

Of, By and For the People

The Role of Government in a Market Economy

Next month we will stumble to the polls to cast our ballots for (or against) candidates and propositions or referenda. Many factors will influence our decisions, including loyalties and values; but lurking in the background are economic considerations as well: Does this person or party favor positions that touch me positively or negatively, and represent the kind of society in which I want to live?

To an economist, assessing a particular public-sector initiative or private market activity involves thinking about how each one affects efficiency. That is: Does it waste our scarce resources and as a result make us less well off than we otherwise would be? Equity is a second important ingredient: Are the proposed policies and likely outcomes fair? The former entails measuring costs and benefits of particular actions; the latter is important but also harder to pin down because the concept of fairness involves subjective judgments.

Public Interest Theory

On the efficiency front, economists point to several aspects in which public intervention can improve market outcomes. Establishing and enforcing rules of the game is one; fostering and maintaining competition in the marketplace is another.

In some instances there can be a divergence between private and social costs or benefits, what are deemed “externalities”. This can be a firm—or an automobile—creating pollution, or the societal value of having an individual get a flu shot or acquire more education. We generally impose taxes or offer subsidies to align the public and private interests in such cases.

Some things are classified as “public goods”. That doesn’t mean public education or a public park, but rather goods or services that one may be able to consume or benefit from without paying. National defense is the best example: We all benefit from it even if we don’t pay. So we tax ourselves to provide these collective goods. (In *Aesop’s Fables*, the well-known line: “But who is going to bell the cat?” illustrates a classic free-rider problem.)

BY ALLEN R. SANDERSON

Redistributing significant amounts of income without state coercion is also difficult because voluntary actions entail significant free-rider aspects.

More controversial are activities that involve economic distress or protect us from ourselves. Living on a seashore or in a forest offers many amenities, but also entails risk. Come a hurricane or wildfire, is protection against loss a private transaction between the property owner and an insurance company, or should society—that is, taxpayers—foot the bill?

Or, once the government has informed me that cigarettes, not wearing a bicycle helmet, or gorging on sweets are potentially harmful, does it then have the right to keep me from smoking, feeling the wind in my hair, or becoming obese? And if a com-



passionate “nudge” doesn’t change my behavior, is prohibition the next appropriate step? Reasonable people will disagree on these issues.

Finally, the extent to which the central government and central bank can outperform markets when it comes to macroeconomic stability—full employment, low inflation, steady growth—is a matter of longstanding debate among economic schools of thought.

Public Choice Theory

Economics Nobel laureate James Buchanan argued that politicians and voters want to provide or receive, respectively, “free lunches”. To get elected and remain in office, public officials pander to their constituencies. (These groups are called “the American people” by supporters or “special interests” by opponents.) And voters want an array of goodies without having to pay the full freight. So this is a marriage made in budgetary hell, leading to borrowing instead of taxing, and deception instead of an honest tabulation of the costs and benefits.

Facing frequent elections, politicians will pursue short-sighted policies that would otherwise not pass a smell test. “Pork” projects, logrolling, bureaucratic bloat, protecting friends from competitive forces, and concessions to powerful unions or senior citizens in exchange for short-term peace and votes are time-“honored” public-sector practices. Think bridges—and high-speed trains—to nowhere, city and state pension liabilities, redundant offices and red tape.

For Buchanan, in the political marketplace—what he termed the Public Choice theory of government—the goal for elected officials, bureaucrats, lobbyists, and voters has very little to do with either efficiency or fairness but rather what economists call “rent-seeking” (or, in Chicagoese: “Where’s mine?”).

Is the steady increase in the size of government over time because there are more and more externality and public-goods problems to address, including poverty, or are our red-state v. blue-state skirmishes more due to candidates and voters trying to manipulate the political process for their own personal benefit?

Something to ponder on the morning of November 4. □