

## Government Failure

### Markets or gov't: how much of each?

- Necessity of gov't: the Great Depression, int'l politics, social harmony, national interests.
- Gov't spending, interest rates, etc: stabilize economy.
- Correct market failure.
- Economists' concerns about efficiency, paternalism.

### Why *and* when do we use gov't to solve problems

- When voluntary action doesn't work.
- When transaction costs of markets are high (organ transfers?).
- When imp. social goals are at stake.
  - Distribution (rather than efficiency).
  - Merit goods
- When long-term or national interest is perceived.
  - Problem of social consensus (why this is hard in Canada).

### Typical Reasons for Gov't Failure

- Short-term thinking in Gov't.
- Pressures of elections (economic cycle vs. political cycle).
- Rational ignorance.
- Unintended consequences.
- Regulatory capture.
- Imperfect Information.

### Economists on Gov't

- Markets are responsive, governments are sticky and lumpy.
- Self-interest in markets is benign, in gov't it is dangerous.

### Preference Revelation

- Elections: markets or democracy: which is best for giving people what they want?
  - Grand symbols, no trade-offs
- Opinion polls: "Do you want more parks, lower taxes, etc.?"
  - "how much?" vs. "yes/no"
  - polls are anti-marginalist, willingness to pay
  - only markets measure preference intensity
  - talk is cheap – action reflects costs.

### Pitfalls and politics of planning – Government Failure(1)

- Unforeseen consequences: offsetting, self-correcting actions.
  - Cigarette and other taxes, black markets.

- Vague laws, specific regulations
  - Legislators decide,
  - bureaucrats act: tied to interests of specific community, influential companies in the industry.
  - Regulatory capture.

#### Some other Dysfunctions

- Bureaucrats are self-interested empire builders.
  - Departments with fixed budgets, poor cost control.
- Gov't service delivery: majority over minority.
- Gov'ts don't mimic markets.
  - No link between taxes paid and services received.
  - Taxes are bundled, services are targeted.

#### More dysfunctions, problems of consensus...

- Hard to get consensus on welfare and taxes.
  - Welfare – public good or robin hood?
  - Taxes – whose programs? (rural vs. urban, young vs. old, student vs. pensioner)
- Result: wide but weak or symbolic appeal wins (law and order, low taxes, etc.).
  - Better way to form a (loose)majority.
  - Easy (low intensity) issues vs. hard issues.
  - Public cynicism.

#### Microdecoupling

- Focused (concentrated) benefits, scattered (diffuse) costs
  - Politics disaggregates.
  - What's the payoff (incentive structure) from political involvement, activism?
    - organized interests, rent-seeking.
    - Silent losers – spread out costs.
    - When is protest rational (Weimer and Vining)?
- Examples:
  - Protectionism, subsidized industries, etc.
  - Saving airline industry (companies, unions).
  - Global warming.

#### Macrodecoupling

- Scattered beneficiaries and concentrated losers.
- Growth of social services, 'tax the rich', re-distribution, etc.
  - Leads to 'exit of the rich'
  - Growth of specialized enclaves and options – private schools, tax havens.
  - Rich suburbs, poor cities.

When will each type of decoupling be problematic?

- Depends upon opportunities for exit and voice.
  - Specialized (disaggregated) interests win when they can threaten exit (relocate).
  - Diffuse (aggregated) interests win when they can give voice to their common interests (vote for lower taxes).