Can Government Deliver the Goods?

by

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Clemson, SC

1998

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I. Introduction

Students in their first course in economics learn that every country faces three problems that it must resolve. What goods will be produced? How will it produce these goods? And, who will get the goods produced? Since the questions deal with economic matters, it is usually assumed that markets will determine the answers. But political forces in government can also provide results. Milton Friedman has observed that every country answers some aspects of each question through market forces and other aspects through the political system. The proportions vary greatly from country to country. At one extreme would be the old Soviet Union and The People's Republic of China under Mao Tse-tung. At the other extreme would be the British Colony of Hong Kong and the United States before the Great Depression. In between are all shades. Cuba, Sweden, Germany, the U. K., the U. S. today, Chile, and Taiwan lie along the line moving from more government control to more market control.

What can we say about these two systems for answering the above questions? Each system must have some advantages, for each is used, though in widely varying proportions. The close relation is shown by the early reference to "economics" as "political economy."

To examine the results we can expect from using each of these systems, we will first look at some broad, general forces that operate in each system. Then we will use the fundamental principles of demand and supply to predict outcomes, and evaluate results. We hope that from these considerations, the strengths and weaknesses of each system will be apparent and each individual will be better able to make wiser choices in answering the basic questions cited above.

II. Deciding with Votes Versus Deciding with Money

In 1959 Gary Becker, a young Professor at Columbia and a later Nobel Laureate in economics, compared the two ways of producing and allocating goods. He noted that a person could take his money, go into the market, and choose the goods on which he wished to spend his funds. That action would determine what goods were produced, how they were produced, and who got them. Similarly, a person could take her vote, go to the polls, cast it for the politician in favor of having government order the production of goods she liked, made the way she preferred, and distributed to the people she thought most deserving. The two systems seemed mirror images of each other. But were there features that make one superior to the other? Becker cited several areas where the two systems differ. We shall discuss three of them.

First, when a person votes for her representative, that person elected will serve for two, four, or six years and cannot be replaced until his term ends. A person may have voted for Bill Clinton who promised in 1992 to reduce taxes, but in the following year raised them markedly. But Mr. Clinton had three more years to serve and could not be removed.

In a market, however, you may enter a Safeway store, based on its promise of quality products, good service, or a large inventory. If Safeway fails to deliver to your satisfaction, you may fire it then and there. You need never patronize it again. Market goods can change rapidly. Government goods change slowly. Not only can the politician remain in office and with power after his services are no longer desired, but the bureaucrat who administers the laws usually has, in effect, a lifetime appointment. An example of a service tied to long tenure is the provision of justice. It should be swift and sure. Instead, it is interminably slow and often random. Federal judges have lifetime tenure. Improving the delivery of justice will take decades, if it can be done at all. Professional arbitrators, however, can be replaced swiftly and their services reflect this condition.

Second, Consumer Reports has long complained about the "bundling" of features on automobiles. In order to get the car with the color and power you want, you may have to buy other equipment that you do not want. The product should be "unbundled," so the consumer would receive and pay for only the features desired.

When the voter elects a mayor, senator, or other official, that person will represent the voter on a large number of issues. The voter may like her congressman's position on the minimum wage, but vigorously oppose his position on most-favored-nation treatment for China. A congressman will represent his constituents on about a thousand pieces of legislation during his two-year term. Many constituents, even those who actively favored him, will support his position on some of these bills but strongly oppose him on others. The congressman is a bundled good, and the voter will be forced to pay for many results she does not want. Dwight Lee has used a Safeway grocery analogy: the consumer enters the store and is confronted with a full grocery cart, containing some goods she wants and some she does not. Her choice is the cart or nothing. In government she must take the representative's bundle; she cannot choose nothing.

In markets, one is not forced to buy all goods from only one supplier. Sears or Wal-Mart will not be the single source of all goods for any consumer. You can vote for only one congressman who will provide you with thousands of rules affecting what is produced, how it is made, and who gets the goods, but in markets you can vote for hundreds, if not thousands, of suppliers of private goods. Even in the purchase of food, the consumer may buy bread at one store, meats at another, and vegetables at a third. In markets a consumer is seldom forced to pay for a good he does not want or that is produced in a way he does not like; in government purchases, he often is.

A third difference between government provision of goods and that done by markets involves what economists call rational ignorance. This can be either costly or inexpensive.

Because the Congress will take action on over a thousand bills during a given session, the typical voter cannot be informed on each and every bill. In fact, he will be completely ignorant about almost all of these bills. This does not imply disinterest in government, laziness, or an inability to understand the bills presented. Rather, the voter is rationally ignorant about these proposals, for he has his own life to lead, family to care for, job to pursue, church to attend, sports team to enjoy and support, and a thousand other things to occupy his time and attention. There is little left over to be spent on these peripheral political issues, many of which may not interest him. Further, even should he pause and study any issue and try to urge his representative to vote on it intelligently, his voice is likely to be lost among the thousands of others also affected. He will be ignorant about ninety-nine percent of all items that come before his congress, legislature, council, or district governing body, and rationally so. His time can be spent more profitably elsewhere. This ignorance is costly to him, but removing it is even more expensive. He is destined to be a loser on most of these government-provided items.

In his purchases and work in private markets, he will also be rationally ignorant about almost all products offered. But these will be products he will not purchase and will not pay for. Most of us are rationally ignorant about the features and cost of yachts, for example. The price system determines how it is produced, and we need not be concerned about others who spend their own money for this product, for we will not spend our money on it. This form of rational ignorance is not costly to the individual. The late Mancur Olson was an early expositor of a fundamental rule of political action. Every law, rule, or regulation by government helps some group and imposes costs on others. A proposal is likely to become law if it concentrates the benefits in the hands of a few people so that each enjoys a sizable gain; while at the same time it spreads the costs over a large population, so each loser bears only a small absolute expense. The gainers, then, have a strong incentive to support the proposal, while the losers have little reason to oppose it actively. They are better off remaining rationally ignorant, spending their time on matters more important to themselves. This provides a strong incentive to prospective gainers to offer a great many proposals that may do little good, at great cost. Rational ignorance when government allocates resources not only creates inefficiency in these programs, it also encourages small groups, often called special interests, to press for allocating more and more goods in this manner. In effect, inefficiency breeds even more inefficiency.

There are some goods, called "public goods" because many people automatically benefit from the good if anyone receives it, that many think government should provide. Examples are neighborhood attractiveness, fireworks displays, water quality, and radio broadcasts. Still, many economists argue markets can provide these goods more efficiently than government can.

When we rely on government, even when democratically elected, to provide the goods we want, produced the way we want, and allocated to the people we want to receive them, we will get fewer of the goods we want, more of the goods we do not want, and encourage the increased use of this inefficient system. Markets are designed to overcome these weaknesses.

III. Demand and Supply of Goods Under Each System

When there is a scarcity of goods and a need to allocate them, Economists turn first to the concepts of demand and supply. These powerful tools will help us examine our questions in a different light and give us significant insights.

We know that people want lots of units of many goods and services, but they cannot have all they want. The concept of demand tells us a person will take more of a good the less expensive it is and that he will demand each good until he gets about the same happiness from the last dollar he spends on the last unit of each good. If he buys a $20 shirt and a $2 pair of socks, he should get about ten times as much satisfaction from the new shirt as from the additional pair of socks. He is then getting about the same happiness from the last dollar spent on each of these goods.

When we answer our three questions using the concept of demand, we know each consumer will look at the many goods out there and their prices, and decide which goods will bring him the greatest happiness from the dollars he spends on them. He knows why he does not buy some goods he likes and why he does not buy more units of some of the goods he does purchase. The goods are not worth the price. He will be as happy as is possible with his income when he follows these rules of demand.

When government produces or allocates goods, it usually provides them at a low or zero price. Schools, police protection, justice in the courts, clean air and water, Medicaid, occupational safety, and welfare payments are all seen as virtually free goods. Many other goods are subsidized, such as public transportation, public housing, and Medicare. When the price of a good is low, or even zero, consumers will want more of it than they would voluntarily have bought at its cost of production. Think how much more food, clothing, and shelter you would buy if the units you want were fifty percent cheaper, or free.

Thus, too much of the good will be produced, meaning we will have to give up other more valuable goods to get these less valuable units of the subsidized or free good. Remember the fundamental economic rule: there is no free lunch, or even a cheap, subsidized, lunch. It just appears free or cheap. We give up beer, tires, and encyclopedias that are more valuable than the value of what we get in cleaner air, higher SAT scores, or better housing for the poor. In fact, added expenditures on these last three items have often given us dirtier air, lower SAT scores, and fewer housing units for the poor.

But when the government-provided goods do supply some positive, but small, benefit, we might think, "Well, at least the recipients will be happier." Strangely, they are far more likely to be dissatisfied with what they have received. First, the extra units are not worth much to them, and second, they will be unhappy because government will not provide them with all the goods they are willing to buy at the low prices. People are more likely to be unhappy over receiving public housing and public transportation than over not getting expensive housing and Lincoln Town cars. Price sends the wrong signal for the first two goods and the right signal for the latter two. Recall the widespread public dissatisfaction during the 1974 Arab boycott when government set gasoline prices below market levels but could not provide all the gasoline people were willing to buy.

Government provision of goods generally creates wasteful consumption and consumer dissatisfaction, a doubly bad result. Market provision leaves consumers happy with what they got and a clear understanding of why they do not want more units which are not worth their cost. The concept of supply tells economists that if demanders will pay a higher price for a good, more units will be produced. Further, this price must cover the cost of the land, labor, and capital needed to turn out these units. If demanders will not pay for the good, it will not be produced. Waste will be avoided. Firms that produce goods that people do not want will go bankrupt. This is how markets avoid wasteful activities.

Markets also promote efficiency. People who learn to provide a better or less expensive good make profits. We call them Ray Kroc or Bill Gates. Markets provide a strong incentive to supply only goods people want badly enough to pay their cost of production. Government- provided goods, however, almost never face bankruptcy. The mail may be late, children may learn little in public schools, Medicare fraud may cost billions, job training programs may leave participants worse off, but none of these programs has been declared a failure or abandoned. There are at least two features that help explain these supply results.

First, those who produce these failed products have little incentive to improve them. The person who produces a better oil drill bit, internet browser, or wash and wear fabric can make millions from the improvement. Incentives for government employees or administrators to improve government programs are almost nonexistent. No incentive; no improvement.

Second, the incentives facing government workers are, in fact, to produce a bad product. Schools can get bigger budgets if their students are failing. The judiciary can get more funds if its cases take longer. The police can improve funding if there is more crime in schools and on the streets. In terms of a supply curve, we are not getting more units of schooling provided at a higher price; we are shifting the supply curve for education upward and getting less education at the same price, or equal education at a higher price. This condition applies to almost all government-produced products; failure pays.

IV. Conclusions

Governments can provide goods or markets can do the job. The two Systems appear similar, but they are very different. The general problems of slow response of government because of political tenure, the bunching of decisions made by government officials, and costly rational ignorance by voters all argue for abandoning this inefficient system.

When government provides goods, people will demand too much of useless goods and become unhappy because they were not provided more and better products. Governmental agencies producing goods have little incentive to become efficient and significant incentives to turn out failed products. They also need not fear a prospect of bankruptcy or competition.

Markets, on the other hand, change quickly, allow many producers, and do not burden those who are ignorant of goods they do not buy. Further, consumers will demand only those goods that benefit them most and suppliers will become efficient or become bankrupt. We often choose government as our preferred provider on the basis of emotion. If we can substitute understanding for emotion, we may become healthier, and we will certainly become wealthier as we become wiser.

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