal number of workers. A minimum wage would make the firm a price taker regarding wages, effectively lowering the marginal cost of labor. In that situation, a minimum wage would serve to increase employment.

Many commentators have apparently concluded that the U.S. economy contains many monopsonistic labor markets. Freelance journalist Noah Smith recently blogged his own summary of results of recent minimum wage research, which he argues support the notion that monopsonistic labor markets mean that a minimum wage increase’s effect on employment would be exceedingly modest (“Why \$15 Minimum Wage Is Fairly Safe,” *Noahpinion* (blog), January 15, 2021).

But is that really what the recent empirical research indicates? In this working paper, Neumark and Peter Shirley, a policy analyst for the West Virginia Legislature who earned his economics Ph.D. under Neumark, present an analysis akin to a meta-analysis showing no evidence of a resurgent monopsony. Their careful work, conducted using the data from the original studies, suggests that labor demand curves do indeed bend downward, meaning that a minimum wage increase will reduce employment. They conclude that these job losses are especially pronounced for teens and unskilled workers.

Nearly 80% of the studies in their analysis have a negative elasticity of labor demand, and almost half of those are significant at the 95% confidence level. For low-wage industries, those proportions are slightly smaller, with two-thirds of studies finding a negative demand elasticity and one-third being negative and significant at the 95% confidence level.

In essence, the talk about there being myriad monopsonies redeveloping in recent years makes little sense. The wealth of new studies on the minimum wage are far from showing this issue is

## IN REVIEW

unsettled; in fact, they show that a higher minimum wage does indeed reduce employment. Whether that loss is outweighed by the benefits of boosting the wages of others can be an open debate, but pretending that job losses do not happen is at odds with most research. —Ike Brannon

## Special Purpose Acquisition Companies

■ “A Sober Look at SPACS,” by Michael Klausner, Michael Ohlrogge, and Emily Ruan. SSRN Working Paper no. 3720919, January 2021.

Investors have complained for some time that the mechanism behind initial public offerings (IPOs) does not appear to achieve an optimal outcome. It usually begins with an investment bank canvassing big investors to get a rough sense of what they might pay for the new company’s stock, to establish a price range. The bank then attempts to steer the company to select an offer price at the lower end of that range.

The investment bank’s intent is to create a scenario in which the price “pops” as soon as it hits the market. The initial jump in price helps the investment bank’s reputation with investors and it also makes the bank some money, as the bank typically receives some of the stock as payment, and garners attention for the firm. However, the steep initial jump in price comes at a cost: if the original price had been set at the higher price, the company would have received more capital.

What’s more, the cost of doing an IPO is not cheap: underwriting fees can be as much as 7% of the value of the company.

Alternatives to the standard IPO process have been tried. Google famously did a reverse auction for its initial offering, but it was widely viewed as having been a disappointment because it raised less money than the company hoped. Some attributed the outcome to its investment banks, none of which wanted the status quo upended. Few reverse-auction IPOs have been attempted since then.

More recently, the music app Spotify did a direct listing, whereby it simply listed its outstanding shares on the market without an underwritten offering. The perceived drawback of this is that existing shareholders are not required to hold onto their shares for a certain period—unlike in most IPOs—so the fear is that without that backstop the shares could tank. That, in turn, dampens demand and the new shares raise less money. While investors watched Spotify’s direct listing carefully, it failed to spur many imitators.

Another alternative to the IPO gained popularity in 2020: the Special Purpose Acquisition Company (SPAC).

A SPAC is a “blank check” shell company created specifically to obtain a private firm and take it public. Investors buy shares in the shell company at a price fixed at \$10, and the principals park the money raised while they search for a promising firm to acquire. Once the principals have identified a target, they inform the shareholders, who vote on whether to approve the acquisition. Shareholders who don’t approve can get their original investment

back with interest. If the process isn’t completed in two years, all shareholders get their investment returned.

The popularity of SPACs exploded in 2020, when companies executed 165 of them, compared to just 59 in 2019. And that popularity is growing: Bloomberg estimates that in January 2021, alone, investors initiated 90 SPACs.

The rise in their use has led some to declare that the SPAC is a superior tool for taking startups public and that it may someday achieve what the reverse auction and private listing couldn’t and supplant the IPO.

However, the popularity of SPACs may prove fleeting, the authors of this paper argue. The problem, they aver, is that SPACs may make a lot of money for the principals who found them, but the investors who buy stock in them often end up not doing very well.

While a SPAC may be simpler to execute than an IPO, it does not appear to be superior for investors. In their analysis of 47 SPACs that emerged between January 2019 and June 2020, the authors found that the average stock price was well below the starting price. The authors attribute this to dilution of the stock, which consists of the sponsor’s “promote,” or disproportionate share of profits, underwriting fees, and the post-merger SPAC warrants. SPACS also have significant costs, but the authors say they are hidden, penalizing those who don’t redeem immediately.

And while stock prices for the SPACS in the data set tend to fall in the first year after the transaction is completed, the authors find that most of the initial investors exited the stock

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***SPAC stock prices tend to fall in the first year after the transaction is completed, but most of the original investors exit the stock shortly after the acquisition.***

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shortly after the acquisition was completed. Investors who bought into the SPAC after acquisition bore the brunt of the losses. Such an outcome is not a sustainable long-run equilibrium, the authors suggest.

They conclude that the benefits of SPACS appear to be overstated, for several reasons. There is little evidence that smaller investors are, in fact, participating in SPACS. The cost of executing a SPAC does not appear to be appreciably less than a regular IPO. And the post-SPAC-closure drop in price suggests to them that savvy investors may soon begin avoiding them.

In the two decades since the dot-com bubble burst, we have seen Congress pass the Sarbanes-Oxley Act of 2002 and the Dodd-Frank Act of 2010 to give regulators more tools with which to govern financial markets. Many people have written about how these have increased the cost of doing an IPO. There have been economists predicting a continuing diminution of U.S. IPOs for two decades. In fact, in the last year a large number

of companies have gone public, many of which have chosen to do so via SPACS.

The authors conclude that the SPAC does not offer a less expensive route to going public, although it may be easier to accomplish. As the market digests the fact that SPACS tend to lag the market post-acquisition because of the higher costs, future SPAC transactions may be forced to become more efficient—although that hasn't yet occurred in the IPO market.

But, the authors note, the higher cost of a SPAC is not endemic to the structure, and this could be addressed if the market forced it to.

This paper sheds light on a new phenomenon. It merits a rapid update that performs the same analysis for all SPACS that occurred in 2019 to see if the explosion of the phenomenon saw an increasing difference between the post-SPAC stock performance and the broader market indices, and whether the dilution problem was lessened. —I.B.

## Securities Regulation

■ “Quantifying the High-Frequency Trading ‘Arms Race’: A Simple New Methodology and Estimates,” by Matteo Aquilina, Eric Budish, and Peter O’Neill. SSRN Working Paper no. 3636323, June 2020.

■ “Innovation in the Stock Market and Alternative Trading Systems,” by Gabriel Rauterberg. SSRN Working Paper no. 3728768, December 2020.

**N**o development in financial markets currently causes more discussion and disagreement than high-frequency trading (HFT). Forty years ago, the “making” of a market in equities was done by “specialists” who owned seats on exchanges. They were compensated by the “spread”—the difference between the price they offered sellers and charged buyers. Those differences were large enough to more than cover costs. The excess profits were capitalized in the prices that specialists paid for the right to trade on an exchange.

Now liquidity is provided by traders using computers. In a previous Working Papers column (Winter 2013–2014) I reported that many commentators view this change positively because the costs of trading have been dramatically reduced along with the rents to specialists. Bid–ask spreads have decreased over time and revenues to market-makers have decreased from 1.46% of traded face value in 1980 to just 0.11% in 2006 and 0.03% in 2015. And HFT reduces stock price volatility. When the temporary ban on short sales of financial stocks existed in 2008, the financial stocks with the biggest decline in HFT had the biggest increase in volatility.

Those who emphasize the costs of HFT focus on an “arms race” among HFT participants to locate their servers closer and closer to the servers of electronic exchanges. This arms race exists because the transfer of buy and sell orders from any of the actual computerized exchanges to the National Market System (NMS) takes real time. This creates the possibility of learning about prices at a computer-

ized exchange and trading on that information through the NMS before the NMS posts the information. Traders have responded to these facts by paying to locate their servers in the same location as exchange servers, utilizing the speed of light to arbitrage price differences at the level of thousandths of a second (latency arbitrage).

In a previous Working Papers column (Fall 2015) I described research that demonstrated that the arms race is the result of exchanges’ use of a “continuous-limit-order-book” design (that is, orders are taken continuously and executed in the order of arrival). In a continuous auction market, someone is always first. In contrast, in a “frequent batch” auction (in which trades are executed by auction at stipulated times that can be as little as a fraction of a second apart), the advantage of incremental speed improvements disappears. To end the latency arbitrage arms race, the 2015 paper proposed that exchanges switch to batch auctions conducted every 10th of a second.

What are the costs of the arms race? If multiple participants are engaged in a speed race, some will succeed and some will fail. But conventional limit order book data don’t have a record of the losers. The first paper in this review relies on the simple insight that computer messages to trading computers that fail to result in trades provide a complete record of speed-sensitive trading.

The authors obtained from the London Stock Exchange all message activity for all stocks in the Financial Times Stock Exchange (FTSE) 350 index for a nine-week period in the fall of 2015. The messages are time-stamped with accuracy to the micro-second (one-millionth of a second).

Their main results:

- The average FTSE 100 symbol has 537 latency-arbitrage races per day. That is about one race per minute per symbol.
- Races are fast. In the modal race, the winner beats the first loser by just 5–10 microseconds, or 0.000005 to 0.000010 seconds.
- For the FTSE 100 index, about 22% of daily trading volume is in races.

The “latency arbitrage tax,” defined as latency arbitrage profits divided by all trading volume, is about 0.5 basis points (0.005%). The average bid–ask spread (the effective charge for liquidity provision) in the data is just over 3 basis points. Thus, the latency arbitrage tax is about 17% ( $0.5 \div 3$ ). If liquidity providers did not have to bear the adverse selection costs of losing races, the cost of trading would be reduced by 17%. This amounts to \$5 billion per year across all global equity markets.

Will exchanges adopt batch trading? The conventional answer is no because they make most of their revenue from charges for the co-location of traders’ servers with the exchange servers to allow faster trades. But the second paper in this review argues that an important component of the explanation for the lack of adoption of batch trading by exchanges is Securities and Exchange Commission regulatory requirements for exchanges.

The main cost an exchange would face in adopting frequent batched auctions would be the cost of obtaining SEC approval.



## IN REVIEW

And once that approval is won, at some significant cost, other participants can free ride on the approval without incurring the legal cost by adopting the same structure themselves.

In addition, the design of a batch auction cannot be patented. As a result, the only way for an exchange to make money through a batch design would be a trade secret, but under SEC regulations exchanges must disclose everything for public comment and subsequent SEC approval.

Alternative Trading Systems (ATSs) are not exchanges and are subject to much less disclosure and regulation than exchanges. ATSs can change their rules more quickly and innovations can remain trade secrets. ATSs just file a form with no notice-and-comment period and responses.

How expensive are the regulatory differences? When Intercontinental Exchange (ICE), the owner of the New York Stock Exchange, purchased the Chicago Stock Exchange, Chicago had trivial volume. ICE was purchasing “an exchange license” for \$70 million, which suggests the costs of the formal SEC exchange application rules are quite substantial. When the ATS Investors Exchange (IEX) applied to become a stock exchange in the fall of 2015 and conduct its trading with a batch design, its application was followed by months of disputes even though its proposed market structure was basically identical to its operation as an ATS. SEC approval took nine months. Two ATSs, OneChronos and IntelligentCross, have adopted batch trading while IEX has not had much success as an exchange.—P.V.D.

## CAFE Standards

■ “Who Values Future Energy Savings? Evidence from American Drivers,” by Arik Levinson and Lutz Sager. NBER Working Paper no. 28219, December 2020.

**T**he original rationale for Corporate Average Fuel Economy (CAFE) standards is that consumers supposedly fail to correctly appreciate the tradeoffs between the higher initial expense of a vehicle with better fuel economy and the subsequent savings in fuel costs over the lifetime of the vehicle. *Regulation* has discussed the evidence for this rationale several times (see “Do Consumers Value Fuel Economy?” Winter 2005–2006, as well as Working Paper columns for Winter 2015–2016, Spring 2017, and Spring 2018). The evidence suggests that, in the aggregate, consumers trade off higher initial costs and subsequent fuel savings correctly.

This paper examines data at the individual level using U.S. National Household Travel Survey (NHTS) data from 2009 and 2017. Instead of asking whether the price premium for a hybrid Toyota Camry, for example, is justified given the average annual mileage such cars are driven, the authors examine the actual annual miles driven and calculate the gasoline expenses of each participant in the survey.

Fuel economy is only one of many attributes that consumers

consider in their purchase decision. The authors use a clever research design to separate the effect of fuel economy from other vehicle attributes: They examine the 24,362 drivers of vehicles available in either a gas or hybrid version, 2,337 of which are hybrids. For each driver, they calculate the annual fuel cost difference discounted at 7% over a 14-year vehicle lifetime. There are 2,430 who would save money in hybrids, and nearly precisely that many, 2,337, actually drive hybrids. But they are mostly the wrong 2,337 drivers. Of the 2,430 for whom a hybrid would save money (given actual gasoline prices and given actual miles driven), only 12% (286) actually drive hybrids. The remaining drivers drive gas cars and drive enough miles annually that they would save money with a hybrid over the vehicle’s life.

More drivers (21,932) would save money in the gas cars. Of those, 91% choose correctly the gas versions. The other 2,051 drive hybrids, overinvesting in fuel efficiency.

A second research design examines all vehicles in the survey data and statistically controls for attributes other than fuel economy to estimate the initial extra cost of a 1-mile-per-gallon increase in fuel economy. The authors find that cost is between \$110 and \$340. Stated differently, the average incremental cost of purchasing a car that travels 1 additional mpg (say from 25 to 26 mpg or 33 to 34 mpg) ranges from \$110 to \$340.

The benefit from that higher initial expense is the reduced use of fuel over the vehicle’s lifetime. Given gasoline prices faced by consumers, the average annual savings from 1 extra mpg in vehicle fuel economy is \$56. Earned annually and discounted at 3% for 14 years and summed, that’s \$618. Thus, on average consumers could spend \$100–\$340 initially to save \$618.

If the lower price for an extra mpg is used (\$110), then 142,924 (92%) of the 155,572 drivers in the sample bought cars with too little fuel economy. The other 12,648 drivers overinvested in fuel savings. The 142,924 drivers who underinvested incur \$6,000 more in average driving costs over 14 years relative to cars with the optimal level of fuel economy, whereas the 12,648 who overinvested lose only \$400.

If future fuel savings are discounted at 7% and the high estimate of the fuel economy price (\$340 per mpg) is used, the two types of mistakes are about equally likely: 53% of survey participants underinvest and 47% overinvest. The average driver who underinvested incurs an extra \$2,400 in total lifetime driving costs, whereas the average driver who overinvested loses about \$1,300.

The interesting policy insight from these results is that CAFE, with its emphasis on increasing aggregate fuel economy, seems to still leave most drivers with the “wrong” vehicle from a fuel economy perspective. In the 2017 NHTS sample, a fleet-wide increase in fuel economy of 1 mpg would save the average driver about \$50 per year. Merely swapping cars among drivers to increase high-mileage cars’ efficiency by 1 mpg (by placing them in the possession of drivers who drive more miles) would save an average of \$30 per driver per year. In other words, better sorting at constant technologies achieves 60% of the savings from a fleet-wide fuel economy improvement.—P.V.D. R

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