Ryan Bourne, Jordan McGillis

Prices and Policy

10 Blocks podcast

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Ryan Bourne joins **Jordan McGillis** to discuss his book *The War on Prices: How Popular Misconceptions about Inflation, Prices, and Value Create Bad Policy*.

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Audio Transcript

Jordan McGillis: Hi, I'm Jordan McGillis, economics editor of *City Journal*. Welcome to *10 Blocks*. Joining me on the show today is Ryan Bourne. Ryan occupies the Cato Institute's Scharf Chair for the Public Understanding of Economics, and he has a book out this spring that fulfills that very purpose, titled *The War on Prices*. Ryan, thanks for joining me.

Ryan Bourne: It's great to be with you, Jord.

Jordan McGillis: Now, Ryan, your job, as your title clearly conveys, is to advance the public's understanding of economics. The premise of your new edited volume is that there's a major misunderstanding about the role of prices and what they represent. Tell us about that misunderstanding and how you seek to correct it.

Ryan Bourne: Well, after this inflation hit, I recognized that there's a lot of the misconceptions and confusions around inflation, which is a change in the general price level, that we thought were buried in the 1970s were, in fact, returning to public debate, so the confusion between relative price changes between goods and services and changes in the overall price level, which inflation manifests itself with, the belief that temporary supply shocks can cause an ongoing or sustained inflation rather than just temporarily lifting the price level.

And indeed, the idea that workers' wage demands contribute to inflation too. And so as a result of that, I think there's a large section of the population who thinks inflation is a result of malevolent actors or one-off shocks rather than primarily being a story about monetary policy. So I really originally started this book thinking that I wanted to address these misconceptions and talk about the monetary roots of inflation.

But the more that we got into it putting together this multi-author volume, the more I recognized that a lot of the fundamental economic errors, not thinking through the supply and demand model that applied to this inflation, also manifested themselves in debates about a range of price controls and other regulatory interventions in individual product markets too.

So the U.S. has seen a big expansion in the use of price controls over the past decade, whether that be the return of rent controls across many states and localities, increased minimum wage rates, anti-price-gouging legislation, and increasingly, Joe Biden's war on junk fees. So ultimately, I wanted a collection of essays to address three major things: to address the misconceptions about inflation, to look at the real economics of historic and current price controls, and then address some of the moral arguments against market prices that underpin many of these policy ideas.

Jordan McGillis: It seems that a lot of what we're experiencing this decade rhymes with the 1970s. There were a lot of lessons that should have been learned that perhaps weren't. Can you talk to me about what occurred during the 1970s inflation and price controls that ensued then and how they exacerbated some problems?

Ryan Bourne: Yeah, sure. So as a result of the inflation in the early 1970s, Richard Nixon introduced a raft of different price controls at different times. I mean, ultimately, it manifested in whole-economy price controls, but we go into detail in the book looking at the price controls on oil and gas. And one of the big takeaways that I took from that chapter was the fact that quite often there are big political economy considerations behind these price controls.

So at any given time for most of that period, there were a raft of exemptions and carve-outs from that legislation. So the major effect wasn't actually a manifestation of price controls resulting in severe shortages, although at certain times that certainly did occur, but actually a big redistribution as it were toward certain players in the industry and toward certain types of consumers.

So I think a big theme that comes away from this book, other than the fact that price controls don't really help deal with inflation, they don't really change the economic fundamentals and monetary fundamentals between the balance of the money supply affecting total spending in the economy and the supply potential of the economy.

Takeaway beyond that is the fact that with price controls, you often get high degrees of redistribution in quite arbitrary ways that policymakers might not intend. That is a great example actually of two key lessons from the book really, which is that price controls do not help solve an underlying monetary inflation, but also they can create big distortions in the economy that quite arbitrarily redistribute wealth.

Jordan McGillis: Can you talk about some specific examples of the distribution effects of price controls, things that would be familiar to an average consumer?

Ryan Bourne: Sure. Well, it depends what price control we're talking about. Well, one price control that people might be more aware of because it affects many people is minimum wage rates, which is, of course, a price control on wages, so a price control on the returns to people's labor. And one might think about that and think, well, that's surely good for low-paid workers, right?

So we're mandating through government that pay levels per hour at least are going to be higher for that group of workers. But of course, that's not the end of the story. If you set a minimum wage rate too high relative to the market level within the economy, too high relative to the return to people's productiveness in any given role, then you risk reducing demand for their service.

So one potential redistributive effect of that is the fact that some people on the margins of the labor market, those often with the lowest skills, the least experienced, may find it harder to get jobs as a result. But that's not the only way a firm might adjust. We have a great chapter in the book by the academic economist Jeffrey Clemens, who outlines the fact that there are many other ways that businesses may adjust to increased minimum wages, and that includes tinkering with much of the remuneration package that a worker might receive.

The firm might offer less in the way of generous healthcare benefits, for example. They might decide to give the workers less flexibility over their schedules as a way of managing those fixed costs. So the distributional effects even of a price control on labor can be very interesting. Because on the one hand, you might think that just mandating a higher wage rate for low paid workers will improve their lot.

And for those that retain their hours, their jobs and nothing else about their package changes, that may well be the case. But then you also have to look at the broader impacts, which can include fewer jobs for certain types of workers, fewer hours being offered by employers or just cutbacks in ways that make the jobs perhaps slightly less pleasant or reduce other benefits that people could get within their remuneration package.

Jordan McGillis: I see. And another quite familiar form that you mentioned earlier is rent control, which is the opposite. It's putting in a ceiling on the raising of the price. Can you describe how that affects people?

Ryan Bourne: Yes. So rent controls are probably the most studied form of price control out there. And as you say, as a price ceiling, they work in the opposite rate. I mean, the crude old style rent controls, of course, just capped the absolute dollar amount that a landlord could charge for services. And the problem that you get there is that in a world in which, say, demand for rental services is increasing, and so the rent is held below the market rate, you can induce a shortage in the sector.

Now, for a vast variety of reasons, including the fact that usually when rent controls are instituted in the real world, there are lots of exemptions and carve outs, quite often, even though some people can find it more difficult to get properties, there are other ways that landlords might adjust. So one way is that landlords may just allow the quality of their property to deteriorate so that the new capped price reflects the market value of the rental services that they're offering.

As part of that decision to not put their property on the market, so reducing the supply, they might convert that property into a condo, for example. We've seen lots of examples of this when rent controls have been instituted across the United States, or they might look to sell it for owner occupation.

So there's a range of ways that individual landlords adjust depending on their circumstances, and the fact that you tend to get a lower overall supply when you reduce landlords' flexibility or reduce the rents they're able to charge means that paradoxically rent control, which is often instituted in the name of helping poor renters, can actually mean there's fewer properties available for them on the market.

Or when they are available, they're actually of a lower quality. So that's the first-order effects of rent control. Of course, there are broader economic impacts too, such as rent controls' beneficiaries. Those who do get rent control properties face a strong incentive then not to move to another area which doesn't have rent-controlled properties because they might lose that benefit. So all sorts of weird and wonderful effects from what looks like a policy on the surface designed to help the poor.

Jordan McGillis: Both of those styles of policies, minimum wage laws and rent control, are pretty strongly left-wing coded, at least here in the United States. But there's another form of public discontent that doesn't seem to have any left-right valence. Everyone's irritated by them, except for those of us weirdos who really love capitalism, and that's airline fees. People hate seeing these small little dinks and doinks when they look at the receipt.

They want to be able to put their bag underneath the plane as they used to without an extra charge. They want to be able to choose a seat. But airlines have found that they can create the most efficient process that satisfies consumer demand and makes them a profit by charging for these little parts of the experience. Talk to me about how consumers should view that and how airlines respond to the discontent and how the government is responding.

Ryan Bourne: Yeah, certainly. So since the deregulation of airlines, airlines have largely unbundled many services. So in effect, what that means is rather than paying some all-in price that guarantees that you'll get a particular seat, you'll be able to take two pieces of luggage, you'll be able to board in a line in which nobody gets preferential treatment, instead of doing that, airlines have built out pricing structures in which you can pay for additional services that are of high value to you.

Now, individuals might not like the fact that those are separated out because what they tend to think, what we tend to think as we're going through the process of buying a ticket is that we tend to regard these as additional charges rather than the airlines adjusting the fees so that certain people pay more than others and you have a degree of cross-subsidy. But in effect, what airlines have done through doing this is democratized air travel. And what do I mean by that?

Well, one of the consequences of being able to charge people for whom it's really important to board the plane first or to carry extra luggage or to have a specific seat on the plane, one of the consequences of that is airlines have been able to lower the basic ticket price, which has enabled air travel to be relatively affordable to vast numbers of people.

Now, obviously, if you were to regard all of those fees as junk fees, as the President Joe Biden often seems to imply, then one natural consequence if you were eventually to go the full hog and ban those fees would be that airlines would bundle up all of those services and just charge one overall price. Now, that would mean in effect that people were paying for services that they didn't really need.

And because of the overall base price being higher than it is today, a lot of people, particularly those on low incomes, would find it much more expensive to travel and so be much less likely to do so. We may not always like the fact that we see these fees added as we go through the process of buying a ticket, but we have to think about how that compares to a world in which those fees and charges were banned or didn't exist.

Jordan McGillis: How does this public discourse relate to credit card regulations that are being discussed or legislation perhaps being discussed on Capitol Hill?

Ryan Bourne: So President Joe Biden, since his State of the Union address last year, has really tried to clamp down on what he defines as junk fees. Now, it's not always clear what that definition is, but certainly part of that is to look at fees and charges within the financial sector. So one of the moves that the administration has made in recent months is to reduce the cap on credit card late fees.

And they've tried to sell this as a massive boon to consumers. If you pay your credit card slightly late, you're getting ripped off by credit card companies. But of course, that's not the end of the story. Credit card late fees help internalize the risk for the business of taking on relatively risky customers who are unlikely to pay their bills on time.

And so the agencies and government themselves admit that introducing such a rule where you reduce the cap on credit card late fees may in fact lead to other adjustments by the business, whether that's increasing the interest rates that these issuers charge, increase in minimum payment amounts or adjustments to credit limits to reduce the risks of taking on customers who tend to make late payments.

So that will obviously offset the total price of using credit cards for many customers. For the vast majority of customers, they won't see big net savings as a result of this reduction in credit card late fees. And in fact, it may well mean that risky customers might lose access to credit services entirely, and then in effect, they face an infinite price rise.

So again, we have to be very careful about thinking about the trade-offs for what ostensibly looks like reducing one fee can actually have a bit of waterbed effect and lead to other adjustments in the pricing bundle that are to other consumers' detriment.

Jordan McGillis: There's a strong similarity between that dynamic and minimum wage laws where the ostensible beneficiaries will actually often lose out entirely on either employment or the service being offered.

Ryan Bourne: Yeah, that's certainly right. And we see this across a whole range of sectors as well. The similar thing with rent control, those who are unable to find properties, for example, find themselves in a similar position. And that's really what we're trying to get across with the whole book.

We're trying to give a broad conception of all the kinds of margins of adjustment we tend to see when price caps or wage floors are set. And that can quite often be a much richer set of responses than just changes in quantity. It can mean changes in quality of the goods as well. So we have a broad number of chapters that look at these issues in a fair degree of depth.

Jordan McGillis: Turning to a deeper portion of the book, chapters 21 and 22 deal with gender discrimination, this chapter by Vanessa Brown Calder titled "The Gender Pay Gap Isn't About Workplace Discrimination," and then you have a chapter that's titled "The Pink Tax Is a Myth." Can you give us an overview of these two chapters?

Ryan Bourne: Yeah, certainly. One of the big themes that we hear that pushes back on the morality of market prices is the idea that firms within markets charge women more through virtue of them being women and pay them less through virtue of being women. So I look at the pink tax in a fair degree of detail. This was the idea that we heard in the 2010s that market prices were inherently sexist. It was all kicked off by former New York City Mayor Bill de Blasio's Department of Consumer Affairs, and then a range of people jumped on the bandwagon.

And what they did was they compared a bunch of different gendered products, which they thought were sufficiently similar, and looked at the prices for those marketed to women against men. And lo and behold, they found that those marketed to women tended to be, if you look at a range of studies, about 7 to 15 percent more expensive. So you might look at that and think, wow, companies are exploiting women. They're charging them more. They're making more profits off them.

Now, as an economist, that makes little sense. If these goods were fundamentally the same, but just differently branded and women themselves were genuinely indifferent between them, then they have an easy option, which is just to buy the men's versions. So an economist will look at this and think there must be meaningful, but perhaps subtle differences between the products. And that's exactly what the research has tended to find.

Some economists who were commissioned by the Federal Trade Commission looked at personal care items in detail, which is the market that tends to be brought up most here, and they found that yes, if you do a crude comparison, you see this big premium on what women are paying. But if you actually control for the main ingredients, so you're comparing genuinely like with like product, women's versions tend to be only very, very modestly more expensive on average and cheaper across a range of different items.

So the conclusion that comes away from the literature is actually women tend to prefer products in many sectors that have higher marginal costs of production and distribution. This is not women being ripped off by companies, it's women choosing products that they willingly pay more for. Indeed, women tend to be less brand loyal than men. They tend to be more astute shoppers. So this is actually a kind of free choice that people are making. And you see a similar story really in regard to discussions of the gender pay gap.

People tend to look at the average pay rate between men and women and assume that this is businesses discriminating against women, and I have no doubt that there is some degree of discrimination against women within certain employers. But when you really look at the carefully calibrated studies, what they tend to find is that the overwhelming degree of the pay gap is driven by differences in occupational choice if you look at an aggregate level.

But then even within occupations, the fact that as women get to an age where they become mothers, they tend to be less likely to maintain jobs that are client facing, require them to be on call the whole time, and they tend to work fewer hours per week. And once you control for all of those factors, the remaining gender pay gap tends to be much, much smaller. So you can argue the degree to which that reflects a broader societal discrimination, but what it certainly doesn't appear to reflect is individual businesses discriminating against women.

Jordan McGillis: Do you know much about changes over the last, say, three decades in gender disparity in pay?

Ryan Bourne: Yeah. We've seen a big decline in the aggregate gender pay gap in that period. And that's probably not surprising because the educational opportunities available to women, the number of women going into higher education, has expanded massively over that period. And indeed, if you look at certain cities like DC and I believe New York, women under the age of 30 tend to be paid more on average than men right now.

So as women have obtained more opportunities to participate in the labor market and been taking those opportunities, the idea that there's inherent sexism because of somebody's sex just doesn't appear to be there. That I think is very good evidence of the fact that what this is really about is choices that occur within families as families get to the time in which they begin to have kids.

Jordan McGillis: And that's very good news for Sephora. What are some of your other favorite chapters in this book that we haven't talked about yet?

Ryan Bourne: Well, there's a wide range of chapters, but I'll just highlight one of the chapters in the inflation section, which is David Beckworth looking at the extent to which this inflation really was driven by supply shocks and the Ukraine war, so the degree to which it was really things going on as we came out of the pandemic or the Ukraine war. And he certainly acknowledges that at particular times, there were clearly things that were going wrong on the supply side of the economy, which temporarily raised the price level.

But you can only really explain the ongoing sustained nature of the inflation by acknowledging that at the same time as that was occurring, there was far too much macroeconomic stimulus in the economy relative to our capacity to produce goods and services. So a simple way of looking at this, which he explores in great detail, is to say, okay, well, let's presume that we didn't want policymakers to adjust to all these supply difficulties by also squeezing demand at the same time.

That might have caused a recession. Instead, let's say that an ideal thing for the government to have done mainly through the Federal Reserve would've been to have a constant growth of nominal GDP, which is total spending on goods and services in the economy. So try and keep the demand side of the economy growing stably over that period. And what it shows is actually beginning in late 2021 through 2022, we saw excess stimulus, which ultimately manifested in that total spending on goods and services, way exceeding its pre-crisis trend.

And that I think is the smoking gun that shows the vast majority of the overall problem that we've seen in this period was on the demand side. That is we saw way too much stimulus in the form of not just borrowing by Congress and signed off by the president, but also excessively loose monetary policy, which has manifested in much higher prices across the board for consumers.

Jordan McGillis: Ryan Bourne's new book is *The War on Prices*. Ryan, where can our listeners find that book if they want to make a purchase?

Ryan Bourne: You can order the book already for pre-order at Amazon, Barnes & Noble, and a range of other bookstores. And if you want more information on the book, including a preview into some of the advanced praise for it, you can look up my Substack, which is called also *The War on Prices*.

Jordan McGillis: Okay, Substack is *The War on Prices*. And where can they see your work on social media?

Ryan Bourne: The best place is probably to follow me on Twitter. My Twitter handle is @MrRBourne. Unfortunately, Ryan Bourne was not available when I joined Twitter. There is a Ryan Bourne on there, but he hasn't tweeted since 2009.

Jordan McGillis: Perhaps with the proceeds from this book, you can buy him out. We'll see.

Ryan Bourne: If I can find him.

Jordan McGillis: All right. As always, you can follow *City Journal* on X @CityJournal, and on Instagram, you can follow us @CityJournal_MI. Ryan Bourne, thank you so much for joining us today on 10 Blocks.

Ryan Bourne: Thank you for having me.

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