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Should the Government Intervene? Analysis on the Question that Still Plagues Economists

Since the revolutions in 1848, the economy has been able to be mathematically modeled due to the emerging concept of abstract value and the unification of the world's economies. Because the economy could now go to equilibrium on its own, a question arose: should the government intervene if the market is unstable or inefficient? Gary Becker, a polish socialist economist, believed that democracy and the market are completely incompatible, which I, and other economists, disagree with. This is an important question still—its answer determines our economic policy.

Gary Becker's economic theory revolves around Say's Identity, which concludes that "relative prices are determinate, commodity quantities demanded and supplied depend only on relative commodity prices, and absolute (money) prices are indeterminate"[1]. In other words, Becker believes that "money is a veil"[2], and thus the money supply is completely irrelevant. Doubling the money supply does not change the value of goods, so there is no need for a change in the money supply— or government intervention. Lankin points out that social and political actors should regulate the economy if money is a veil, but Becker disagrees. Becker believes that governments should never step in and regulate the economy because both markets and the government are imperfect. Thus there is no advantage to submitting the market to government intervention because this will only compound distortions in the market. He also says that

1 Becker, Gary. "Irrational Behavior and Economic Theory"
2 Becker, Gary. "Irrational Behavior and Economic Theory"

although individuals are irrational, the market takes care of the irrationality: "demand curves result not so much from rational behavior per se as from a general principle which includes a wide class of irrational behavior as well… hence the market would act as if 'it' were rational"[3]. Becker supports his claim that government intervention would distort the market by listing political imperfections such as the voting process, barriers to entry in large scale politics, interests that lead to altruism, and term limits which prevent longevity. Becker comes to his conclusions on government intervention based on what is going on around him. Becker is writing in post-WWII United States when the economy is booming. He went to the University of Chicago where he was vastly influenced by Milton Friedman— whose goal was economic stability through political freedom. Becker does adequately answer the question of government intervention and back it with mathematical modeling and problems with democratic institutions, but his model only works at full employment. This is impossible to reach and if the economy was not booming, the market would not run as smoothly.

In *A Monetary and Fiscal Framework for Economic Stability*, Milton Friedman sets the groundwork for his path to economic stability. It is this work that Becker uses to form the basis of his economic theory. Friedman's biggest goal is economic stability and his basic long run objectives are "political freedom, economic efficiency, and substantial equality of economic power"[4], which he acknowledges should be the same objectives for most economists. Where Friedman differs from most economists is his idea of a responsive government. Friedman believes that the government should fund programs "entirely in the basis of the community's outputs and needs"[5]. Friedman calls for a stop of discretionary fiscal policy because he believes

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[3] Becker, Gary. "Competition and Democracy"
[4] Friedman, Milton. *A Monetary and Fiscal Framework for Economic Stability*
[5] Friedman, Milton. *A Monetary and Fiscal Framework for Economic Stability*

it to be detrimental the economy in the long run. The government should not use ad hoc judgement— a concept that Becker wholeheartedly agrees with. His belief in free market capitalism also leads him to conclude that there should be no more quantitative easing. Like Becker, Milton Friedman believes that money should be no more than a symbol of value. Due to this belief, Friedman does not think the government should intervene with fiscal policy, but instead should set up a monetary framework. Even though the government should only focus on what the people need, it is important to note that Friedman realized this still requires taxes and a central banking system. He lays out his approach to the central banking system, saying that "the chief monetary functions of the banking system [are] the provision of depository facilities, the facilitation of check and clearance… the creation of money to meet government deficits or the retirement of money when the government has a surplus"[6]. Taxes should be strictly to govern budget items and the government should only create and retire money as necessary. Friedman believes in the rule of law, instead of political intervention, and that the government should only fund exactly what the people agree they need and are able to pay for.

Milton Friedman's economic theory is also greatly influenced by what is happening historically when he wrote *A Monetary and Fiscal Framework for Economic Stability* in 1948. Like Becker, he studied at the University of Chicago School of Economics and is writing in post-WWII America when the economy was booming and very liquid. Friedman becomes aware that business activity controls the economy and concludes that the United States should have less government because consumers are behaving rationally. He also draws on the Great Depression and believes that during it there was too much focus on the short run, which hurt the economy. Friedman believes that a big part of the Great Depression came from the government intervening

[6] Friedman, Milton. *A Monetary and Fiscal Framework for Economic Stability*

too much and paying for many social programs that the people did not ask for. While Friedman's approach to government intervention seems logical, what he does not put together is that the economy's downfall during the Great Depression was not solely because of short run affixations. It is also impossible to say whether something else would have helped more because WWII ultimately saved the economy, not any economic policy. This shows Milton Friedman's biggest flaw—he made up his much of his own economic history, so he does not see how the post WWII American Economy is such a special case. While I do agree that the government should not pay for all social programs, because this is unnecessary, Friedman is unaware of the inefficiencies that lay in waiting for an entire community, or country rather, to decide what it needs.

One of the first economists to write after the 1848 Revolutions, Carl Menger, brings a different approach to the problem of government intervention in the economy. Menger was living in the Austria-Hungary Empire during the start of the Industrial Revolution. After 1848, the Industrial Revolution had begun and the new acceptance of abstract value and time brought the world's economies together, much thanks to WS Jevons' "Utility Theory of Value". But, the Austria-Hungary Empire was behind with very little GDP growth and not much of an Industrial Revolution. The Napoleonic Wars left the empire week and the institution of serfdom still lingered, leaving the new cities empty. Carl Menger knew he needed to figure out how to get his country on the map. His first proposition was to free all serfs. Wales and England had already eradicated serfdom and were leading the world in the Industrial Revolution. According to Menger, government intervention is necessary to get an empire back on track. He believes that the government needs to intervene in order to get from a lower civilization to a higher civilization, especially when it comes to the formation of the economy. Serfdom is inefficient because serfs are free loaders; they live off the land and have access to all its resources, but do not pay rent. By eliminating serfdom, the land can be sold to the highest bidder and this will cause former serfs to migrate into the cities, furthering industrialization. Eventually Sophie the Archduchess of Austria does free the serfs and Austria gets back on the world economic map.

Menger also proposes the elimination of all "substantive units of value" and value given to "imaginary goods"[7]. In order to become part of the world economic system, which is now founded on abstract value and time, the Austria-Hungary Empire must accept abstract value. But, Menger takes this idea to a much more extreme level than the economist William Stanley Jevons. Once again Menger believes that the government should step in, and eliminate the particular by getting rid of religious holidays, cultural holidays and practices, all local customs, and any communal forms of mediation. Menger calls for a government implementation of a regulatory regime that favors abstract value instead of traditional privilege. He believes that the "higher a civilization… the number of imaginary goods becomes smaller"[8], so in order to become a higher civilization nontrivial, religious, and local customs must be abolished. But, even though Menger believes the government should implement a regulatory regime that favors abstract value, he does not believe in public institutions or services. Menger sees public institutions and services as inefficient. He believes that the second real problem with economics is the cost of time and error and the way to prevent this cost is to own all the orders of goods. In other words, the answer to time controlling time is private property. The biggest aim and control in the end is to bend real time in order to be as efficient as possible. So, Menger does believe in government intervention in order to jump start the economy and set it up for success, but once the government helps set up a country that suites the market it should not intervene anymore. I agree with Menger in the

[7] Menger, Carl. *Principles of Economics*
[8] Menger, Carl. *Principles of Economics*

sense that the economy needs to lay the foundation for the market, but believe that he took it to an extreme level. He does adequately answer the problem of government intervention. The big flaw I see in Menger's analysis is that the complete elimination of things that give people joy will lead to unhappiness, which decreases productivity. It is also impossible to completely eliminate public services; the government cannot be completely separate from the market once its formed.

After the 1848 Revolution there was a need for government intervention because the set-up of the economy was changing and countries had to change with it in order to be productive. Becker would have disagreed with Menger's idea of the government driving and creating the new market. Menger exposes a flaw in Becker's idea that the government and the market are completely incompatible, because if governments had not allowed for the acceptance of abstract time and created economies that would good for capitalism then they would have been left out of the Industrial Revolution and never taken off. Menger came before Becker, but there are economists that come after Becker that prove he is wrong as well. One such economists is Robert Lucas. Lucas is an American economist who went to Berkeley and saw the after effects of both World Wars. Lucas completely disagrees with Becker and believes that we need market intervention to correct distortions in the market and to eliminate local, traditional customs and laws. With his second statement, Lucas sums up one of Carl Menger's main points on government intervention. Both economists see the importance of the eradication of local customs and laws in order to raise GDP and be a productive country. This slips through Becker's fingers.

Lucas rejects both Friedman and Becker's economic theories, which he backs up with his Lucas Model for GDP growth that analyzes the world economies form 1800-2100. From this model Lucas concludes that every country starts the same. Once some countries start to develop, then other countries catch on. Later developing countries actually develop at a faster rate because they can use the knowledge, take technology, and adopt the institutions of successful governments instead of creating everything from scratch. From this analysis, Lucas concludes governments intervention is necessary and that the government is the institution that creates the basis for a country's economy by allowing for new ideas and technology to come in. Lucas believes that the government needs to step in to correct distortions as well. Corrections are necessary because capital does not flow downhill like it should. There is inequality that can only be fixed if the government intervenes. This inequality stems from first adopters eliminating all historical, social, and cultural accidents that stood in the way of economic growth and because they adopted regulatory mechanisms to ease capital flow. Although Lucas believes that the government must correct distortions, he does not believe in regulating capital. A common belief among the economists we have discussed so far. Lucas adequately shows how governments must lay the groundwork for regulations in the economy, however he does not see how the government has the potential to distort the market. While he does acknowledge that regulating capital is a bad idea, he does not even entertain the idea that certain government interventions have the potential to distort the market. Overall he addresses the government's role in the economy very well.

Giovanni Arrighi is the most recent economist whose ideas on government intervention I will discuss. It is important to note that at the time Arrighi is finishing writing *The Long Twentieth Century* in 1994, NAFTA was signed which created a free trade zone between the United States, Canada, and Mexico and the Cold War had just ended. So, Arrighi has seen how governments can end trade and hurt the economy and how they can help it. Arrighi brings forth to the idea that the world economy is made up of long periods of discontinuous change that start and end with a big war. In each of these "Cycles of Accumulation"[9], a new world power takes over. This leading country determines the foundation of the world economy. The four cycles so far are the Genoese Cycle (15th-17th Centuries), the Dutch Cycle (16th-18th Centuries), the British Cycle (19th Century), and the United States Cycle which we are currently in[10]. Arrighi uses the first cycle, the Genoese Cycle, to show how other countries benefitted when Italy was in charge. Italy's neighbors benefitted from the stability and reliability of trade that stemmed from its establishment of security, laws, regulations, and institutions. All of Europe benefitted from Italy's hegemony; its stability raised all ships. Each of these transitions displays a very flexible adaptation to changing conditions— the economy changes with the political changes of the world. Through these cycles of accumulation, Arrighi proves that a change in government, the political realm, is what has changed and pushed the economy throughout history. He adequately explains how governments are an important part of the market because they set the groundwork which affects all economies. Arrighi also realizes the flaws of the system and states that these cycles lead to competition among countries, which leads to instability. But, each time there is instability a war occurs and a new power comes to charge—starting the cycle all over again.

Arrighi predicts that we are on the verge of a new Cycle of Accumulation, which is why the question of government intervention has become so important again. This would knock the United States off the podium. Since the 2008 Recession the economy has been trying to comeback. While I agree that the government should not always intervene, it is important to note how the government forms the groundwork for the market. Becker is incorrect thinking that democracy and the economy are completely incompatible, because without government

[9] Arrighi, Giovanni. *The Long Twentieth Century: Money, Power, and the Origins of Our Time*.
[10] Arrighi, Giovanni. *The Long Twentieth Century: Money, Power, and the Origins of Our Time*.

institutions the necessary steps to becoming a capitalist society would not have been taken, leaving some countries behind. When the new cycle starts I believe that the government should help the market fit the world economy. Government intervention is necessary during big political changes where the market must change. I believe that the 2008 Recession could have been avoided and that the Fed should not use quantitative easing because this can lead to bubbles which is the exact cause of the 2008 downfall. Instead they should continue to use the Taylor method to affect the interest rate and do everything to keep inflation at a 2-4% level. The United States should regulate financial instructions, but not capital, and in doing so will make sure that the economy runs efficiently. I, also, agree with Lucas— there should be a monetary framework and rules that are to be followed. Although rules should be the foundation, there are times in the short run where discretion is necessary, so I propose using constrained discretion once the economy has adapted to the new change in the world market.

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