

III. PUBLIC CHOICE AND GOVERNMENT AS A SOLUTION

A. PROBLEMS OF COLLECTIVE ACTION

- A standard method of analysis in social sciences (not economics) is to predict actions of a group from the interests of the individual members of the group.
- By that reasoning,
 - Farmers who want higher corn prices would lobby the government to require ethanol as a gasoline additive.
 - Consumers who want lower sugar prices would successfully lobby the government to abolish protection for US sugar beet producers.
- That prediction ignores the disincentive to group action that comes from the free rider problem: what we have analyzed as a prisoner's dilemma game.
- Sometimes groups can successfully overcome the free rider problem.
 - Public TV does get a significant share of funding from listener supporters.
 - Farmers have successfully lobbied to require ethanol in gasoline, boosting the demand and therefore the price of corn.
 - Consumers have never succeeded in having their interests considered in trade policy on sugar.
- The groups that successfully overcome the problem are usually either small ...
 - Personal interactions encourage contributions
 - Cooperation by all might become rational, as in the iterated prisoners' dilemma game (Hardin, p. 13)
- ... or they finance their joint efforts with profits from direct services they provide their members.
 - AARP provides discounts on hotels and other services in exchange for membership fees
 - And they finance their lobbying as a side activity from those membership fees.
- Most large groups with low commitment to the group cause cannot organize for joint purposes
 - Consumers can't get sugar quotas increased for low-cost cane growers (e. g., Cuba).
 - ⇒ Their group is large, diffuse, with a relatively low level of interest in the issue of sugar quotas
 - ⇒ The sugar beet producers, on the other hand, represent a small group, intensely interested in the issue of sugar quotas, with interests opposed to consumers.

B. GOVERNMENT AS A SOLUTION

- For large groups, government is a device for overcoming the free-rider problem.
- Collective actions that are in "everyone's" interest are carried out by government, with forced contributions by everyone, through taxes.
- A problem: Government officials respond to individual incentives too.

- In the issue of sugar quotas, government ends up as a tool of the better-organized beet producers rather than the unorganized consumers,
- even though the social cost of quotas is high.

C. WHAT ACTIVITIES MIGHT BE APPROPRIATE FOR GOVERNMENT?

1. Enforcement of contracts

- This is a good that could be treated as part of another class (goods with external effects), but is worth separate consideration.
- Start with the issue posed by Thomas Hobbes, in *Leviathan* (1946, original ed. 1651).
- Consider a society without government, in which the only property rights are determined by brute strength:
 - The economy would then not flourish, for lack of a link between effort and reward.
 - ⇒ "During the time men live without a common power to keep them all in awe, they are in that conditions called war; and such a war, as if of every man, against every man.
 - ⇒ "To this war of every man against every man, this also in consequent; that nothing can be unjust. The notions of right and wrong, justice and injustice have there no place. Where there is no common power, there is no law, where no law, no injustice. Force, and fraud, are in war the cardinal virtues.
 - ⇒ "Whatsoever, therefore, is consequent to a time of war where every man is enemy to every man, the same is consequent to the time wherein men live without other security than what their own strength and their convention shall furnish them withal. In such condition there is no place for industry, because the fruit thereof is uncertain: and consequently no culture of the earth; no navigation nor use of the commodities that may be imported by sea; no commodious building; no instrument of moving and removing such things as require much force; no knowledge of the face of the earth; no account of time; no arts; no letters; no society; and which is worst of all, continual fear, and danger of violent death: and the life of man, solitary, poor, nasty, brutish and short." (Ch. 12)
 - The fundamental reason for government is to enforce property rights, so society can be economically productive.
 - **Government is an organization with a comparative advantage in violence. It protects property rights in exchange for tribute.**
 - Hobbes' analysis in *Leviathan* could see no stopping point for the power of government, once that definition is granted.
 - Leviathan, the monster from the ocean depths, was his metaphor for all-powerful government
 - Given its limitless power, Hobbes concluded that the only proper governmental authority would be a religious one (preferably Christian): beneficent, but with no limits on its power.
 - Locke, going over the same ground, concluded that Hobbes looked at the problem wrongly.
 - The government is empowered by the governed, who give up power to their government only in exchange for a fair return:

- ⇒ "Nor shall private property be taken for public use without just compensation", as the eminent domain (or "taking") clause of the U. S. Constitution says it.
- For more on Locke's views, go to
<http://www.blupete.com/Literature/Biographies/Philosophy/Locke.htm#Government>
and follow links there to read more about Hobbes' views, too.
- Assume that the individuals in the government are self-serving, and greedy:
 - Government then has the delicate task of balancing their greed against the requirements of economic efficiency: the old conflict between the size of the pie and the share of it you can claim.
 - If the governed have any power, or choice, their chief challenge is to design restraints to limit the tribute they must pay to the government.
 - They will try to devise limits on government taxing and spending.
 - ⇒ Balanced budget amendment to the constitution
 - ⇒ Campaigns for lower taxes.
 - ⇒ We'll discuss further below under heading of "constitutional economics".

2. Public goods

- Goods that
 - (a) can be provided at zero marginal cost to other users if they are provided at all,
 - (b) and users cannot be excluded if they don't pay (?)
- Examples
 - Sidewalks
 - Radio and TV signals
 - National defense
 - Weather forecasts
- (a) and (b) above lead to different problems:
 - (a: $MC = 0$) means that it is inefficient to deny access to anyone who wants to use the good
 - ⇒ therefore should not charge a positive price if it would discourage any user.
 - (b: Can't exclude potential users) means that it is impossible to prevent "free riding"
 - ⇒ therefore they can provide examples of prisoners' dilemma.

3. Quasi-public goods, shared goods, or collective goods

- For these goods, when usage is sufficiently high, crowding means that more for me does mean less for you (marginal cost is no longer zero).
- Examples
 - Roads, streets

- Parks
- Libraries
- Before crowding sets in $MC = 0$ so efficiency says we should provide to everyone.
- **Goods with substantial external effects**
 - Examples
 - Control of air and water pollution

D. CONSTITUTIONAL ECONOMICS (MCKENZIE)

"The fox knows many things, but the hedgehog knows one big thing."

(Archilochus (Greek poet, b. 675?, BC, d. 635?, BC)

Who is the fox, and who the hedgehog? Here's a clue:

- "Typically, when economists observe market failures, they design corrective policies and then recommend that government apply these policies to improve performance of the economy. This would be a satisfactory approach if, as is implicitly assumed, the only motivation of political decision makers is much like their counterparts in the private sector, but they have their own personal agenda, which may or may not be consistent with the broader public interest; it no longer follows that market failures call for corrective government action."

(McKenzie, p. 4).

- "Agreement, not efficiency calculated by way of cost-benefit studies, is the hallmark of constitutional economists, because ultimately we must agree to maintain the semblance of a stable society.

"Constitutional economics seeks reform that will generate the necessary agreement for social stability."

(McKenzie, p. 14).

- Attention paid to constitutional economics was greater in the '80s and early '90s, when there were persistent government deficits.
- Recently, with projected surpluses, there was less pressure to limit government; maybe now, with projected deficits again, the pressure will return.
- Basic argument:
 - There is continuous pressure to expand government spending and government regulation.
 - To fight these pressures, we need to make it hard to increase spending or to spend without taxing, and hard to impose new regulations.
 - That is what a constitution does: Puts laws in a place where it is very hard to change them.
 - Therefore we need an economic constitution.
- McKenzie identifies the 4 main elements of an economic constitution, (in the opinion of US constitutional economists):
 - Balanced budget amendment
 - Limit growth in taxes to no more than growth in national income

- Limit the “power of inflation taxation” by limiting money growth to a rigid rule, say 3% or 5% per year
- Return as much fiscal power as possible to states and communities.
- Once the rules are set, you live with the outcomes.
 - You can’t judge whether the outcome should be changed.
 - You must judge whether the rule leading to the outcome should be changed.

E. THE ROLE OF GOVERNMENT IN A FREE SOCIETY (FRIEDMAN)

- “To the liberal, the appropriate means (for collective action) are free discussion and voluntary cooperation, which implies that any form of coercion is inappropriate. The **ideal** is unanimity among responsible individuals achieved on the basis of free and full discussion.” (Friedman, Ch. 2, p. ; boldface added).
 - This does not sound like a “liberal” in the current US political spectrum.
 - It isn’t. Friedman uses the term “liberal” the way it was used in the 19th century.
- Historians have defined liberalism in a variety of ways. Here are a few¹:
 - Liberalism can best be explained negatively, as opposition to excessive state power.
 - A coherent body of principles based upon the idea of individual freedom. A coherent philosophy based upon the principles of the moral primacy of the individual in relation to the state or society, and the moral equality of individuals.
 - A distinction is made between "positive" and "negative" liberty. During the course of the 19th century the nature of liberalism changed from a defense of "negative" liberty (i.e. hostility to all state activity) to a defense of "positive" liberty that tolerated much greater state intervention especially in the area of welfare (advocated by the so-called New Liberalism in the late 19th century).
- When Friedman refers to the views of a liberal, he means the “negative” liberal that wants government out of our lives, not the “New Liberal” that is closer to what is labeled a liberal in this century.
- The role of government, according to Friedman (only where markets don’t work):
 - Government as rule-maker and umpire
 - Action through government on grounds of technical monopoly.
 - ⇒ Technical monopoly: Choose among imperfect instruments: private monopoly, public monopoly, or public regulation of the private monopoly.
 - ⇒ Argues for private monopoly on grounds of how we adapt to technical change
 - Action through government on grounds of neighborhood effects (*i.e.*, external effects)
 - ⇒ Pollution
 - ⇒ Highways
 - ⇒ Parks: Local and national

¹ Excerpted from a University of Adelaide History Department course syllabus on the web, URL <http://arts.adelaide.edu.au/person/DHart/ClassicalLiberalism/LiberalEurope/Bibliography/Intro.html#anchor104304>

- ⇒ “Every act of government intervention limits the area of individual freedom directly and threatens the preservation of freedom indirectly” (Friedman, p. 32).
- Action through government on paternalistic grounds
 - ⇒ Care of the insane
 - ⇒ Children
- Activities now undertaken, not justified by liberal principles:
 - ⇒ Agricultural price supports
 - ⇒ Trade restrictions and tariffs
 - ⇒ Government control of output
 - ⇒ Rent control, price or wage control
 - ⇒ Legal minimum wage rate or legal maximum price
 - ⇒ Detailed regulation of industry (ICC, FCC)
 - ⇒ Social security programs
 - ⇒ Licensure provisions
 - ⇒ Public housing and other subsidy programs for housing
 - ⇒ Military draft in peacetime
 - ⇒ National parks
 - ⇒ Legal prohibition on carrying mail for profit
 - ⇒ Publicly owned and operated toll roads.
- “This list is far from complete.”