AIER Research Reports

Volume XCI
August 2026

AIER

Research Reports

AIER publishes over 100 articles per month that are distributed in digital form. Research Reports contains Business Conditions Monthly plus 8 of the most representative, chosen here for popularity, variety, and relevance. These articles are often reprinted in venues around the web, including Seeking Alpha, Intellectual Takeout, Mises Brasil, and dozens of other outlets. To read all of them, go to www.aier.org

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August 2026

From the Senior Director of Research

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Every technological revolution produces its monuments. The nineteenth century stretched railroads across continents. The twentieth built sprawling automobile factories, oil refineries, and semiconductor fabrication plants. Today, the defining monuments are hyperscale AI data centers: vast, power-hungry complexes of concrete, fiber, and silicon feeding an insatiable demand for computation. The next generation is being planned at the gigawatt scale, rivaling the electricity demand of major cities.

The prevailing assumption is that these facilities represent the inevitable future of artificial intelligence. Bigger models require bigger data centers. Bigger data centers require more power generation, transmission infrastructure, and specialized chips. Scale itself has become the organizing principle.

But history offers a reason for skepticism. Today's hyperscale AI campuses may not be the destination at all, but merely a transitional stage: a necessary, if temporary, bridge between one technological paradigm and another. The truly consequential question may not be whether the current investment boom succeeds, but whether its sheer gigantism survives the next wave of innovation.

Joseph Schumpeter famously described capitalism as a process of "creative destruction;" new technologies relentlessly overthrow old ones. Every generation mistakes its newest industrial architecture for permanence, but progress is a process of concentration followed by decentralization.

Mainframe computers gave way to minicomputers. Minicomputers yielded to personal computers. Centralized server rooms evolved into distributed cloud computing. Mobile phones became smartphones. Each generation initially required enormous investment, but technological progress reduced size, cost, and energy consumption. Artificial intelligence may prove no different.

Today's frontier models require immense computational resources to train. But training is only one phase of the AI lifecycle. Inference, the actual use of models by businesses and consumers, is already moving toward smaller, more efficient architectures. Distillation compresses massive models into smaller ones with surprisingly little loss in performance. Quantization further reduces computational demands, while algorithmic advances often produce larger efficiency gains than improvements in semiconductor manufacturing itself.

The result is familiar. What initially appears possible only at extraordinary scale becomes economical at much smaller scales.

Imagine a world a decade from now in which most AI inference occurs locally: on smartphones, autonomous vehicles, industrial robots, enterprise servers, or neighborhood-scale computing hubs. Today's race to build ever-larger hyperscale campuses will resemble less the construction of permanent cathedrals than temporary scaffolding. But if so, how much of today's investment represents genuine capital formation, and how much could eventually be revealed as malinvestment?

The Austrian School uses the term "malinvestment" to describe capital deployed in ways that later prove economically unsustainable. Sometimes investors misjudge future demand, but malinvestment does not imply irrationality. Some of history's greatest technological revolutions were accompanied by substantial overbuilding.

In the nineteenth century, railroads investors financed thousands of miles of redundant track. Many companies failed, and fortunes were lost. But the infrastructure that remained remade society. The fiber-optic boom of the late 1990s likewise produced spectacular bankruptcies alongside the communications backbone that powers today's internet.

Artificial intelligence seems likely to follow the same pattern. Society genuinely needs vastly greater computing capacity, but technological innovation may rapidly reduce that requirement before much of today's planned infrastructure earns an adequate return. Both can be possible at once.

Attempts to frame AI as a bubble and AI as a revolution therefore miss the point. Technological revolutions routinely generate both extraordinary innovation and extraordinary capital misallocation. Civilization can be transformed even as private fortunes evaporate.

Will the physical architecture currently being built enjoy the same longevity as AI itself? Perhaps today's AI campuses become indispensable infrastructure whose value compounds for decades. Perhaps they become the equivalent of redundant railroad lines or dark fiber — economically disappointing but socially transformative. Or perhaps they will be indispensable in launching an AI era before being partially displaced by smaller, cheaper, and more distributed systems.

The defining question of this decade's AI boom will not be whether artificial intelligence succeeds, but whether the colossal infrastructure now rising across the landscape represents the permanent foundation of that future…or merely the temporary bridge to something far more efficient.

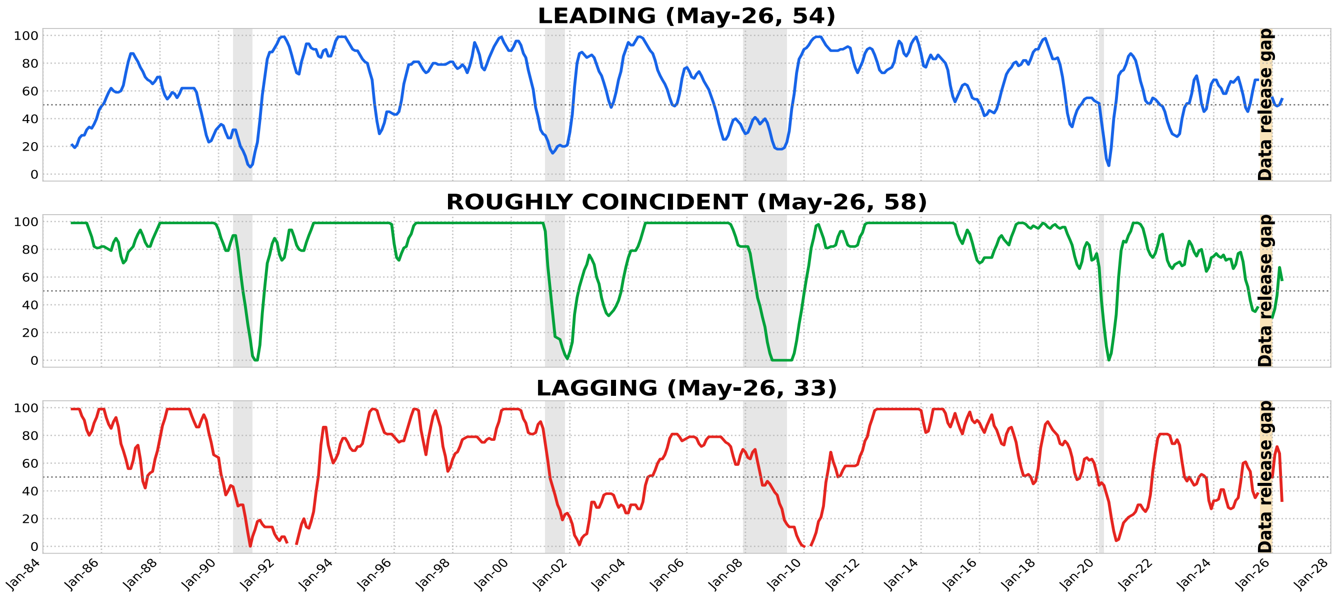
Peter C. Earle, Ph.D
Managing Editor, *AIER Research Reports*

August 2026

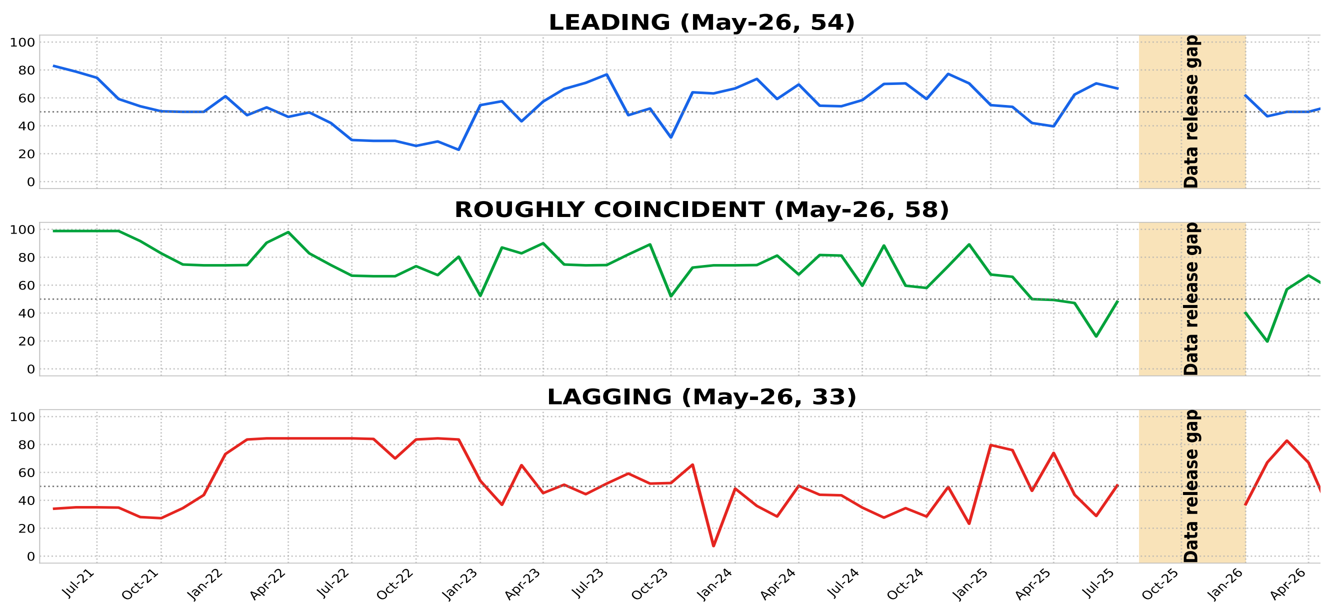
Business Conditions Monthly May 2026

Peter C. Earle
Senior Director of Research

AIER Business Conditions Monthly Indicators — All Time



AIER Business Conditions Monthly Indicators — Five Years



The May 2026 AIER Business Conditions Monthly (BCM) points to an economy that remains mixed, with a modest improvement in forward-looking breadth, a softer read on current activity, and a clear deterioration in lagging conditions. The Leading Indicator rose to **54** from **50**, moving slightly above neutral after last month's evenly split reading. The Roughly Coincident Indicator declined to **58** from **67**, suggesting that current activity remains positive but less broadly firm than in April. The Lagging Indicator fell sharply to **33** from **67**, indicating that slower-moving measures weakened meaningfully after last month's more expansionary reading.

LEADING INDICATOR (54)

The Leading Indicator came in at **54**, with six of twelve components improving, one essentially unchanged, and five declining.

Positive contributions came from a mix of financial-market, demand-sensitive, orders, and yield-spread measures. The Conference Board US Leading Index Stock Prices 500 Common Stocks rose **6.5 percent**, while Conference Board US Manufacturers New Orders Nondefense Capital Goods Ex Aircraft increased **1.1 percent**. Adjusted Retail and Food Services Sales Total SA advanced **1.3 percent**, United States Heavy Trucks Sales SAAR rose **11.2 percent**, and Debit Balances in Customers' Securities Margin Accounts increased **8.5 percent**. The 1-Year to 10-Year US Treasury Yield Spread narrowed **0.3 percent** and was scored positively after inversion. US Average Weekly Hours All Employees Manufacturing SA was effectively unchanged, contributing neutrally.

Those gains were offset by weakness in several important forward-looking areas. The University of Michigan Consumer Expectations Index fell **8.3 percent**, pointing to another deterioration in household expectations. US Initial Jobless Claims SA rose **18.4 percent** and was scored negatively after inversion. Conference Board US Leading Index Manufacturers' New Orders Consumer Goods and Materials slipped **0.2 percent**, while US New Privately Owned Housing Units Started by Structure Total SAAR dropped **13.9 percent**. The Inventory-to-Sales Ratio Total Business declined **2.3 percent** and, under the BCM scoring approach, was scored negatively.

Taken together, the leading components suggest a forward-looking environment that improved modestly but remains divided. Equity prices, capital goods orders, retail activity, heavy truck sales, margin debt, and the yield-spread signal provided support, while consumer expectations, initial claims, consumer-goods orders, housing starts, and inventories restrained the index. The rise from **50** to **54** points to a slightly better leading picture than in April, but not a decisive or broad-based acceleration.

ROUGHLY COINCIDENT INDICATOR (58)

The Roughly Coincident Indicator registered **58**, with three of six components improving, one essentially unchanged, and two declining.

Current activity remained modestly positive, though less uniformly strong than in April. Conference Board Coincident Personal Income Less Transfer Payments rose **0.3 percent**. US Industrial Production SA edged up **0.1 percent**, and US Employees on Nonfarm Payrolls Total SA also increased **0.1 percent**. The US Labor Force Participation Rate SA was effectively unchanged and therefore contributed neutrally.

Two components weakened. Conference Board Coincident Manufacturing and Trade Sales declined **0.7 percent**, and Conference Board Consumer Confidence Present Situation SA fell **4.0 percent**. Those declines suggest that while income, production, and payrolls continued to advance, sales activity and present-situation sentiment softened during the month.

Overall, the roughly coincident data point to continued expansion in current conditions, but with less breadth than in April. The decline from **67** to **58** reflects a cooling in real-time activity rather than a broad contraction. Payrolls, income, and industrial production remained supportive, while weaker manufacturing and trade sales and softer present-situation confidence pulled the index lower.

LAGGING INDICATOR (33)

The Lagging Indicator stood at **33**, with two of six components improving and four declining.

Two slower-moving measures contributed positively. US CPI Urban Consumers Less Food and Energy Year over Year NSA rose **3.7 percent**, and US Manufacturing and Trade Inventories Total SA increased **0.4 percent**. Those readings provided support from inflation and inventory measures.

The remaining components weakened. US Commercial Paper Placed Top 30 Day Yield declined **0.4 percent** and was scored negatively. Conference Board US Lagging Average Duration of Unemployment increased **6.6 percent** and was scored negatively after inversion. Conference Board US Lagging Commercial and Industrial Loans declined **1.1 percent**, and

Census Bureau US Private Construction Spending Nonresidential SA slipped **0.3 percent**. Together, those moves point to softer trailing conditions across short-term credit yields, unemployment duration, commercial lending, and nonresidential construction.

The lagging data deteriorated meaningfully in May. The drop from **67** to **33** suggests that much of the residual strength visible in April's backward-looking measures faded during the month. While core inflation and inventories remained positive contributors, the broader lagging category turned contractionary, with weakness concentrated in credit, labor-market duration, lending, and construction-related measures.

May's BCM results describe an economy that is still mixed, but less comfortably balanced than in April. Relative to April, the story is one of modestly better leading conditions, softer coincident momentum, and a sharp weakening in trailing measures — not a broad rollover, but a less reassuring mix than last month.

DISCUSSION, JUNE— JULY 2026

Recent inflation data point to a sharp improvement in headline price pressures, but a less decisive easing in the underlying measures most relevant to the Federal Reserve. June's CPI was substantially softer than expected, with headline prices falling **0.4 percent** as gasoline dropped nearly **10 percent**, while core prices were essentially unchanged and year-over-year core inflation slowed to **2.6 percent**. The improvement extended well beyond energy: shelter inflation moderated, medical services and car insurance declined, airfares barely increased, discretionary services cooled, and core goods prices fell for a second consecutive month, suggesting that most tariff-related passthrough has already occurred and that consumers are increasingly resisting further price increases. The breadth of inflation also narrowed considerably, with fewer than half of core categories rising at annualized rates above the Fed's **2 percent** target. Producer prices reinforced the near-term disinflationary signal, as headline PPI fell **0.3 percent** on cheaper gasoline, lower transportation costs, and subdued services inflation, while portfolio-management fees and airfare — important inputs into the Fed's preferred PCE index — came in below expectations. Upstream pressures have not disappeared, however: core PPI remains elevated from a year earlier, manufacturing inputs are still rising, freight costs remain high, and healthcare prices strengthened. Moreover, May's PCE report showed that inflation had accelerated before the June energy reversal, with core PCE reaching **3.4 percent** as portfolio fees, air travel, and healthcare accounted for much of the increase, while strong income growth and resilient consumer spending reduced the urgency of monetary easing. Taken together, the reports suggest that May likely marked the peak in headline inflation and that lower energy prices, softer goods prices, cooling shelter, and weaker pricing power are restoring disinflation, but persistent service sector and producer side pressures will allow the Fed to maintain a hawkish posture while leaving interest rates unchanged through the remainder of the year.

Recent labor market data continue to portray an economy that is cooling gradually rather than deteriorating abruptly. June's employment report showed payroll growth slowing to 57,000, with downward revisions to prior months and a narrower breadth of hiring, yet the three-month average remains above most estimates of the pace needed to stabilize unemployment. The decline in the unemployment rate was less encouraging than it appeared, reflecting a sharp drop in labor-force participation — including a notable decline among prime-age workers — rather than stronger hiring, while wage growth remained modest and consistent with easing inflation pressures. Job creation continues to be concentrated in higher skill service industries such as healthcare, professional services, and finance, while consumer-facing sectors including leisure, hospitality, retail, and information weakened. Other labor indicators present a somewhat firmer picture: ADP payrolls and the May JOLTS report point to steady hiring, low layoffs, stable quits, and job openings that remain sufficient to support continued expansion without generating significant wage inflation. At the same time, early evidence suggests artificial intelligence may be beginning to reshape hiring patterns, with employment softening in technology, information, and financial activities through slower hiring and attrition rather than widespread layoffs. Taken together, the labor market appears neither overheated nor recessionary: hiring is moderating, labor demand remains generally healthy, wage pressures are contained, and the combination of softer employment growth and subdued inflation should leave the Federal Reserve comfortable remaining on hold while monitoring whether the recent cooling proves temporary or marks the beginning of a more sustained slowdown.

June's purchasing manager surveys point to continued but moderating expansion across both manufacturing and services, with demand still solid, supply conditions improving, and cost pressures easing from their recent war-driven peak. The ISM manufacturing index slipped to **53.3** but remained near a four-year high and marked a sixth consecutive month of growth, supported by capital investment tied to artificial intelligence, defense spending, inventory accumulation, and strength across most industries. New orders and production slowed, however, employment remained slightly contractionary, backlogs grew at their weakest pace of the year, and factory commentary stayed cautious amid tariffs, elevated metals costs, stretched lead times, weaker consumer demand, and lingering uncertainty surrounding the Middle East. The most encouraging development was a sharp decline in the prices-paid index as falling oil prices relieved pressure on energy-intensive inputs, although overall costs remain well above early-year levels. Services activity followed a similar pattern: the ISM services index eased to **54.0** as new orders and production decelerated following May's inventory buildup, but the sector continued to expand, export orders and backlogs strengthened, supplier performance improved, and employment increased. Taken together, the surveys suggest that the economy retains considerable momentum but is shifting toward a slower and better-balanced expansion, with firms still investing and hiring selectively even as demand visibility weakens, inventories rise, and producers remain wary of tariffs, geopolitical disruptions, and persistent input-cost pressures.

Measures of consumer and small-business sentiment improved in early summer, reflecting lower energy prices and growing confidence that economic conditions are stabilizing, though both households and firms remain cautious about inflation and geopolitical risks. The University of Michigan's preliminary July consumer sentiment index rose to its highest level since February as falling gasoline prices eased pressure on household budgets, inflation expectations moderated, and buying conditions for major durable goods improved. Even so, concerns about the cost of living remained widespread, and because most survey responses were collected before renewed US military action against Iran pushed oil prices higher, some of July's improvement may prove temporary. Small businesses likewise became more optimistic, with the NFIB Small Business Optimism Index posting its strongest reading of the year as better sales expectations, stronger hiring intentions, and increased capital spending plans pointed to firmer momentum heading into the second half of 2026. Uncertainty surrounding investment decisions declined, supply chain disruptions eased modestly, and hiring plans returned to their long-run average, although labor shortages and inflation remained the most frequently cited obstacles. Taken together, the surveys suggest that lower energy costs have materially improved economic confidence across households and businesses, but persistent inflation concerns, labor constraints, and the risk of renewed energy-price shocks continue to temper the outlook.

The FIFA World Cup appears to have provided a meaningful, if temporary, boost to US consumer spending in June, with its effects likely to become more evident in the Bureau of Economic Analysis' personal spending report due July 30. Host cities experienced stronger restaurant traffic, as reflected in OpenTable reservation data, while retailers also benefited: Amazon moved its Prime Day promotion into late June to coincide with heightened consumer engagement during the tournament, supporting online merchandise sales. The event also fueled unprecedented sports betting activity, with more than $5 billion wagered through prediction markets such as Polymarket and Kalshi, record June betting volumes in New Jersey, and sharp increases in wagering in New York. However, that surge may not translate into stronger measured consumer spending because the BEA records gambling expenditures as net gaming revenue rather than total wagers, and early state data suggest casino and sportsbook revenues softened despite higher betting volumes. Taken together, the World Cup likely lifted June consumption primarily through hospitality and retail spending rather than gaming, contributing to an estimated **0.4 percent** increase in nominal personal spending (roughly **0.5 percent** in real terms) while providing a modest but noticeable tailwind to overall consumer demand.

Building on signs of resilient consumer demand, June's industrial production report painted a somewhat softer picture on the supply side, although it appears weaker than many other indicators would suggest. Industrial output rose just **0.1 percent**, with factory production essentially flat as declines in most durable-goods industries offset gains in computers and electronics, household appliances, transportation equipment, and several nondurable categories including food, apparel, printing, and energy products. Business equipment production weakened, though oil and gas drilling and utility output continued to expand. The report stands in contrast to stronger ISM manufacturing surveys, improving manufacturing employment, and other measures pointing to healthier factory activity, suggesting that June's production figures may understate underlying momentum rather than signal a meaningful deterioration. Even so, while continued investment in artificial intelligence, defense, and industrial infrastructure should support demand for capital goods and durable manufacturing over the coming months, the evidence still falls well short of indicating the broad-based manufacturing renaissance that some observers have anticipated.

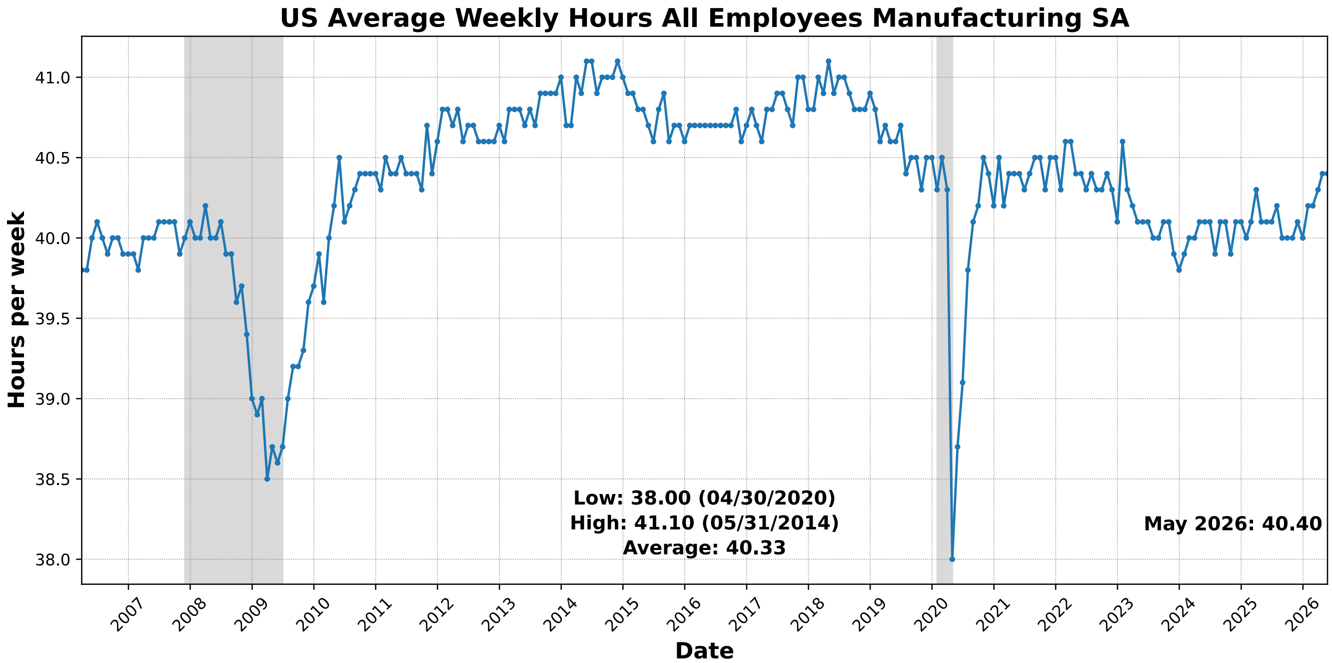
The Federal Reserve's latest Beige Book largely reinforced the picture emerging from recent economic data: growth continues at a modest pace, inflation pressures are gradually easing, and policymakers have little reason to alter their current stance. Business contacts across most districts reported slightly improved sentiment, supported by lower fuel prices, resilient consumer spending, including a boost from World Cup-related tourism in some regions, and continued strength in manufacturing tied to artificial intelligence, data centers, machinery, and defense. Labor markets remained generally healthy, with employment expanding modestly despite persistent shortages of skilled workers in technical and trade occupations. Price pressures also moderated, as every district reported inflation that was either unchanged or slower than in the previous survey, although expectations for future inflation remained mixed amid uncertainty surrounding energy markets and geopolitical developments. Overall, the Beige Book suggests an economy that continues to expand without significant overheating, providing further support for the Federal Reserve's strategy of maintaining a cautious, mildly hawkish posture while leaving interest rates unchanged as it awaits clearer evidence that inflation is moving sustainably back toward target.

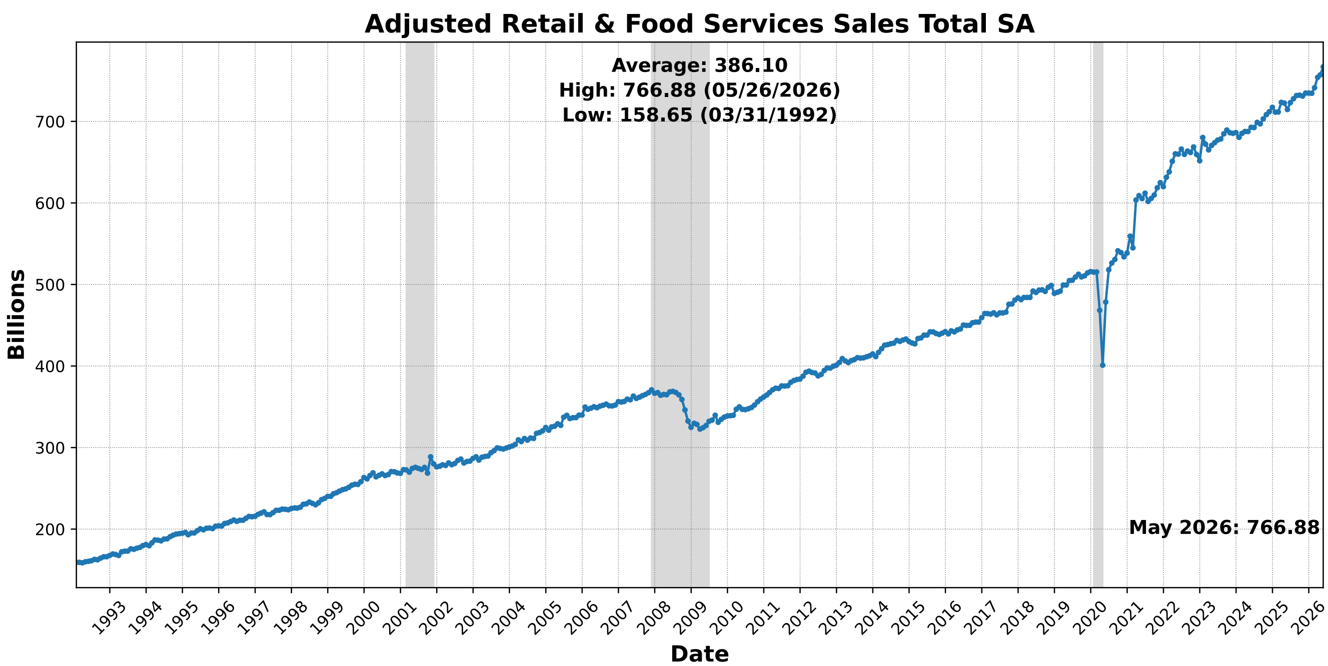
Attention now shifts to the July FOMC meeting, where officials are widely expected to leave interest rates unchanged despite lingering concerns over inflation and renewed geopolitical risks stemming from the lengthening and increasingly unpredictable conflict with Iran. While softer June inflation data and easing energy costs before the latest oil price rebound strengthen the case for patience, policymakers are also likely to scrutinize incoming GDP, personal spending, Core PCE, employment costs, and consumer confidence data for evidence that resilient consumer demand and continued AI-driven investment are not rekindling underlying inflationary pressures. The result is a policy outlook that remains finely balanced: the Fed appears comfortable staying on hold for now, but is unlikely to signal an imminent easing cycle until disinflation becomes more firmly established.

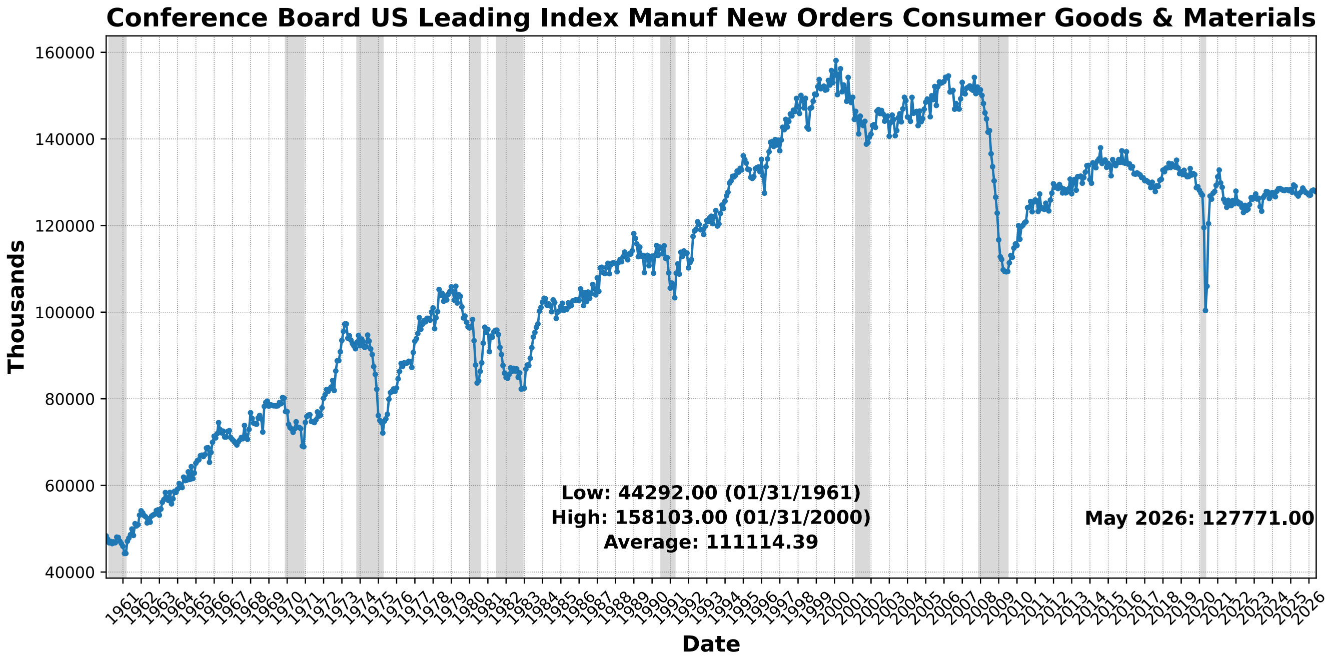
In the aggregate, recent economic data suggest the US economy continues to expand at a moderate, more sustainable pace rather than sliding toward recession. Inflation is easing, labor markets remain resilient despite slower hiring, and business activity continues to grow, supported by AI-related investment and steady consumer spending. While geopolitical risks, elevated services inflation, and lingering producer-price pressures warrant caution, the overall picture is one of continued expansion with gradually cooling inflation: conditions that should keep the Federal Reserve on hold as it awaits further evidence that price stability is being restored.

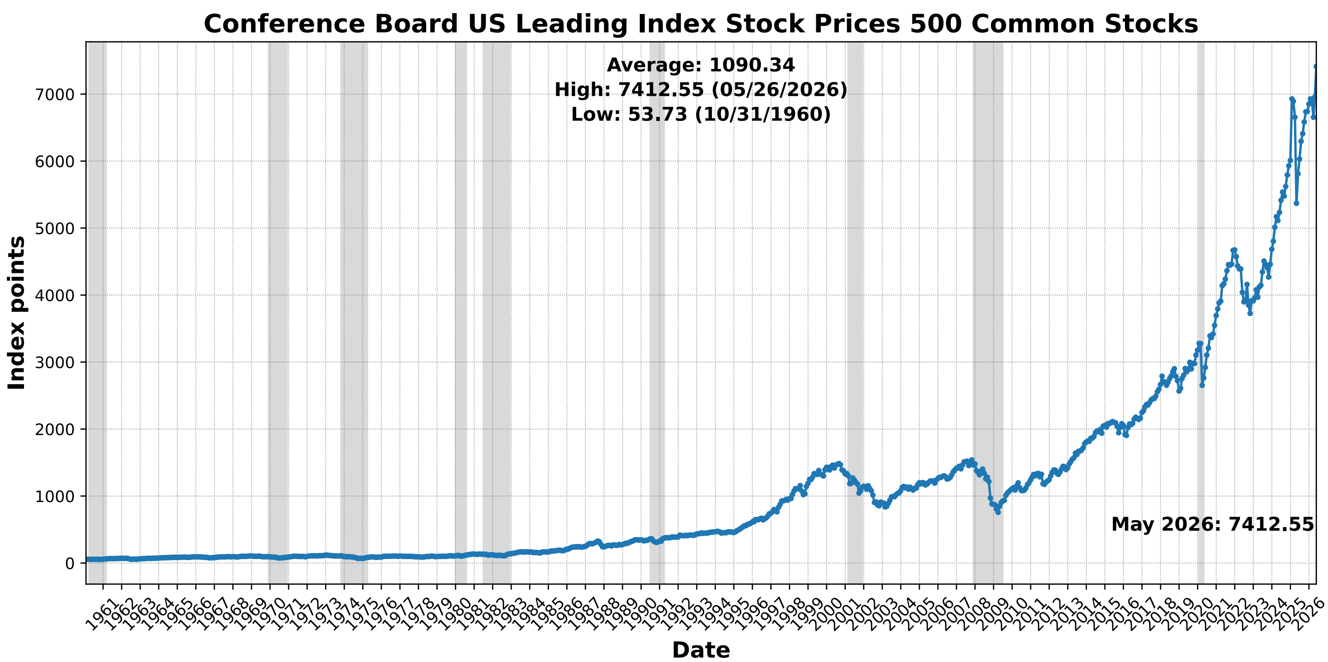
Early corporate earnings reports reinforce that cautiously optimistic outlook. An alternative, real-time gauge of economic activity generated by Bloomberg and based on whether S&P 500 companies exceed sales expectations has produced one of its strongest early readings since 2015. Twenty-nine of the first thirty-one reporting firms surpassed revenue forecasts through July 22. Because firm revenue growth provides a cleaner measure of underlying demand than earnings (which can be boosted by cost-cutting or financial engineering) the unusually broad strength in sales suggests second-quarter GDP may ultimately exceed current consensus forecasts by roughly a quarter of a percentage point. The sample remains small and should be interpreted cautiously, but the early earnings season adds to a growing body of evidence that consumer demand, business investment, and overall economic activity were firmer in the second quarter than many economists had anticipated, which in turn reinforces the case for continued economic expansion alongside a Federal Reserve that remains comfortably on hold.

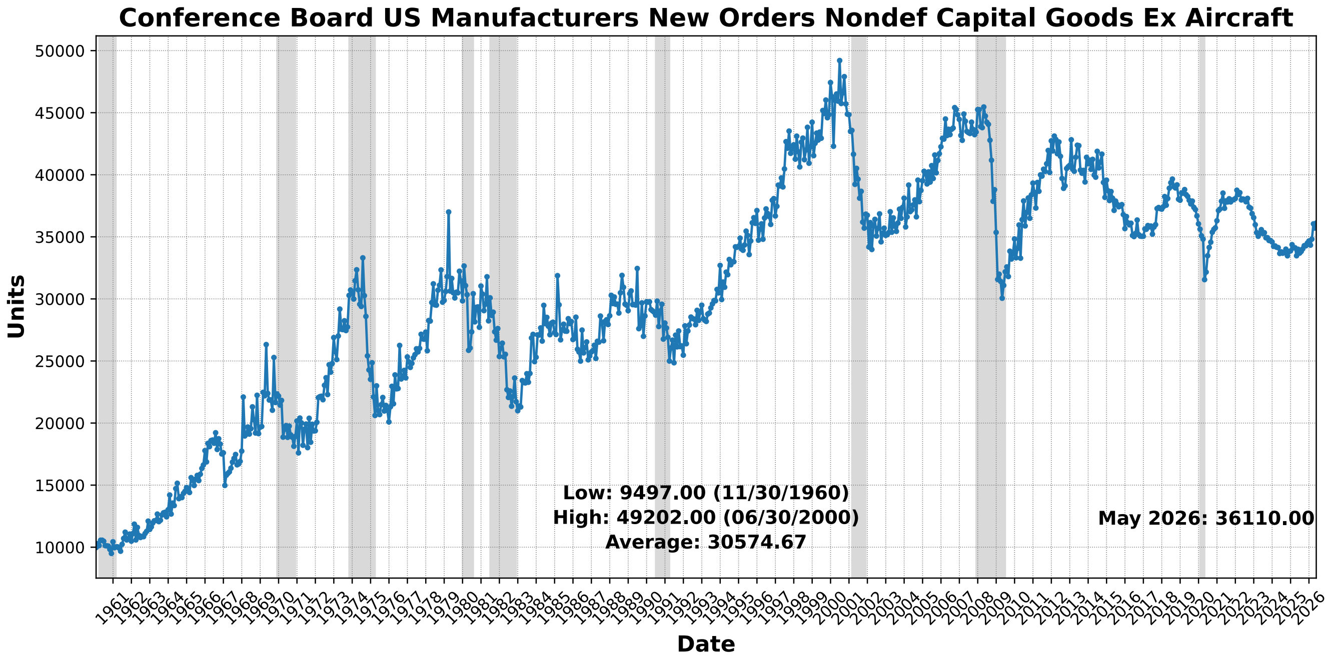
LEADING INDICATORS

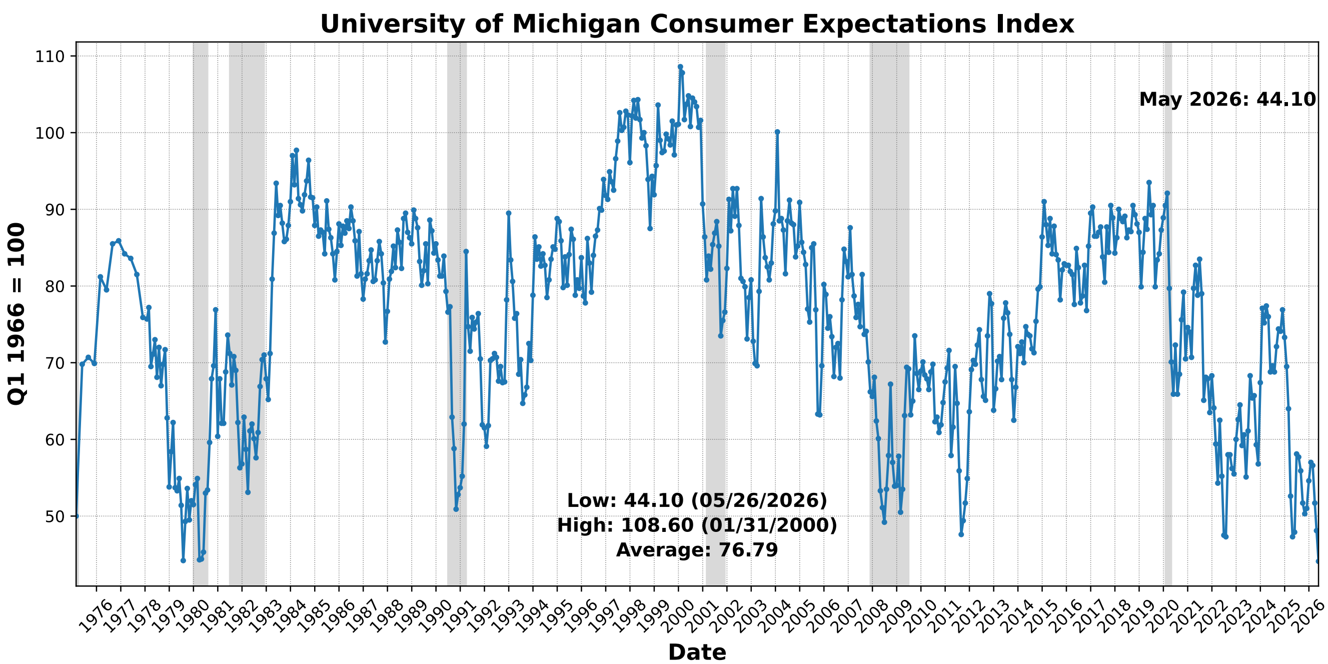


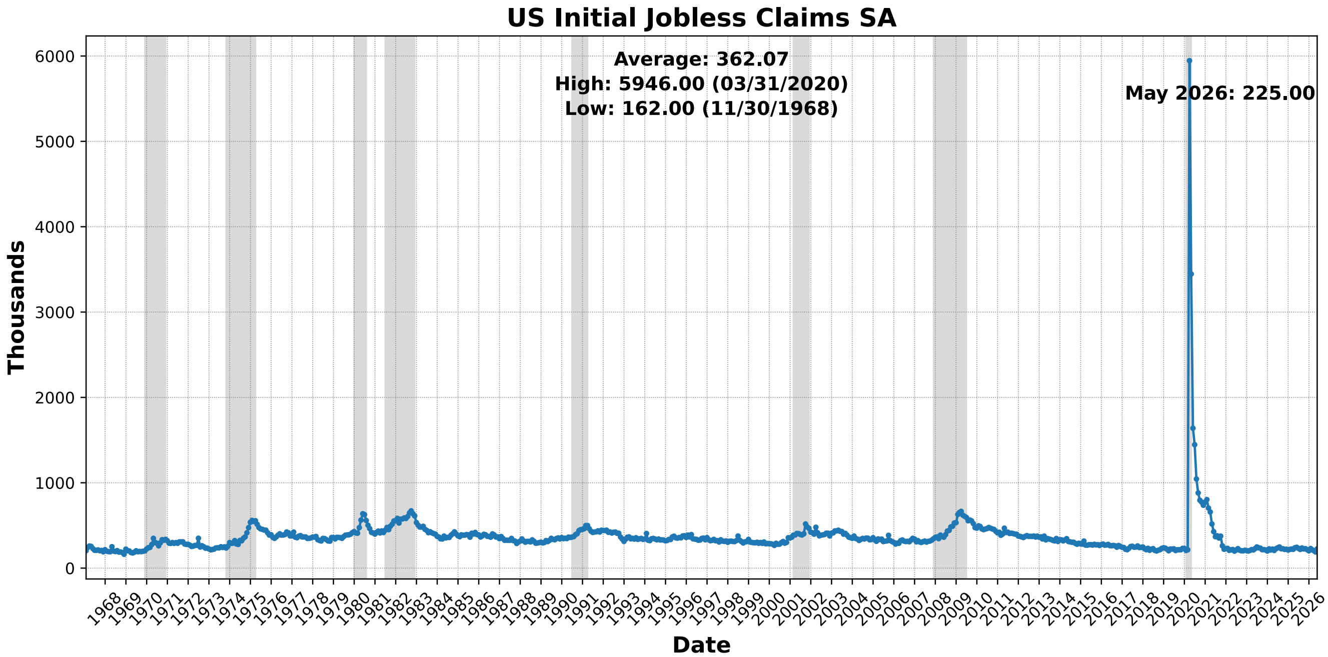


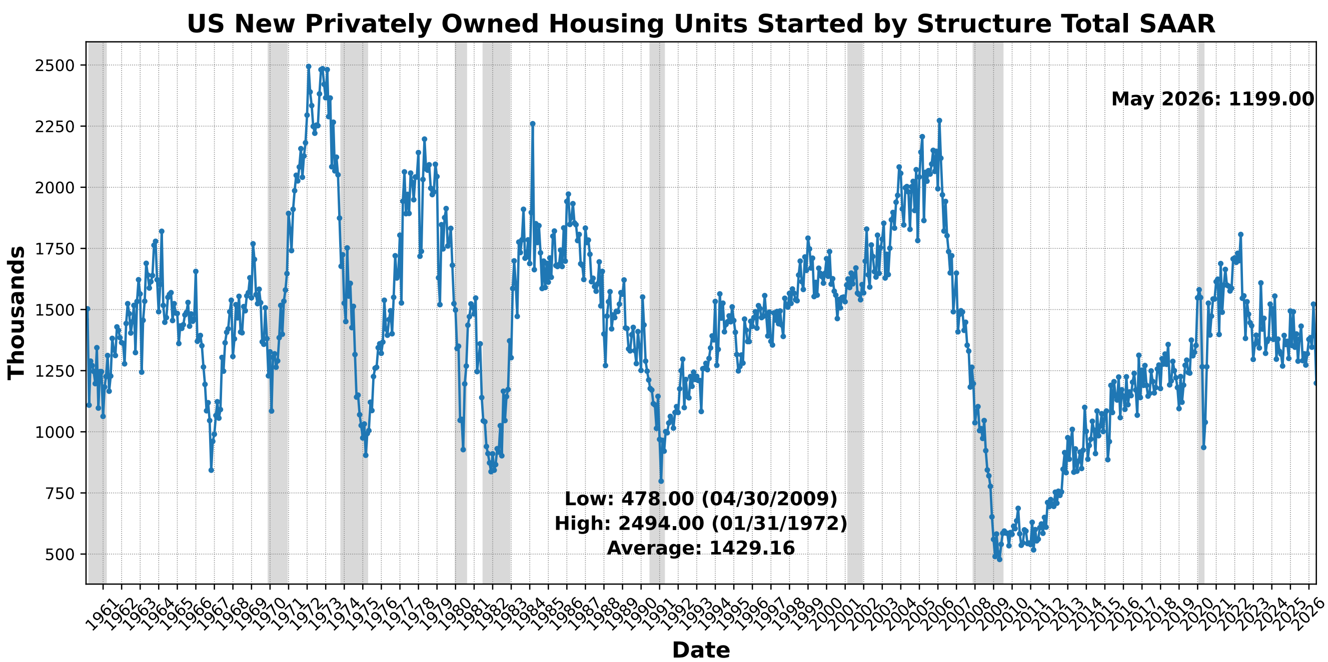

Conference Board US Leading Index Manuf New Orders Consumer Goods & Materials
Thousands
Date
Low: 44292.00 (01/31/1961)
High: 158103.00 (01/31/2000)
Average: 111114.39
May 2026: 127771.00

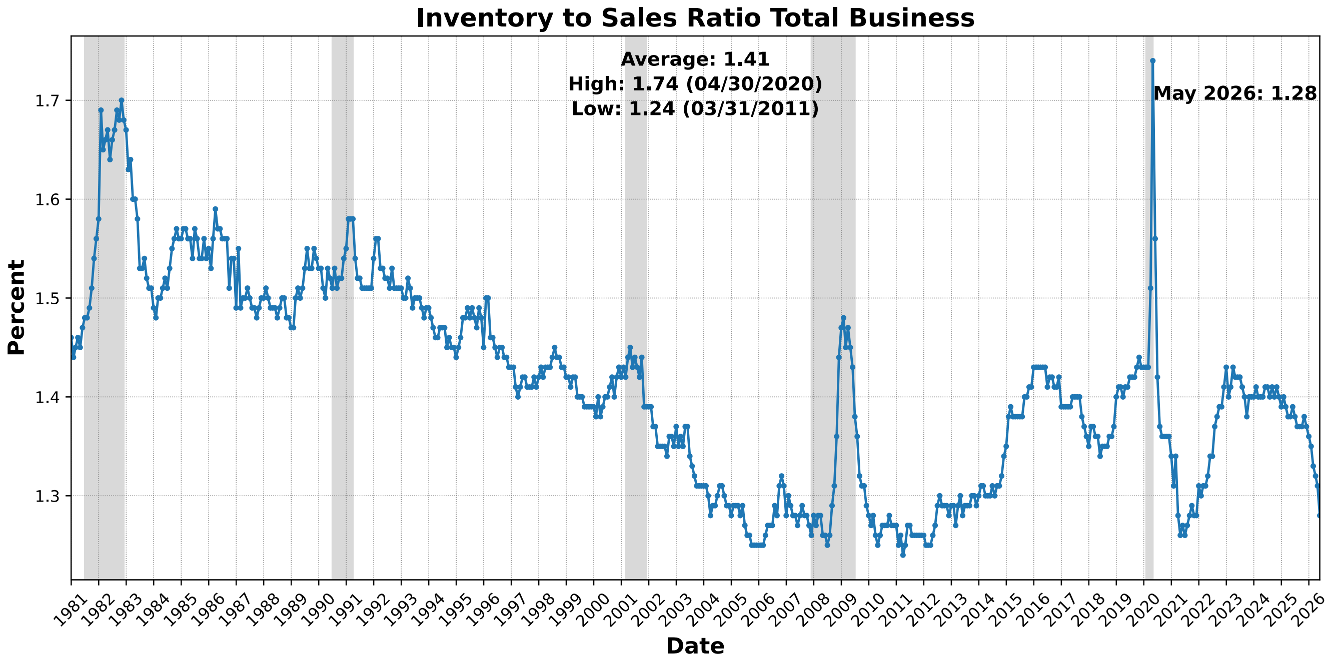

Conference Board US Leading Index Stock Prices 500 Common Stocks
Index points
Date
Average: 1090.34
High: 7412.55 (05/26/2026)
Low: 53.73 (10/31/1960)
May 2026: 7412.55

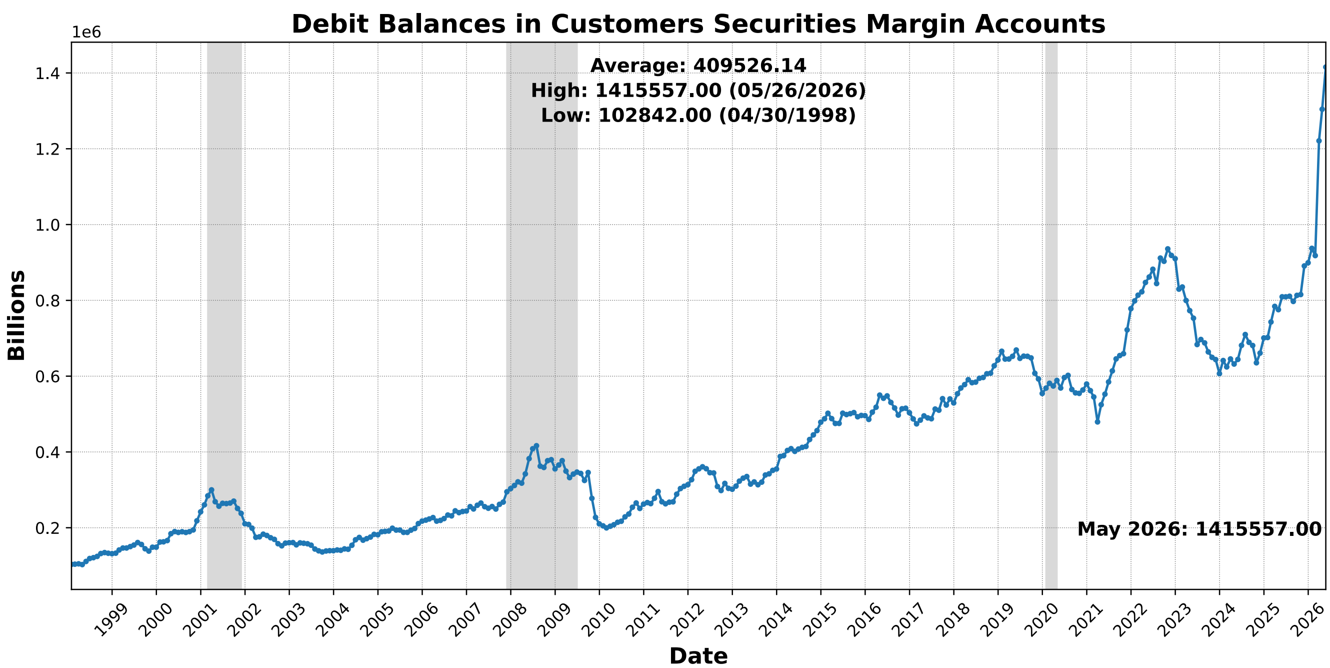

Conference Board US Manufacturers New Orders Nondef Capital Goods Ex Aircraft
Units
Date
Low: 9497.00 (11/30/1960)
High: 49202.00 (06/30/2000)
Average: 30574.67
May 2026: 36110.00

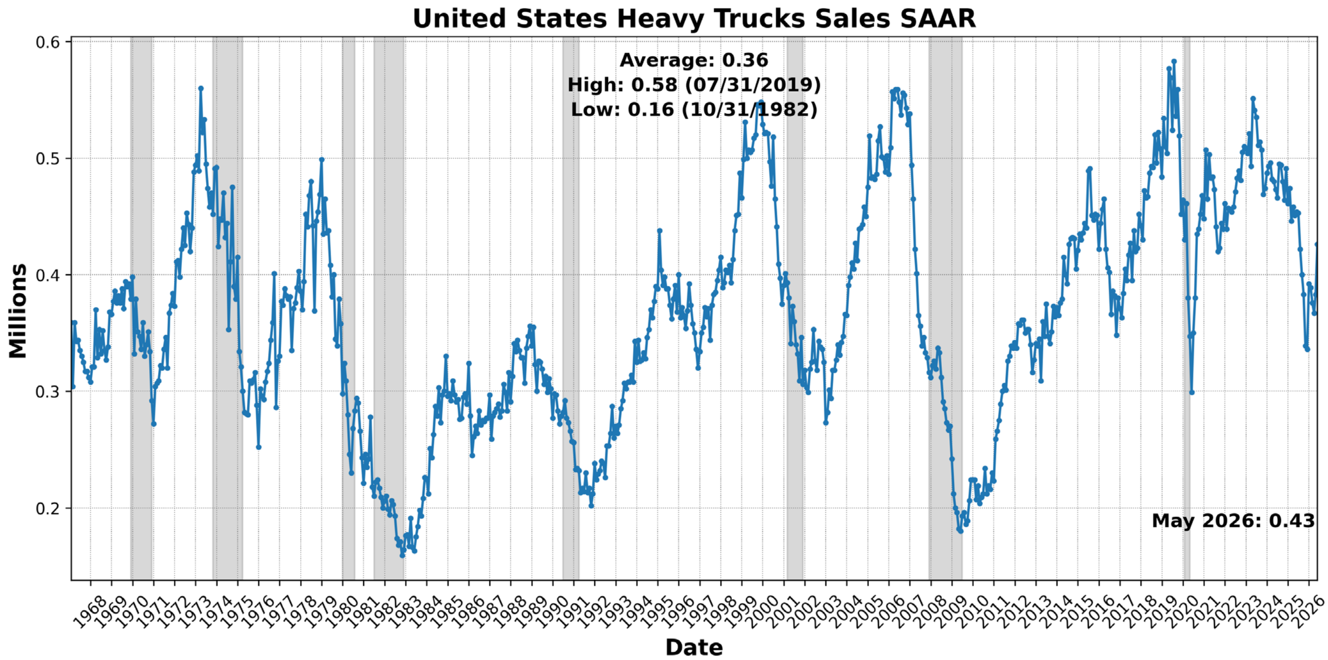

University of Michigan Consumer Expectations Index
Q1 1966 = 100
Date
May 2026: 44.10
Low: 44.10 (05/26/2026)
High: 108.60 (01/31/2000)
Average: 76.79

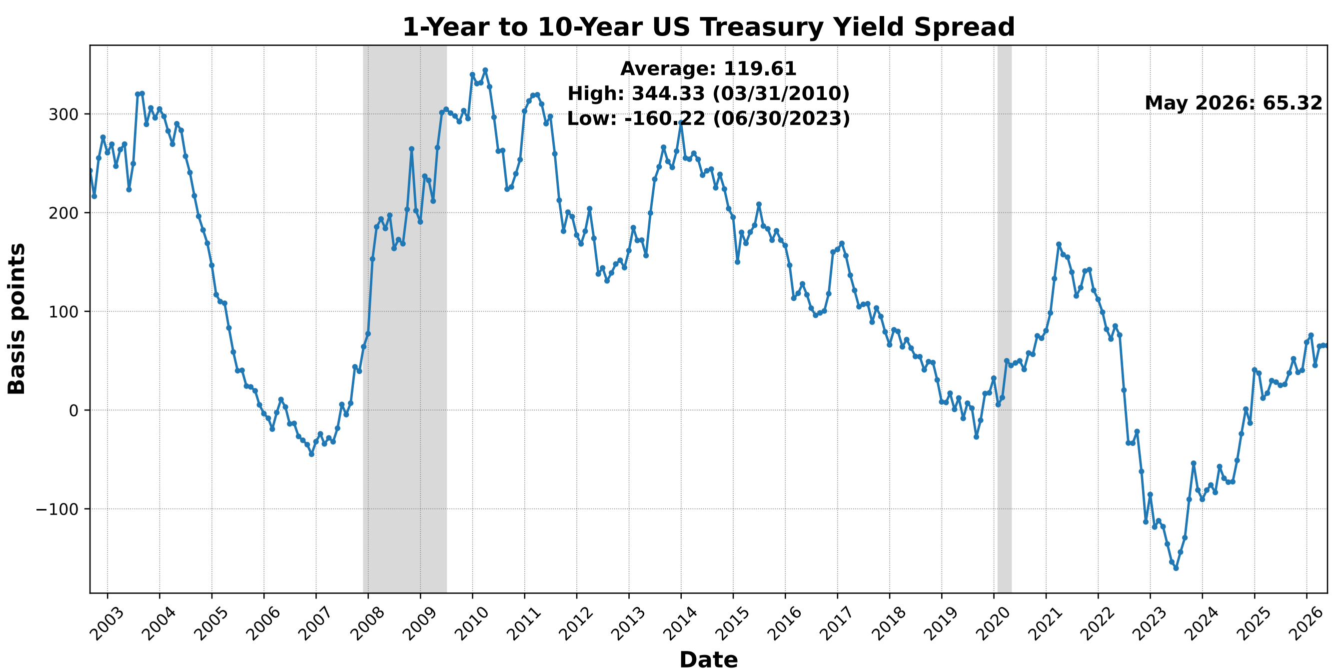

US Initial Jobless Claims SA
Average: 362.07
High: 5946.00 (03/31/2020)
Low: 162.00 (11/30/1968)
May 2026: 225.00
Thousands
Date


US New Privately Owned Housing Units Started by Structure Total SAAR
May 2026: 1199.00
Low: 478.00 (04/30/2009)
High: 2494.00 (01/31/1972)
Average: 1429.16
Thousands
Date

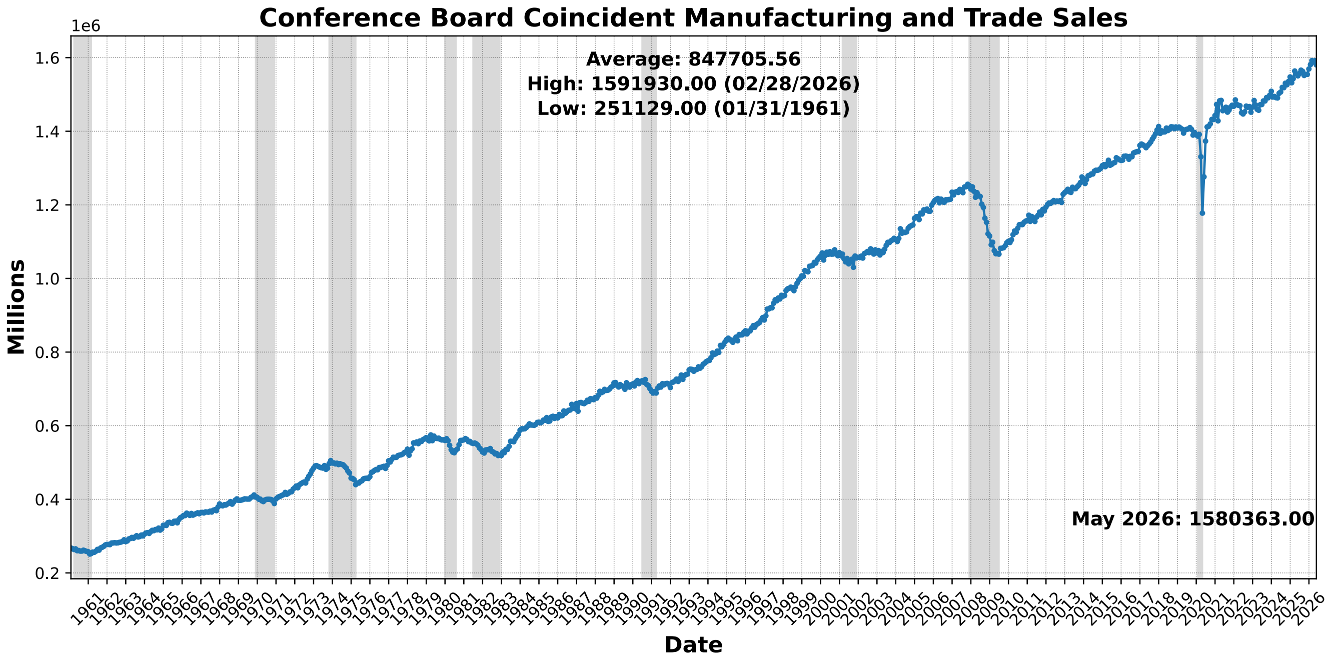

Inventory to Sales Ratio Total Business
Average: 1.41
High: 1.74 (04/30/2020)
Low: 1.24 (03/31/2011)
May 2026: 1.28
Percent
Date

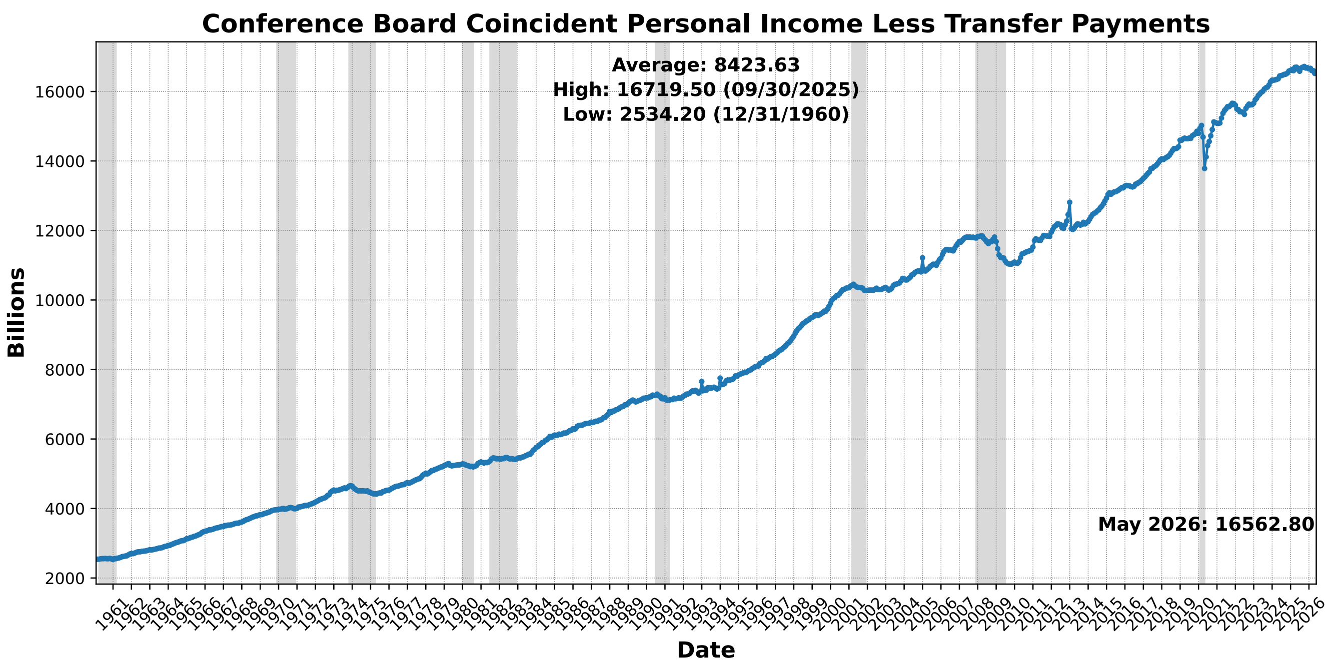

Debit Balances in Customers Securities Margin Accounts
1e6
Average: 409526.14
High: 1415557.00 (05/26/2026)
Low: 102842.00 (04/30/1998)
May 2026: 1415557.00
Billions
Date

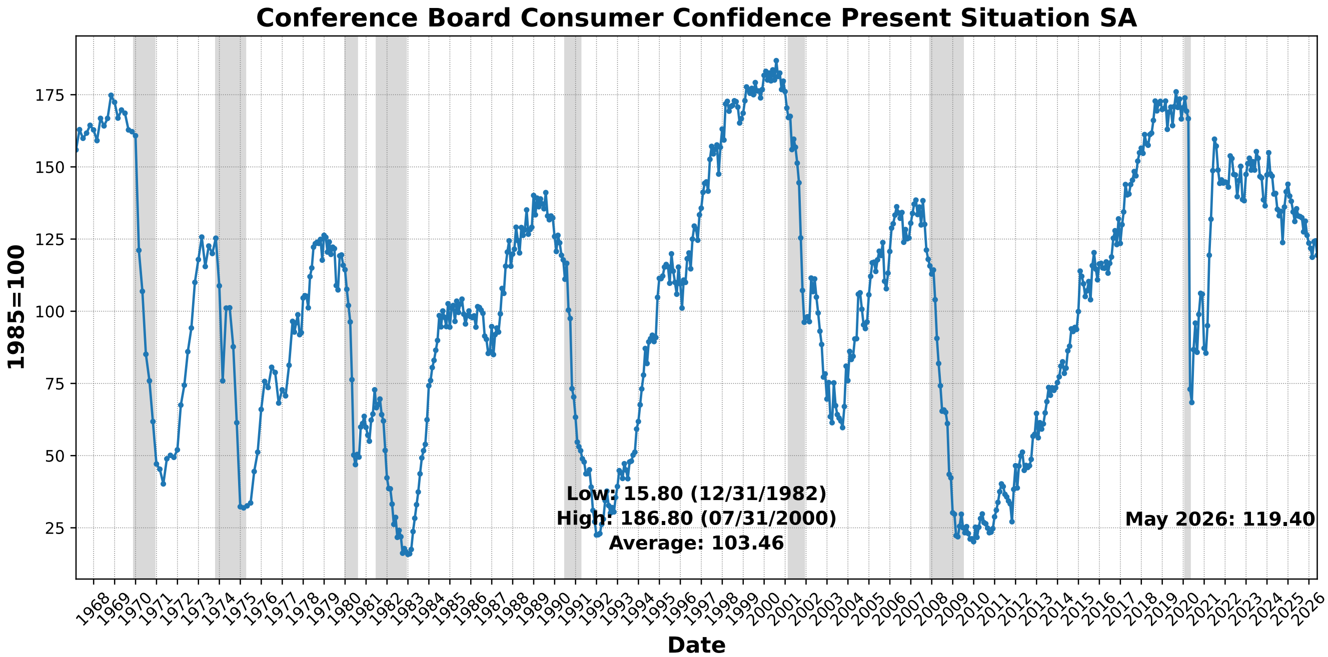

United States Heavy Trucks Sales SAAR
Average: 0.36
High: 0.58 (07/31/2019)
Low: 0.16 (10/31/1982)
May 2026: 0.43
Millions
Date

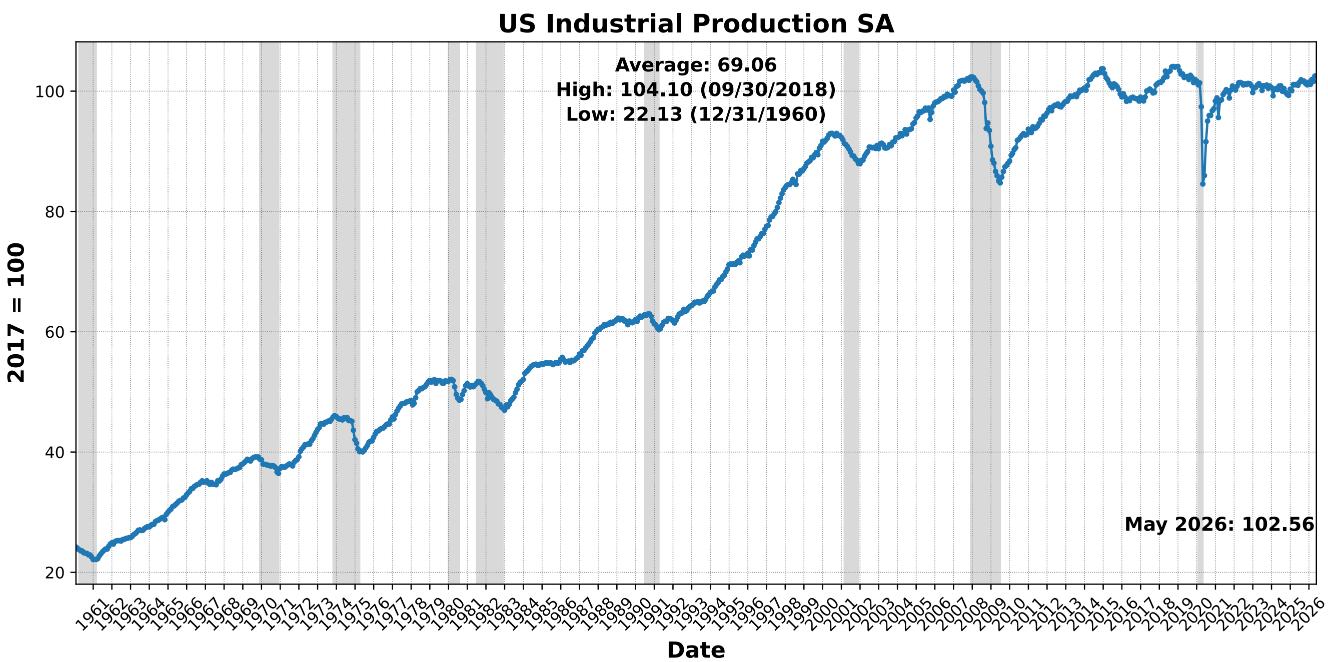

1-Year to 10-Year US Treasury Yield Spread
Average: 119.61
High: 344.33 (03/31/2010)
Low: -160.22 (06/30/2023)
May 2026: 65.32
Basis points
Date

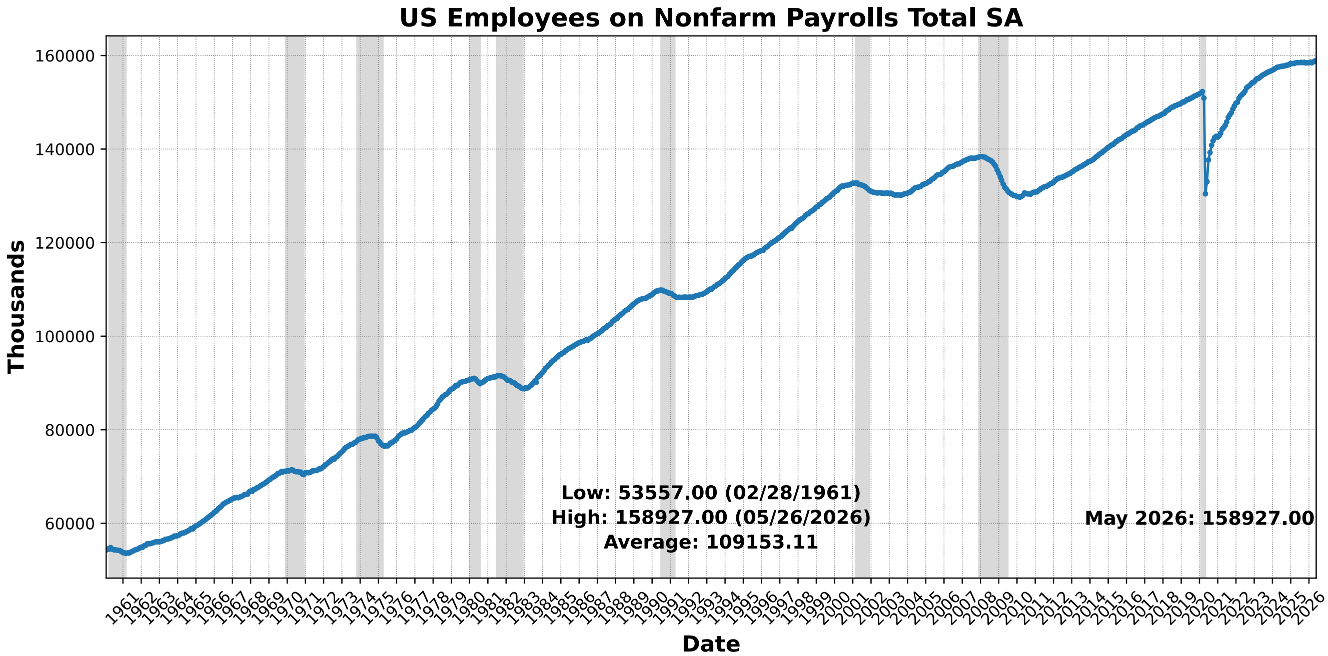
ROUGHLY COINCIDENT INDICATORS

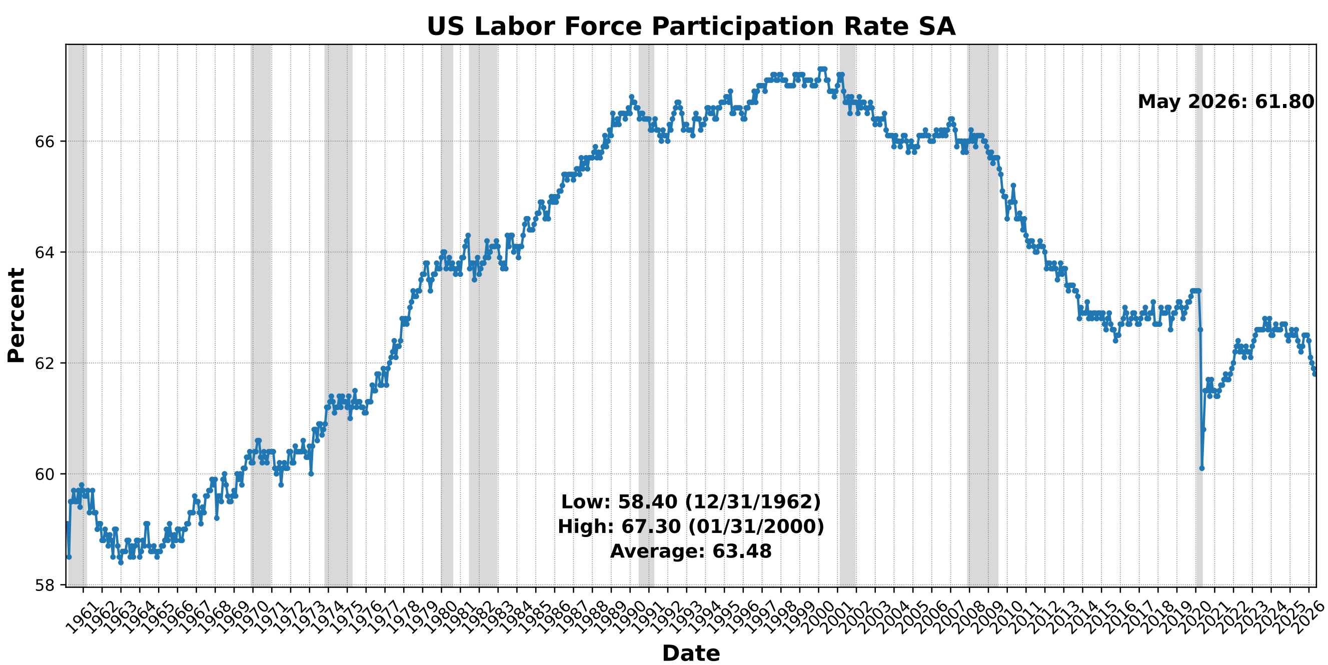




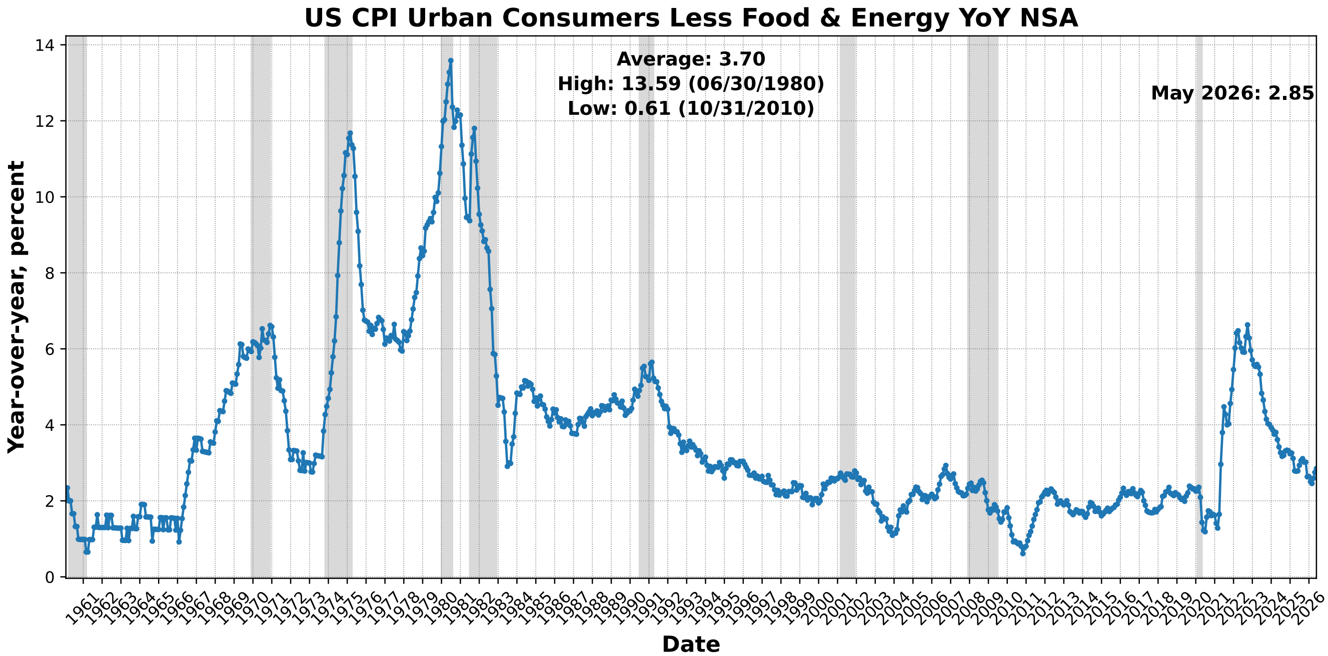

Conference Board Consumer Confidence Present Situation SA
1985=100
Low: 15.80 (12/31/1982)
High: 186.80 (07/31/2000)
Average: 103.46
May 2026: 119.40
Date

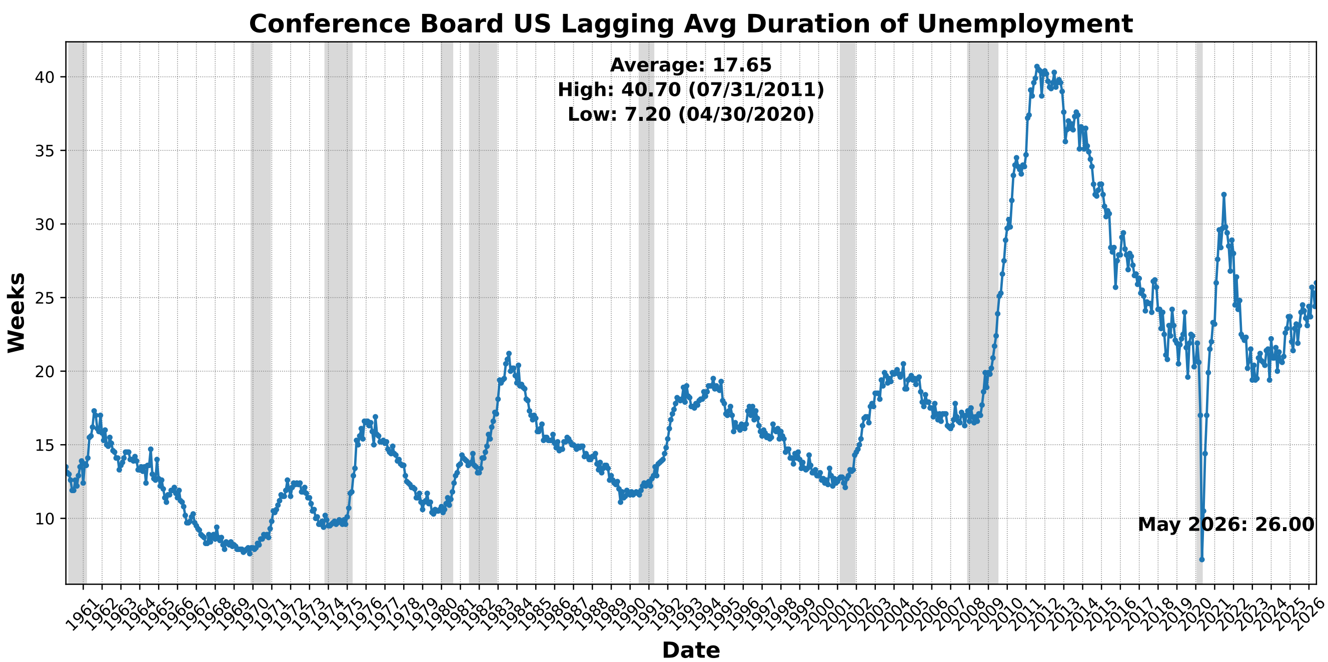

US Industrial Production SA
2017 = 100
Average: 69.06
High: 104.10 (09/30/2018)
Low: 22.13 (12/31/1960)
May 2026: 102.56
Date

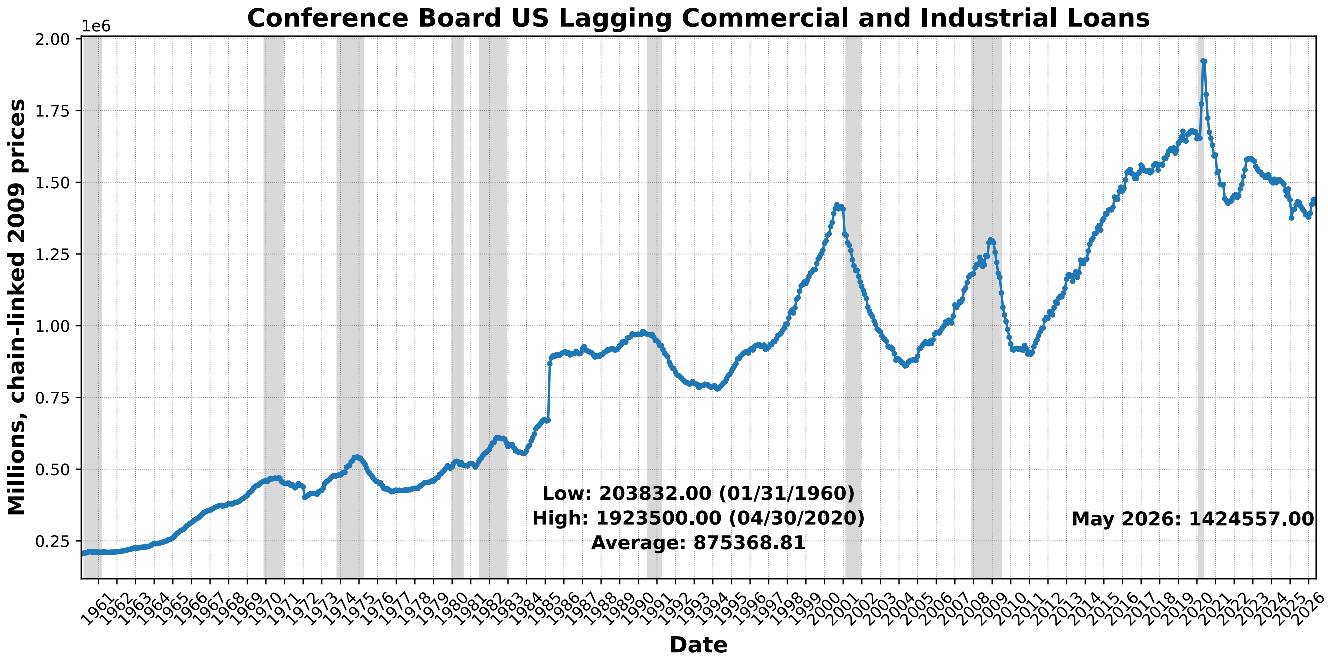

US Employees on Nonfarm Payrolls Total SA
Thousands
Date
Low: 53557.00 (02/28/1961)
High: 158927.00 (05/26/2026)
Average: 109153.11
May 2026: 158927.00

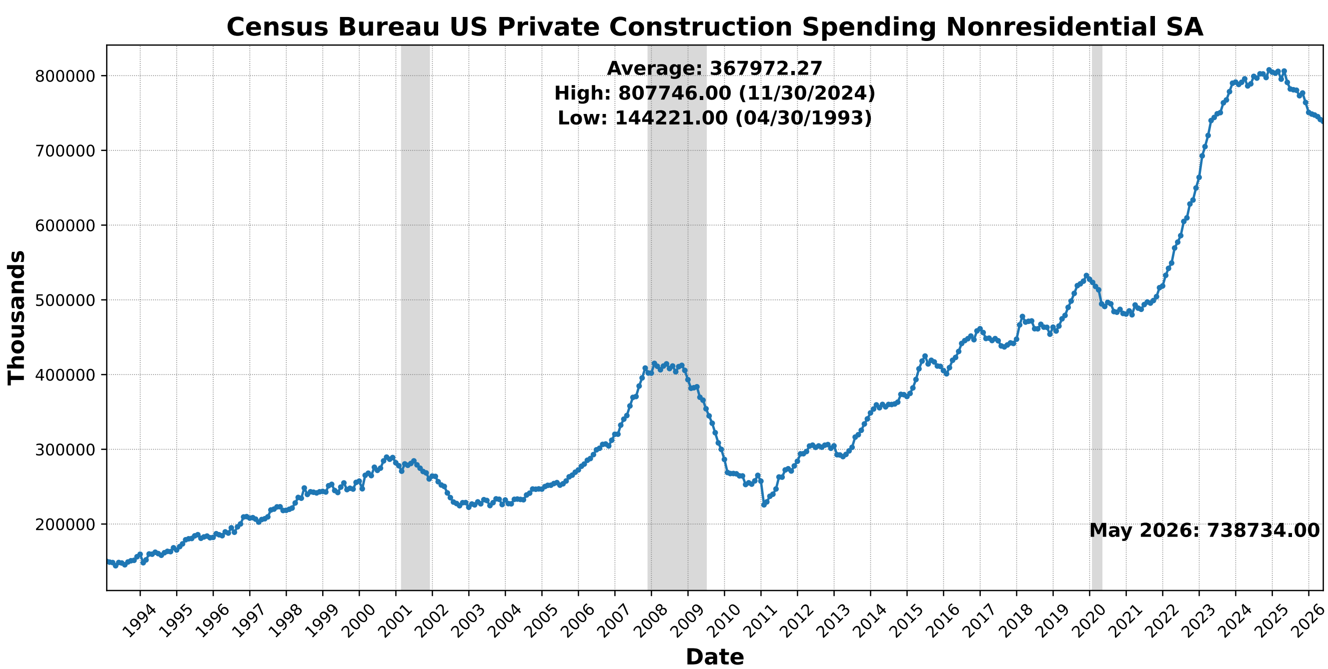

US Labor Force Participation Rate SA
Percent
Date
May 2026: 61.80
Low: 58.40 (12/31/1962)
High: 67.30 (01/31/2000)
Average: 63.48

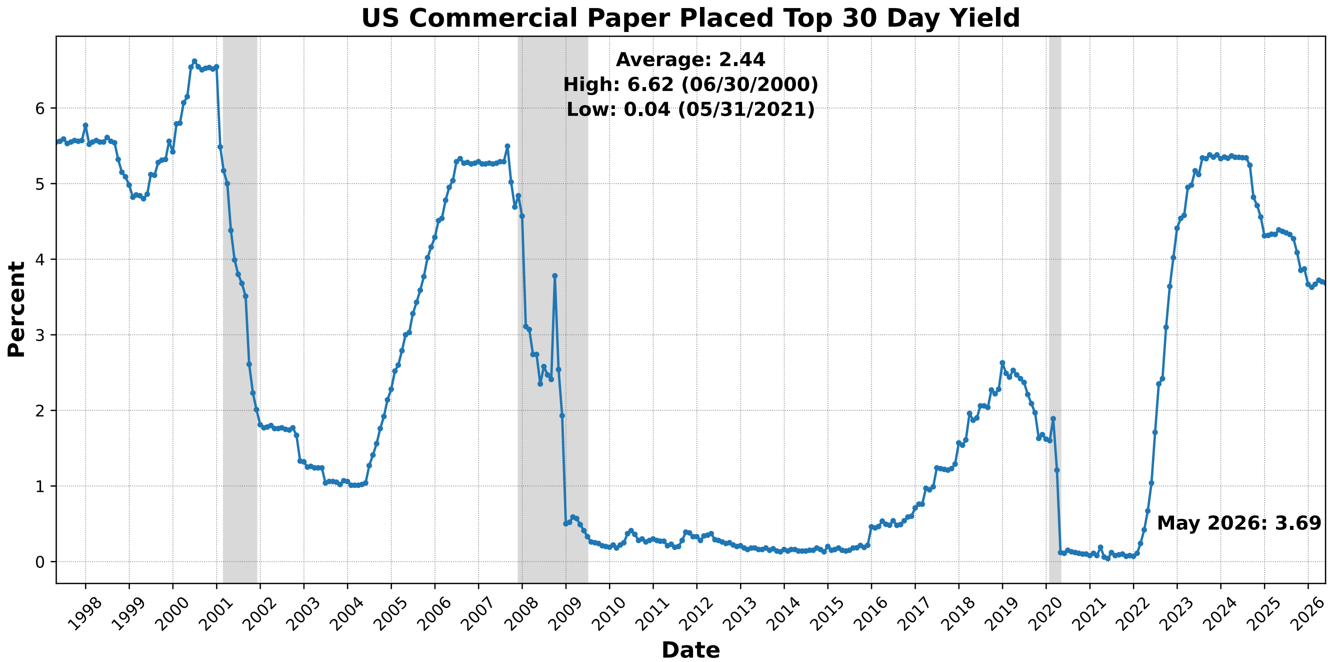
LAGGING INDICATORS

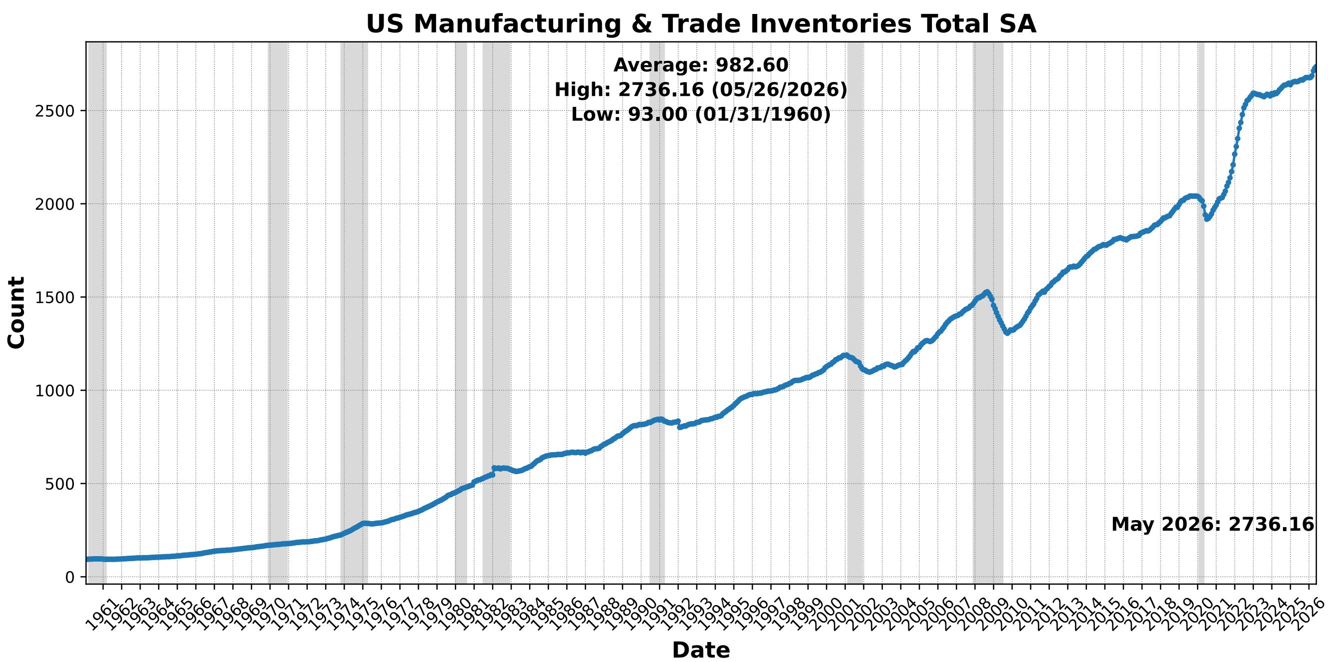





Conference Board US Lagging Commercial and Industrial Loans
1e6
Millions, chain-linked 2009 prices
Low: 203832.00 (01/31/1960)
High: 1923500.00 (04/30/2020)
Average: 875368.81
May 2026: 1424557.00
Date


Census Bureau US Private Construction Spending Nonresidential SA
Average: 367972.27
High: 807746.00 (11/30/2024)
Low: 144221.00 (04/30/1993)
May 2026: 738734.00
Thousands
Date


US Commercial Paper Placed Top 30 Day Yield
Average: 2.44
High: 6.62 (06/30/2000)
Low: 0.04 (05/31/2021)
May 2026: 3.69
Percent
Date


US Manufacturing & Trade Inventories Total SA
Average: 982.60
High: 2736.16 (05/26/2026)
Low: 93.00 (01/31/1960)
May 2026: 2736.16
Count
Date

Capital Market Performance

Ticker		Short Name	%1M	%3M	%1YR	3 Year Annualized Total	5 Year Annualized Total	10 Year Annualized Total
SPR	d	S&P 1500 Composite Index	+.63%	+3.42%	+16.39%	18.7158	12.1853	15.1481
SPXT	d	S&P 500 Total Return	+.86%	+3.61%	+17.41%	19.1945	12.5283	15.4968
SPX	d	S&P 500 INDEX	+.79%	+3.32%	+16.02%	19.1693	12.5061	15.4800
MID	d	S&P 400 MIDCAP INDEX	-.85%	+3.91%	+17.57%	13.4489	8.8152	11.6149
RTY	d	RUSSELL 2000 INDEX	-2.66%	+5.09%	+29.58%	15.8112	7.2527	11.6031
SXXP	d	STXE 600 (EUR) Pr	+1.36%	+5.86%	+17.19%	15.1880	10.5443	10.4706
TLT US	d	ISHARES 20+YR TR	-4.70%	-3.99%	-3.68%	-2.3683	-7.8259	-1.9379
QLTA US	d	ISHARES AAA - A	-2.46%	-2.71%	-2.32%	3.8227	-.6297	1.8915
CRY	d	TR/CC CRB ER Index	+12.33%	+3.80%	+30.91%	12.1873	12.7922	6.2621
XAU		Gold Spot $/Oz	+1.75%	-12.73%	+23.28%			
XAG		Silver Spot $/Oz	+2.15%	-21.20%	+55.91%			
ILM3NAVG		Bankrate 30Y Mortgage Rates Na	+1.83%	+5.35%	-1.62%			
ILM1NAVG		Bankrate 15Y Mortgage Rates Na	+1.85%	+5.57%	+.50%			
MB301ARM		5 Year ARM	+1.88%	+8.94%	-.67%			
ILA3NAVG		Bankrate 30Y Fixe Mtg Refis Na	+.43%	+.29%	-3.19%			

(Source: Bloomberg Finance, LP. Data subject to shutdown limitations.)

August 2026

Hamilton's Economic Vision Had One Crucial Blind Spot

Donald J. Boudreaux

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Speaking in January at Davos, US Trade Representative Jamieson Greer said that President Trump’s protectionism revives the policy first proposed by Alexander Hamilton. Like countless attempts to justify US protectionism and industrial policy, Greer’s effort praises Hamilton’s Report on the Subject of Manufactures.

More recently, Scott Bessent, now holder of a job first held by Hamilton — US Treasury Secretary — also boasted of the administration’s Hamiltonian creed. Given the fame of Hamilton’s Report, and Hamilton’s key role in America’s founding, a close look at his Report is warranted.

IMPETUS FOR THE REPORT

Requested by the US House of Representatives in January 1790, Hamilton submitted his Report on December 5, 1791. It was the longest and most famous of four major reports submitted to the House by Secretary Hamilton.

According to Hamilton, the House requested that he devote attention to “the subject of Manufactures; and particularly to the means of promoting such as will tend to render the United States, independent on foreign nations, for military and other essential supplies.” He complied.

AMERICA’S ECONOMY SHOULD HAVE A STRONG MANUFACTURING SECTOR

The Report opened by making the case that America would benefit from a larger manufacturing sector despite America being unusually rich in land. Without naming Thomas Jefferson, the Report‘s opening was a challenge to Jefferson’s conviction that America should remain a nation mostly of yeomen farmers.

Offering this challenge, Hamilton relied on Adam Smith (also without naming him) to expose the errors of physiocracy — that is, the belief that net economic value is produced only by agriculture. Yet Hamilton went further, arguing that manufacturing can be *more* productive than agriculture. In making this argument, Hamilton was impressive; one might even sense in it an anticipation of some insights revealed by economists’ marginal revolution of 80 years later.

Regardless of how much or little Hamilton intuited of marginalism, he deserves credit for emphasizing the reality and significance of opportunity costs. To produce some increment of agricultural output requires that some increment of manufacturing output not be produced. And that increment of agricultural output is worthwhile to produce only if its value exceeds that of the foregone manufacturing output. Thus did Hamilton defuse the arguments of persons who believed that, to establish the case for keeping America an agricultural nation, it’s sufficient to point to the positive market value of agricultural output.

In this way, and some others, Hamilton revealed a keen ability to think insightfully about economic matters. Nevertheless, on a full assessment, Hamilton in the Report got more wrong about economics than he got right. Not content to support only the removal of artificial barriers in the US against domestic manufacturing, Hamilton argued strenuously that the government must actively promote American manufacturing. That promotion should consist chiefly of subsidies (“bounties”) supplemented by protective tariffs.

HAMILTON RESPECTED BUT REJECTED ADAM SMITH

The renown of Smith’s Wealth of Nations obliged Hamilton to try to refute Smith’s argument that, in Hamilton’s summary, “industry, if left to itself … without the aid of government will grow up as soon and as fast, as the natural state of things and the interest of the community may require.” For Hamilton, what Smith called “the obvious and simple system of natural liberty” was too simple, at least for a young country without much industry. Here’s Hamilton:

> *Against the solidity of [Smith’s] hypothesis … cogent reasons may be offered. These have relation to — the strong influence of habit and the spirit of imitation — the fear of want of success in untried enterprises — the intrinsic difficulties incident to first essays towards a competition with those who have previously attained to perfection in the business to be attempted — the bounties premiums and other artificial encouragements, with which foreign nations second the exertions of their own Citizens in the branches, in which they are to be rivalled.*

The first-mentioned impediment to American manufacturing was Americans’ alleged lack of entrepreneurship. Habit-bound and excessively risk-averse, too many Americans would stick with familiar agricultural pursuits and refrain from launching new manufacturing endeavors. Further discouraging Americans from venturing into manufacturing were the established competitors abroad who would out-compete upstart rivals.

For Hamilton, simply being long-established was, in free markets, a nearly insurmountable competitive advantage. But in addition, foreign manufacturers might also practice what we today call "predatory pricing," as well as enjoy their own subsidies. Therefore, Hamilton believed that manufacturing would arise and thrive in America only if the rates of return on these enterprises were boosted by the government.

Hamilton here forgot his own counsel to attend to opportunity costs. He simply presumed that whatever additional manufacturing activities were encouraged by the government would increase the net value of US economic output. He also ignored both the knowledge problem (How do politicians know which particular industries to encourage?) and the public-choice problem (With subsidies and protection being doled out by politicians, what prevents this doling from being distorted by interest-group politics?).

Hamilton also had a cramped understanding of economic competition. (In fairness, this understanding still infects economics textbooks today.) For him, competition consisted of firms producing a largely given set of outputs with largely identical technologies. Although he can't be faulted for not reading Joseph Schumpeter's 1942 work on creative destruction, even in 1791 evidence was growing that the major source of economic growth was entrepreneur-driven creative destruction. Such innovation introduced not only new products, but also completely new and improved means of producing existing products.

In such an innovative economy, being long-established wasn't the great advantage that Hamilton assumed it to be. Just ask, for example, the American millers whose traditional manner of milling flour was rendered obsolete starting in the 1780s in Delaware by Oliver Evans's automated flour mill.

HAMILTON'S CURIOUS EVIDENCE

Attempting to augment his case for active government encouragement of manufacturing, Hamilton offered curious evidence. Responding to opponents who insisted that America's economy was unfit for manufacturing, he boasted that America's economy was already demonstrating an impressive ability to support manufacturing.

Writing about the prospects of profitable investment in manufacturing, Hamilton said that "it is certain that the United States offer a vast field for the advantageous employment of capital; but it does not follow, that there will not be found, in one way or another, a sufficient fund for the successful prosecution of any species of industry which is likely to prove truly beneficial." He continued: In addition to America's "multiplying" banks, another ready source of funding for manufacturing was foreign capital, which he wisely welcomed as "a precious acquisition." Indeed, "the attraction of foreign Capital for the direct purpose of Manufactures ought not to be deemed a chimerical expectation. There are already examples of it."

Question for Hamilton: If it was certain that the US offered vast opportunities for profitable investments in manufacturing, and if such investment was already occurring, why did such investment need to be further stimulated by the government? Hamilton's inconsistency is evident.

Another example of Hamilton's inconsistency is worth mentioning. When he argued for subsidies and protective tariffs for goods produced with iron, his evidence for the worth of such government assistance was the fact that such manufacturing had significantly grown in the US since the American Revolution and was flourishing. His argument was that this industry deserved protection precisely because it had proven itself capable and successful. Presumably, Hamilton would defend this inconsistency by maintaining that, without government assistance, this industrial growth — and that of other critical manufacturers — would stop short of its optimal point.

Here's where Hamilton-as-economist faltered most seriously. He made the incorrect presumption that markets fail to generate optimal economic growth because, in the end, he didn't appreciate just how effectively resources are allocated by market signals and incentives — by competitively determined prices, profits, and losses.

At least for fledgling nations with relatively little industrial capacity, he believed that intervention from the top was required.

THE LASTING LESSON

Studying the Report on the Subject of Manufactures makes clear that Hamilton, contrary to the assertions of Greer and Bessent, was far from being a protectionist in the mold of Donald Trump.

Not only was Hamilton's case for protection confined to the need to stimulate industrial capacity in a country lacking such capacity, he also preferred subsidies over tariffs (because tariffs, unlike subsidies, reduce supplies of targeted goods), and he welcomed, rather than bemoaned, net inflows of foreign capital.

Nevertheless, Hamilton ultimately had too little confidence in free markets. The late Gordon Wood's assessment of Hamilton-as-economist is accurate

> *Hamilton was so wedded to a hierarchical view of society that he could only imagine industrial investment and development coming from the top down. Thus he was incapable of foreseeing that the actual source of America's manufacturing would come from below, from the ambitions, productivity, and investments of thousands upon thousands of middling artisans and craftsmen who eventually became America's businessmen. Hamilton's historical reputation as the prophet of America's industrial greatness therefore seems somewhat exaggerated. He certainly wanted a powerful and glorious nation, but he was no more capable of accurately foretelling the future than the other American leaders.*

August 2026

A Forgotten Founder Who Warned Against Cronyism

Jeffrey L. Degner
Research Fellow

Many of our founding fathers are familiar names, but a few others' contributions are largely unnoticed and underappreciated. John Taylor of Caroline is one such man.

Modern critics often dismiss the founders' contributions because they were also slaveholders, which was true of Taylor, though he wrote of it negatively. His goals of freeing and "re-exporting" slaves to Africa to avoid violent revolt might strike modern readers as objectionable, but were fairly progressive for the time. With this context understood, it is most accurate to view Taylor as producing a defense of agrarian democracy.

Joseph Stromberg called Taylor "the philosopher and statesman of agrarianism" and "the most systematic thinker" among Virginia's planter intellectuals. Jefferson likewise admired his work. Yet Taylor was more than an agrarian spokesman. Taylor developed a sophisticated critique of institutional arrangements and political privileges that encouraged cronyism — a critique that remains surprisingly modern.

Long before Buchanan and Tullock fully articulated the Public Choice school of thought and state capture had its name, Taylor warned that political power would attract organized interests seeking special privileges. Furthermore, in *An Inquiry into the Principles and Policy of the Government of the United States*, he argued that "faction" was not primarily caused by differences among people. Instead, it came from government-created opportunities for favored groups to profit through legislation. He also articulated how conflicts are fomented by government-granted economic privileges. These were the result of "mercantilist economic interference."

Taylor distinguished between wealth earned through production and wealth obtained through political favoritism. One of his most powerful ideas is his distinction between productive and political wealth. This foreshadows Franz Oppenheimer's observation that there are only two ways of producing wealth: the political and the economic. The former relies on coercion, the latter on value creation. Both Oppenheimer and Taylor would oppose subsidized capital, privileged banks, and government-backed financial interests on moral grounds. But Taylor was ultimately concerned about the fate that would befall the rural, agrarian culture he so loved.

Taylor's solution to these forms of political gain was not better rulers but less concentrated power. One of the most striking parts of the essay is his assertion that liberty depends on the fragmentation of authority. His views on federalism were clear: power should be divided so thoroughly that no institution could dominate society. Least of all a central bank and a debt-ridden treasury.

Taylor believed public debt was not merely a fiscal issue but a mechanism for creating a politically dependent class. He articulated grave concerns over debt-financed standing armies, which would encourage imperial sentiments, raise tax burdens, and lead to a "paper aristocracy" that grew wealthy through these processes, and that they represented a distinct faction or class, separate from productive agricultural citizens. Once established, he wrote, "it can as easily deprive nations of the right of self-government as it can rob individuals of their property."

Many believe that class conflict is strictly a Marxist construct. But a long tradition of classical liberals has sounded the alarm over societal rifts that emerge through the processes that Taylor and Oppenheimer warned against. Taylor believed class conflict was generated less by markets than by political privilege. But contrary to Karl Marx, he blamed state privilege, whereas Marx blamed private ownership of the means of production.

While Taylor's agrarian concerns may belong to a bygone era, his distinction and warning about politically versus productively generated wealth still ring true. The modern administrative state has grown tremendously since the Progressive era and has given rise to numerous politically backed privileges within the American economic landscape. From certificate-of-need regulations in healthcare to protectionist tariffs, Taylor's warnings have gone largely unheeded.

America's 250th anniversary is an opportunity to recover forgotten founders and the stories of their lives. The greater opportunity, however, is to rediscover the ideas that made them revolutionary: that commerce and agriculture should be free from government-granted privilege.

If the Founders were willing to pledge to each other their lives, fortunes, and sacred honor, then we, as their heirs, should summon the political will to dismantle the institutions and policies that have fostered the very kind of cronyism John Taylor warned against.

Even at 250 years old, it is not too late to do so.

August 2026

The Myth of the Free-Riding Billionaire: Ray Madoff's *The Second Estate*

Paul Mueller

Director of Economics & Economic Freedom

Wealthy professionals can be strident egalitarians or naive optimists about the benefits of government spending — or so it would seem after reading law professor Ray Madoff's book *The Second Estate: How the Tax Code Made an American Aristocracy*.

Madoff clearly has an axe to grind against America's wealthiest citizens, and she is deeply critical of the legal mechanisms they use to protect and transfer their assets. Her argument often seems to boil down to this: Why should wealthy Americans keep so much of their wealth for personal use rather than allow the public — or, more specifically, Congress — to decide how those resources should be spent?

Yet *The Second Estate* is no low-brow polemic. Professor Madoff knows federal tax policy well, and her explanations of the tax code and the ways wealthy individuals use it are often insightful. My disagreement is not with her description of the mechanics of taxation, but with her underlying assumption — at times explicit, at times implied — that concentrated wealth is inherently harmful because it deprives the federal government of resources.

The wealthiest Americans pay hundreds, thousands, or even millions of times more in taxes than the average taxpayer. More importantly, the companies they create and build make the country more prosperous and generate enormous tax revenues in the process.

This should be obvious upon reflection. The businesses created, owned, or led by members of the Forbes 400 employ millions of people and generate tens of billions of dollars in federal tax revenue each year.

Yet *The Second Estate* presents a very different picture: a special class of Americans who exist above the reach of the tax code and avoid contributing their fair share to government revenue. We can set aside the questionable assumption that more federal revenue is automatically beneficial for most Americans. The deeper flaws in Madoff's argument stem less from what she says than from what she leaves out about the super-wealthy.

MYTHS ABOUT THE RICH AND TAXES

Professor Madoff is correct to distinguish between different types of federal taxes. Income from dividends, interest, and the sale of assets (capital gains) is generally taxed differently — and often at a lower rate — than income earned through wages.

Long-term capital gains and qualified dividends are typically taxed at rates of **0**, **15**, or **20 percent**, depending on income level, while wages are subject to both income taxes and payroll taxes. Employees pay **7.65 percent** in Social Security and Medicare taxes through FICA, and employers pay another **7.65 percent**. Capital gains, by contrast, are not subject to payroll taxes.

As a result, a billionaire's effective federal income tax rate can be lower than that of an employee earning a middle-class salary. Madoff correctly explains how these differences affect taxpayers who receive income through wages versus those who receive income through investments.

Suppose Adam is self-employed while Betty receives all of her income from dividends and long-term capital gains. The following table illustrates how their federal tax burdens would differ at income levels of $80,000, $160,000, and $320,000.

Same Income, Taxed by Source

Federal tax owed — earned income vs. investment income · single filer, 2026

Federal tax owed	$80,000	$160,000	$320,000
Adam — self-employment	$16,648 (20.8% of income)	$40,663 (25.4% of income)	$101,939 (31.9% of income)
Betty — qual. dividends / LTCG	$2,168 (2.7% of income)	$14,168 (8.9% of income)	$42,728 (13.4% of income)
Adam pays roughly	7.7× Betty	2.9× Betty	2.4× Betty

Assumes single filer, 2026 tax year, standard deduction, solo self-employment (with QBI where applicable). Illustration only — not tax advice.

Madoff explains how wealthy individuals often borrow against their assets rather than sell them. They don't pay taxes on those loans (though they do pay interest). This is true. Sometimes individuals with a net worth of tens or hundreds of billions of dollars will report little or no income in a year because their "salaries" or wages are very small and they didn't realize any capital gains.

But the fact that the ultra-wealthy can avoid paying federal income taxes some years does not mean they avoid them altogether. They have to pay down their loans and lines of credit periodically. And if they want to make exceptionally large purchases or investments, loans from banks are not enough. Then they must sell shares, realize gains, and pay taxes. The super-wealthy undoubtedly pay far more dollars in taxes than any middle-class or upper-middle-class individual.

Elon Musk, for example, famously paid about $11 billion in income taxes in 2021. This particular tax bill was anomalous both for its size and because the IRS taxed much of it as ordinary income at a high tax rate. Musk had a huge block of his stock options that he had to exercise or lose. Yet even if those were the only income taxes he ever paid over the course of 50 years, that would still come out to ~$200 million in taxes annually — far more than any but the very wealthiest Americans earn over their lifetimes, let alone what they pay in income taxes.

Most of the super-wealthy find ways to pay lower rates on their income. Still, many wealthy individuals pay vast sums, in the tens or hundreds of millions of dollars, annually on dividend income (Steve Ballmer pays approximately $250 million *every year*). There are also large one-time tax payments from capital gains. Ken Griffin paid roughly $4 billion in 2021, Jeff Bezos paid about $2 billion in 2020 and 2021, Jensen Huang paid more than $100 million in 2024 and 2025, and Tim Cook paid roughly $300 million in 2021.

Even accounting for the payroll taxes paid by ordinary wage earners, these tax payments represent the equivalent of thousands upon thousands of "Adams" paying federal income taxes. And this is where the shortcomings of Professor Madoff's argument become clear.

Her account gives the impression that the ultra-wealthy largely avoid taxes because their effective tax rates are often lower relative to their income or wealth. While wealthy individuals certainly have ways to reduce their tax liabilities and structure their assets efficiently, it is inaccurate to suggest that they simply avoid paying federal taxes.

It is also misleading to ignore the many other taxes the super-wealthy pay.

They pay property taxes on their land and houses every year. In places like Los Angeles and New York City, those tax bills can reach hundreds of thousands or even millions of dollars. They pay taxes when they shop, dine, or travel. They pay transfer taxes, building fees, development fees, and a host of other taxes and charges.

That is hardly "free-riding" on the tax system — especially when they pay many times (10, 100, or even 1,000 times more) than the average taxpayer while consuming nowhere near that proportion of government services.

THE WEALTH CREATION THE TAX DEBATE IGNORES

Even this oversight, however, misses the most important contribution of the super-wealthy to society: wealth. Focusing on how much Elon Musk or Jeff Bezos or the Mars family pays in personal income or other federal taxes in a specific year is a red herring. It is a rounding error compared to how much wealth their companies have generated for shareholders *and* how much tax revenue they have generated. Focusing on the corporate income taxes paid (or not) by individual companies makes similar mistakes.

Consider Tesla. Over the past five years, the company has reported relatively little federal income tax liability (about $48 million in 2023) despite nearly $20 billion in net income. This is largely because Tesla has carried forward previous losses, invested heavily in new capital, and benefited from certain green energy and research-and-development tax credits. Yet Tesla employs roughly 134,000 people. If the average wage for those employees is $100,000, the company would pay more than $1 billion annually in employer-side FICA taxes alone. Employees would pay another $1 billion-plus through their share of payroll taxes — not including the income taxes they pay.

Those figures are small compared to what Amazon (1,100,000 employees), Apple (90,000 employees), Meta (45,000 employees), and Alphabet (115,000 employees) pay in FICA taxes — over $10 billion annually for the employer share alone.

Madoff's quixotic crusade against dynastic or family wealth is just that — tilting at windmills. Only a quarter or so of people on the Forbes 400 list inherited the majority of their wealth. And that number gets smaller as you move to the top 100 and then the top 50. Inherited wealth can only last if it remains invested in companies rather than cashed out or spent. For every example of inherited wealth growing, there are more examples of inherited wealth becoming depleted.

WHO OWNS WEALTH?

All of this raises a basic question: Why should we care that families such as the Mars, Walton, or Koch families possess wealth they can pass on to future generations?

Madoff argues that the wealthy "free-ride" on the tax system. But this assumes their money somehow already belongs to the government or the public.

It does not.

Madoff also suggests that the super-wealthy exercise undue political influence from the shadows. In this, she leaves the solid ground of analyzing existing tax rules and mechanisms to the ideological concerns and disapproval she has for large concentrations of wealth in general.

Could the tax code be fairer and better than it is? Certainly. Will her specific recommendations make it so? I'm not sure. But will politicians implement her "ideal" policies? Assuredly not.

Besides raising revenue, the tax code should distort and discourage economic activity as little as possible. While everyone benefits from clear rules of the game that promote competition and responsibility, it's far from clear that they would all benefit from more "tweaks" to the tax code to close loopholes. Revenue with minimal distortion, not leveling the fortunes of the super-wealthy or making sure they pay their "fair share," should guide tax policy.

Lobbyists, insiders, and wealthy individuals have certainly influenced the tax code for their own benefit. But so have middle-class homeowners through mortgage deductions, residents of high-tax states through state and local tax (SALT) deductions, and lower-income Americans through welfare programs and tax credits. This is how the political game is played.

Rather than criticizing the super-wealthy for minimizing their tax liabilities as best they can, policymakers should focus on reducing government spending so that everyone else's taxes can be reduced too. Reducing political power, limiting the coercive reach of the state, and allowing individuals to keep more of what they earn would do far more to improve Americans' lives than taking more money from the wealthy and giving it to politicians.

Such broad-based reforms would also be more just.

August 2026

States Relying on Federal Aid Face a Reckoning

Thomas Savidge
Research Fellow

On July 1, 2026, 46 states rang in Fiscal Year 2027. New York started FY 2027 April 1, Texas will start FY 2027 on September 1, and Alabama and Michigan will start FY 2027 on October 1. Whatever the calendar, many state leaders enter the year with less room for error than they enjoyed during the federal transfer surge six years ago.

As states face sluggish population growth, policymakers must be ready to face a new fiscal landscape. The states best positioned for that landscape will be those that protect economic freedom by keeping taxes, spending, regulation, and long-term obligations under control. States that answer slow growth with government expansion will enter the next downturn with fewer options.

Population trends are increasing pressure. From 2024 to 2025, population growth rates slowed in 48 states as international migration declined. Only Montana and West Virginia were able to attract Americans from other states at a rate that outpaced the decline in domestic migration.

More concerning is the nationwide slowdown in long-term growth rates across the states. Consistent, long-term decline threatens tax bases, labor markets, and budgets. At the same time, Americans continued moving across state lines. South Carolina led the nation in recent growth, while California lost residents.

These movements matter because people carry income, consumption, and entrepreneurial energy with them. A state that loses residents and businesses loses workers, consumers, entrepreneurs, and, ultimately, taxpayers. Government spending pressures, however, do not automatically fall at the same pace as a shrinking tax base. Much of state spending is "locked in" to promises made years ago: debt service on bonds, pensions and benefits to public employees, Medicaid, infrastructure, and public payrolls.

This competition is real. Households compare cost of living, including taxes, along with job prospects. Employers compare labor markets and the cost of doing business, including taxes and regulations. A state that makes work, investment, and construction easier has a better base than one that punishes growth.

Over the past several years, states have masked many of these spending problems with extraordinary surges in federal transfers. Figure 1, next page, shows the latest spending data from the states by revenue sources.

In FY 2021, with federal stimulus packages from the pandemic steadily flowing, federal funds accounted for **40.8 percent** of total state expenditures. That share steadily receded, but dependence has not disappeared. Across all states, federal funds for FY 2025 totaled $1.077 trillion, or **33.5 percent** of total state expenditures. On an average-state basis, federal funds accounted for **34.1 percent** of spending, only slightly below general funds at **35.1 percent**.

This gives Washington substantial influence over state budgets due to the strings attached to federal funds. Federal transfers arrive with rules, preset priorities, and maintenance-of-effort expectations. Federal transfers allow Washington to influence state and local policy beyond direct legislation. They soften state budget constraints, distort spending priorities, and weaken accountability. States can expand programs without bearing the full political cost because federal taxpayers outside of the state help finance them. Voters then struggle to see who is responsible for spending growth, federal mandates, or future shortfalls.

That exposure is dangerous in a period of slow population growth and fiscal stress. As Washington adjusts transfer programs, states will face hard choices: raising taxes, cutting spending, borrowing, or some combination of the three. States that built ongoing commitments on temporary aid will be most exposed. The adjustment will be hardest where federal dollars supported recurring commitments.

Federal dependence, however, impacts all fifty states. Figure 2 (next page) shows federal funds as a percentage of total state spending for FY 2025.

As Figure 2 shows, federal dependence cuts across the partisan divide. The two states with the largest dependence on federal transfers, Indiana (**46.4 percent**) and Louisiana (**48.6 percent**), are red states. Indiana has experienced 18 years of Republican trifectas between 1992 and 2026 while Louisiana has experienced eight Democrat trifecta years and eight Republican trifecta years during the same period.

Federal exposure is shaped by numerous factors. A high federal share may mean different things in different states. In a leaner state budget, such as Indiana, federal funds can occupy a larger share because own-source spending is lower. In a high-spending state, such as New York, federal funds may instead help sustain a broader set of programs. Regardless, changes to federal transfers will require painful decisions from state leaders.

Additionally, the type of government may affect how state leaders respond to federal cuts. Since

1992, divided government has declined and trifecta governments (single-party control of the executive and legislative branches) have become more common. As of January 2026, 39 states have trifecta governments (23 Republican, 16 Democratic) while only 11 have divided governments. The duration of continuous, unified government matters more than party label alone.

The longer a single party remains in power, the more opportunity it has to build durable commitments, reward allies, and entrench interest group coalitions. That does not mean every durable trifecta will spend recklessly. It means voters should ask whether unified government has been used to restrain commitments or to hard-wire them into future budgets. States with large long-term obligations will have less flexibility when revenues slow, federal transfers change, or the next downturn arrives.

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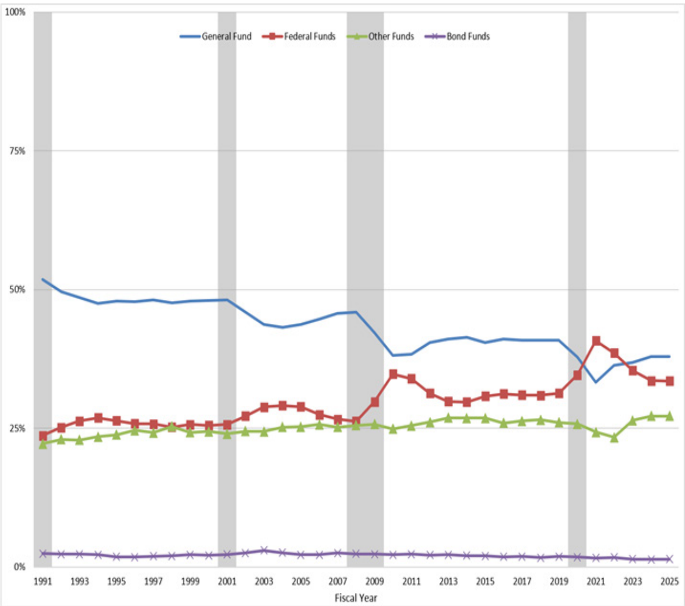
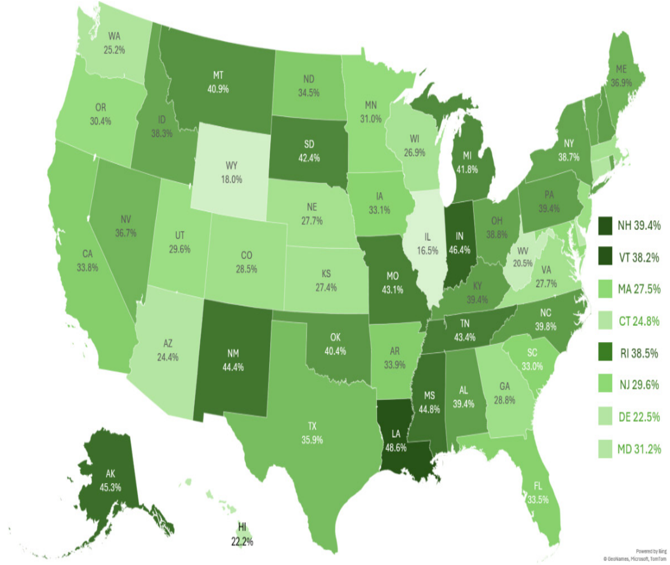
Figure 1: State Expenditures by Source (50 State Average)



National Association of State Budget Officers data, modified by the author.

Note: State expenditures are capital intensive.

Figure 2: Federal Funds as a Percentage of Total State Expenditures



National Association of State Budget Officers data, modified by the author.

Note: State expenditures are capital intensive.

Judges Can Void a Tariff. They Can't Rebuild Our Reputation.

David Hebert
Director of Economics and Economic Freedom

The Trump administration finalized new Section 301 tariffs on dozens of trading partners, ranging from **10** to **12.5 percent**, perfectly timed to take effect as the temporary global tariff of **10 percent** under Section 122 expires. The basis for these new tariffs is a five-month investigation into whether those countries have done enough to keep goods made with forced labor out of their supply chains.

There has been plenty of coverage on this. Ilya Somin lays out why this action is likely illegal and runs afoul of Section 301's own requirements as well as the major questions and nondelegation doctrines. Scott Lincicome argues, powerfully, that the investigation itself was a sham, with the outcome promised early and repeatedly by several members of the administration well before the investigation was completed.

But there's a far worse outcome from this that cannot be undone by courts, elections, or policy reversals. These new tariffs and their justifications have only served to further destroy the relationships with allies and trading partners that we had previously taken as given. The costs of this will outlast every tariff schedule, court ruling, and this administration. They won't show up on BLS reports, BEA analyses, or Fed surveys. But they will be felt by every single American for years to come.

As a result of these tariffs, Japan, South Korea, and Australia now face **12.5 percent** tariffs for their alleged complicity in using forced labor. China is in the same boat. Three of our closest allies are now accused of being just as negligent about slave labor as China.

Canada, the European Union, the United Kingdom, and Mexico now face **10 percent** tariffs for their alleged forced labor practices. Canada and Mexico are, of course, also parties to the USMCA, a trade agreement that this very president negotiated, signed, and called "a colossal victory" only to then walk away from. That same week, the President hit Canada with an additional **50 percent** tariff on goods ranging from "wine to hockey sticks to cement" regardless of whether or not those goods qualify under the USMCA.

So in the span of a week, the White House effectively told Canada, our closest trading partner and ally, that America's word means nothing and then told them that they are complicit in forced labor.

An ordinary tariff is a tax. Trading partners are annoyed, sometimes retaliate, and sometimes negotiate. These tariffs are different. We didn't just tax Japanese goods. We announced to the world, as an official finding of the United States government, that Japan is profiting from slavery and needs to be punished for it. Norway, Switzerland, Australia, the United Kingdom, and South Korea are guilty of this, too. Then we set a penalty that just so happens to approximate the Section 122 tariffs that just expired.

Foreign officials must now contend with an even clearer reality: not only is an agreement with the United States not worth the paper it's printed on, but we will accuse you of horrendous practices if it means that an administration can re-impose tariffs. Our trading partners saw that the findings of investigations will be written to fit the desires of an administration instead of the facts on the ground. They learned that not only is America protectionist but that they will publish a serious moral accusation against a friend when doing so is politically convenient.

This changes how other countries will deal with us going forward.

Consider what a foreign trade minister in Tokyo or Ottawa does next. Obviously, over the coming days, they will be releasing press statements. But over the following years, two things become obvious. First, an agreement with the US is never a settled matter. Second, compliance with the American findings buys nothing because the US Trade Representative did not issue any guidelines of what sorts of labor practices could be adopted to lift these tariffs.

If nothing you do can get you off the list, there's no reason to try. And if no trade agreement is actually binding, there's no need to come to the table. Instead, there is every reason to find new trading partners.

That work is already happening. The countries hit by tariffs this week have been signing agreements with one another, expanding trading blocs that do not include the US, and diversifying supply chains away from the American market. Every one of those deals is a small, but largely permanent move away from doing business with America. Factories being built in Europe, China, and India won't be picked up and moved if the US suddenly reverses its tariff policy. These lost opportunities won't show up in BLS reports, BEA analyses, or Fed surveys.

The impacts of these tariffs and the accusations they come with aren't confined to the commercial realm. They also affect our national security. Alliances, whether they be trade or otherwise, work based on accumulated good will. When we ask a country to host our submarines or NATO members to send troops somewhere, we draw upon the goodwill that we have accumulated over decades. Those governments have to sell the request to their own legislatures and voters who will sensibly ask: "What has America done for us lately?" And unfortunately, trade policy over the past 18 months has not engendered support.

A schedule of tariff rates can be repealed by proclamation. An accusation, once made and in the name of the United States government, is not so easily repealed. Those accusations carry weight because, traditionally, we have used them sparingly and when the evidence was abundantly clear. Now, if Lincicome is correct, our credibility on this stage has been strained.

These new tariffs may not survive on a legal basis. Courts struck down the emergency tariffs in February and the Section 122 tariffs in May. Somin expects this action to be challenged and believes that courts will strike these down, too. Whether or not the courts strike these down, too, the damage is already done.

The trust that America enjoys took generations to build and is being spent at a record pace. In the meantime, the world is moving on and increasingly without us. Unfortunately, courts cannot restore what was actually lost this week. Judges can void tariffs and force refunds, but they cannot unsay an accusation.

August 2026

Welcome to Trillionistan. Don't Get Comfortable.

Peter C. Earle
Senior Director of Research

Not long ago, the notion of *trillions* belonged either to the furthest cosmic reaches of the universe or the submicroscopic world of atoms. These numbers describe galaxies in the observable universe, roughly two trillion, or, at the opposite extreme, the picosecond — one trillionth of a second — is used to measure molecular motion and chemical reactions. Until recently, magnitudes denominated in trillions were almost entirely confined to the theoretical hinterlands of astronomy, physics, and schoolyard exaggeration.

Today, trillion-dollar quantities have become commonplace in economic and financial life. At least 12 American companies boast trillion-dollar market capitalizations, with Apple approaching $5 trillion. BlackRock now manages more than $15 trillion in assets. The largest technology firms, cumulatively, measure their investments in the trillions as they build data centers, semiconductor capacity, and power systems on an unprecedented scale. SpaceX's 2026 initial public offering valued the company at more than $1.7 trillion, and its subsequent surge briefly pushed Elon Musk's paper wealth above $1 trillion.

Billionistan opened its gates in 1901, when JP Morgan assembled US Steel into the world's first billion-dollar corporation. Perhaps it surrendered statehood on January 13, 2016, the day Powerball offered the first billion-dollar lottery jackpot. After ten more, Billionistan moved from a numerical destination to a waypoint. We now inhabit Trillionistan.

Governments, unsurprisingly, were early movers; they frequently are. Trillion-dollar economic figures first appeared during the great hyperinflations of the twentieth century. In the United States, the national debt crossed $1 trillion in October 1981, inaugurating an era in which ever-larger fiscal quantities gradually lost their capacity to shock. Annual deficits now exceed the entire national debt of 45 years ago, while America's current indebtedness — as measured by the fiscal gap — extends into the *hundreds of trillions*.

Public finance is only one province of Trillionistan. The larger phenomenon is the steady upward drift of nominal magnitudes — and our tendency to mistake financial scale for real, truly productive achievement. Prices rise, credit and money supplies balloon, economies grow, markets deepen, and expected future earnings are capitalized across ever-longer horizons. Each process quietly extends the number of zeroes layered onto economic life.

Inflation is plainly part of the explanation. A dollar simply buys far less than it once did. Even if nothing real changed — if no new factories were built, no technologies discovered, and no improvement in living standards achieved — the same collection of assets would be priced higher over time as each dollar lost purchasing power. Nominal dollar records are easier to achieve than real value-driven ones.

But inflation alone cannot explain Trillionistan. The economy has also become larger, richer, more technologically sophisticated, and more global. Companies now serve billions of customers, software scales almost without cost, and intellectual property can generate extraordinary returns worldwide. Genuine wealth creation and monetary depreciation are operating simultaneously, both enlarging the nominal quantities around us. But it's difficult for most observers to distinguish between a trillion dollars of productive assets, a trillion dollars of debt, a trillion-dollar market cap, a trillion-dollar spending bill, and a trillion dollars of future pension liabilities.

Sound economics cautions against confusing abstract money prices with the goods, services, productive capacities, and human satisfactions to which those prices refer. Additional wealth is not created merely because accountants add zeros to balance sheets, central banks expand the money supply, or financial assets are quoted at higher prices. Yet neither are such price changes meaningless. Money is a messenger: prices may reflect changes in scarcity, expected earnings, risk, preferences, credit conditions, monetary supply, or some combination of them. Wealth is created when entrepreneurs discover more valuable ways to arrange scarce resources, including capital and labor, to satisfy human wants. Market prices signal judgments about those uses, but they are not themselves the value being created.

Viewed through that lens, a trillion-dollar company is less alarming, and perhaps more inspiring. A trillion-dollar market capitalization is not a warehouse containing a trillion dollars; it is the market's continuously revised estimate of future earning power (see the price trend in SpaceX since the IPO for confirmation of that phenomenon). Stock prices condense millions of judgments about technology, competition, consumer demand, production costs, and risk into a single signal of likely value. That estimate — whether it proves accurate or wildly optimistic — is a wager, a priced forecast of the future, rather than an inventory of existing riches.

Like the trillions now being committed to AI infrastructure, some investments will transform productivity; others will become expensive monuments to extrapolation. Entrepreneurship has always involved speculation. The more important question is whether monetary policy choices have the effect of systematically warping entrepreneurial judgment and promoting malinvestment.

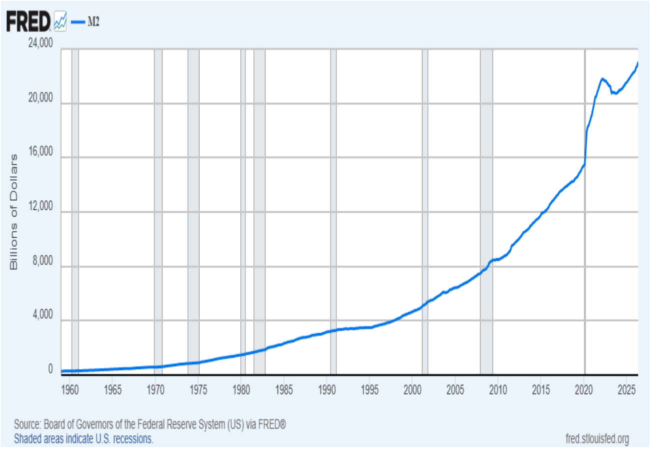
Persistently easy credit and artificially suppressed interest rates do more than raise prices generally. They encourage longer-duration projects, inflate the present value of distant earnings, and allow financial valuations to outrun the economy's underlying productive capacity.

Certainly not every trillion dollar valuation is a bubble. Monetary distortion and genuine innovation frequently coexist. Railroads truly transformed nineteenth-century Millionistan — the impressive Mohawk and Hudson Railroad was built for just $600,000 — though many fortunes disappeared in speculative railroad manias. The internet continued to power our economy well after the collapse of the dot-com bubble. Artificial intelligence may likewise reshape civilization while simultaneously destroying vast quantities of invested capital. Entrepreneurial ventures, especially at the cutting edge of technology, are entrepreneurial wagers. Profit and loss exist precisely because no one knows the outcome beforehand.

Life in Trillionistan has rewired our perceptions. Large numbers anesthetize. A million dollars once represented unimaginable wealth; a billion eventually replaced it; today even the billion is becoming commonplace. As each numerical frontier becomes familiar, it commands less wonder and less scrutiny. We experience reflexive suspicion of individuals who command great fortunes, but slip into complacency toward inflation, debt, and public liabilities. In both cases, the magnitude obscures the institution that produced it

Not all trillions are created equal. A trillion accumulated through entrepreneurial discovery differs fundamentally from a trillion generated through monetary expansion, leverage, or habitual political can-kicking. Most modern trillions contain elements of both: genuine productive achievement expressed through a steadily depreciating unit of account. The trillion has migrated from cosmology and quantum mechanics into ordinary economic discourse because the economy has genuinely grown, but also because the monetary unit has contracted precipitously.

The important question, then, is not whether another company, fortune, industry, or balance sheet will cross the trillion-dollar threshold. Many will. The more interesting and relevant question is what kind of trillion it will be: one representing genuine wealth creation, one reflecting the capitalization of future possibilities, one inflated by monetary expansion, or some unstable mixture of all three. In Trillionistan, the zeros hint at the scale, but they do not tell us the actual story. And even as we acclimate ourselves to the trillion, the foundations of Quadrillionistan are quietly being laid.



The Fed Needs Independence, Not Immunity

Nicolas Cachanosky
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The Supreme Court denied the President's stay application in *Trump v. Cook* on June 29, allowing Governor Lisa Cook to keep her seat. This was a 5–4 decision on an emergency-docket stay, not a final ruling on the merits, and it resolved far less than the headlines suggest.

WHAT THE RULING SETTLED, AND WHAT IT DID NOT

The Court held that the President's removal of Cook failed on narrow procedural grounds. He gave her no notice and no chance to respond before firing her. Nothing stops him from trying again. If he does, the underlying question of whether alleged pre-office mortgage fraud constitutes "cause" to remove a sitting Fed governor remains completely open, because the Court declined to spell out precisely what "cause" requires, leaving that question to be litigated the next time a president wants a governor gone.

The coalition that produced even this narrow holding is also not built to last. Chief Justice Roberts and Justice Kavanaugh joined the three liberal justices to form the majority.

The three dissents don't agree with each other any more than they agree with the majority: Justice Thomas would eliminate for-cause protection for the Fed as unconstitutional; Justice Barrett objected mainly to the Court reaching a constitutional question the government never raised; Justice Alito (joined by Gorsuch) objected to deciding this much on an emergency-docket record the lower courts barely developed.

A 5–4 majority that fragile, on a question this narrow, is not the kind of precedent that survives a change in the Court's composition unscathed.

INDEPENDENCE OF WHAT, EXACTLY?

The majority's defense of Fed independence leans on the Fed being "a uniquely structured, quasi-private entity" with a "distinct historical tradition," language that treats independence as a kind of institutional mystique. Justice Thomas takes the opposite extreme view: the Fed wields executive power, so it should answer to the President like any other agency.

Yet the Federal Reserve was never independent of the government in any general sense. Congress created the Board; Congress alone can rewrite the statute that defines its powers. And the Fed chair testifies to Congress, not to the President, as a matter of statutory design. The President's role was always a narrow one: nominate governors and remove them only for cause. In other words, execute Congress's will. "For cause" protection is intended to insulate monetary policy decisions from a specific pressure: the incentive an elected official has to lean on monetary policy for short-term gain ahead of an election. That is a narrower and more defensible claim than either "the Fed is special" or "no agency should ever be insulated from anything."

THE CASE FOR INSULATING THAT ONE THING

The dilemma is structural, not personal. You can have a skilled central banker serving under a president inclined to misuse monetary policy, or a poor central banker serving under a president who would never try to misuse it. The Constitution vests executive power in one person, by design, a single point of accountability, but also a single point of failure.

Monetary policy, by contrast, is set by a committee whose members, in theory, have smaller, less coordinated, and mutually offsetting incentives to politicize decisions than a single elected official seeking reelection. Insulating that committee's decisions from removal-by-displeasure doesn't guarantee good policy. But it bounds how much damage one bad political actor can do to it. That is a more modest claim than the one usually made for central bank independence.

This ideal deserves a real-world caveat. A committee that votes together as often as the FOMC does is not perfectly diversified against shared error. The near-unanimous "transitory inflation" call of 2021–22 is a reminder that groupthink can exist in a body such as the FOMC as well. Insulation reduces correlated political risk. It does not eliminate correlated forecasting risk.

WHAT DOES THIS MEAN FOR MONETARY POLICY?

The ambiguity *Trump v. Cook* leaves unresolved exacts a direct cost on the very thing insulation was built to protect: the credibility of monetary policy itself.

Modern central banking depends heavily on expectations (through forward guidance or otherwise): the Fed signals its future policy intentions to shape market expectations today. That only works if markets trust that the Fed's signals reflect economic analysis rather than political accommodation. A Fed whose governors know they can be removed under a standard no court has defined, for reasons no statute limits, is a Fed whose forward guidance is conditional to presidential approval. The interest-rate path the Fed projects carries weight only if markets believe the governors on the Fed Board who help set it won't be replaced the moment that path displeases the White House. *Trump v. Cook* does nothing to remove that asterisk. And the split vote is not very reassuring.

THE UNDERLYING PROBLEM

Why did a case about an old mortgage application make its way to the Supreme Court?

The Federal Reserve Board, which Congress insulated in 1913, set short-term interest rates, supervised member banks, and designed and executed monetary policy. That's it. The Board that Cook serves on does much more.

The Dodd-Frank Act, passed in 2010, gave the Fed consolidated supervisory authority over nonbank financial firms designated "systemically important" by the Financial Stability Oversight Council, and imposed enhanced prudential standards on every bank holding company above a statutory asset threshold. The same Board sets emergency lending policy under Section 13(3) of the Federal Reserve Act — an authority that let the Fed extend credit peaking at $710 billion in 2008 to keep firms like AIG and Bear Stearns from collapsing, and that backed a 2020 lending capacity exceeding $2.6 trillion during the pandemic, with Congress appropriating $454 billion to backstop it. In 2023, under its general safety-and-soundness authority rather than any specific congressional mandate, the Board ran a pilot climate scenario analysis (CSA) with six of the country's largest banks; an example of how far that authority can stretch.

None of this is illegitimate; Congress authorized nearly all of it by statute. But Congress added each grant of power without revisiting whether the original case for insulating monetary policy has anything to do with insulating bank examinations, emergency lending, or systemic-risk designations, let alone climate change policies.

The Court's own discomfort with this gap is already on the page.

A footnote in the majority opinion declines to bless Fed powers "attenuated from monetary policy." As Alexander Salter has observed elsewhere in this publication, that footnote reads as a quiet acknowledgment that the Fed's broader supervisory and enforcement machinery doesn't sit easily with the Court's own reasoning. Justice Barrett presses the same concern in dissent, asking whether all of the Fed's current powers actually relate to monetary policy, and whether those that don't are simply grandfathered in. Even within the majority, the tension surfaces: Justice Kavanaugh argued the Court had to settle the Fed's categorical status immediately because leaving it open after *Trump v. Slaughter* would itself be too costly, and yet the same opinion left the definition of cause, the question every future removal fight will turn on, to be resolved case by case, indefinitely.

Cook's case was never just about whether one governor said something untrue on a mortgage application. It was about who controls a Board that can move trillions of dollars and rewrite supervisory standards for the banking system, a far larger prize than the one the original insulation was built to protect, sitting behind the same undefined "for cause" standard.

A governor's protection from removal cannot apply to some of her votes and not others. There is an uncomfortable trade-off: either every part of the modern Board stays insulated together, and an unelected body runs a large slice of executive power outside the executive branch, or insulation comes off entirely and governors who need their monetary policy decisions to be independent from electoral pressure become removable at presidential pleasure. That choice only looks forced because it treats the Board's expanded mandate as one indivisible office. It isn't.

ONLY CONGRESS CAN CLOSE BOTH GAPS

Justice Kavanaugh's concurrence ends with the right answer to half the problem: any further change to Fed independence "must occur through the legislative process." He's right that courts can't durably settle whether the Fed gets to be independent.

The dilemma dissolves once you stop treating the Board as a single office. Keep "for cause" protection exactly where the original rationale justifies it: the governors who vote on interest rates and the money supply. Move everything else — bank supervision, systemic-risk designation, emergency lending — to a separate body whose officers answer to the President under the standard *Slaughter,* decided the same day, already set for ordinary executive functions (for better or worse).

The Fed's removal fight is still contested only because it does both kinds of work under a single, undefined standard. Separating them ends that.

Congress should therefore do two things. First, define "for cause" by statute for the seat that remains insulated, with notice and a hearing required before removal. Second, move the Fed's non-monetary powers to a body that operates under the standard *Slaughter* already established, rather than letting the Fed borrow protection it was never designed to need. Protect the part of the job insulation was built for. Stop pretending the rest of the job needs the same shield.

August 2026

The Unintended Consequences of Vacancy Taxes

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Vacancy taxes are a popular idea among that segment of the left that is still resisting supply-side reforms as the economically literate solution to the housing crunch. But the number of perfectly decent housing units sitting vacant year-round in desirable markets is vanishingly small, and owners will respond to vacancy taxes in undesirable ways too.

Vacancy taxes have been in vogue recently. France has a nationwide housing vacancy tax, Ottawa implemented one a few years ago, Washington, DC has enacted a vacancy tax on both residential and commercial properties, and San Francisco has an active commercial vacancy tax.

Do these vacancy taxes reduce rents? The best available evidence says no. These taxes do appear to reduce vacancies, but it is unclear whether they also reduce housing supply. After all, one way to avoid a housing vacancy tax is to reclassify a structure as nonresidential, such as by removing the kitchen.

Some people seem to be under the impression that landlords are hoarding a large number of long-term vacant units for no apparent reason. Supposedly they do this because they are "speculating" on the vacant units. But if you're speculating on housing, why wouldn't you rent it out and make some extra income while you're seeing if the underlying value will rise?

In fact, when more housing units become vacant, rents fall. This is an extremely clear relationship, validated by sophisticated scholarship as well as the plain evidence of one's eyes. Here's a chart from the left-leaning Center for Economic and Policy Research (Figure 1, next page). High vacancy rates are followed by declines in rental costs.

And here are two charts of Austin, Texas recently posted by Nolan Gray on X (Figures 2 and 3, next page). Vacancy rates in Austin fell dramatically right before rents rose equally dramatically. Then as rents fell back, vacancy rates rose again.

When housing providers have vacant units, they cut rents to attract renters. That's just basic economics.

In most cases, it makes no sense to hold property and pay property taxes and insurance on it while making no income from it, even in the absence of vacancy taxes. When Ottawa enacted a vacancy tax, it found that it applied to only a few thousand units. As of 2023, 4,140 dwelling units had to pay the vacancy tax there, amounting to **1.2 percent** of the housing stock to which the law applies and **1.0 percent** of the total housing stock. Glenn Gower frames the tax as a success because between 2022 and 2023, 1,602 previously vacant housing units became occupied. But even if we assume that every single one of these newly occupied units was driven to the market by the vacancy tax, that's just **0.4 percent** of Ottawa's housing stock, with an infinitesimal effect on rents under any reasonable assumptions about the elasticity of housing demand.

It's unclear whether vacancy taxes will even reduce rents on net. Will housing providers treat vacancy taxes paid as another cost of business that they must recoup from their tenants? If so, they may raise rents on already-occupied units to cover the cost of the vacancy tax.

In fact, there are a few rare cases when it does make sense to leave a unit vacant. For example, if the unit is substandard and requires massive, costly renovations that one cannot yet afford to perform, it may be better to keep the unit vacant rather than undermine one's reputation and brand in the community by renting out a substandard unit that elicits complaints and perhaps even unfavorable regulatory attention. Thus, a vacancy tax may disproportionately force substandard units into the market.

Second homes are also typically vacant for a majority of the year, making them potentially subject to vacancy taxes. Zohran Mamdani's *pied-a-terre* tax in New York is apparently intended to deter people from having second homes in the city, with the idea that these homes will be made available to full-time residents.

But let's think through the consequences of deterring high-net-worth individuals from visiting and spending time in New York. How will these changes affect the important retail, hospitality, entertainment, and arts industries in the city? Will the tenants helped by a small number of second homes' coming to market lose more in wages and employment from the second-order effects of the tax?

One final reason why a housing provider might hold a unit back from the market is that rent controls and eviction protections could mean that the rental income would not cover the operating cost of renting out the unit. These are reasons to roll back rent control and eviction protections rather than force housing providers to take losses. After all, if the owners of rental buildings find that their line of work has negative returns, they will try to get out of it. And that could mean, alongside deferred maintenance, condoization, demolitions, and residential-to-commercial conversions, a decline in multifamily structure property values, putting more of the property tax burden on everyone else in the city. Indeed, New York's tightening of rent stabilization in 2019 has done just this, even playing a role in forcing Signature Bank into FDIC receivership and New York Community Bancorp into near-collapse.

What about vacancy taxes on *commercial* properties, as Washington, DC and San Francisco have enacted and Tacoma, Washington is considering? High commercial vacancy rates in the 2020s are a legacy of the pandemic and the rise of work-from-home. Commercial rents and values have already dropped to rock-bottom in much of the country. Will punishing these owners with vacancy taxes help the situation? Owners of vacant commercial buildings need more cash flow and collateral to finance conversions, not less. (It's also not clear that owners will comply with commercial vacancy taxes: San Francisco's commercial vacancy tax has resulted in widespread underreporting.)

The solution to vacant commercial buildings is to reform local zoning rules and permitting processes to speed conversion of these structures to other uses. If necessary, cities could also consider tools like land-value taxation or tax-increment financing (TIF) to reduce the extent to which property taxation disincentivizes value-increasing improvements. These solutions face their own limitations, from the difficulty of assessing the unimproved value of urban land to the potential for TIF to be a tool of cronyism, but at least they rely on improving the financial strength of partners in development, not harming it.

Even if vacancy taxes work exactly as designed, they are not a major solution to the housing crunch. Their positive and negative effects are generally small. The biggest problem with vacancy taxation is its use as a totem by people who oppose housing solutions that would make a real difference, namely, making it easier and less costly to build housing.

Figure 2: Rents in Austin, Texas

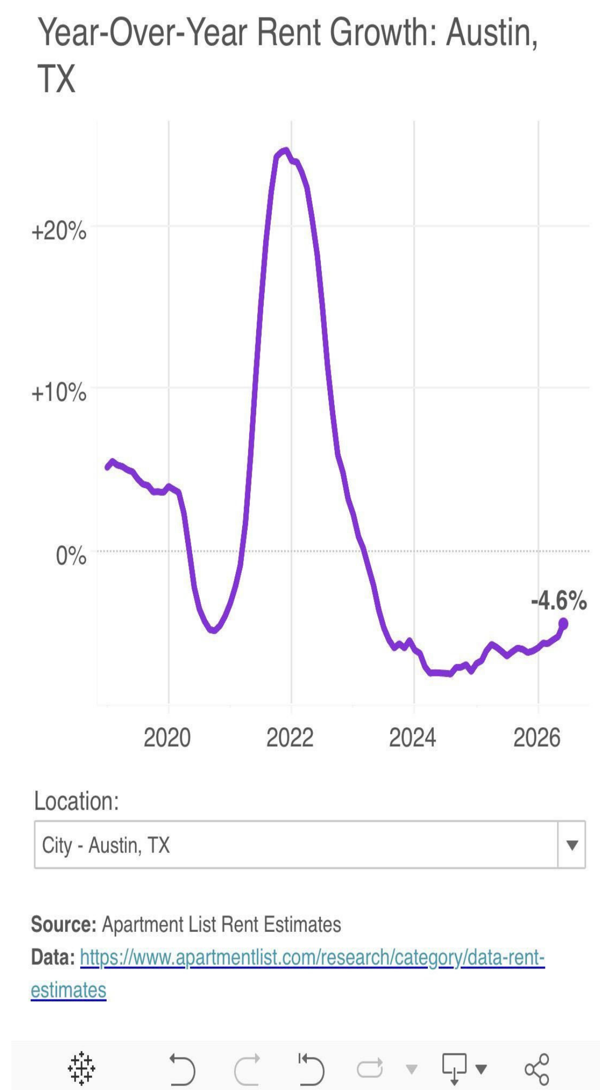


Figure 1: Vacancy Rates and Change in Rental Costs

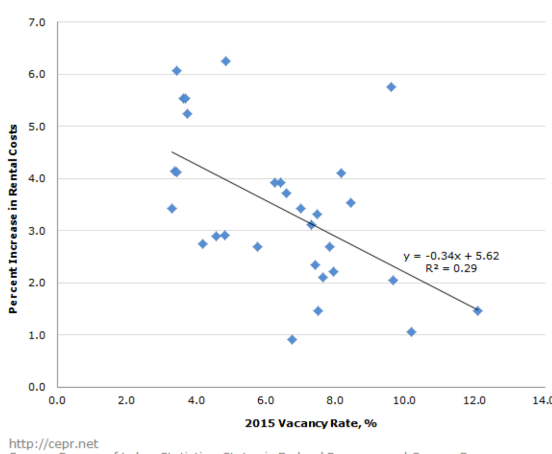
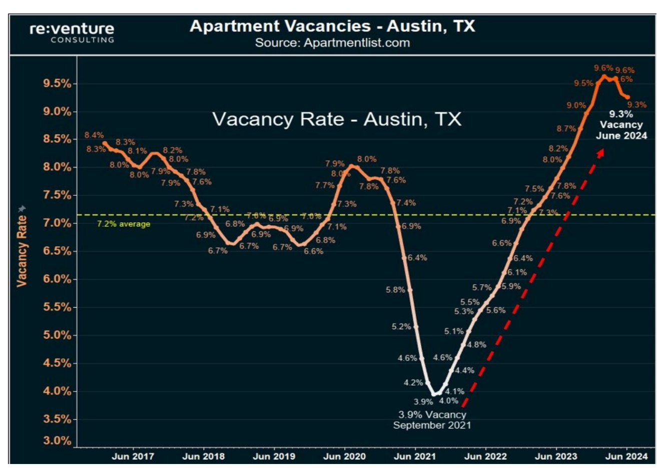


Figure 3: Vacancy Rates in Austin, Texas



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