IN REVIEW

Why Regulation Will Likely Keep Illegal Weed Dominant

REVIEW BY DAVID R. HENDERSON

As more and more state governments legalize recreational use of marijuana—14 had done so by 2021—an obvious question to ask is, will the amount of legal marijuana sold and consumed eventually exceed the amount of illegal marijuana sold and consumed? Thinking through the economics, my answer would have been yes. Make it legal and the risk of producing and selling it falls. Those who continue to produce illegally face the risk of prosecution and confiscation. Legal marijuana, therefore, should have an advantage in the market.

But in *Can Legal Weed Win?* economist and lawyer Robin Goldstein of the University of California Cannabis Economics Group and agricultural economist Daniel Sumner of the University of California, Davis answer no. They argue that the heavy regulation of legally produced marijuana gives a leg up to illegal marijuana—or, as they call it in the book, "weed." They make their case by guiding the reader through the history of marijuana legalization and regulation, and by analyzing the basic economics of legal and illegal markets. I find their case persuasive.

Push for prohibition / The authors start by explaining why they use the word "weed" instead of "marijuana." They write, "We prefer a term used by buyers and sellers in real markets to a term used by government regulators." They had me at "government" and so I will adopt their usage.

In the book's first chapter, Goldstein and Sumner give a brief history of the legal status of weed. They note that in the 1800s it was completely legal in the United States. But in the early 1900s, governments started pushing the idea that weed was particularly harmful. It didn't take long for state governments to prohibit it, which they did long before the federal government entered the picture. Interestingly, California was the second state to prohibit weed, after Massachusetts.

Welcome to California / In 2000, a group of like-minded libertarians and I formed the Monterey, CA-based Foundation to End Drug Unfairness Policies (FEDUP) to advocate the legalization of all illegal drugs. Our main concern was not the availability or price of illegal drugs; only one of our group used them. Rather, our concern was the lives shattered by the government's drug war. People were being imprisoned for buying, producing, or selling illegal drugs and, because of the extensive government regulation of entry into various occupations, those with a prison record could not legally work in many occupations in which they could otherwise have easily become qualified. Although we set our sights high, we thought that, at the very least, weed would eventually be legalized. And it was, in steps.

In 1996, California voters passed Proposition 215, making it legal for people with medical conditions to grow weed for personal use if they had a doctor's recommendation. (See "Limiting Federal Regulation of Cannabis," p. 2.) But police and sheriffs continued to crack down on its production and distribution.

In 2003, California's legislature passed SB 420, which authorized patients to have collective or cooperative weed cultivation projects if they were not for profit. The authors point out that "the most important thing to know about SB 420 is what it didn't do: regulate or authorize commercial sales." Accordingly, there was no state licensing, taxation, or other state regulation.

Recreational weed in California was legalized in 2016 with the voter-passed Proposition 64. The good news out of Prop. 64 was that many people who would have been busted for weed would not be. We shouldn't underestimate that increase in freedom. But the rest of the news was bad. Legal producers faced the usual regulation imposed on any business by Sacramento. On top of that, Prop. 64 singled out weed producers and distributors with additional regulation.

Business owners who wanted to obey the law had to get licenses and pay special taxes on weed. The state government set a "cultivation tax" at $9.65 per ounce and an excise tax of 27 percent of the wholesale price. Goldstein and Sumner estimate that the net effect of those taxes and local-government taxes is a tax rate of 35 to 50 percent of the retail price of legal weed.

There were other regulations. Starting in 2018, it became illegal to sell weed after 10 p.m. Also, write the authors, not just in California but everywhere in North America, weed retailers are prohibited from also selling alcohol and tobacco.

They note that two popular methods of consuming weed are illegal: One is the blunt, a hollowed-out cigar that is

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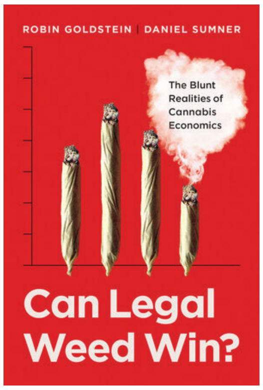
filled with weed; the other is the spliff, a hand-rolled joint that combines weed and tobacco. Although the authors don't say this explicitly, it seems as if the authors of Prop. 64 and regulators in other states asked, what are the most popular ways to use weed so that we can ban those ways?

Finally, in California each local government can prohibit retail outlets in its jurisdiction. In Pacific Grove, where I live, that is exactly what the local government has done.



Can Legal Weed Win?

By Robin Goldstein and Daniel Sumner

211 pp.; University of California Press, 2022

Getting the business / One person who did not reckon with the raft of regulations that would come with Prop. 64 was Sabrina Fendrick of the National Organization for the Reform of Marijuana Laws (NORML). Goldstein and Sumner have a chapter titled "Sabrina's Story" in which Fendrick says she knew how to think about criminal justice while at NORML but later "realized how little I knew as an activist about how hard it is to operate a cannabis business." In an interview with Goldstein, Fendrick lamented, "I wish I had been more critical and engaged in the drafting" of Prop. 64.

Call this Fendrick's "George McGovern moment." McGovern, a U.S. senator from South Dakota between 1963 and 1981 and the Democratic candidate for president who ran against Richard Nixon in 1972, was on the left end of the Democratic spectrum. Not surprisingly, given his views, he was not sympathetic to the travails that business people experienced, both in running a business successfully and in dealing with government regulation and taxes. McGovern learned the hard way. A few years after leaving the Senate, he bought and operated a 150-room inn in Stratford, CT. In a 1992 op-ed in the *Wall Street Journal*, he wrote that he wished he had had this first-hand experience when he was in Washington because "that knowledge would have made me a better U.S. senator and a more understanding presidential contender." Similarly, Fendrick stated: "I hadn't actually realized how [legal] language can completely change how a business operates. Sometimes for good, sometimes for bad."

The effects of these heavy regulations in California were dramatic. By 2021, the authors write, "California had less than one-third the number of weed retailers listed on Weedmaps" as it did in 2017, just before the regulations took effect.

Because weed is so heavily regulated in California, the authors argue, illegal weed still dominates. While it's true that producing something illegally carries risk and that risk gets factored into the price, it's also true that heavy regulation and special taxes on weed make legal weed expensive. The net result, the authors show, is that in California legal weed is substantially more costly than illegal weed.

Future of weed / In one of their final chapters, Goldstein and Sumner speculate about the long-term prospects for weed. They predict that more state governments will allow legal weed and that eventually it will be legal to sell it across state borders. This, they argue, will mean that higher-priced producers in heavily regulated places like California will lose business to producers in less-regulated places like Oklahoma where, as a bonus, land is cheap.

Where the authors are at their best in this chapter is in debunking the common claim that in a few decades the U.S. weed industry, measured by annual revenue, will be a multiple of its current approximate $25 billion. They agree with forecasters that weed output will be a multiple of output today, but for that very reason the price will be much lower. They even argue that the effect of higher output on price could be so substantial that overall revenue in 2050 will be lower than it is today.

An interesting aside is their noting that the Supreme Court justice who has been the "most supportive of legal weed over the past few decades" is Clarence Thomas. It's probably not because he uses weed; call it a hunch. It's because Thomas saw clearly, unlike six of his colleagues, that Diane Monson and Angel Raich (in *Gonzalez v. Raich*, the 2005 decision that Congress may criminalize the production and use of homegrown weed even if state law allows its use), in Thomas's words in his dissent, used "marijuana that has never been bought or sold, that has never crossed state lines, and that has no demonstrable effect on the national market for marijuana." Thomas continued, "If Congress can regulate this under the Commerce Clause, then it can regulate virtually anything—and the Federal government is no longer one of limited and enumerated powers."

Elsewhere in the book, the authors do make an important mistake in telling the history of the term "the dismal science" to describe economics. They correctly note its author, Thomas Carlyle, but they badly miss his ominous reason. They write that he was referring to Thomas Malthus's view that the price of food would not fall. That wasn't it. Rather, Carlyle noted that the free-market economists of 1800, who dominated economics at the time, strongly opposed slavery. That, to Carlyle, was what made economics "dismal."

Conclusion / The subtitle of *Can Legal Weed Win?* is "The Blunt Realities of Cannabis Economics." That's a nicely descriptive subtitle. If I were to choose the subtitle, though, it would be "Be Careful What You Wish For." Many of us who have supported legalizing marijuana didn't reckon with—but should have—the raft of regulations and special taxes that would accompany legalization. My particular group, FEDUP, had no excuse. After all, one of us is an economist who studies regulation, and we had all lived in California for years. *R*

IN REVIEW

In Defense of Shareholder Capitalism

REVIEW BY PHIL R. MURRAY

Executives of the Business Roundtable used to proclaim that the purpose of a corporation is to earn profits for stockholders. Then, in 2019, they changed their purpose statement to emphasize a commitment to "customers," "suppliers," "the community," and "the environment," along with "shareholders." That change prompted University of California, Los Angeles law professor Steven M. Bainbridge to write *The Profit Motive: Defending Shareholder Value Maximization*. He states, "My goal is to put forward an unabashed defense of the proposition that the purpose of a corporation is to sustainably maximize shareholder value over the long term."

The book examines the conflict between advocates of shareholder capitalism and advocates of stakeholder capitalism. The former advance Milton Friedman's idea that "The Social Responsibility of Business Is to Increase Its Profits," to borrow the title of his (often misunderstood) 1970 *New York Times Magazine* essay. The latter argue for corporate social responsibility (CSR) and environmental, social, and governance (ESG) issues. There are multiple definitions of both CSR and ESG, and different views of the effects each has on a corporation's bottom line. Bainbridge adopts no single definition of either. The salient feature of CSR and ESG is what they have in common: an emphasis on the interests of stakeholders such as workers and members of the community.

Bainbridge bases his approach on "law, history, and economics." Take his explication of the Michigan case *Dodge v. Ford Motor Company*. In 1916, Henry Ford announced the company would cut its dividend payment, using the automaker's massive cash reserves to build another factory, lower automobile prices, and continue to pay workers high wages. Brothers John and Horace Dodge, who had recently expanded from being auto parts suppliers to making their own automobiles and who were also early investors in Ford, objected to the plan. As shareholders, they took Ford to court for two reasons: to stop the construction of the factory and to make Ford resume paying dividends. The Dodge brothers won their case at the lower court level, and Ford appealed.

Bainbridge documents that Henry Ford's "stated goal was to do 'as much good as we can, everywhere, for everybody concerned … [a]nd incidentally to make money.'" In 1919, the Michigan Supreme Court decided that Ford's directors neglected to make the interests of stockholders a priority, as they were legally required to do, and ordered Ford to reinstate dividend payments. However, the higher court reversed the part of the lower court's decision that prevented Ford from building the factory. Bainbridge remarks that had Ford stated he was only interested in making profits, he would have prevailed on both counts.

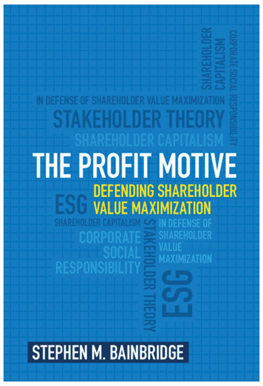
Directors' judgment / Although the court thwarted Ford's plan in part, corporate directors would not have to fear an onslaught of suits filed by shareholders and judges interfering in their plans. Judges refrain from taking up cases based on "the business judgement rule." "Accordingly," Bainbridge explains, "courts would defer to the judgment of the directors unless a complaining shareholder could show something beyond mere negligence, such as fraud or self-dealing on the directors' part."

Some law professors go so far as to claim that the business judgment rule trumps the *Dodge* decision and gives directors legal cover to advance the interests of stakeholders. Bainbridge rejects this idea because judges continue to take up cases involving disputes between directors and shareholders. In 2010, for example, the Delaware Court of Chancery took up a case between the directors of Craigslist and eBay, the latter having a minority stake in the former. Craigslist clearly stated its goal was to benefit stakeholders; eBay sued to press the directors to focus on shareholder value. The court sided with eBay. Bainbridge adds, "The fact that the business judgment rule typically precludes a court from deciding whether directors breached the shareholder wealth maximization norm does not mean that the norm is not the underlying doctrine." The rule enables judges to refrain from substituting their authority for that of directors in every case but does not bar judges from hearing cases in which directors might be putting stakeholders before shareholders. The *Dodge* decision is a cornerstone of corporate law. Bainbridge declares, "When we say that shareholder value maximization is the law, we mean the law writ large."

Beyond Friedman / Having made the case that the purpose of a corporation is to make profits for shareholders, Bainbridge devotes his largest chapter to why that should be. A reader might be surprised to learn that he considers Friedman's argument for shareholder value maximization based on private property rights to be inadequate. "Shareholders are not owners," Bainbridge explains, "so their rights are not grounded in property." Shareholders are in effect contractors who negotiate for the corporation's residuals.

Another inadequate argument is based on the accurate observation that stakeholders fare well in an economy with profit-seeking firms. Workers generally see their standard of living rise, the air and water tend to become cleaner, and so forth. But, Bainbridge points out, "a rising tide does not lift all boats." Directors may make decisions that impose hardship on stakeholders. For instance, the decision to shutter a factory will render workers unemployed. Making decisions in business creates risk; various groups bear risk associated with the decisions that directors make.

There are serious problems with stakeholder capitalism that lead one to support shareholder capitalism. In the "Bainbridge hypothetical," the directors of a company plan to replace an outmoded factory with a new one. They can construct the factory either in the United States or overseas. If the directors choose the United States, American workers will benefit by keeping their jobs. If the directors choose overseas where wages are lower, shareholders will benefit by earning higher profits. If the directors are accountable to shareholders, they will construct overseas. If the directors are accountable to their American workers and other stakeholders, it is not clear what they will do. Bainbridge reckons that "the board would lack a determinate metric for assessing its options." "After all," he asserts, "directors who are responsible to everyone are accountable to no one." Suppose proponents of stakeholder capitalism urge the directors to construct the factory in the United States to benefit American workers. That decision entails an "implementation problem": other stakeholders such as lenders, environmentalists, and consumers may resist. Of course, shareholders will create an implementation problem for directors who intend to benefit other stakeholders at their expense because they will balk at financing business decisions contrary to their self-interest.



The Profit Motive: Defending Shareholder Value Maximization

By Stephen M. Bainbridge

223 pp.; Cambridge University Press, 2023

Challenging stakeholder capitalism / University of Iowa law professor Robert Miller is one of several scholars who maintain that stakeholder capitalism undermines democracy. He points out that if carbon dioxide emissions are negative externalities to be treated like pollution, government regulation is necessary. So far, owing to the citizenry's lack of interest in reducing these emissions, legislatures have not delivered significant regulations. Bainbridge quotes Miller, "Stakeholderism provides a possible answer to this problem: it may be possible to convince corporations to do voluntarily what they are not required to do legally."

Bainbridge mentions United Technologies' announcement during the 2016 presidential campaign to close a Carrier furnace plant in Indiana, moving the work to Mexico. Donald Trump sharply criticized the decision on the campaign trail. Following his election and touring the plant in the weeks before he took office, United Technologies' officers reversed course. Bainbridge states,

> Whether the request comes from the right or left, asking corporate executives to take on governmental functions not only asks them to undertake tasks for which they are untrained and for which their enterprise is unsuited, it also subverts the basis of a liberal democracy.

The author's statement makes sense by itself, but it is difficult to see how it follows from the scenario involving United Technologies. What "government functions" did Trump hound United Technologies' CEO into taking? Political interference in business decisions seems to be a greater threat to shareholder capitalism than stakeholder activism is to democratic institutions.

Imagine directors, shareholders, and other stakeholders in a "hypothetical bargain" to determine labor compensation. Bainbridge assumes that "we can draw on our experience and economic analysis to predict what the parties would do in such a situation." Given that shareholders vote for directors and that directors benefit when the corporation earns profits, directors have incentives to bargain for shareholder value maximization. Shareholders, of course, have an incentive to bargain for shareholder value maximization.

Bainbridge refers to Miller's analysis again. Stakeholder advocates expect stakeholders to receive a share of corporate profits when times are good but do not expect stakeholders to share in the losses when times are bad. Bainbridge quotes Miller: "No rational commercial party would ever agree to such terms." Bargaining theory even predicts that workers and other stakeholders will choose shareholder value maximization. Experience shows that workers and other stakeholders may expect shareholder capitalism to generally improve their well-being over time.

The following logic applies as well: "Because shareholders will place a higher value on being the beneficiaries of director fiduciary duties than will non-shareholder constituencies, gains from trade are available, and we would expect a bargain to be struck in which shareholder wealth maximization is the chosen norm." The details of such a bargain—that is, precisely how shareholders convince stakeholders to choose shareholder value maximization—would be interesting to know. Unfortunately, Bainbridge leaves those details to the reader's imagination.

Shareholder capitalism is not heaven on earth. Bainbridge recognizes as much when he borrows Winston Churchill's characterization of democracy by likening shareholder capitalism to the least bad economic system. Undaunted, he goes on to explain how the pursuit of profit makes the world a better place. First, prices are necessary if the economy's land, labor, and capital are going to produce the most goods and services. Profits are a price: the return to owners of corporations. If directors do not aim to maximize profits, corporations that satisfy consumer wants will fail to attract land, labor, and capital away from corporations that do not satisfy consumer wants. Second, profits serve as a reward for entrepreneurs who innovate and cause the economic growth that lifts most people out of poverty. Third, to pursue profit is to exercise one's economic freedom, which is necessary to preserve political freedom.

Greenwashing / Despite serious flaws in stakeholder capitalism, the business press is rife with discussion of ESG. Bainbridge attributes this to "greenwashing": firms feigning a concern for environmental and social issues in order to increase sales. Theory and evidence support his view. In principle, CEO compensation is so tightly linked to corporate financial performance that CEO conduct is bound to be consistent with shareholders' interests, not environmental or social issues. Empirical research indicates that CEOs who endorsed the Business Roundtable's 2019 statement act no more in the interests of stakeholders than CEOs who did not endorse the statement; the former CEOs more often run afoul of regulations than the latter, according to one report. According to another, Business Roundtable CEOs who backed the 2019 statement "paid out 20 percent more in dividends and stock buybacks during the COVID-19 pandemic" than did CEOs who did not back the statement. Finally, the Business Roundtable CEOs who signed the 2019 statement did not bother to change their "corporate governance guidelines" to reflect the sentiments toward stakeholders expressed in the statement. CEOs may talk about stakeholders' interests, but they act in the interests of shareholders.

Conclusion / *The Profit Motive* is a comprehensive and powerful rejection of the ideology of stakeholder capitalism and an affirmation of shareholder capitalism. Law professors and law students will learn the legal history of corporate purpose and access an abundance of sources in the notes. Economists will find justification for the belief that firms should maximize profits. Executives will likewise learn how to better defend their plans that benefit stockholders at the expense of other stakeholders. Citizens in general will profit (pun intended) from acquiring a better understanding of the role of profits in a capitalist society. *R*

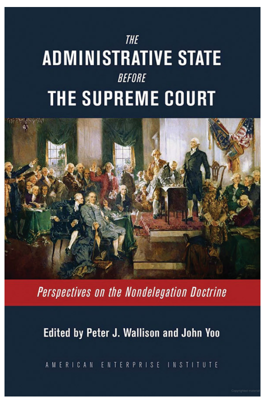
Restoring the Nondelegation Doctrine

REVIEW BY GEORGE LEEF

In recent months, we have seen the following: the U.S. Department of Education announced that it intends to implement new rules on the repayment of federal student loans that will, for many students, make college nearly free; the Consumer Product Safety Commission stated its goal of banning or at least inhibiting the purchase of stoves that use natural gas; and the Federal Housing Finance Authority declared that it is going to change mortgage lending so that buyers with good credit scores will have to subsidize those with poor scores.

The common thread in these cases is that an executive department agency wants to legislate. Bureaucrats want to enforce laws of their own devising. Doing that raises a problem under the U.S. Constitution, which vests all legislative power in Congress. The Founders envisioned a distinct separation of authority between the lawmaking Congress and the law-enforcing executive branch. And the third branch of government, the judiciary, was expected to decide disputes and interpret the meaning of the laws when necessary.

In *The Administrative State Before the Supreme Court*, Peter Wallison, a senior fellow at the American Enterprise Institute, and John Yoo, a professor of law at the University of California, Berkeley, probe the question, how can executive agencies like those mentioned above be allowed to implement such policies? The Supreme Court is supposed to make sure that the other branches don't usurp each other's powers.



The Administrative State Before the Supreme Court

Edited by Peter J. Wallison and John Yoo

390 pp.; American Enterprise Institute Press, 2022

For roughly a century and a half after the nation's Founding, it adhered to the nondelegation doctrine, which holds that the legislative and executive branches could not delegate their responsibilities either to other governmental entities or to private parties. In a famous New Deal–era case, *Schechter Brothers Poultry*, the Court declared one of Franklin D. Roosevelt's signature policies, the National Recovery Act, unconstitutional because the vagueness of the law gave policymaking power to executive branch bureaucrats. Congress had impermissibly delegated its authority.

But after FDR's court-packing threat, the Court's majority shifted and took a relaxed view of lawmaking by the administrative state. Since the late 1930s, the nondelegation doctrine has been moribund. The Constitution, however, remains unchanged and the reasons for having a separation of lawmaking and law enforcement are as sound as ever. Moreover, the Supreme Court has lately shown interest in reviving the doctrine, making the book's collection of essays timely and valuable.

Beyond the details / In his introduction, Wallison explains that the Founders wanted divided political power "because they had seen in other countries that the people's liberties are in jeopardy if the same person or group can both make the laws and enforce them." The Supreme Court developed the nondelegation doctrine to prevent Congress from transferring its responsibility to the president or his officials. The Court held to that rule until it was cowed by FDR and later staffed largely by justices who were sympathetic with the "progressive" argument that society had become so complex that it simply had to be governed by expert administrators in a wide array of fields. Believing that Congress couldn't possibly enact all the needed regulations, the courts chose to give great deference to the agencies. Trouble is, that allows contentious matters of public policy to be decided by unelected bureaucrats.

In the book's first essay, Judge Douglas Ginsburg explores the history of the nondelegation doctrine back to Chief Justice John Marshall's opinion in the 1825 case *Wayman v. Southard*, where he wrote that Congress was responsible for the enactment of laws, but executive branch officials could "fill up the details." The problem, of course, is where to draw the line. Ginsburg observes that when the Court began accepting vague phrases like "regulate in the public interest," it was giving far too much leeway to executive branch officials.

He also points out that agencies like to "search for new ground to occupy," leading them to make policy when new technologies emerge that were never contemplated at the time Congress wrote the statute authorizing their actions. Why wait for Congress to act when we can promulgate rules that we think are advantageous?

In their essay, Todd Gaziano and Ethan Blevins of the Pacific Legal Foundation argue that the Supreme Court already has a solid doctrine that would solve delegation issues, namely the "void for vagueness" standard it applies in criminal law. When criminal statutes are not specific enough that a citizen can know with certainty that his conduct will be illegal, courts strike them down under that standard. Gaziano and Blevins maintain that this is equally applicable to many of the expansive grants of power to agencies that amount to little more than admonitions to do whatever they think is in the public interest. The Occupational Safety and Health Administration, for example, is supposed to implement rules "reasonably necessary and appropriate" for protecting workers. That language invites the agency, the authors write, "to make it up as they go along."

Mark Chenoweth and Richard Samp, both of the New Civil Liberties Alliance, begin their essay by examining the reasons why the Court abandoned the nondelegation doctrine and find none of them convincing. They then propose an "absence of standards" test:

> When a statute fails to include *any* binding standards that limit an agency's rulemaking authority—but rather lists some goals to which the agency should aspire—Congress should be deemed to have improperly delegated its legislative authority.

Consider President Trump's imposition of steel tariffs under a statute giving the president authority to mandate tariffs to protect national security. That is so vague, the authors note, that it is impossible for courts to know if the president is or is not acting as Congress authorized.

Boston University law professor Gary Lawson argues that the Court needs to "rediscover" the nondelegation doctrine and finds a strong analogy in the common law of agency. The American people are the principals and have delegated certain tasks to their governmental agents under the Constitution. The Founders were familiar with the law of agency and thus it makes sense to view delegation issues as agency questions. Just as an agent is entrusted with some degree of discretion in carrying out a principal's directions, so must the executive branch have some discretion in enforcing statutes passed by Congress. Lawson acknowledges that agency law analysis won't always provide crisp, clear answers, but it would get the courts asking the right questions.

Restoring responsibility / In his essay, law professor Jonathan Adler of Case Western Reserve University points out that when Congress is allowed to get away with delegation of its legislative responsibilities, the effects are bad. It allows the elected representatives to pass the buck on to unelected bureaucrats and then say, "We didn't do that" if the administrative rules prove to be damaging. Members of Congress are more apt to consider the inevitable tradeoffs of policymaking than are bureaucrats. Adler also points out that telling agencies to base their rules on "science" doesn't constrain their discretion. As our COVID experience has shown, claims about what science dictates are controversial and, even if not, a fixation on some aspect of science can overlook other factors that need to be considered.

Saikrishna Bangalore Prakash of the University of Virginia Law School seeks to reassure people that the sky will not fall if the Court were to revitalize the nondelegation doctrine. Some on the political left have fretted that if the Court did so, it would lead to chaos, with vast numbers of administrative rules suddenly eliminated. Prakash points out that the courts don't work that way. They rule on specific cases and precedents and won't automatically swoop down on agencies to render them powerless. Furthermore, Congress can codify existing rules deemed worth retaining. And looking to the future, Congress will learn to legislate more carefully so that it is making the important decisions, not the bureaucrats.

What about the states and their constitutions? Hillsdale College professor Joseph Postell looks at how they have dealt with the delegation problem. He finds that the courts in several states have been vigilant. For example, in 2013 the Louisiana Supreme Court struck down a statute under which rice growers were taxed to pay for a state marketing scheme, with the assessments decided upon by the growers themselves. The court ruled the legislature cannot delegate its taxing authority to private entities. Postell reports the nondelegation doctrine to be strong in nine states. The Supreme Court might learn something from them.

New York Law School professor David Schoenbrod laments that members of Congress have figured out how they can avoid "high risk votes" by conferring on bureaucrats vague powers to make rules that affect American citizens. The Constitution requires that in Congress each member must vote individually, and the votes must be recorded to prevent lawmakers from dodging responsibility. Allowing delegation, he writes, "guts consent of the governed." Schoenbrod's proposal for a judicially manageable approach would be for courts to base their decisions on whether a challenged rule had been declared "significant" by the Office of Information and Regulatory Affairs. Rules found to be significant would not be valid unless adopted by Congress. The current threshold for significance is $100 million, and that would mean that many agency regulations would have to go through Congress.

In his concluding essay, Yoo writes that "favoring a strict nondelegation doctrine test implies greater trust in yesterday's framers than in today's judges." Indeed it does, and the country would be better off if we could somehow get back to our intended separation of powers. *R*

Do We Know the Outer Limits of the Fed's Power?

REVIEW BY VERN MCKINLEY

Just a few weeks into the U.S. government response to the COVID-19 pandemic, on March 26, 2020, *Today* show host Savannah Guthrie asked Federal Reserve Chair Jerome Powell, "Is there any limit to the amount of money that the Fed is willing to put into this economy to keep it afloat?" Powell, who was appointed by Donald Trump and re-appointed by Joe Biden, responded candidly: "The only limit on that will be how much backstop we will get from the Treasury Department…. Essentially the answer to your question is no—we can continue to make loans."

Their conversation is recounted in the aptly titled *Limitless*, a new book by Jeanna Smialek. As she summarizes it, "The Fed's power across a wide range of markets, Powell was acknowledging, was on the brink of becoming limitless." Such comments are by no means isolated, as she also quotes Minneapolis Fed President Neel Kashkari saying of the Fed's money-making power, "There's an infinite amount of cash at the Federal Reserve."

Limitless is Smialek's first book. She is the Federal Reserve reporter for the *New York Times* and a regular questioner at Powell's periodic news conferences on monetary policy and the state of the economy. She previously worked for *Bloomberg News* and *Bloomberg Businessweek*.

Limitless was released late last February. I read it during the spring, as the Fed, the Treasury, and the Federal Deposit Insurance Corporation applied their expansive systemic-risk powers during the failures of Silicon Valley Bank, Signature Bank, and First Republic. Needless to say, the book was a timely read.

The methodology / In the book, Smialek ambitiously combines an abbreviated history of the evolution of the Fed's powers since its creation with a deep look into the changes to the role of, and expectations created by, the Federal Reserve in the wake of this century's global financial crisis and the pandemic.

Limitless's tracing of the historical evolution of the Federal Reserve's powers follows other recent books on the Fed, such as Peter Conti-Brown's *The Power and Independence of the Federal Reserve* (see "The Ulysses/Punch Bowl View of the Fed," Winter 2016–2017) and Sarah Binder and Mark Spindel's *The Myth of Independence* (see "Financial Crisis, Blame, Reform (Repeat)," Summer 2018). Smialek commits a large share of her book to the Fed's pandemic response, like Nick Timiraos' *Trillion Dollar Triage* (see "Was It Really Triage?" Summer 2022).

The history / As Smialek warns the prospective reader in her introduction, "The chapters ahead jump around chronologically." She begins with the role of the Fed as of late 2019 in the lead-up to the pandemic and in the early months of financial instability in March 2020. That 2019–2020 rerun is followed by three chapters (about 20 percent of the book) dedicated to the history of the evolution of central banking in the United States (from 1791 to 2019), followed by a return to the contemporary period.

Smialek's whirlwind tour of people and events will be familiar to those who have read about the history of central banking and the Fed during this period, and for those readers this material can be skimmed. She writes of Hamilton's First Bank of the United States, Nicholas Biddle's management of the Second Bank of the United States, and Andrew Jackson bringing an end to that early era of central banking.

She writes that "instability dogged" the system during the remainder of the 1800s and "the system was prone to runs." (It should be noted that both conditions persist in the 2000s.) She informs readers of the greenbacks of the 1860s, the onset of the National Bank Era, William Jennings Bryan, the Panic of 1907 (the rationalization to create the Federal Reserve), and J.P. Morgan's subsequent "private bank bailout." Then, she gets to Jekyll Island and Sen. Nelson Aldrich's bill that ultimately became the Federal Reserve Act. The book summarizes the early history of the Fed, including the New York Fed's Benjamin Strong and the chairmanship of Marriner Eccles. It explains the Treasury–Fed Accord and the reign of William McChesney Martin.

Finally, she describes the modern era of the Fed, with inflation subdued under Paul Volcker; the ensuing Great Moderation, mostly under Alan Greenspan; the Great Recession under Ben Bernanke, with the Fed's massive response of loose money and financial institution bailouts; and the modest efforts at normalization under Janet Yellen.

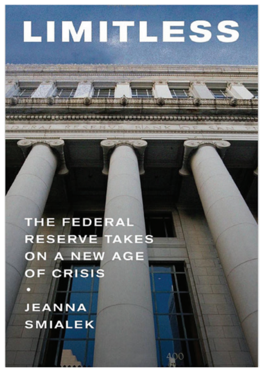
Ever-growing role / Smialek raises a good question in her introduction: "Is it healthy for our democracy to have a Fed this powerful?" But she doesn't provide a clear, well-defended answer, though she seems to be in the "yes" camp. In an interview that followed the release of her book, she commented:

> I feel like the point I try to make in the book … is that there's nothing nefarious about the Fed's evolution into being a very powerful organization. And it's not a conspiracy and it's not some sort of giant group of elites trying to take over the world. I explicitly try to counter that narrative.… We need someone to back all of that [the market(?)] up. And there's a good reason that power's been vested in the Fed because it's very nimble, because it's not going through some sort of democratic process.

I have a different, more skeptical summary of those historical developments: We don't need an elite group of "smart people" to accrue enormous power and control over our economy, working through an organization lacking in transparency and accountability. This danger is especially clear when that elite group makes mistakes that have broad effects, such as allowing inflation to rear its ugly head after a 40-year absence.

The new inflation / In the last chapter before her Epilogue, entitled "A Year of Uncomfortable Questions," Smialek describes the "Federal Reserve's new problem…, an inflationary burst…, an overly large mistake…, to spend money inefficiently on the short-lived sugar high of stimulus."

She lays much of the blame for the current inflation on overzealous fiscal policy that was "at least partially because of policies passed by … the new [Joe Biden] presidential administration and Congress in Washington." She also rightly notes that Donald "Trump … had been supportive of another round of large checks."



Limitless: The Federal Reserve Takes on a New Age of Crisis

By Jeanna Smialek

384 pp.; Knopf Publishing, 2023

Fiscal policy by both administrations surely deserves blame. Smialek also explains that "waves of coronavirus continued to disrupt factories across the globe," affecting the balance between goods and money. Still, she lays some of the blame on the Fed, "Very low rates were encouraging more families to attempt to buy a car or try for a house, which they might then have to remodel and furnish in an added boost to consumption, so the Fed's policies were also visibly playing a role."

Smialek also makes a strong case that the Fed made massive mistakes on inflation forecasting:

> Powell and the majority of his colleagues had spent much of 2021 predicting that price gains would calm down as pandemic weirdness worked itself out, labeling the inflation "transitory." The chair had used his speech at that year's Jackson Hole conference to list reasons why inflation was likely to fade on its own eventually.

Opaque Fed / Smialek gives the Federal Reserve system far too much credit for its recent, limited transparency moves:

> It has tried to become more transparent and publicly accountable as it has grown more important.… The central bank wanted to be transparent not because it made policy more effective—the Bernanke innovation—but because it wanted the public to feel heard.

She neglects to raise the longstanding Fed efforts to push back on transparency, like in the lawsuit filed by Bloomberg in the wake of the 2007–2009 financial crisis where the Fed fought tooth and nail to avoid disclosure of the most basic information about their bailout and lending programs. (It ultimately lost at the Supreme Court.) She also ignores the Fed's egregious lack of transparency under the cloak of banking supervision, sometimes referred to as confidential supervisory information, and the operations of the Federal Reserve Banks, which are not subject to basic federal transparency laws such as the Freedom of Information Act.

Fan club / I commented in my review of Timiraos's book that he showed himself to be a Powell fan. Smialek, similarly, is a fan of former Fed vice chair (and, before that, board member) Lael Brainard:

> Owing in large part to her thoroughness and competence, Brainard maintained the respect of her colleagues, even though she was out of step with them ideologically.… She was often prepared to the point of absurdity. Staffers told stories about times they had been sent to brief her only to realize that she knew as much about the topic at hand as they did.

In my review of Timiraos, I wrote, "My personal preference is to read a historical summary from an author who takes a more critical approach." That applies to Smialek, too.

Conclusion / I found *Limitless* to be a useful update of how the 2020 interventions were more of the same from the Fed. But the presented history is just too cursory to have much value to readers other than someone unfamiliar with the other histories I have noted, as well as Allan Meltzer's multi-volume *History of the Federal Reserve*.

Smialek made a good point about the future of the Fed in a recent interview:

> I think it really builds on this idea that once the Fed adds a power to its toolkit, that power is usually expanded in the future. And I think that's very much what we saw in 2020.

For me, the Fed's likely future is troubling. There has been a lack of humility among U.S. central bankers over the last 15 years, and I expect that will continue. Fed chairs are always confident they are making the right moves at the right time in the right measure in applying their ever-growing powers and are properly balancing the risks that flow from their efforts to counteract market forces.

Smialek does not seem to share that view. Despite the concerns her research raises, she continues to believe we need the Fed "to back all of that up." This conclusion overlooks the damage that was done by Powell and Brainard in 2020. R

Combating Public Employee Unions

REVIEW BY GEORGE LEEF

What if Minneapolis police officer Derek Chauvin hadn't been on duty the day he arrested George Floyd and brought about his death? If some other officer had made the arrest and treated Floyd humanely, that would have spared the nation a great deal of violence and destruction.

There had been many credible complaints against Chauvin for being overly aggressive and too "tightly wound" for the job. Those complaints went for naught because the city's police commissioner had no authority to dismiss or even reassign him. The collective bargaining agreement between the police union and the city made it virtually impossible for city officials to take action against bad cops. Managerial control had been ceded to the union and cumbersome procedures meant to protect members were put in place. If only that hadn't been the case.

In his latest book, *Not Accountable*, lawyer Philip K. Howard looks at the damage that has been done to America by allowing public workers to unionize. He writes:

> Micromanagement and expansive rights became integral to the public union playbook for control—no innovation is allowed unless the official can show it complies with a rule; no decision about a public employee's performance is valid without objective proof in a trial-type hearing. Clearing out the legal underbrush is what's needed to restore officials' freedom to use common sense in daily choices.

Moreover, he argues, the power of public employee unions allows them to dictate governmental priorities, invariably with public resources flowing to union members rather than to public needs.

Collective bargaining / How did this happen? Private sector unions have existed and bargained with companies since the latter decades of the 19th century, but public employee unions were unthinkable well into the 20th. The early union leader Samuel Gompers opposed the idea of police unions, seeing a conflict of interest between public service and personal gain. And President Franklin D. Roosevelt, so friendly to trade unionism, was adamantly opposed to it in government, declaring, "The process of collective bargaining, as usually understood, cannot be transplanted into the public service."

Nevertheless, by the 1960s, unions and collective bargaining for government workers was being discussed, with academics leading the way. Law professors argued that it was unfair to exclude public employees from having the same rights as workers in the private sector, suggesting that strikes might result if those rights were not granted. In 1962, President John F. Kennedy repaid unions for their campaign support by signing Executive Order 10988 allowing collective bargaining for federal employees. In 1967, New York passed a statute permitting state workers to unionize and bargain collectively. Today, most states have embraced public unionization.

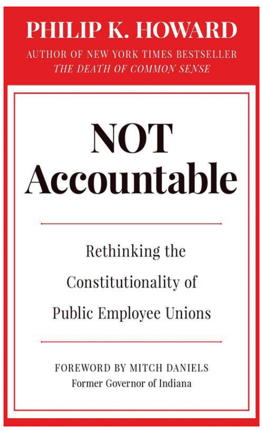
The resulting government employee unions quickly began pressing their advantages. Although strikes were usually illegal, the unions discovered they could engage in them without adverse consequences. (President Ronald Reagan's firing of striking air traffic controllers in 1981 was the exception to the rule.) They realized they could dominate public officials through collective bargaining contracts that spell out union rights in minute detail. Most significantly, they realized that through political action they could elect their friends to office and thus sit on both sides of the bargaining table. In that respect, one of the most telling illustrations occurred when New Jersey Gov. Jon Corzine bellowed to a union rally in 2006, "We will fight for a fair contract!" Howard asks, "Whom was he going to fight?"

Public unions now wield enormous power. Suppose that a city wants to compensate teachers for their abilities. The teachers' union would block that because the contract specifies that seniority determines compensation. Therefore, old teachers who are just going through the motions must be paid the most, and young, energetic, imaginative teachers can't be paid more than the contract specifies. The same holds for layoffs, which must be done in reverse order of seniority, not competence.

The teachers' unions hate nothing more than competition and they have flexed their muscles to get their political allies to limit the growth of non-union charter schools. Last year, for example, the Biden administration proposed regulations that would force charter schools to serve "diverse populations." The irony is that charters are highly popular with minority parents who want to escape from big-city public schools. One might think that a Democratic administration would be happy with better educational options for a key part of their voting base, but the unions have found a way to restrict charters by mandating that they enroll more white and Asian students.

Howard also focuses on the high personnel costs that follow from public unionization. Government workers are usually paid more than comparable workers in the private sector, but where the costs really mount are in pensions, which are often twice as generous as in the private sector. Giving in to union pension demands is politically easy because the big costs won't hit for years to come. Eventually, however, the pensions must be paid and the politicians will either reduce services to residents or raise taxes to afford the pensions' dollar drain. Making matters worse, it's often easy for public workers to retire at a rather young age, qualify for their pension, then work for another branch of government for a few years to qualify for another pension.

The unions also use their political might to write laws they favor. In California, for example, unions pushed through a ballot initiative compelling the state to spend 40 percent of its budget on public education. All other needs will have to fight it out for the remainder.



Not Accountable: Rethinking the Constitutionality of Public Employee Unions

By Philip K. Howard

201 pp.; Rodin Books, 2023

Fighting the unions / Sometimes a mayor or governor wants to make changes in the arrangements with unions. Doing so is certain to lead to war. In 2006, Adrian Fenty was elected mayor of Washington, DC. He was serious about improving the District's schools and appointed education reformer Michelle Rhee as school chancellor. She began closing the worst schools, firing hundreds of low-performing teachers, and instituting merit pay. Those moves were intolerable to the teachers' union, which fought Rhee tooth and nail. It spent over $1 million to defeat Fenty in the Democratic primary in 2010, thus removing the reformist threat and intimidating future candidates who might have ideas about changing the status quo.

By ceding control over schools, police, and other functions to public employee unions, lawmakers have impermissibly delegated away their authority.

Similarly, Ohio Gov. John Kasich secured passage of a bill to require public employees to contribute modestly to their pension and healthcare benefits. The union establishment counterattacked with a $42 million campaign (with funds coming from unions nationwide) to take the law to referendum. With heavy campaign expenditures and a well-targeted get-out-the-vote operation, the unions won the election and defeated Kasich's reforms.

The one instance Howard reports where public unions were beaten was in Wisconsin, where Gov. Scott Walker sought to make union membership optional for public employees, along with other changes to cut the state budget. The unions fought back by occupying the state capitol en masse for days on end. Walker was not deterred, and his bill passed. Then, the unions mounted a recall effort that fell just short of removing him from office.

Going to court? / Political successes against what Howard aptly calls the "bureaucratic kleptocracy" of public union control are so few and far between that he declares the situation "not reformable." The unions have a chokehold that cannot be broken by regular political processes. For that reason, the author argues that salvation can only be found in the courts. How so?

His first argument is that elected officials have illegally delegated their authority to govern. Under the federal and state constitutions, neither legislative nor executive power may be delegated to other branches of government or to private parties. By ceding control over schools, police, and other functions to public employee unions, lawmakers have impermissibly delegated away their authority.

There is something to be said for this idea, but it's impossible to imagine a lawsuit against, say, the governor of California for having delegated the authority to run the state's schools to the unions surviving a motion to dismiss. The union lawyers would argue that state law has been followed exactly and if the plaintiffs don't like the way the schools are run, they can vote for candidates who will do things differently. A judge is apt to agree.

Howard also contends that the Guarantee Clause of the U.S. Constitution weighs against the system of union control. That clause reads, "The United States shall guarantee to every state in this Union a Republican Form of Government." Howard explains, "This provision forbids states from adopting any structure that might give operating control to an aristocracy or other permanent group, breaking the linkage between voters and governing decisions." That's essentially what states like California, Illinois, New York, and others have done by allowing public unions to take control of government operations. The solution, Howard writes, is for the Supreme Court to uphold the Guarantee Clause and rule that "organized political activity by public employees involves an unavoidable conflict of interest with the core values of the Constitution."

Unfortunately, that too is almost inconceivable. The only time that a case involving a somewhat similar dispute came to the Court, it declined to intervene, saying that the matter was not justiciable. (That 1849 case, *Luther v. Borden*, arose in Rhode Island when two rival factions each claimed legitimate control over the state.) The current Supreme Court would be just as leery of wading into the political mess of a state like California and overturning established arrangements that empower the public unions.

If there is a solution, it will occur when enough productive people leave the cities and states that have made Faustian bargains with public unions and find their budgets so strained that they're unable to meet all their obligations. If Uncle Sam resists the inevitable cries that these states can't be allowed to go bankrupt and refuses to bail them out, then the remaining people will have to choose between big tax increases and politicians who pledge to govern in the public interest rather than the interest of the unions.

Although I see no prospect for Howard's solution working, the book is nevertheless valuable for its examination of the manifold harms done by public union power. It cautions cities and states that have not yet allowed public unionism to get a foothold to continue to resist. R

Understanding Insurance Markets

REVIEW BY PHIL R. MURRAY

Readers who enjoy learning how markets work will appreciate the new book *Risky Business* by Liran Einav (Stanford), Amy Finkelstein (MIT), and Ray Fisman (Boston University). The authors explain that insurance markets are "selection markets" in which firms face different costs for providing their good or service depending on who the buyer is. Some buyers are high cost while others are low cost. The problem is that the buyers know whether they will be higher- or lower-cost, but the sellers do not readily know.

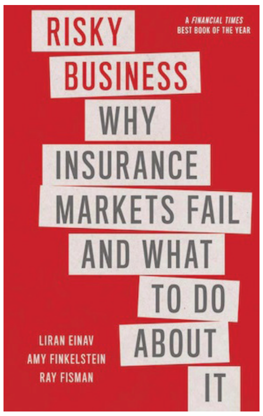
When the 2010 Affordable Care Act's insurance mandate was before the Supreme Court, Justice Antonin Scalia asked, "If a paternalistic government could force people to buy health insurance, could it also force people to buy broccoli?" Astounded that Scalia seemingly did not understand the difference between a selection market good and an ordinary good, the authors declare, "That was the moment we realized we had to write this book."

Adverse selection / Selection markets are precarious. Einav, Finkelstein, and Fisman illustrate this with a non-insurance product: AAirpass, which American Airlines rolled out in 1981. Buyers paid $250,000 for "unlimited first-class travel for life." Management underestimated the enthusiasm some buyers would have for flying. Some buyers arranged multiple-city trips. Some flew to international destinations and back every other day. To stem the losses, American increased the price to $1 million. This made matters worse, as many lower-cost buyers dropped out of the market while higher-cost buyers remained. The moral of the story is that "the customers who are willing to pay the most are sometimes the ones you want the least." American held out for a while but quit selling AAirpasses in 1994.

In contrast to the AAirpass, divorce insurance failed quickly. The authors tell the story of John Logan, who offered a policy called WedLock. Einav, Finkelstein, and Fisman identify two selection problems: couples who know their marriage is doomed—a classic "adverse selection" scenario—and schemers who plan to divorce. Logan attempted to avoid those problems by including a waiting period before a claim could be filed; as the authors note, "Waiting periods are a common technique that insurers employ to deal with selection." WedLock charged a premium of $1,900 per year, with the earliest payoff of $12,500 after four years. The payoff would rise by $2,500 per year so long as the policyholder continued to pay the $1,900 premium.

Yet, WedLock failed "within two years of its introduction" because of a lack of demand. The authors explain, "The payout was sufficiently modest that a *New York Times* story on Wedlock suggested that couples would be better off putting the money they would have spent on divorce insurance premiums into a savings account instead." Interestingly, the *Times* assessment is incomplete. The interest rate on the savings account would have to be at least 21 percent to beat WedLock's $12,500 payoff after four years. Neither the couples who knew their marriages were doomed nor the schemers should have been deterred by the four-year waiting period. The situation was different if a couple stayed married for 10 years. If they had put $1,900 in the bank at the beginning of a decade and every year for another nine years, they would accumulate $25,093 after 10 years at an interest rate of 5 percent. That's closer to WedLock's payoff of $27,500 in the event of divorce after 10 years. The interest rate on the savings account would only have to be about 7 percent to beat the insurance payoff. The *Times* critique of WedLock makes more sense the longer a couple remains married. But it is similar to the owner of an automobile complaining about paying auto insurance premiums because he's never been in an accident and made a claim.

One of the authors, Fisman, tells the story of his learning that he would need costly dental work. He did not have dental insurance at the time; he planned to enroll at the next opportunity and let the insurance cover the cost. He then learned that dental plans do not pay for major work because insurers intend to avoid customers who want to enroll when they know they will run up a big bill.



Risky Business: Why Insurance Markets Fail and What to Do About It

By Liran Einav, Amy Finkelstein, and Ray Fisman

271 pp.; Yale University Press, 2022

In addition to storytelling, the authors introduce recent scholarship to illustrate selection problems. Economist Marika Cabral documented that workers at Alcoa Corporation who paid for a dental plan that would cover more procedures subsequently had more procedures. She specifically found that "in the month following an upgrade, total dental spending of employees who switched into the higher-cap plan was, on average, about 60 percent higher and remained elevated for half a year." If your dental insurance does not cover expensive procedures, that is because "insurers have for the most part decided that it just isn't worth it to offer 'real' insurance."

Long lives / Annuities—financial instruments that give beneficiaries a regular payment for as long as they live—are a form of insurance. As they do with other forms of insurance, the authors begin their discussion of annuities with a human-interest story and then share the latest academic research. They tell the tale of Frenchwoman Jeanne Calment, who agreed to give up the flat she lived in, upon her death, in return for the equivalent of $500 per month in 1965—an arrangement that today we would call a reverse mortgage. Although Calment was 90 years old at the time, she got the better end of the deal, living to be 122. The authors suspect that she knew she would live a long life. Recent academic work supports that possibility.

According to Einav, Finkelstein, and Fisman, economists recommend that savers annuitize "most" of a retirement portfolio. But few savers do. The authors ask, "Why don't more people behave the way economic theory says they should and annuitize their savings?" Blame selection. The Society of Actuaries tallies the life expectancies of buyers of annuities, while the Social Security Administration tallies the life expectancies of the general population, which represents those who don't buy annuities. It turns out that people who buy annuities live longer than those who do not. "According to calculations by the economists Jim Poterba and Adam Solomon," for example, "a sixty-five-year-old male annuitant had a one-year mortality rate that is half that of the sixty-five-year-old male population at large." Individuals who somehow know they will live long lives buy annuities. It follows that "the higher survival rates of annuitants at any age translate directly into higher costs to insurance companies." Thus, insurance companies have raised the price of annuities to offset the higher costs. The high prices are why the public refrains from buying annuities.

Recall that when insurance providers raise prices to manage the selection problem, customers that cost less to serve will exit the insurance pool and render the business unprofitable. The authors do not explicitly explain why the market for annuities survives despite the high prices. They do explain that "insurance is valuable peace of mind," which "can keep even some of the 'good customers' (those with lower costs) from dropping out and help the market survive." That explanation appears to conflict with their statement that "Almost no one buys annuities if they can help it."

Assessing risk / In a selection market, the price adjusts to overcome the selection problem. Take the market for car insurance. Safe drivers cost less to insure than unsafe drivers. Drivers know whether they are safe or unsafe. Insurance companies seek to differentiate the safe from the unsafe, set lower prices for the former and higher prices for the latter, and thereby reduce the selection problem. They excel at assessing a driver's risk of getting into an accident. For instance, they know that drivers with higher credit scores are less accident-prone. Insurance companies are so adept at assessing risk that Einav, Finkelstein, and Fisman state that "the detailed data and advanced pricing algorithms get rid of most selection." Still, some selection persists, so they declare that "the price isn't right."

Three factors explain why collecting information and adjusting price fail to eliminate adverse selection: "technological limitations, fear of consumer backlash, or legal restrictions." Let's stick with the market for car insurance. It is technologically possible to monitor a driver's activity with an "onboard tracker." However, the technology might be unreliable. The authors cite customer reviews that give the impression that "this type of insurance can lead to higher rates even if you're not that bad a driver." Furthermore, consumers balk at agreeing to an onboard tracker in return for a lower premium "because it feels creepy." Fairness is the basis of legal restrictions. "If someone is living on the wrong side of the tracks," the authors ask, "should they be penalized with higher auto insurance rates than those offered to others with identical driving histories who live in nicer parts of town?" So, state regulators weigh in on what is fair. Even though drivers with higher credit scores are safer, regulators in California prohibit insurance companies from using that information to set premiums. The insurance companies endeavor to make the market more efficient, and increase their profits, but regulators block them on grounds of fairness.

Regulations are paradoxical. Einav, Finkelstein, and Fisman state, "Laws that aim to promote equal access in the name of fairness may exacerbate adverse selection." According to them, "most economists" reckon that "mandates are the best and most straightforward solution to selection problems." Then they admit that "mandates aren't a panacea." Requiring a minimum level of insurance does nothing to prevent high-cost customers from purchasing as much insurance as they can, which is half the selection problem. Regulators might require too much insurance simply because at some point the marginal benefit of additional insurance becomes less than the marginal cost. The authors do not claim to know the right level of insurance to require. Also, regulators face the difficult decision of how to penalize those who violate a mandate.

The fundamental tradeoff is between efficiency and equity. In the market for health insurance, the tradeoff is between reducing adverse selection and the idea that "one price is fair, in the sense that no one is being penalized for being born sick or disabled." Einav, Finkelstein, and Fisman illustrate with numbers. They assume that "healthy" consumers cost $60 per month to insure, and they will pay at most $70 per month for a policy. "Sick" consumers, who cost $100 per month to insure, will pay at most $150 per month. The most interesting outcome is based on the assumptions that "no one can afford monthly premiums above $80" and that the government "can only afford a subsidy of $10 to one group." If the government subsidizes the healthy and insurers set a price of $80, both the healthy and the sick sign up. An insurer will gain $70 + $10 – $60 = $20 for every healthy consumer and lose $80 – $100 = –$20 for every sick consumer. An insurer will do this "because the $20-per-customer losses from paying the medical bills for the very sick ($100) is offset by the $20-per-customer profits after paying the medical bills of the healthy ($60)." The counterintuitive result is that "the best way to help the sick is to subsidize the healthy." The authors immediately inform the reader that this optimal policy "might not play well in the court of public opinion." Note that the analysis omits any consideration of a distortion caused by taxing people to finance the $10 subsidies.

Conclusion / Einav, Finkelstein, and Fisman succeed in illuminating the selection problem and making insurance markets interesting. Read the book to understand the puzzling features of several insurance markets as well as financial and labor markets. Also, read the book to appreciate the tradeoffs involved in regulating insurance markets. Sounding like Thomas Sowell, they reason, "There are no right or wrong answers, only trade-offs."

The authors reveal plans for two more books: *Riskier Business* and *Riskiest Business.* Judging from the quality of this effort, if they find the time to write the sequels, the time will be well spent. R

The Bigger They Are, the Louder They Beg

REVIEW BY VERN MCKINLEY

Hedge fund manager Bill Ackman of Pershing Square Capital Management raised his profile after the collapse of Silicon Valley Bank (SVB) last March by demanding on Twitter, in a verbose tweet, that the government protect all depositors in the failed institution, even those with hundreds of millions of dollars on deposit.

The government (in the form of the Federal Deposit Insurance Corporation, Federal Reserve, and Treasury) did just that. The ensuing intervention redounded to the benefit of Ackman's billionaire buddies in Silicon Valley who were exempted from a very explicit guarantee: the FDIC ostensibly only insures deposits up to $250,000 per depositor.

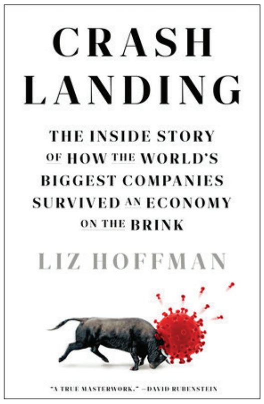
Ackman is one of many characters that Liz Hoffman follows in *Crash Landing*, her new book on the government's pandemic response. It offers a wide-ranging look at the cafeteria capitalists who reap billions in profits during good times and then demand government bailouts when their gravy train crashes. Hoffman has worked as a senior reporter at the *Wall Street Journal* and now is an editor for *Semafor*, a nascent news website that launched in 2022. *Crash Landing* is her first book.

The book's subtitle, *The Inside Story of How the World's Biggest Companies Survived an Economy on the Brink*, stirs memories of the major book releases in the wake of the Great Recession, in particular Henry Paulson's *On the Brink*. The reference indicates how some of the major characters in Hoffman's book navigated their respective crises during the pandemic and, as in the case of SVB or 2008 instability, begged the government for bailouts. Previewing these individual stories for the reader, I don't believe that *Crash Landing* is an appropriate moniker for these outcomes because Hoffman's examples show how much the government was willing to "foam the runway" and avoid allowing actual crash landings for some of the largest companies in the United States during the pandemic. Companies that did not rely on government support were also able to navigate the pandemic era and avoid a crash landing.

Hoffman's organizational style for the book is like Andrew Ross Sorkin's *Too Big to Fail* (Viking, 2009), the leading book chronicling the global financial crisis of 2007–2009. Like Sorkin, Hoffman traces her cast of characters throughout the pandemic, from the early months of 2020 when people were getting their heads around the idea of a global pandemic, to the early days of 2021 when evidence was beginning to build that the government bailouts were too generous. She weaves her story through this time frame, checking in on primary characters and the key industries they work in to determine progress in procuring their own tailored favors from the government.

Ackman is an outlier in the book, as his primary objective during the crisis was to solve the puzzle of how to make an investment killing while the world struggled with the pandemic. The book's prologue starts in February 2020 as he gives one of his many speeches before "the wannabe billionaire crowd," this one in London. At the time, he struggled to piece together the available evidence on the building pandemic. Weeks later, when Hoffman checks in with Ackman again, he wakes up in the middle of the night with a premonition: "The stock market is going to crash." His conclusion: "We need to either sell everything or put on a massive hedge." The latter strategy would "pay out if stocks cratered as he suspected." Selling everything would cut against his moves to "shed his reputation as a corporate raider for a softer image.… A massive hedge it was, then." The next time Hoffman checks in on Ackman, in late February 2020, he "had bought more than $1 billion of credit-default swaps." His firm "paid $27 million in premiums and commissions. Ackman thought it was the bargain of a lifetime." It took a few days to unwind the underlying trades, but by the end of March 2020, "the trade would ultimately net nearly $2.6 billion in profits on an initial investment of just $27 million."

Just another bailout story / The companies Hoffman examines in *Crash Landing* include airlines, automakers, and more modest-sized hospitality industry players. Although she does not trace back predecessor government interventions, any historian of bailouts can rattle off examples of when these first two industries were the beneficiaries of previous interventions. Aviation industry bailouts began in the 1970s with the rescue of Lockheed and continued through the airline bailout after the September 11, 2001, terrorist attacks. Auto bailouts go at least as far back as the Chrysler bailout of the early 1980s and more recently the GM and Chrysler (yes, again) bailouts in 2008. So, when the pandemic rolled around, it was no surprise that these same industries traveled to Washington hat-in-hand to avoid the fate of so many smaller businesses and industries.



Crash Landing: The Inside Story of How the World's Biggest Companies Survived an Economy on the Brink

By Liz Hoffman

304 pp.; Crown Publishing, 2023

Automobile industry / After some tough years in the early 2000s, by 2019 Ford "seemed to have found its way back." The iconic company had just released an electric powered Mustang and it was developing its first electric F-150 truck. But by April 2020, Ford was a "fallen angel" and "nobody wanted what they had to sell," resulting in its debt being downgraded to junk territory. Bill Hackett, the Ford CEO, called Fed Chairman Jerome Powell to plead for support. Hoffman writes, "He was under pressure from his board, from investors, from his competitors, to raise cash, and there was no doubt Ford needed it." Like the banks that pleaded for bailouts in 2008, he was desperate: "The last thing Hackett wanted was to cut Ford's dividend, which offered steady income to thousands of the company's retirees.… Almost apologetically [while talking to Powell], he hinted at some type of federal aid." Powell responded: "The U.S. government is going to be here." Hoffman writes: "Now the U.S. government had said it was willing to buy Ford's bonds which … would send a message to the rest of Wall Street's investors that they were safe. And right on cue, the price of Ford's existing bonds shot up on the news."

Airline industry / Delta and the other airlines had enjoyed what Hoffman calls a "champagne decade" from 2006 to 2019, bouncing back after the bankruptcies of the mid-2000s. At the beginning of 2020, Delta CEO Ed Bastian, for instance, was celebrating a $2 billion investment in South America's biggest airline. But by March 4, Doug Parker, the CEO of American Airlines, along with his counterparts from Southwest, Alaska Airlines, Hawaiian Airlines, JetBlue, and United Airlines were meeting with President Donald Trump and Vice President Mike Pence in the White House.

Trump politely ignored a reporter's question on a possible bailout. Hoffman writes:

> [A] reporter asked Trump whether he was weighing financial support for the industry and Trump responded: "Don't ask that question please. I don't want you to give them any ideas."

But by mid-March the bailout began to take shape:

> The industry was looking for grants, not loans.… The airlines wanted a suspension of the 7.5 per cent tax … on all flights … and [the airlines] would promise not to lay off employees.

The final price tag came into view as Parker told Treasury Secretary Steve Mnuchin that "the industry would need $50 billion to stay afloat.… The airline executives had decided that what they needed to do [was] beg the government for a bailout." In typical Chicken Little fashion, Parker told Senate Majority Leader Mitch McConnell, "If this continues without assistance, there won't be an airline industry."

Hotels and Airbnb / In mid-2019, Chris Nassetta, the president and CEO of Hilton Worldwide was "toasting a decade-long economic boom that had been very good to corporate America and to Hilton," according to Hoffman. But by early March, "corporate travelers … had disappeared overnight. Big conferences … were being cancelled. Spring leisure bookings were dropping by half.… Hilton might not make it."

In the same industry about this same time, Brian Chesky, CEO of Airbnb, was preparing for an initial public offering worth tens of billions of dollars after a decade of explosive growth. But by the early months of 2020, he was worrying about an 80 percent drop in bookings in China over a three-week period.

Although hard hit like the airline and automobile industries, the players in the hospitality industry took a different route. Hilton leveraged itself in March 2020 by drawing down $1.5 billion on a credit line and "raising another $1 billion from a credit-card points deal … with American Express." Airbnb relied on a war chest of $3 billion of cash twinned with a $1 billion loan at 11 percent interest combined with $500 million in debt that would convert into shares of the company. Airbnb also laid off about a quarter of its staff, with a severance package worth a minimum of 14 weeks' pay and assistance transitioning to new jobs.

Conclusion / Hoffman does a good job of contrasting the different approaches of the industries in navigating the challenges of the pandemic, especially the contrast between self-help and government bailouts.

She does, however, engage in one of my pet peeves from the Great Recession when, without much supporting evidence, she mimics those in government who argued that, without interventions, the financial system would have turned into a pile of rubble. She does her best to track this style of rhetoric: "The efforts undertaken by Mnuchin and others in the government—like the actions taken by their predecessors in 2008, many of them equally unpopular—would keep the largest economy in the world from imploding," and, "Programs that they hoped would calm chaotic trading markets and lessen the risk that what had begun as a health crisis would take down Wall Street and, with it, the economy," and, "Powell would later admit the Fed had crossed a lot of red lines that had not been crossed before in its effort—ultimately successful—to keep the economy on the rails," and, "The federal government needed to keep the entire economy from collapsing," and "The 2020 playbook from financial regulators and elected officials in Congress staved off an economic collapse." Yet, there are no citations in the book that support the case for these potential dire outcomes.

In fact, Hoffman's book is rather light on citations (just over seven pages) as compared to what I have come to expect from such books. Other books I have reviewed contain substantial supporting citations, such as the 70 pages in Nomi Prins's recent book *Permanent Distortion* (see "Collecting Evidence on Central Banks' Distortions," Summer 2023).

Nonetheless, Hoffman tells a good story. The lesson here is if you are a big enough company or industry and have a loud enough megaphone and the right connections, you too can get bailouts to help you weather tough times. *R*

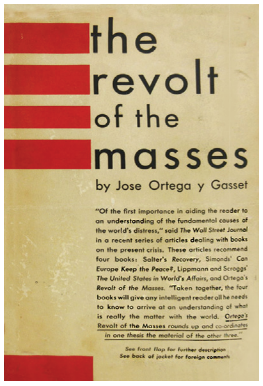
From the Past

A Philosopher in Search of Liberalism

REVIEW BY PIERRE LEMIEUX

Although influenced by many philosophical currents, Spanish philosopher José Ortega y Gasset (1883–1955) is considered a defender of individualism and liberalism. Today he is viewed as only a minor figure in the history of philosophy, but his 1930 book "La Rebelión de las Mases," translated into English in 1932 as *The Revolt of the Masses*, remains well known. It so impressed liberals of the time that Friedrich Hayek favorably quoted and cited it.

There are some questionable ideas in *The Revolt of the Masses*, but it contains many important observations. In our era of growing illiberalism, it is fitting to look back on the book some nine decades after it first appeared in English.



***The Revolt of the Masses* (authorized translation of "La Rebelión de las Masas")**

By José Ortega y Gasset

192 pp.; W.W. Norton & Company, 1932

The mass-man and the state / Ortega views the revolt of the masses as the most important fact of his time. The "mass-man" (including the mass-woman, of course) is the "average man," "not specially qualified," "undifferentiated." Mass-men are those "for whom to live is to be every moment what they already are, without imposing on themselves any effort towards perfection." It should be noted this is not class theory. Ortega makes clear that we often see "nobly disciplined minds" in working classes, while in the upper classes of surviving nobility and among intellectuals we frequently find "the mass and the vulgar."

The mass-man does not have a moral code. He wants rights without obligations. He rejects "courtesy, truthfulness and, above all, respect or esteem for superior individuals." The "superabundance" brought by a growing standard of living has turned the mass-man into a sort of "heir-man," akin to the spoiled child and the hereditary aristocrat. The mass-man's inheritance, Ortega tells us, is civilization with its conveniences, its security, and all its advantages such as "marvellous instruments, healing medicines, watchful governments, comfortable privileges." But the ignorant mass-man doesn't realize that the maintenance of these benefits requires the respect of certain liberal institutions.

The masses don't just have empty opinions, they also dominate politics through the "hyperdemocracy" that has replaced the old democracy in which minorities could live "under the shelter of liberal principles and the rule of law." Without referring to "some higher authority," which includes "superior individuals," the mass is a mob—"it lynches." "The masses" is another name for the new middle class that appeared at the end of the 18th century and took over the state. In Ortega's mind, these are the masses who rebel.

The state is "the greatest danger that to-day threatens civilization." It absorbs "all spontaneous social effort." Inherited from liberal democracy, the state takes over society. Ortega quotes Mussolini's maxim: "All for the State; nothing outside the State; nothing against the State." Fascism is "a typical movement of mass-men." The state, now occupied by the masses, endeavours to "crush the independence of the individual and the group." Hence "the enormous increase in the police forces of all countries" except England where, Ortega specifies, the state faces limits.

Authority and spontaneous order / *The Revolt of the Masses* shows a tension between liberty and authority. Ortega makes statements like, "The function of commanding and obeying is the decisive one in every society." He idolizes the new democratic national state based on a common programme of action instead of blood and language. Of course, he did not know public choice analysis, which a few decades later would show how imperfect are the processes of majoritarian democracy. The reader must remember that the book was published in 1930.

Ortega believed that the "demoralization of Europe" led to its abandonment of world leadership, which led to the demoralization of the world and the rebellion of the undirected masses. He still hoped that Europe would reject communism, an imminent threat at the time; fortunately, he explained, the European is an individualist. But he thought that this would require "the building-up of Europe into a great national State," a surprising hope for the time.

The ideal national state, Ortega argues, brings together everybody in "a plan of common life with an enterprise in common." "The subjects," he writes, "are now the State." He did not seem to understand the distinction, formulated by French political theorist Benjamin Constant in the 19th century, between the ancient conception of liberty, which is collective liberty, and the modern liberal concept of individual liberty. When the author of *The Revolt of the Masses* writes that "either I rule or I obey," he seems to think that "I" can rule collectively without "I" then having to obey the collective. The Spanish philosopher, who was obviously not familiar with economics, did not fully understand the possibilities of a spontaneous (or autoregulated) social order. Hayek later explained how, in such a social order, each individual is free to pursue his own individual goals without someone or some group giving him commands.

Incomplete liberalism / In a vibrant passage that Hayek used in part as a chapter epigraph in his *Law, Legislation, and Liberty* trilogy, Ortega wrote:

> Liberalism is that principle of political rights, according to which the public authority, in spite of being all-powerful, limits itself and attempts, even at its own expense, to leave room in the State over which it rules for those to live who neither think nor feel as it does, that is to say as do the stronger, the majority. Liberalism … is the supreme form of generosity; it is the right which the majority concedes to minorities and hence it is the noblest cry that has ever resounded in this planet. … It was incredible that the human species should have arrived at so noble an attitude, so paradoxical, so refined, so acrobatic, so anti-natural. Hence, it is not to be wondered at that this same humanity should soon appear anxious to get rid of it.

The Revolt of the Masses is, however, silent about the institutions that are necessary to restrain the majority and buttress this generosity. The quote ignores that what is at play is so much generosity as an ethics of reciprocity that is in everybody's enlightened self-interest. (See "An Enlightenment Thinker," Spring 2022.)

Another tension we find in *The Revolt of the Masses* is between the dignity of the individual and the mass-men produced by hyperdemocracy. The distinction that should be made more explicitly in the book is between, on the one hand, the dignity of "natural equals" (in James Buchanan's terminology) who in a constitutional democracy mostly govern themselves individually and are ipso facto responsible for their actions, and on the other hand the scorn well-earned by the mass men who pretend to govern others.

The middle class and the good life / As we have seen, Ortega identifies the mass-men as being comprised largely of the prosperous middle class that appeared in the 19th century. He does not seem to fully realize that this middle class generated the Great Enrichment, that self-interest on the market is beneficial to virtually everybody, and that what is detrimental is when a group tries to govern others.

The middle-class issue can be related to the apparent disdain that the Spanish philosopher expresses for the consumer society. This brings back the old philosophical question of whether the good life is the easy life or, instead, a "noble" life of effort and struggle. (See "Fukuyama: Interesting Books, With Some Baggage," Fall 2022.) Ortega blames the mass-man for abandoning himself to indolence and inertia. I would argue that the terms of the debate must be changed: in the libertarian or classical liberal perspective, each individual makes his own choice as to whether he wants to be a hero or an ordinary person or someone in between.

There is a less critical way to read *The Revolt of the Masses*. According to the late professor Francisco Lopez Frias of the University of Barcelona, Ortega's conception of the heroic life was not as elitist as we might think. Lopez explains, paraphrasing Ortega:

> Authentic heroic behavior is that based on not renouncing any of the responsibilities and obligations presented, and that goes for individual situations as well as collective ones. The hero is not, then, the exception, but the norm, the everyday. … Liberals must accept responsibility and refuse to renounce a single liberty, no matter how insignificant it may seem.

Acute observations / In the process of grappling with these difficult issues and without the benefit of the knowledge we have gained over the past hundred years, Ortega frequently makes acute observations and prescient predictions. He tells us that, when the mass-man reads, he "does so with the view, not of learning something from the writer, but rather of pronouncing judgment on him when he is not in agreement with the commonplaces that the said reader carries in his head." Don't we meet many such mass-men today?

Ortega views "the scientific man" produced by 19th-century technicism as the prototype of the mass-man. Science is essential, of course: "China reached a high degree of technique without in the least suspecting the existence of physics," he writes. "It is only modern European technique that has a scientific basis, from which it derives its special character, its possibility of limitless progress." But science requires narrow specialization. Thus, the scientific man has no culture. Contrary to Einstein, "who needed to saturate himself with Kant and Mach before his own synthesis," the typical scientific man is "astoundingly mediocre, and even less than mediocre." He is "a learned ignoramus." Perhaps a good example in our own days is the public health expert. (See "The Dangers of 'Public Health,'" Fall 2015.)

Ortega's mass-men seem to prefigure the obscurantist era that we seem to be entering today. The mass-man is not interested in the conditions of civilization, even in the conditions of science, which provides him with "his motor-car … but he believes that it is the spontaneous fruit of an Edenic tree." He is like a primitive with no knowledge of history and who cannot but repeat mistakes of the past.

Historically and culturally *tabula rasa*, Ortega's mass-man often resembles today's woke or MAGA. He does not believe in reason and a world of intelligible truths. He "accepts the stock of commonplaces, prejudices, fag-ends of ideas or simply empty words which chance has piled up within his mind, and with a boldness only explicable by his ingenuousness, is prepared to impose them everywhere." Intellectually, he is a barbarian. "Hardly anyone offers any resistance to the superficial whirlwinds that arise in art, in ideas, in politics, or in social usages."

Still, Ortega believed that the forces of darkness would be defeated. He makes an astonishing prediction: "There is now coming for *Europeans* the time when Europe can convert itself into a national idea … a gigantic continental state." Given what happened a decade after *The Revolt of the Masses* appeared, its author was certainly right to fear ethnicism and nationalism. The European Union partly owes its existence to Europeans' fear of another war.

We have seen that Ortega's liberalism is not egalitarian in the socialist sense of an equal wisdom of everybody to politically dictate how others should live. Many if not most libertarians and classical liberals would agree with this idea in the context of formal equality before the law and a limited state. In *The Constitution of Liberty*, Hayek wrote, "The liberal, of course, does not deny that there are some superior people—he is not an egalitarian—but he denies that anyone has authority to decide who these superior people are."

We might read *The Revolt of the Masses* as the work of a philosopher in search of classical liberalism. R

READINGS

- *Law, Legislation, and Liberty*, by F.A. Hayek, edited by Jeremy Shearmur. University of Chicago Press, 2022.
- "Ortega y Gasset: On Being Liberal in Spain," by Francisco Lopez Frias. *Analecta Husserliana* 29: 149–166 (1990).
- *The Constitution of Liberty,* by F.A. Hayek. Henry Regnery Company, 1960.

Working Papers ➺ BY PETER VAN DOREN

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

Antitrust

■ **"Doomsday Mergers: A Retrospective Study of False Alarms," by Brian C. Albrecht, Dirk Auer, Eric Fruits, and Geoffrey A. Manne. SSRN Working Paper no. 4407779, April 2023.**

■ **"'Killer Acquisitions' Reexamined: Economic Hyperbole in the Age of Populist Antitrust," by Jonathan M. Barnett. SSRN Working Paper no. 4408546, May 2023.**

Populist antitrust is back. Lina Khan chairs the Federal Trade Commission (FTC), Jonathan Kanter heads the U.S. Justice Department's Antitrust Division, and Tim Wu was special assistant to President Joe Biden for technology and competition policy. But the intellectual attack on populist antitrust is also back. So, which view better fits the facts?

The first of these papers, by Brian C. Albrecht et al., revisits mergers from the recent past that were criticized by populist opponents but were allowed to go forward. They found:

- At the time of the Amazon–Whole Foods merger, Kahn criticized it as allowing "Amazon to leverage and amplify the extraordinary power it enjoys in online markets and delivery, making an even greater share of commerce part of its fief." But Whole Foods' market share hasn't changed and consumers have enjoyed more convenience and lower prices.
- Over the last two decades, the beer industry has had many mergers that populists predicted would increase the price of beer and decimate craft beer producers. But prices did not increase on average and the craft-beer segment has continued to thrive.
- Critics argued that Bayer's acquisition of Monsanto would increase the price of corn, soy, and cotton seeds. Seed prices have remained constant.
- When Google acquired Fitbit, opponents claimed the merger would augment Google's advertising dominance, harm user privacy through the selling of their health data, and reduce competition in wearable devices. The evidence suggests the opposite has occurred: Google's share of online-advertising has declined, Fitbit's market share of wearable-devices has declined, and Google does not use data from Fitbit in its advertising platform.

Concludes Albrecht et al., "Popular and populist fears about corporate consolidation are often completely untethered from economic reality and wildly erroneous. The less these fears influence antitrust policy, the better."

The second paper, by Jonathan M. Barnett, examines the acquisition of small startup firms by large, established companies like Amazon, Google, Facebook, Apple, and Microsoft. Critics like Sens. Tom Cotton (R–AR) and Amy Klobuchar (D–MN) introduced legislation in 2021 "to prevent big tech firms from making killer acquisitions that harm competition and eliminate consumer choice."

Barnett argues such legislation would undermine the venture capital–based innovation system in the United States. The most common mechanism by which initial investors in startups monetize their investments is acquisition by a large firm rather than going public through an initial public offering (IPO) of stock. A study of the universe of non-biotech venture capital–backed, U.S.-based startups from 2002 through 2022 found that 61 percent failed or were acquired by larger firms at a loss to initial investors. Just 35 percent were acquired at a profit to initial investors, and only 4 percent had a successful IPO.

Why does innovation have these characteristics? Barnett notes that small firms can use "high-powered incentives" (that is, stock) rather than cash to support innovation, but large firms have an advantage in converting an innovation into a product that can be manufactured and distributed on a mass scale. The populist antitrust proposals thus would effectively eliminate the most-used monetization mechanism for technology startups.

Still not convinced? Barnett argues that if you really want to preserve the options of small firms to innovate and flourish independently without the necessity of acquisition, you should favor the existence and enforcement of patents, an argument he has presented in *Regulation*. (See "Weak IP's Hidden Subsidy," Spring 2021.) Small firms can license their enforced patents and avoid acquisition to monetize their innovations.

'Predatory' Loan Interest Rate Controls

■ "Credit for Me but Not for Thee: The Effects of the Illinois Rate Cap," by J. Brandon Bolen, Gregory Elliehausen, and Thomas W. Miller Jr. SSRN Working Paper no. 4315919, June 2023.

On March 23, 2021, Illinois enacted the Predatory Loan Prevention Act (PLPA). The PLPA sets a 36 percent "all-in APR" (including non-credit charges, making it more restrictive than the Truth in Lending rate) ceiling for loans below $40,000. Banks and credit unions are exempt from the Illinois rate ceiling.

The costs of making loans do not vary that much with loan size, so costs are a higher percentage of small loans and thus interest rates on smaller loans must be higher. One estimate in the literature concludes that a 36 percent interest rate cap would preclude loans of less than $2,900 from breaking even. Thus, Illinois' 36 percent all-in APR is likely binding on small-dollar unsecured installment loans from finance companies.

This paper examines credit bureau data from Illinois and Missouri (which had no interest rate controls) over four consecutive quarters, from the fourth quarter of 2020 to the third quarter of 2021, roughly two six-month periods before and after the PLPA.

The rate cap decreased the number of unsecured installment loans in Illinois by 6 percent and increased the average size of unsecured installment loans in Illinois by 23 percent. The number of subprime loans in Illinois decreased by 38 percent, but the average subprime loan size increased 35 percent. This increase in average loan size is consistent with the notion that a larger loan is needed to make small loans profitable at a maximum rate of 36 percent. Despite being explicitly exempt from the new law, banks and credit unions in Illinois did not increase their supply of these loans after the interest-rate cap was enacted.

Minimum Wages and Poverty

■ "Minimum Wages and Poverty: New Evidence from Dynamic Difference-in-Differences Estimates," by Richard V. Burkhauser, Drew McNichols, and Joseph J. Sabia. NBER Working Paper no. 31182, April 2023.

The consensus of economists has long been that minimum wage increases did little to reduce poverty because most minimum wage labor is not supplied by individuals living in poor families and many people in poor families do not work. A 2019 paper by Arindrajit Dube, "Minimum Wages and the Distribution of Family Incomes" (*American Economic Journal: Applied Economics* 11(4): 268–304), challenged that consensus, finding that increases in the minimum wage decreased poverty. The Congressional Budget Office cited Dube to conclude that 900,000 individuals would be lifted out of poverty from an increase in the federal minimum wage from $7.25 per hour to $15 per hour.

Subsequent papers have challenged Dube's work.

Most disputes regarding empirical work in economics are about the *failure to include* variables in regressions that are statistically related to the outcome (in this case, aggregate poverty rates) as well as the causal variable of interest (the minimum wage). The addition of those variables reduces the apparent effect of the variable of interest (in this case, the minimum wage).

This paper criticizes Dube for the opposite problem: *including controls* for state unemployment rate and per-capita state gross domestic product. The authors argue these controls are inappropriate because the minimum wage affects poverty through those variables: its negative effect on employment and hours. Burkhauser et al. use the state house-price index and the unemployment and average wage rate among more highly educated individuals to control for state macroeconomic conditions that are less likely to capture pathways through which minimum wages affect the labor market and poverty. The result is no effect of minimum wage increases on the poverty rate.

The authors also recalculate the effect of a $15 minimum wage on poor families with descriptive statistics. Fewer than 10 percent of those whose hourly wage rate would be affected by a $15 minimum wage live in poor families. Approximately two-thirds live in families with incomes over two times the poverty line and nearly half live in families with incomes over three times the poverty line.

Educational Expenditures and Outcomes

■ "Pricing Neighborhoods," by Sadegh Eshaghnia, James J. Heckman, and Goya Razavi. SSRN Working Paper no. 4477536, June 2023.

Educational inequality is often attributed to expenditure differences across school districts. And public-school funding equalization is an explicit goal of many educational reform advocates as well as state-level constitutional litigation.

In Denmark, per-pupil expenditures and teacher salaries are mandated to be equal across public schools except for students with special needs and for cost-of-living adjustments. Despite the equalization, high-quality teachers are attracted to schools with high-quality students and parents.

Controlling for housing and neighborhood characteristics, households are willing to pay 2–3.5 percent more for housing ($6,700) with average characteristics. Households are paying for their children to attend schools with better student peers and teachers, and with better adult peers. Educational inequality occurs even when expenditures are equalized. *R*