

## BRIEFLY NOTED

# Bootleggers, Baptists, and Beer Labels

◆ BY E. FRANK STEPHENSON

In July 2016, the Beer Institute announced its “Brewers’ Voluntary Disclosure Initiative” whereby brewers will voluntarily include nutritional information on beer cans and bottles. Much like labels on food, beer containers will now indicate calorie, carbohydrate, and alcohol content.

The ostensible reason for calorie labeling is consumer information. Center for Science in the Public Interest president Michael Jacobson trumpeted the Beer Institute’s calorie labeling announcement as “good news for consumers.” Kris Sollid of the International Food Information Council proclaimed that calorie labeling “may make it easier to keep calorie consumption in check” and concluded that with calorie labeling “maybe ... some people will think twice” before drinking more beer.

Perhaps such information would help beer drinkers, but a recent literature review concluded that “current evidence suggests that calorie labeling does not have the

intended effect of decreasing calorie purchasing or consumption.”

**Raising rivals’ costs** / Looking beneath the foamy claims about enhanced consumer welfare reveals that familiar political machinations are likely lurking beneath the surface of the Brewers’ Voluntary Disclosure Initiative. The Beer Institute is the trade group for large industrial brewers such as Anheuser-Busch and MillerCoors, and its announcement of the calorie labeling initiative indicated that six major breweries, which together comprise more than 80% of the U.S. beer market, will adopt the voluntary calorie labeling.

Why would large brewers want to voluntarily include such information on their

labels? Large brewers like Anheuser-Busch are losing market share to the hundreds of smaller craft brewers that have sprung up in recent years in the United States. Instead of being limited to choosing from a handful of nearly identical American light lagers produced by the mega brewers, beer drinkers may now choose from a wide array of styles such as wheats, stouts, Belgians, and pale ales. While individual craft brewers comprise a negligible presence in the beer market, collectively they are eating away at the dominant position that large brewers have enjoyed since the end of Prohibition. However, most craft beers have more calories and higher alcohol content than mass-market brews like Budweiser. Thus, beer labeling can be viewed as an attempt to persuade calorie-conscious consumers to shift back toward Bud and its ilk. As such, calorie labeling would simply be a form of market competition, albeit collusively coordinated via the Beer Institute.

But there is likely more going on here than good old-fashioned market competition, especially given the evidence about calorie labeling’s inefficacy. Beginning in May 2017, U.S. Food and Drug Administration rules will require chain restaurants to include calorie information for beers on their menus. (The rules also apply to many other beer sales outlets with multiple locations such as convenience stores, sports venues, and bowling alleys.) When the FDA issued its regulations about restaurant menu labeling, the Beer Institute issued a press release indicating its “support [for] calorie labeling of each beer listed on menus in restaurants and retail establishments.”

The restaurant menu labeling requirement advantages large brewers over craft breweries. Calorie and nutritional labeling requires costly laboratory testing that reportedly runs \$300–\$1,000 per beer. Such fees for laboratory analysis amount to a fraction of a penny per bottle for mass-market producers because of their large volumes, but they are a significant cost burden for smaller craft breweries because they have to spread the costs over a smaller quantity of beer sold. Such effects are exac-



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erbedated for craft brewers that rotate beers frequently, produce seasonal specialties, or occasionally tweak their recipes.

The large breweries' support for the FDA's menu labeling is not a healthy sign of market competition. It is an attempt to gain an advantage over rival producers using government regulations. And

it is a reasonable guess that large breweries' voluntary calorie labeling is simply a step toward requiring calorie counts on all beers. Just as the Beer Institute supported the FDA's menu labeling regulations, expect the future to bring similar Beer Institute enthusiasm for extending calorie requirements to all beers. **R**

## The Government Is Lousy at Lending

◆ BY IKE BRANNON

**W**hat role should our government have in capital markets? This debate has been ongoing since at least the Great Depression, and has intensified following last decade's financial crisis.

At face value the current debate appears to revolve around the extent of government regulation. Should big banks have more regulations or higher capital requirements than smaller banks that are not "systemically important," meaning their failure would not lead to broader financial problems? To what extent should regulators prevent discrimination against borrowers or ensure some modicum of competition?

But at a more basic level the battle is about who gets to allocate capital. The answer for many on the political left is that it should be the government, and they've had amazing success in bringing that about in some sectors. It's not entirely clear that the right opposes that idea.

**Student loans** / For starters, consider the market for student loans. It is completely dominated by the federal government, of course. Under its virtual monopoly, borrowing for college has skyrocketed, and total student debt now exceeds \$1.3 trillion. To say that this lending market has problems is an understatement: over 40% of people holding student debt are not making payments, according to a recent *Wall Street Journal* analysis.

The reason for this failure is that the disintermediation created by government-

guaranteed student loans frees schools from having to worry about whether students who secure their loans through the financial aid office will actually repay the debt. The school won't be out of luck if there's a default; it's the government. And since college debt isn't dischargeable under bankruptcy except under circumstances of extreme poverty, the feds can eventually get their money from all but the poorest borrowers. More than a few schools exploit this government guarantee to target students of dubious ability and means and sign them up for student loans to finance their classes.

**Housing finance** / Clearly this is not a recipe for a healthy lending market. But it is not unique; in fact, it bears a striking resemblance to the lending market for housing. These days, government-controlled Fannie Mae and Freddie Mac essentially are the market, as there is virtually no private activity in the creation of the mortgage-backed securities that ultimately finance most home loans. There's also a disconnect between the nominal lenders and the ones who end up holding the capital: as long as the local mortgage provider can sell a loan, it will make it. Fannie and Fred-

die are the only ones doing the buying. They have become more selective about what mortgages they buy, but they are receiving the same political pressures they did a decade ago to cease "discriminating" against the poor and minorities, and to buy loans from less creditworthy applicants with less money down.

It was never the policymakers' intent that these government-sponsored enterprises essentially control most of the capital in the home loan market. But that lack of intent does not mitigate the problems this dominance creates. While not everyone necessarily sees this as a problem, the Federal Housing Finance Administration—Fannie and Freddie's overseer—has decided it will assuage those who don't like it by creating a "common trading platform" that ostensibly will make it easier for the private market to compete in the securitization of housing assets.

It's a fool's errand, however. As my Cato colleague Mark Calabria and I recently wrote for *Bloomberg BNA*, the private market is not sitting out of the mortgage-backed



securities market because it does not have the right software ("Can the Private Market Return to Home Lending?" July 14, 2016). The issue is that if there is another housing downturn, investors holding Fannie and Freddie paper know they're safe thanks to government protection; not so for private housing paper. Nobody wants to be on the

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hook if the housing market tanks again, so Fannie and Freddie have the market to themselves these days.

**Government as lender** / The government is the only game in town in two different trillion-dollar lending markets, and that should concern everyone. There's no evidence that these markets function any better because of government's outsized role—far from it, in fact.

The reality of financial markets is that sometimes borrowers will find themselves unable to pay back their lenders no matter how much due diligence the lender did. Occasionally these defaults may create larger systemic problems that can bankrupt lenders or hobble the wider economy. Government can regulate capital markets as much as it wants, but it cannot change this eventuality. Punitively punishing the “bad actors” in the financial crisis that dared compete and socializing entire lending markets are not good policy solutions.

It's impossible for any government to resist making investments for political reasons once it gets its hands on capital. Japan discovered this decades ago and China is learning it now. Less than a decade removed from a housing crisis that nearly destroyed global financial markets that was made worse by bipartisan pressure to boost home ownership through any means necessary, our government has resumed putting pressure on Fannie and Freddie to support extending mortgages to riskier borrowers.

The government's financial meddling doesn't stop with student and home loans. If the U.S. Department of Labor succeeds in making it easier for states to run their own retirement accounts, those efforts could evolve into the states using their inherent competitive advantages to squeeze out private fund providers. If we think we are above the self-dealing and corrupt “investments” that Asian countries make with the capital their governments control, we are delusional.

Before the government becomes a player in yet another financial market, we should take steps to reverse its oversized presence in lending. R

## Do Presidents Rush Rules to Avoid the Congressional Review Act?

BY SAM BATKINS

There is ample evidence and literature that outgoing administrations tend to increase regulatory output after Election Day, up until the next president takes office. This “midnight regulation” is a rational way for a departing president to cement as many domestic priorities as possible. But it arguably is also an attack on the will of the people because it is most pronounced when there is a party change in the White House, indicating a popular desire for policy change.

To address midnight regulating, Congress adopted the “carryover” provision of the Congressional Review Act (CRA). The provision allows an incoming Congress to overturn a rule enacted in the waning weeks of the outgoing presidency. But is this power effective? Or do presidents act to finalize regulations well before Election Day, beyond the provision's reach? In other words, is there a “twilight” before the midnight regulation period?

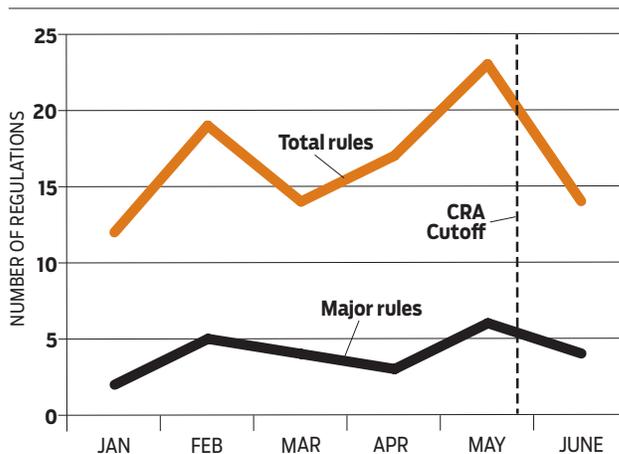
**Carryover provision** / The CRA allows a sitting Congress to review final rules for 60 legislative days after the rule has been issued. In that period, Congress can pass legislation, subject to presidential veto, blocking the rule. The carryover provision extends this power to an incoming Congress for a rule issued during the last 60 legislative days before adjournment of the previous Congress. In essence, this provision gives the new Congress 75 legislative days to review

and block the new rule.

But Congress has only used its CRA power once, despite all of the late-term presidential regulation. This raises the question, do outgoing presidents avoid this review by finalizing controversial regulations before the final 60 legislative days of a congressional term?

Prima facie, presidents would face some difficulty with employing this strategy. First, the exact day the carryover provision becomes effective cannot be known until Congress adjourns its session. Any president wishing to finalize a flurry of rules would have only a vague idea ahead of time of the carryover provision's start date and it would be largely dependent on another branch of government. For instance, the carryover date for 2016 was initially estimated to be May 17th, a fig-

FIGURE 1  
2016 REGULATIONS BY MONTH



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ure later confirmed by the Congressional Research Service. But Congress stayed in session a few extra days (relative to its initial calendar), pushing the carryover day closer to May 23rd. So if there is a party change in the White House following this November's election, the (currently) opposition-controlled House and Senate could decide to take off November and December, in which case the carryover date would be closer to May 1. This might be too much uncertainty for a president to plan a regulatory agenda around the CRA.

**A rush?** / To detect a twilight phenomenon, we have only a limited amount of data to examine. There is some evidence that the administration and regulators (the CRA applies to independent agency actions as well) may be twilight-regulating this year. Figure 1 displays the rate of total and major rulemakings so far this year, with a line denoting a probable CRA carryover date.

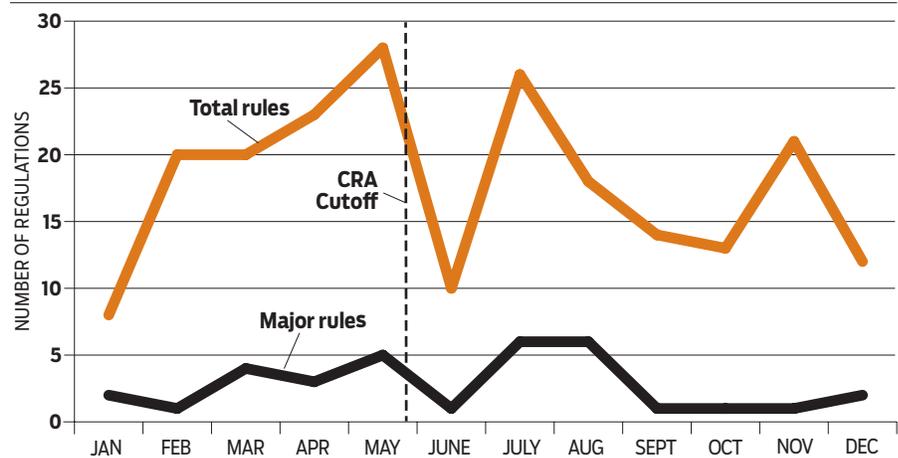
The figure is hardly a slam dunk in favor of the hypothesis that presidents act to finalize rules before the CRA takes effect, but there is a noticeable spike in May for both total and major rules. Here are a few especially controversial rules released from the Office of Information and Regulatory Affairs (OIRA) the month before the CRA cutoff:

- E-cigarette regulation
- Methane standards for oil and natural gas
- Overtime expansion
- Renewable fuels standard

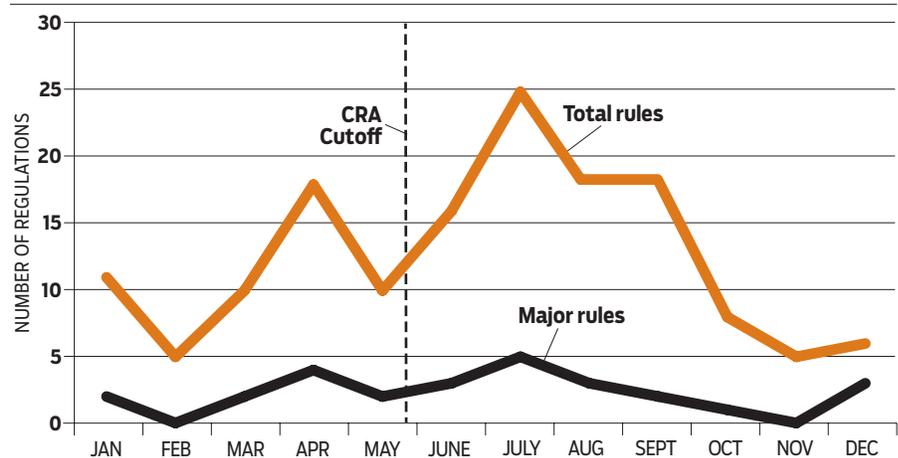
In May of 2016, OIRA approved 14 significant rulemakings, which was more than any other May in a presidential election year since 1996. Regulators also estimated the rules would impose \$22 billion in costs, compared to just \$2.8 billion in costs for the rules approved in May of 2015. These data are suggestive, though it should be noted that they don't prove that the carryover provision of the CRA rushed certain decisions by the Obama White House.

Another source of data to test this

**FIGURE 2**  
1996 REGULATIONS BY MONTH



**FIGURE 3**  
1997 REGULATIONS BY MONTH



hypothesis is the Unified Agenda, which shows various rulemakings' progress through the regulatory process. Were there rules issued before their target publication dates (a rarity in the regulatory world) in order to beat the carryover deadline? For example, the administration said it was still analyzing comments from its controversial fiduciary rule as late as December 2015. However, OIRA started review of the proposed rule in January and the rule was final by April, ahead of schedule and well before the carryover date. Likewise, the Environmental Protection Agency's final fracking standards for oil and natural gas weren't expected to be final before June 2016, but OIRA

concluded review in early May. Finally, the overtime rule was expected to be final in July of 2016, likely past the CRA date. However, OIRA concluded review on May 17 and it was officially published shortly thereafter. These instances are suggestive, though they do not yield statistically significant findings.

We conducted a much larger review of every rulemaking from 1996 (when the CRA was adopted) to the present. We used the CRA deadline as computed by the Congressional Research Service, and then examined rulemaking activity (both major and overall rules) the month before that date. The control was non-presidential election years when a CRA date is still computable.

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During presidential election years, OIRA approved an average of 4.6 major rules (including eight in 2016) in the month before the CRA carryover date took effect. In non-presidential election years, this figure was 4.1. Looking at all rulemakings, not just major rules, regulators approved 21.5 final rulemakings in the month before the carryover date during presidential election years. During off-year elections, OIRA released just 17.2 regulations the month before the carryover date.

A *t*-test finds that these differences are not statistically significant. However, this is a small sample size: there is only a comparison between average activity in six presidential election years since 1996 and 15 non-presidential election years. The higher presidential election year averages and a graphical look at the timeline of regulations suggest that administrations are cognizant of the CRA cutoff date.

For example, Figure 2 displays major and overall regulatory activity from OIRA in 1996 and 1997. As with 2016, there was a noticeable spike in regulatory activity the month before the CRA took effect in 1996, with 28 regulations. Compare that to 1997, which is shown in Figure 3. That was a non-presidential election year, when OIRA approved just 13 rulemakings and there was actually a decrease in activity before the hypothetical CRA carryover date took effect.

**Conclusion** / At first blush, the notion that presidents act to cement their regulatory priorities before the next Congress has a chance to repeal them sounds like a truism, rather than a hypothesis in need of empirical testing. There is some suggestive evidence indicating small spikes in regulation before the CRA carryover provision becomes effective, but the difference between off-election years is not statistically significant. This could be due to the small sample size or simply because the speculative nature of the carryover date does not motivate presidents to rush major regulation. From what we do know, presidents can always wait until the midnight period to implement major rules. 

## Trade and Adjustment Costs

◆ BY PIERRE LEMIEUX

A National Bureau of Economic Research paper released early this year has caused a small commotion in economic circles. In the paper, titled “The China Shock: Learning from Labor Market Adjustment to Large Changes in Trade,” the authors, David Autor (Massachusetts Institute of Technology), David Dorn (University of Zurich), and Gordon Hanson (University of California, San Diego), calculate that the costs of adjustment to the shock of Chinese imports from the early 1990s and especially since 2001 (when China joined the World Trade Organization) have been enormous. Workers negatively affected by Chinese imports suffered job losses or permanently lower incomes.

Some economic commentators have interpreted the paper as an indictment of free trade. Others—including *The Economist*—read it as dealing with adjustment costs, not as a statement that trade brings no net benefits. Moreover, Autor et al. note that the China shock was a one-time affair that is now dampened by higher wages in China. Yet, writes *Bloomberg.com* columnist Noah Smith, “Economists should still re-evaluate their benchmark theories, and ease up their adamant rhetoric of free trade.”

Is it possible that, contrary to what economists have thought at least since Adam Smith, free trade is bad?

One generally ignored caveat is that trade between China and America is far from free. Trade agreements are as much managed trade as free trade. As Paul Krugman concisely put it in a 1997 article, “The economist’s case for free trade is essentially a unilateral case: a country serves its own interests by pursuing free trade regardless of what other countries do” (quoted by Autor et al.). In America as elsewhere, we are very far from this.

**Jobs and protectionism** / Jobs have been lost

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in manufacturing and “offsetting employment gains in other industries have yet to materialize,” states the paper’s abstract. We should be very careful with this focus on jobs. The number of jobs should not be the metric. My rough estimates suggest that the mechanization of American agriculture has destroyed at least 15 million net jobs, but this is a plus, not a minus, since it was accompanied by lower food prices and higher real income. (See my *Who Needs Jobs?* Palgrave Macmillan, 2014.) Income and ultimately welfare are what matters, not sweating and work.

Standard economic theory proves that free trade creates net benefits. As economics students know, the geometric proof is beautiful and compelling, but the gist of it is not difficult to grasp. Consumers gain because they pay lower prices, and they gain more than domestic producers lose. If this were not the case, domestic producers could bribe consumers, through lower prices, to patronize their own products instead of their foreign competitors’. Moreover and less directly, free trade generates lower prices for many domestic producers’ inputs.

To be unqualified, this proof assumes that the welfare of a foreigner has the same weight as the welfare of a fellow citizen. It is a safe moral assumption to make, if only because one’s foreigner is the fellow citizen of another. You only need to have been born across a political border to be the “other.” Equal human value is also a safe political assumption if we don’t want the clash of national interests (which are the interests of the de facto rulers) to launch prosperity-destroying trade wars or real wars.

Even if one assumes instead that a national government should defend its



nationals' interests against foreigners' interests, it is only in special circumstances—if it can manipulate the terms of trade—that it can succeed in doing so. And protectionism typically leads to retaliation, which amounts to the retaliator sinking a ship in his own harbor to get even with the trading partner who has done the same in his harbor. Protectionism is not very rational policy.

**Mutual prosperity** / The ultimate foundation of free trade rests on what economists call the benefits of exchange: both parties to an exchange benefit, otherwise one would have walked out. The same principle applies to a consumer (and his middleman such as Walmart) and his foreign supplier: both parties benefit.

It is true that third parties are sometimes harmed in a non-violent sense. If domestic consumers buy their widgets from a foreign supplier because they are less expensive, domestic competitors lose. But as we have seen, the losses of domestic producers and their employees will normally be more than compensated by the lower prices that consumers get. In a free trade regime, the individuals who lose in the labor (or capital) market will gain from purchasing their own consumption goods at lower prices because foreign suppliers compete with domestic suppliers. Free international trade generates more prosperity, and we would expect few to be net losers.

How do we know that free international trade creates general prosperity? Because the argument is exactly the same for free domestic trade. Domestic trade between, say, Vermont and California can cause disruptions and shocks. Taxi drivers in Vermont are certainly disrupted by Uber. Cheese manufacturers in Vermont are potential disrupters for their California

competitors. Creative destruction is necessary for prosperity. This is no less true at the international level.

Autor et al. estimate that one million American manufacturing jobs were lost because of Chinese imports between 1999 and 2011. They add to this loss another 1.4 million jobs (which result, in part, from a questionable aggregate demand effect). These are viewed as short-term distributional and adjustment costs; they are not a net long-term efficiency cost. The authors acknowledge that these costs do not negate the net benefits of free trade. The benefits of free trade come out more clearly in an *Econtalk.org* podcast interview of Autor by Russ Roberts. In short, it is difficult for an economist to oppose free trade.

**Market inflexibility** / Why have these distributional costs (including adjustment costs) been higher than expected?

The reason is that labor markets have been much less flexible than we would have expected. Of the workers disrupted by Chinese imports, few switched industries or moved to another region. As noted by Autor et al., government assistance programs—Trade Adjustment Assistance and unemployment benefits, but mainly general assistance programs such as health and disability benefits—gave perverse incentives to workers displaced by Chinese imports. I think the regulation of labor markets should also be considered, from occupational licensure to minimum wages and European-flavored regulation of labor markets. Market inflexibility is the problem, not trade as such.

Shocks, creative destruction, and change are the bread and butter of prosperity. Consider again the example of agriculture. From 1950 to 1970 only, 3.7 million

jobs disappeared from agriculture, but the labor market adjusted quite easily.

In the United States, as in other developed economies, manufacturing employment has been riding a long-term downward trend. The proportion of (non-farm) Americans occupied in manufacturing has gone from about 30% in the 1950s to 16% in 1990, and to less than 10% from 2006 on. The lost manufacturing jobs moved to services industries. Economists Andrew Bernard, Valerie Smeets, and Frederic Warzynski argue that, in many cases, the conception and distribution activities have stayed in the same firms, which have simply been reclassified in government statistics as non-manufacturing.

“We’ve always known,” writes economist Scott Sumner, “that local labor markets can be hit hard by import competition, and thus [Autor et al.] don’t really change our understanding of trade in any major way.” We must accept that any change, whether from trade or technical change, will generate some losers along with the many winners. We can never be sure that the former will be fully compensated out of the larger gains of the latter. However, both theory and history show that free markets are the best system to assure that net gains will be maximized and the number of net losers minimized.

I think that the policy conclusion to be drawn from Autor et al. and similar estimates is that government interventions—subsidies to disrupted workers and perhaps especially labor market regulations—have created rigidities that prevent the economy from adapting to shocks at minimum cost, as free markets would. This is the problem that needs to be addressed. R

#### READINGS

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