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The Politics of Market Intervention

In an ideal democracy, the winning strategy in the competition for votes would be delivery of efficient, corruption-free government. The most capable candidates would rise to the positions of greatest responsibility. They would concentrate on updating and upgrading the services that government is best equipped to provide, including law enforcement and national defense.

At election time, the incumbents would make their case for staying in office. Focusing on such items as budget management and the updating of laws in our changing world, they would present an honest account of their performance. Meanwhile, the challengers would offer specific plans for doing the job better. Voters would then have a sound basis for either re-electing or replacing the incumbents.

Office seekers inevitably discover a much easier way to get elected and reelected: They buy the votes of special interest groups by favoring them with unwarranted intrusions in the marketplace. Politicians learn that they can move up the ladder faster with a kind word and a subsidy than with a kind word alone. Best of all, they don't even have to spend their own money.

The corrupt practice examined in this book is far more insidious than simply handing out cash at the polls. It is the perfectly legal, outright purchase of political power with taxpayers' money under the guise of building a coalition.

A BIPARTISAN EFFORT

The ideological brand names *conservative* and *liberal* reveal little about any particular politician's willingness to inject government into the marketplace. On the campaign trail, candidates differentiate themselves by attacking one another's positions on noneconomic hot-button issues such as abortion and school prayer. But once in office, they uniformly settle down to the real business of rewarding their backers by making the playing field less level.

Democrats and Republicans are like-minded on this matter. They diverge only in the particular constituencies that they shower with favors at the taxpayers' expense. Furthermore, the shrewdest benefit seekers work both sides of the street. That way, they ensure that they will get to feed at the trough no matter which party triumphs.

Businesspeople are among the most enthusiastic participants in this charade. Although they grumble about government's high cost and intrusiveness, they don't refuse to truck with politicians who perpetuate their power through billion-dollar giveaways. The business leaders are too intent on lobbying for their own subsidies, which in their minds are always uniquely justified.

Naturally, the captains of industry plead their case in the name of objectives more politically correct than profit maximization. If they claim to be primarily interested in creating jobs, that ploy conveniently enables them to enlist labor unions in their schemes. Creating affordable housing and encouraging Americans to save are other subterfuges that facilitate their masquerade as champions of the little people.

A REASONABLE STANDARD

With the complicity of both the right and the left, abetted by the combined forces of labor and capital, the election-through-subsidization scheme threatens to expand to infinity. To prevent the handouts from bankrupting the nation, the political system is forced to devise some objective test for subsidies. Politicians of all stripes and interest groups of every description must agree on a standard for determining whether a proposed government intervention in the marketplace is warranted.

Here, at last, is some good news. Economists have hit on a suitable criterion. The simple rule is to leave economic activity to the market, except where the market fails. *Failure* means that goods and services do not wind up being allocated efficiently.

This principle is not a matter of significant controversy among economists. Although they vary in their political opinions, economists broadly agree about the benefits of a properly functioning market. Both liberal and conservative economists believe that people's free decisions to buy and sell generally lead to optimal employment of resources, provided information is readily accessible and barriers to competition are low. There is a consensus that unimpeded markets tend to satisfy consumers' wants and allocate scarce goods equitably. And an efficient economy is a prosperous economy that opens doors to individuals who hope to improve their circumstances.

Even in boom times, some workers can't find employment, and it is appropriate for government to provide income to them. Direct income support is likewise necessary for individuals with disabilities that limit their capacity to support themselves through participation in the labor market. But when the market is putting resources to their best use, government can't improve conditions by injecting itself into the process. Dictating prices, subsidizing one segment of market participants, or creating regulations won't make anyone better off, except at the cost of making someone else worse off. Government intervention in the economy is appropriate only when, for whatever reason, the market fails to produce an optimal outcome.

A common example is the need for government to channel resources into education. By creating a skilled and productive workforce, education benefits not only its direct recipients, but also society at large. The nation would allocate less than the optimal amount to education if the level of investment was determined solely by individuals' personal demand for it.

Economists aren't alone in recognizing market failure as a fair criterion for deciding when government should take matters into its own hands. Politicians, from conservative to liberal, also accept the idea—at least in theory. They are sensitive to voters' suspicions that a costly new program might have no legitimate purpose. Accordingly, when elected officials concoct some new subsidy or regulation, they feel obliged to defend it on the grounds that leaving people to the mercy of the marketplace has resulted in an economic injustice.

In practice, politicians often concoct the program first and only afterward find a supposed market failure to justify it. Sometimes, to their chagrin, their initial so-called market failure gets completely discredited. This forces them to dream up a new one.

But even though politicians play games with market failures, they don't publicly dispute the underlying principle. As a result, the real debate focuses on how frequently markets fail. The more failures that occur, the more subsidies the legislators can justify. More subsidies mean more opportunities to buy votes. Consequently, politicians are predisposed to see market failures all over the place.

MYTHICAL MARKET FAILURES

There are some economists who reinforce the politicians' bias toward lending credence to every alleged market failure. These true believers perceive that government is uniquely effective in curing social problems and therefore ought to be as large as possible. A centerpiece of their case is the New Deal's reining in of unrestrained financial markets. That series of reforms, they are mistakenly convinced, ended for all time the scourge of bank runs and stock market crashes. Imbued with faith in the benefits of government intrusion, these prointervention economists are eager to proclaim additional market failures.

Economists who yearn for a bigger and more active government promote their cause in the court of public opinion. As they seek to win over voters, most of whom have only a rudimentary understanding of economics, the prointerventionists avoid deadly dull statistics. Instead, they rely on persuasive stories.

Two particularly popular tales of market failure involve subjects familiar to most voters: Betamax and the QWERTY keyboard. According to the first story, clever marketing caused a manifestly superior video recording technology to lose out to an inferior one—Video Home System (VHS). The second story is about a scientifically designed typewriter and computer keyboard that has failed to replace the silly setup named for the letters in the upper left-hand corner. According to this tale, the highly inefficient QWERTY system has survived only because it got there first.

To politicians, whose self-interest lies in adopting the interventionists' viewpoint, the conclusion is clear: The market can't even get these comparatively trivial things right. Surely, then, the market needs the helping hand of government on more vital matters such as savings rates and the level of homeownership.

Diehard advocates of increased government intrusion are unfazed that their pet stories have been thoroughly debunked. Economists Stan Liebowitz, of the University of Texas at Dallas, and Stephen E. Margolis, of North Carolina State University, overturned the verdict of market failure in both cases during the 1990s.[1]

Liebowitz and Margolis showed that the minor technical differences between the Betamax and VHS systems were of interest only to professional video editors (who, by the way, continued using the Betamax system). The difference that mattered in the much larger consumer market was the length of recording time that the competing systems offered. Consumers had a choice between a compact cassette with a short running time and a bulky cassette with a long running time. Under fair competitive conditions, consumers chose VHS, because unlike Betamax, it ran long enough to record football games and feature-length movies.

As for QWERTY's rival, the Dvorak keyboard, no reliable ergonomic evidence supports the claims for its superiority. Although a 1943 study by the U.S. Navy concluded that typists achieved greater speed with the Dvorak keyboard, the study's data failed to truly support the conclusion. Neither was the case for replacing QWERTY upheld by a subsequent General Services Administration study. Liebowitz and Margolis uncovered a likely explanation for the navy's apparent bias in favor of the Dvorak system: At the time of its study, the navy's top time-and-motion expert was Lieutenant-Commander August Dvorak, who owned the patent on the eponymous keyboard.

These findings are a caution to anyone wishing to determine the true frequency of market failures. An investigation of the interventionists' showcase examples heightens skepticism about the wisdom of government intrusion. Similar inquiries call into question countless other rationales for subsidies and regulations.

For politicians, however, objective intellectual inquiry is beside the point. Debunking traditional justifications for market intervention reduces government officials' capacity to buy votes with taxpayers' money and to maintain the appearance of "doing something." Once the country starts down that road, candidates could wind up having to run on their records of actual achievement, rather than on their ability to secure unfair advantages for their supporters.

PLAN OF ATTACK

Making a persuasive case that the government's intrusion in the marketplace is largely unwarranted represents no small undertaking. Subsidies in areas such as housing and agriculture are solidly entrenched sacred cows. It is so hard to imagine life without these intrusions that many readers will find the arguments against them highly counterintuitive. Utter disbelief will likely greet any questioning of the wisdom of constraints on record industry payola and short selling in the stock market.

But the provocativeness of the subject matter should open people's minds to the possibility that a more market-based economy would be a more equitable economy. Encouraging that sort of outside-the-box thinking is this book's ambitious, yet realistic objective. The intention isn't to dissect every major example of government intervention, but instead to examine some egregious examples and highlight the common threads.

Part I in this book, "A Nation of Subsidies," focuses on government meddling in forms ranging from trade protection, to publicly financed athletic stadiums, to subsidies for the arts. Some of these outrages represent hugely inefficient allocations of resources, whereas the adverse economic effects of others are comparatively minor. The pattern is accommodation of special interests masked by false claims of lofty public purposes. On close examination, society's disadvantaged frequently become more, rather than less disadvantaged as a result of tampering with markets.

Part II, "Restraint of Trade," deals with unwarranted intrusions into ordinary commercial activities. Unable to restrain themselves, politicians unnecessarily stick their noses into apartment rentals, banks' strategies for recovering the cost of operating automatic teller machines (ATMs), and even audience ratings for television programs. Whatever market failure the elected officials claim to be redressing, the market havoc they create is generally worse.

Government interventions in the market cause immense economic harm, yet that's not necessarily a reason for voters to reject them. In a democracy, the people are just as entitled to approve a bad program as a good one. But in a perfect world, politicians would at least describe their proposals honestly. Chances are, the voters would do a creditable job of spotting the clunkers and giving them thumbs-down.

Part III, "Telling It Like It Isn't," shows just how far the system is from perfection. From the exaggeration of their impact on the nation's economic performance to their long record of phony campaign finance reform, politicians have proven themselves masters of false advertising.

Finally, the Epilogue poses the question, "Can This Mess Be Fixed?" Without giving away the ending, suffice it to say that I undertook this project in hopes of actually making a difference. Although that is an ambitious goal, nothing is impossible, even when the government is involved. But if the world is to change, the first step is to change people's minds.