The Role of Government

This lesson looks at the role of government in a market economy.

“Public economics” is an area of economics that studies government activities in a free market.

This field is sometimes called “public sector economics, “public finance” or “political economy” in books and articles you read.

Government provides two functions in a free enterprise system.

1. It runs our Courts (legal system)

2. It provides Public Goods

1. Courts

Our legal system includes our legislatures, law enforcement agencies and the courts.

In a free enterprise system, elected officials, police departments and judges do not “tell people what do to.” We the People are free to self-regulate, self-govern, make private choices as we arrange our economic trades.

Legal authorities exist to enforce the voluntary agreements we form, and *prevent force and fraud.* Their job is to prevent actions that are involuntary or violent – activities like slavery, murder, theft, domestic violence, sales of defective or dangerous products, and toxic pollution that harms the well-being of others.

Our courts and legal system provide the following three services.

A. Protect Property Rights

Courts in a free market protect your peacefully owned property. This includes protection of your rights to your physical self (including your labor and time), and all the items you accumulate by trading your labor time and converting it into physical assets.
The physical items you own include any real estate you have, your durable goods such as vehicles, and the many consumer goods and services you possess and use.

In a free society, we are allowed to independently decide both our consumer choices and our producer choices (career and work plans). Freedom is great. But freedom does *not* mean we are free to do ***anything*.** We are <u>not</u> free to steal a neighbor’s car. We are <u>not</u>

free to refuse to pay workers agreed-upon wages and benefits. We are <u>not</u> free to pollute a local aquifer or dump trash onto another person's property.

Rules for peaceful conduct are important for free markets. Those rules are <u>backed by force</u>. Courts, combined with law enforcement agencies, provide that force.

When the United States was formed, we deliberately chose to ***limit*** the force which the government can exercise over citizens. Government force is used only to protect our peaceful activities and property. The force granted to public officials is *defensive* not offensive. It applies coercion to **protect** - not restrict - our peaceful choices and transactions

The 'rules of the road' governing free markets are outlined in our founding documents, U.S. Constitution and Bill of Rights.

Not every country mandates a well-defined set of individual rights. That's what makes the United States a unique nation.

The societal benefits of banning **offensive** government force have been witnessed repeatedly through history. Economists acknowledge that our free market system is dependent on the protection of individual liberty.

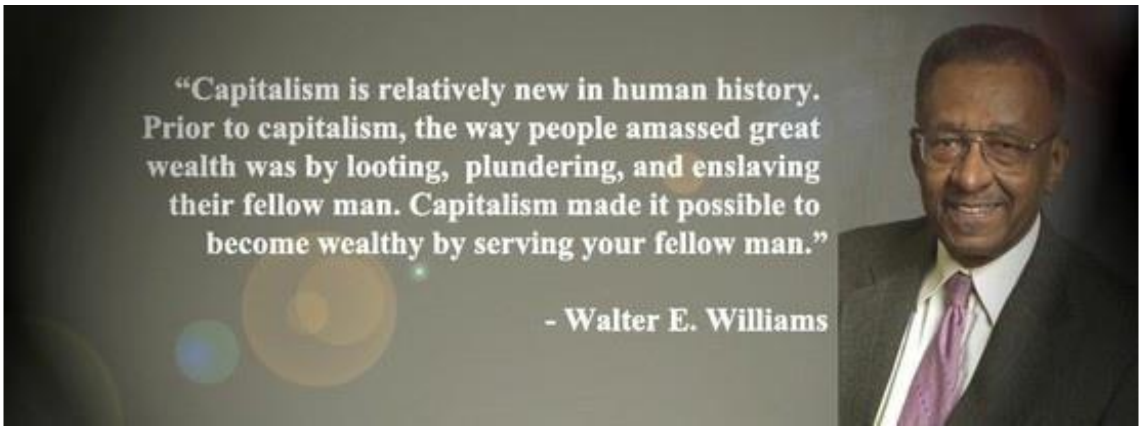
Freedom means you – as a businessperson, artist, engineer, or scientist - are at liberty to keep what you earn. Keeping what you earn used to be known simply as "being free" - from slavery.

When people are allowed to peaceful compete and have the freedom to make their own consumer choices and future plans – they are motivated to work more, take risks and invest in costly but potentially revolutionary technologies which boost our productivity.

More wealth and exciting innovations are created for everyone.

After you leave my economics class, you will hear numerous comments attacking individual liberty. People who make these remarks don't understand what free enterprise is about. They confuse 'crony capitalism' with genuine capitalism - and say personal freedom involves to social 'Darwinism' and 'selfishness.' So ask them, "With no freedom for people, isn't that just slavery? We got rid of the Divine Right of Kings. If public officials can make all our choices - aren't *they* being selfish?"

Government plays an important role in a free enterprise system, but it is limited.



B. Enforce contracts

Millions of trades take place between people every day. These voluntary agreements are legal contracts.

Whether verbal or written down, market contracts contain the details of what a buyer and a seller are agreeing to trade.

Contracts include details such as a description of the product, the extent of any warranty (if any) for services or product defects, how complaints are resolved, and how payments will be made. When you get cell phone service - you sign a contract. When you get your car serviced – the receipt you retain is a contract. When you click a terms-of-service button at a website or for an app - you enter a contract. Minor surgery at a doctor's office, a whitewater rafting trip, and many other services you purchase may have liability forms you'll sign. Those are contracts. When you buy a home or condo, the dozens of pages signed or initialed are "contracts," or purchase agreements.

You've heard the phrase, "Good fences make good neighbors." That's exactly what contracts defining property rights do. They preserve peace between people. When we know our agreed boundaries and the rules of the game are made clear, fighting diminishes and productive work resumes.

If the contracts are clear and well-defined, markets function well. People are happy.

Courts and our legal system exist to protect buyer and seller rights as outlined in billions of individual agreements.

Trades can sometimes face problems. Buyer and seller can disagree on the details. If your phone stops working and is still “under warranty,” the law protects you as the buyer. If a customer tries to return work boots to a shoe store after being worn for 10 years - the law protects the seller.

It is a miracle that the numerous trades we see each day occur without problems.

But, disputes do arise.

Nobody likes to “go to court.” It is expensive and time-consuming. So when a dispute occurs, the buyer and seller will normally talk to each other and try to resolve the matter on their own. Sometimes they hire a private attorney or arbitrator to resolve a dispute. In short, government courts are not the *only* method for mediating contracts. But if private talks fail, our courts can be used.

United States courts exist to support the Rule of Law. “Rule of Law” means that we operate through the millions of hourly voluntary contracts allowed by the Constitution. So Rule of Law means ruled - or regulated - by peaceful trading.

Courts and federal agencies must act only to facilitate interpersonal agreements. Everyone has equally-protected freedom to enter contracts. Courts stay out of it, if it’s voluntary. Courts remain impartial regarding market transactions. Courts are there to serve as the neutral referee in the “game” of voluntary trade. Our Courts (at least in theory) respect all individuals involved. Equal treatment before the law. ‘Equal justice for all.'

When disagreements arise, the Courts do not arbitrarily 'pick winners.' A judge does not take sides and say, “That price is too high!” or “too low!” Courts do not step in and declare, “This contract is unfair!” They do not automatically side with either labor or management in a contract negotiation. The buyer and seller obviously have different views on the ideal price (as we showed in lessons 8 - 12). Judges examine the existing market contract - and review their language to determine which side may be legally correct when parties seek an impartial opinion in court.

There are many types of law – from real estate law to divorce law. From medical malpractice law to maritime law. There is even “bankruptcy” law, developed over the centuries to handle the reality that contracts are often impacted by natural disasters and bad shocks (as we surveyed in lesson 1). BK law gives us an orderly process and defines trader's rights when things "go sideways." For example, as we discussed in lesson 16 bondholders are to be repaid before stockholders, if a borrowing business becomes insolvent. So, if you are planning to attend law school, be ready to choose a specific area of law you would like to enter.

C. Fix ambiguities

A third function of the legal system is to settle disagreements about private ownership.

There are times when individual property rights are simply **unknown**.

New laws and revisions to contracts must be added to better define rights.

For example, a 3-story 'McMansion' built on a residential street may end up producing shade on a neighbor's solar panels. The tall new house ends up depriving a neighbor of sunlight he uses for electricity. Who owns the "rights" to the sunlight?

Disputes over ownership are inevitable. Contracts are never completely defined. Every contingency cannot be anticipated because our foresight is imperfect.

Some court cases indeed amount to "frivolous" lawsuits, and those are identified and thrown out by judges. But many legal conflicts will genuinely arise due to poorly-defined rights. This can happen between a buyer and seller, between neighbors, or between nations.

When ownership rights are unclear, normally peaceful people will start to argue - and fight.

Both sides "want" the valued good – whether it is to a resource like sun light, or a valued activity like practicing your drums in your apartment at midnight.

Controlling resources is critical to individual and national survival. So, these are not trivial matters.

Resource disputes appear in our news feeds daily. If someone drills underground for crude oil or for fresh water, we may quickly see a lawsuit. The resource that a business owner decides to extract on "his" property may directly impact surrounding property owners. Fresh water drawn by a newly dug well may deplete an aquifer used by dozens of existing adjacent farms and homes. Who "owns" the underground water supply the new entrant is now accessing? A legal settlement (revised agreement) is needed.

As another example, think of loud pool parties at your apartment building at 1 AM. Sounds like fun! You pay monthly rent, so you come to understand you have rights to use the pool. But at 1 AM, *other* renters want peace and quiet in order to sleep. When we sign a rental agreement we see many rules and restrictions listed - and this is why! Disagreements have arisen in the past, so rules had to be added to clarify everyone's rights.

Here are a few more examples of rights disputes:

Woman says 'It's My Right to Feed the Birds' – her Neighbors complain about Bird Poop on their laundry...

Pickleball noise - driving people crazy!

My neighbor's loud rooster - depriving me of sleep!

Conflicts over rights are called, "Spillovers" or "Externalities" in economics. An **externality** is any positive or negative effect that one person's activities cause to someone else. A **negative** externality is a bad effect - like air pollution that an autobody shop might cause to nearby homes as it spray-paints cars. Or your neighbor's dog barking at 2AM.

It important to realize that "externalities" are in some cases a matter of personal opinion. They amount to an individual's subjective viewpoint and not every spillover is objectively "'good" or "bad." My neighbor's barking dog may annoy me (**negative externality**) or I may take comfort from hearing it (**positive externality**) because when the dog barks at strangers it protects *my* house as well. ☺

Because externalities can be subjective judgments, economists notice that the most efficient way to resolve many legal conflicts is at the local or neighborhood level. The individuals directly involved in a dispute usually settle it most efficiently. An expansive, new government regulation or costly court battle always is not always needed and can result in an inefficient outcome for a community or a nation.

When disagreements are resolved in a decentralized way, we say this demonstrates **The Coase Theorem**. A famous economist named Ronald Coase won a Nobel Prize for showing that "externalities" are best handled at the micro or local level.

Two neighbors who know each other and their town will best remedy conflicts which develop. If my dog barks in the morning because he wants to be fed, and my neighbor's night job means he needs to sleep late in the morning - I may simply agree to change the times I feed my dog, so he doesn't bark. Problem solved. ☺

Going back to the McMansion example – if a 3-story house shades a neighbor's solar panels, rights to the sunlight might be amicably resolved out of court. Lawyers are expensive! The cheapest (lowest cost) remedy might be to set up a couple inexpensive mirrors bought at Walmart or local thrift shop, to redirect the sunlight. Private arbitrators might also be hired to settle matters. Only as a last resort do citizens choose a lengthy legal process.

Some politicians (and many political science professors) don't understand the benefits and practicality of The Coase Theorem. For these analysts, a massive new piece of legislation such as a national restriction residential noise on is the only reasonable solution to the problem. Such mandates do not necessarily give the best solution for every neighborhood or community, however. "One size does not fit all" since as we noted, an externality may be viewed as a positive or a negative depending on those involved. One city's 'negative' externality such as a stinky cow farm may simply be viewed as an acceptable aspect of the economy in another town.   "I smell money," farmers say.

The proven success of solving disputes through local negotiations is why many Americans dislike "red tape" and "Feds" – agencies and public officials who pass sweeping national mandates (backed by force). Senator Jones wants his name on some bill, Jones' "Quiet Neighborhoods for America Act" to show a few constituents he's "doing something." The other 99% of voters don't want a new law or all the paperwork and regulations it brings.

Local controls and decentralized decisions are the essence of what we call, "Federalism." Town and state governments will discover the most efficient legal settlements to regional disputes. No national policies or global agencies are necessary.

Many restrictions arose during the Covid pandemic. The virus was contagious and believed a source of serious "negative spillovers" for people during their weekly activities and transactions. However, restrictions varied from one U.S. state to another. Citizens living in farming states wanted fewer restrictions because they mostly work outdoors, and don't come into close contact with other people. States with large congested cities made different rules with more restrictions. And within each state there was significant disagreement, with public meetings and protests. Thanks to Federalism and States' rights, we are afforded freedom, flexibility and efficiency. If you as an individual are miserable with your state's regulations you can move to another state that shares your risk preferences, opposition to mandates, and concerns about unconstitutional laws – and many Americans have been doing so.

Local cities and towns across the country have numerous small governance committees. City Councils, County Commissions, Zoning, Conservation and Planning Committees, School Boards and Budget Committees meet year-round, and most of them are elected positions.

These tiny committees are there for a reason: to manage public finances and services - and provide a forum to resolve or prevent conflicts over "externalities."

Before major new construction can happen in a town, for example, people are invited to come to town meetings and express concerns and opinions they have - increased noise, greater traffic near schools, water runoff to other properties, etc. Public discussion helps prevent conflicts before they happen. Everyone identifies their rights, responsibilities and concerns ahead of time. Airing issues early helps keep a town and a marketplace peaceful and orderly (respectful of rights). The decisions made to assign rights do not always satisfy everyone. The discussions are often tense and heated. But having free speech and open public hearings is critical to achieving the best result possible.

Every town has unique geography, traditions and employment hubs. Barking dogs and cow smells are viewed differently by people in New York City than by a farming community in Iowa. Most voters ignore their town zoning and planning committees, but they are important. You should run for a local elected committee. Serve your community, learn how to listen, and help resolve externalities. It's fun! ☺

Externalities as Market Shocks

In a way, externalities are just like the "economic shocks" or resource disturbances we surveyed in lesson 1.

Daily survival is unpredictable. New technologies like solar power can - yes - be a positive or good "shock" to boost our limited energy supplies – but can also bring a negative impact to some transactors like the McMansion owner trying to build a place next to a one-story ranch home with solar panels.

The scarce resources that we all rely on can change suddenly, for better or for worse. That means the stability of all our market contracts is also at risk.

Insurance policies and bankruptcy law do provide a measure of predictability when small disasters hit our lives.

But massive disruptions can occur.

After several major quakes including the Northridge earthquake happened in California, some companies stopped offering earthquake insurance due to the extreme cost of fulfilling those contracts.

Though it seems unfair, changes to the insurance contracts offered is our economy's way of saying, 'until civil engineers come up with more earthquake-proof structural designs, these are high-risk areas!'   As economist Arthur Marget put it, *"Prices have a job to do. Prices should be free to tell the truth."*

Catastrophic events like a major solar storm or megavolcano explosion at Yellowstone could disrupt to every contract on Earth beyond repair. Then all bets - and all contracts - are off.

As we noted in lessons 2 and 3, massive resource changes can abruptly change institutions. They can cause billions of deaths, economic hardship, social chaos and loss of peace and freedom (anarchy) for long periods of time.

"Climate Change" as an Externality

Big externalities mean big government - sweeping new laws and regulations.

Some "spillovers" are said to involve so many nations and populations that they require a legal resolution at the international level. The U.N. Law of the Sea is one recent example.

Today, Climate Change (formerly called "Global Warming") is said to present one such global challenge.

Our continued use of crude oil and other traditional fuels has been argued detrimental to our entire planet's environmental stability. The U.S. Congress and the United Nations have attempted to draft resolutions forcing citizens and businesses to "decarbonize" their energy sources and move toward reliance on renewables such as wind and solar power.

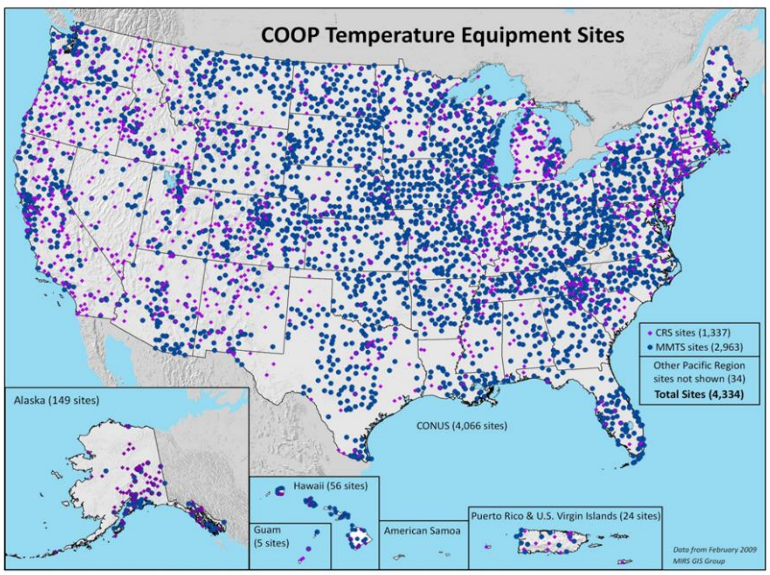
Massive new regulations sound like central planning – a socialist system we explored in lesson 6. For this reason there is continued debate about Climate Change. Is it ‘a thing’ - or just a rationale for increased government control?

Name-calling surrounding the issue is common today. “You’re a science-denier, if you say Climate Change isn’t real!” “You’re a globalist, if you want to mandate electric vehicles!”

This isn’t helping resolve the dispute. Voters have a voice through their elected representatives, and Congress should study the issue objectively before passing any new mandates or regulations which impact the lives of millions.

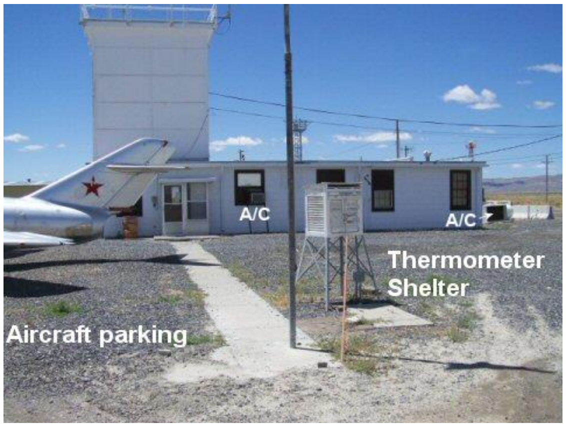
New laws obviously should be based upon reliable information. As an economist, I retain concerns about some of the temperature data being used.

Take a look at the map below. There are hundreds of temperature-gathering stations located around the United States. (From: https://www.weather.gov/coop/)



70% of the temperature stations shown were detected [out of compliance]() with standards established for collecting accurate temperature readings. A website called “Surface Stations” conducted a survey of the sites on this map and provides data indicating most of the official thermometers are located too close to heat sources such as BBQ grills, asphalt parking lots, airplane takeoff lanes, buildings and A/C exhaust vents. Surface Stations shows U.S. temperature readings started rising in the 1960’s through the 1970’s, decades during which we began installing A/C units and adding asphalt parking lots. Here are some pictures from meteorologist Anthony Watts’ *www.surfacestations.org* site. (See also his new website, https://wattsupwiththat.wpcomstaging.com/.)

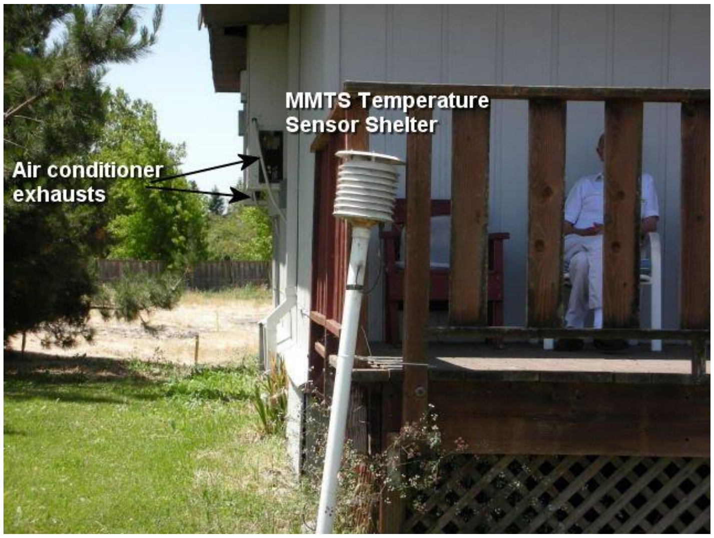
Below is a picture of one of the temperature “shelters” out of compliance with standards for accurate readings. It is located near an A/C unit, and close to an area where airplane exhaust occurs:



Another non-compliant temperature station is shown below. It is located near aircraft parking and next to asphalt parking which creates heat:

This next image (below - on the white post) shows the temperature-gathering equipment is located just above a BBQ grill, and next to asphalt parking:

The last two pictures below show the equipment is located close to A/C exhaust fans, again violating the minimum standards for accurate temperature gathering:



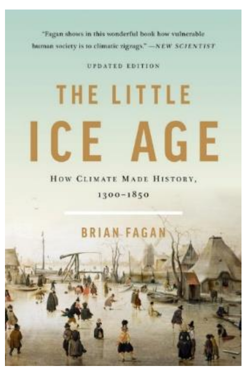
MMTS stands for “maximum/minimum temperature-measuring system.”

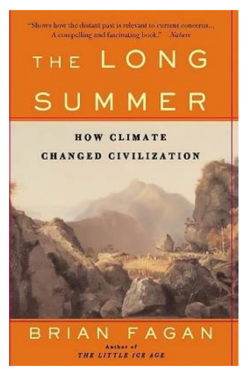
Official temperature-gathering stations are required to be set up in open areas such as a large field and located far from artificial heat sources such as buildings, parking lots, and air-conditioners - [like this one:]

If 70% of U.S. temperature-gathering stations are out of compliance with standards for accurate readings, perhaps we have relied on faulty data to argue for laws shutting down fossil-fuel industries and the critical products and services these resources provide to our economy.

There is much to learn about Earth's climate and why it changes. The Sun's activity has a significant impact. Major *natural* disasters, such as meteor strikes and large volcanic eruptions, also dramatically alter climate.

I recommend a couple of interesting history books which describe how climate changes have occurred over the centuries - long before 'fossil fuels' were in use. Brian Fagan is an anthropologist and excellent writer. His book "The Little Ice Age" describes how climate has experienced large swings of both warm and cold periods during the years 1300 to 1850. These changes were observed before modern industrialization, gasoline-powered cars, and oil-burning furnaces came along. In a companion book, "The Long Summer," he explores weather patterns over the past 20,000 years. Fagan illustrates that Earth's climate has never been stable. It has experienced long warm periods, followed by very long cold periods. Today's widespread fossil fuel use could even be creating beneficial conditions which *protect* us from the next Little Ice Age.





If you ask, "*Professor Brown, who* <u>*do*</u> *you trust on the Climate Change issue?"* I would say no one. Neither the fossil fuels industries nor the solar and wind industries. Economists are aware of the dangers of crony capitalism and the fact that industries often attempt to influence public policy for their own enrichment. As analysts, we don't accept on face value press releases from either petroleum companies or electric vehicle producers. Different industries conduct studies and issue claims which provide marketing opportunities for their sector. This issue will continue to be critically examined. We should all continue to follow opposing arguments and new research – if Google, FaceBook and Twitter do not censor what we are reading.

If you attend Law School you'll discover there is no "right" or "wrong" side to many disputes. The rules (property lines) are simply murky and people need to discuss the situation and find an agreeable solution. Your neighbors aren't zombies, space aliens or enemies. They are just like you. Most of us just want to be left in peace to conduct our lives. Conflict resolution takes place between ordinary people - both of whom have genuine and sincere cases to make. For example, Family sues country club, wins nearly $5 million after 'too many golf balls' damaged their house.

Yes, you are looking to "prosecute law breakers" and "defend the innocent." But the study of Law is more than that. You will learn more about "externalities" and Economics and law are closely related fields. Econ majors often go to Law School – and they have an advantage, because they study similar subjects.

We need to be cautious when forming legal remedies to externalities. What seems a good idea - adding more "solar power" or insisting on "plastic recycling" - may generate larger problems down the road:

California went big rooftop solar panels - now it's a PROBLEM for land fills

"Recycling Plastics" may make things WORSE

2. Public Goods

The second function of the government is to provide citizens with "Public Goods."

What is a public good? Only a few goods and services are viewed as public goods in economics. And because they come from the government, the goods are usually financed coercively through taxation.

"Public" goods are goods and services we use collectively – together, everyone at the same time.

Examples are National Defense (the military) and our national highway system (the freeways we use to get to work, go shopping, attend school, etc.).

"Private" goods as we said are items we consume individually – alone. Examples are a cup of coffee, reading glasses, and a haircut. The "Run the Courts" role of government is there to support the *private sector* where the peaceful sales of private goods take place.

Private Goods & Public Goods are distinct goods.

In the news, there is debate about what a "public good" is. Some public officials such as Senator Bernie Sanders and Representative Ocasio Cortez suggest that *any* good or service we use is potentially a public good. From ski trips to body piercings, any item we consume "could" be provided by government via taxation. Every good or service we use is potentially a "public good," some politicians suggest.

This Bernie/Ocasio Cortez view of public goods brings us to a 100% centrally planned economy. In lesson 6 we explained that this means a Socialist economy. Every dollar we'd earn would flow back to the government as taxed money. The government then decides what array of goods and services will be funded and produced for the people.

Because of scarcity, not everything we'd like to have as citizens can be produced. Even if a central planning board is set up, the production committee must then decide which "public goods" will happen. Only the ones the Central Planners agree are worth having will show up on your local store shelves.

The definition of "public goods" thus becomes a political decision – up to the judgments of powerful central planning bureaucrats. Economists have a more narrow, technical definition of "public good," as we will present below.

The second problem is, if we assert all goods and services are potentially "public goods," a centrally planned economy results in perpetual conflict. When all money is taxed for collective use, disagreements will arise regarding how the money is spent. A new school? New cars - for everyone? Cosmetic surgery to boost mental health? Does everyone agree on the "best" choices of products and services? No.

The bigger the role of government in economic decisions, the more we are locked into arguments over which goods and services are "needed." The United States Congress today remains in constant conflict. It enjoys record low opinion poll ratings - and hasn't created a balanced budget in years. Meanwhile, our federal debt climbs to record levels.

Economists support a large private sector (free market) along with a modest public sector providing essential government services because we are lovers, not fighters. When most products are "privately" decided and only a few key goods are "publicly" produced, we avoid the chronic conflicts and the growing deficits which future generations must fund.

Political Science and Sociology professors will sometimes tell you that anything government funds is a "public good." Yes, citizens can certainly cast their votes to have government fund "free" pet care and bailouts to tobacco farmers. However, we can more precisely describe what "public goods" are while maintaining a vibrant free market system.

Let's look at the distinction between private goods and public goods as economists define it.

Private Goods

Private goods are things we use individually - like a vape pen, hair color or a tattoo. These goods are chosen and consumed by individuals, not "collectively" by all citizens. People consume private goods independently on their own - they decide how much (or how little) of these goods they will buy. People can also choose not to consume private goods offered in markets – pot-bellied pigs, hot sauce, snow boards. Private goods are purchased from private (individually-owned) businesses in the economy. Also, you can't force a third party (another person) to pay for the private goods **you** want. You pay for them yourself.

2 characteristics

Private goods are rival in consumption: That means - the good **can only be used by one person at a time.** When I eat pancakes or wear reading glasses, you can't consume them along with me. We're "rivals" in the item's use. Example: if I wear my favorite boots, you can't wear them. Shoes are "rival" in consumption, economists say. Two people can't use them at the same time.

Private goods are excludable: That means – the user **can be blocked from using the good until he or she pays for it.** People can be "excluded" (prevented) from consuming private goods until they agree to purchase them. Example: I want french fries, but I must pay McDonalds first. I can be excluded - until I actually pay.

Public Goods

Public goods are goods we use together. We also pay for them together. A town of citizens or an entire nation may collectively decide to fund a public good. If I decide I want ice cream, I drive to a store to get it. The ice cream is a private good. I can go buy it, other people don't need to help me make the decision, and only I pay for it. But the road that I traveled on to get my ice cream. That is a public good. The road is open for use by everyone in town. Not just by me. My usage doesn't prevent others from using it. Many of us can use together, at the same time. Public goods tend to be very large items – such as a major highway.

2 characteristics

Public goods are non-rival in consumption: That means once a public good is produced by the government, everyone can use it - at the same time. My use doesn't interfere with your use.

Example: if we build a levee (large dirt and gravel bank) to protect our town from floods – the town levee protects everybody at once. My "use" does not diminish your benefits from it. So, public goods are called "non-rival in consumption." Two (or more) people can use it at the same time - unlike private goods and services such as a pizza or surgery to repair an injured knee, which are "rival" in consumption. Because we literally cannot exclude anyone from benefitting from a flood levee, the project must be funded with **taxation**. We "mandate" payment from every household using taxation.

Flood levee prevents flooding of a town

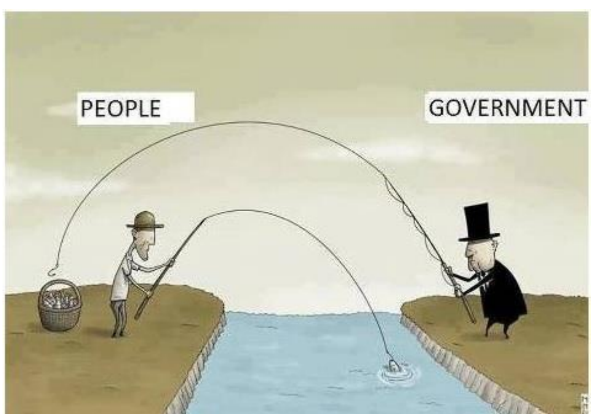
Public goods are non-excludable: That means, users cannot be blocked from it, even if they haven't paid for it. An example is a light house. Once it is built, ALL the town's fishermen with their boats along the coast instantly benefit. This is not like the situation of ice cream (private good) where the ice cream shop can block users if they are non-payers. With a public (nonexcludable) good**, everyone** immediately benefits **whether they paid to use it or not.** Thus, in order to cover the costs of a public good -- the community (meaning the government) imposes taxes (forced payments). Taxes force citizens to help fund the "public goods" that are collectively used.

Our military is the classic example of a public good. It is non-rival because once we have an army to protect us from invasion by another aggressive country, all our citizens enjoy protection. It is non-excludable because everyone - including those who haven't paid - are protected. Unlike a private good such as a new tee shirt, you cannot be blocked (excluded) from consuming national defense if you haven't paid.

Free Rider Problem

Many non-paying citizens may occur with public goods. They are called "**Free Riders.**" Since people can freely enjoy use of a public good once it becomes available, there will be people who won't or don't pay. Private businesses in free markets will not supply public goods voluntarily for this reason! They cannot block use before payment is received. The inability of private firms to successfully finance and provide public goods is called **Market Failure.** The 'failure' is, again, because public goods cannot be voluntarily priced – they are ***non-excludable***.

Taxes we pay for Public Goods



To acquire the money needed to fund public goods, we must force citizens to pay for them with taxation.

There are many types of taxes that governments use to raise revenue for public goods and services. Property taxes, sales taxes, gasoline taxes and income taxes. In finance and accounting classes, you will hear about three categories of income taxes: progressive, regressive, and proportional.

Income taxes we pay are called "progressive" if higher income earners pay a higher PERCENTAGE of their income in taxes than do lower income earners. **"Regressive"** income taxes mean lower income earners pay a higher PERCENTAGE of their income in taxes than do higher income groups. A lump-sum tax is a single, flat amount everybody pays, such as $5,000. A lump-sum tax is a "regressive" tax because it equals a small percentage of a high income, and a huge percentage of a low income. But lump-sum or “head” taxes are viewed as the most <u>efficient</u> type of tax for encouraging incentives to work. When people know they can keep more of what they earn after paying the ‘lump-sum’ used for public goods’ costs, they would be more willing to work extra hours overtime, obtain more training or an advanced degree to make more income, etc.

Economists recommend "lump sum" taxes for that reason. After each person works enough to earn enough to “pay in” the $5,000 to cover their annual costs of using town roads - THEN we each are at liberty go back to doing what we’d like with our equal endowment of “24 hours a day” of time - such as computer gaming, if you like. Or – you can work harder, and make more money with your remaining time. You keep the money earned from staying up late studying or working longer hours each day. Highly "progressive" taxes defeat that purpose. Why would anyone work "overtime" hours if the added income is mostly taxed away? You would not bother. So, progressive taxation destroys incentives to work more, be productive, and invest in accumulating more skills. Just take “leisure time”! Why bother exerting yourself to gross an extra $10K per year you’ll never see?

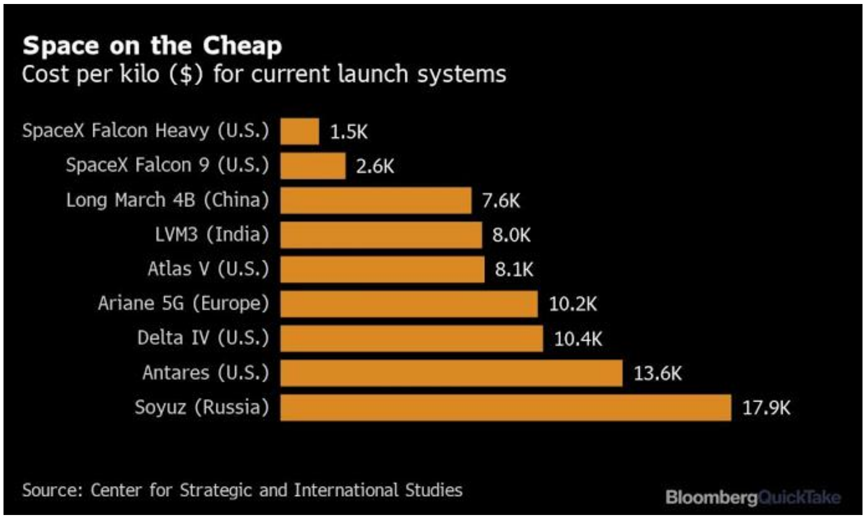
"Proportional" income taxes involve a flat *percentage* tax. All income groups, from high to low, pay the same percentage of their income to government. For example, a 10% income tax for everyone. Notice that high income people actually PAY MORE dollars than low income people, since 10% of a large number is - more dollars. But it is called "Proportional" taxation.

Marginal Tax Rate refers to the amount of taxes you pay on an additional ('marginal') amount of dollars earned. If you make $30,000 and your tax rate is 10%, suppose you earn another $1. The government might tax any income over 30,000 at a higher rate -- so, you may have to pay a "50% rate" on that added $1, meaning half of it goes to government. The "marginal" (added) tax rate is 50%. If the marginal tax rate goes up as you earn additional dollars, this really defeats the purpose of "overtime" pay for additional hours worked - doesn't it….

Other taxes such as a **sales tax** are also used. A sales tax is often placed on private goods that "go with" a public good we use. This makes them similar to a **user fee.** Highways are maintained with funds from taxes on gasoline sales. **Property taxes** are placed on homes and businesses to pay for local schools used in your community.

Privatization (outsourcing) of Public Goods

Economists argue that public goods like roads can be privatized. That means they can supplied and maintained by <u>private</u> businesses, even though the funds come from taxation. In short, citizens can enjoy the benefits of business competition! A town can request that private-sector contractors submit a "bid" to pave public roads – and firms ***compete*** with each other to "win" the contract to pave town roads. Competitive bidding for public contracts improves the quality and lowers the costs for a town's or a nation's taxpayers. Public schools benefit from competition when they request bids from private vendors to provide cafeteria services or bus transportation. Federal agencies also use private competitors to obtain more efficient, lower cost services.



Find yourself someone who looks at you - like Elon looks at his Falcon Heavy!

In Argentina, public officials decided to “privatize” (make more competitive) management of the country's water supply. Argentina's water was bad and toxic. Officials decided to open up their water management to competitive bidding. The result: water quality improved. Infant death rates due to poor water were reduced 8% nationally - and were reduced 24% in the cities. Check out the article below.

Water Privatization: Raise a glass

Mar 20th 2003, The Economist

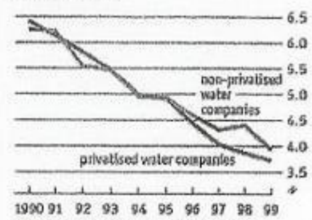
How to improve child health

FEW issues have generated more heat at this week's third world water forum in Kyoto than the privatisation of water supplies. Only dam-building arouses more hostility among non-governmental organisations (NGOs). Water, in their view, is too precious and too important to be put into private hands. Private companies, runs the argument, will care about profits, not about the impact of water on human health and disease. A new study* by three economists, two based in Argentina and one at the Haas School in Berkeley, California, suggests that the NGOs are wrong. Examining Argentina's privatisation campaign in the 1990s, one of the world's biggest and one of the few to involve extensive privatisation of local water services, they find that privatisation may actually bring benefits for the health of young children, the group most vulnerable to disease.

Life and death

Argentine child mortality rates*

Municipalities with:



*Deaths per 1,000 children aged under 5 years

Source: S. Galiani, P. Gertler, E.Schargrodsky

The study takes advantage of the fact that water services in Argentina are the responsibility of local governments, and that only 30% or so of municipalities chose to privatise them between 1991 and 1999. That creates a control group for comparing child mortality. Water privatisation in Argentina certainly brought increases in productivity and profitability. The largest privatisation involved the transfer to Aguas Argentinas, a consortium led by Lyonnaise des Eaux, a French company, of OSN, a federally owned entity in Buenos Aires. At the end of the first year, prices for both water use and connection were lower than they had been at the start. Non-payment of bills had been high; by cutting customers off after three unpaid bills, the company got 90% of people to pay. The number of employees, whose average age was over 50, was cut by almost half. In its second year, Aguas Argentinas was highly profitable.

In the decade before privatisation, OSN had invested too little to replace depreciating assets. In the late 1980s, the proportion of the population receiving water had been falling and summer shortages frequent. From $25m a year in the decade before privatisation, the company's investment rose to about $200m a year in 1993-2000. Connections to the water and sewerage networks rose, especially among poorer households: most richer households and families in the city centre were already hooked up. Besides, the government set targets for connecting the poor, who have also been largely protected from subsequent disconnections.

Other water privatisations in the country seem to have achieved broadly similar results. Among municipalities in Argentina that privatised in 1990-96, the number of households connected to the network rose by 4.2 percentage points more than in districts that remained in public hands.

Before privatisation really got under way, in 1995, child mortality rates were falling at much the same pace in municipalities that eventually privatised and those that did not. After 1995, the fall accelerated in privatising municipalities (see chart). The fall was concentrated in deaths from infectious and parasitic diseases, the sort most likely to be affected by water quality and availability. Deaths from other causes did not decline.

These effects were much stronger in municipalities with high levels of poverty than in those that were better off. **Overall, childhood mortality fell by 8% in areas where water services were privatised, and by 24% in the poorest areas.** **The NGOs in Kyoto campaigning against privatisation are therefore likely to be condemning more children, not fewer, to death from waterborne diseases.**

PUBLIC COSTS OF PRISONS, EDUCATION ALSO FALL + QUALITY IMPROVES WITH ↑ COMPETITION. (PRIVATIZATION, OUTSOURCING.)

Outsourcing or privatization are not always feasible even though it benefits a nation's citizens. Public-sector labor unions for example, often control the supply government services. They legally restrict entry by competing vendors, and increase the costs to users. Public unions maintain a "monopoly" over services because politicians can be influenced by campaign contributions unions make. The legal barriers make it impossible to open governmental services to the benefits of competition. In California, "privatized" prison services have been publicly attacked. The attacks have come from (surprise!) prison-guard unions who don't want new entrants competing with them.

Closed monopolies mean higher prices (as we discussed in lesson 14 on monopoly power) and slowed technological advance. As a result, taxpayers receive lower quality service at a much higher cost. To get trees trimmed along public streets, or sidewalks repaired "by the city," there may be long delays and significant costs. Unionized bus drivers in some cities make $150K+ per year. College students would gladly drive a bus for half that amount. No wonder many American cities are financially broke.

Labor unions are not the only ones who enjoy protectionism. Big businesses lobby government officials and may corrupt the open bidding process through influence peddling. Businesses make large campaign donations or offer board positions to politicians in return for the lucrative public contracts. As we already noted this is "crony capitalism" - not free market competition.

When government officials "pick the winners" instead of having the end-users decide them, that is socialism. The protected interest group "wins" - by avoiding what most of us do ***daily*** - compete successfully to retain jobs and customers.

Many public services, from schools to road maintenance, can readily be provided by ***private companies*** rather than a government bureaucracy and protected labor union. Wherever competition is allowed and encouraged, end-users benefit. And - they get choices. That includes union workers as well! Especially retired union folks. They *also* need to use our roads – and they pay taxes for them.

Not every big project is a “public” good. A shopping mall costs millions to construct. But no government was needed because the goods and services of the mall are **excludable.** Users can’t access its products until they **pay** for them. So even though a mall is massive, it is not classified as a "public" (government-provided) good.

We all benefit from competition or what I call, “production diversity” – choices among constantly emerging technologies and new management ideas. Competitive pressures may even mean that traditional, often very expensive, public goods eventually become unnecessary. New technologies emerge, and suddenly - we no longer face “market failure”! **Public goods** we think we ‘can’t live without’ such as a highway system - **may become obsolete** when brand new technologies comes along: **The flying taxi market may be ready for takeoff, changing the travel forever!**

The Internet: Private or Public Good?

Social media and the internet are used by ***everyone.*** The Web lets us discuss millions of things together - from the best local restaurants to international politics.

Facebook, Google, YouTube, Twitter and other online providers give us shared communication channels and (mostly) free speech.

Are these companies offering a Private Good - or a Public Good?

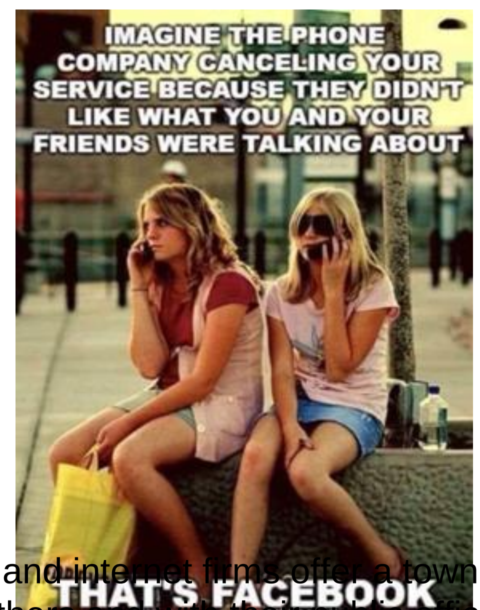
If Twitter and other sites are selling private services, then they are private publishers. They can freely choose to filter what users are permitted to publis. They can choose who uses the platform and maintain restrictive Terms of Service policies. But as private publishers, that means they can also be subject to lawsuits if users believe they are unfairly blocked. If posted language allowed by these “publishers” is found to slander or defame someone’s character, the companies again may face legal liability.

But if these social media giants are providing a “public square” where **all citizens can speak freely and collectively** - then big tech companies are supplying public goods which are non-rival and non-excludable. They are then “open to all” and can avoid lawsuits about defamation and other harms.

Big Tech firms are subject to U.S. Code 47 section 230. This government law requires them to conduct themselves as a "Public Square" which is open to all users:

Section "230" says "'**No provider or user of an interactive computer service shall be treated as the publisher or speaker of any information provided by another information content provider'** (47 U.S.C. § 230). In other words, online intermediaries that host or republish speech are protected against a range of laws that might otherwise be used to hold them legally responsible for what others say and do. The protected intermediaries include not only regular Internet Service Providers (ISPs), but also a range of "interactive computer service providers," including basically any online service..."

Despite the language in Section 230, **social media companies have encountered legal trouble because they want things both ways.** They have censored specific speech and shadow-banned some businesses and individuals. They then turn around and claim they're "a public forum" to avoid costly lawsuits related to libel and 1st Amendment violations. They also harvest user data for monetary gain as a private company - but still want continued protection from lawsuits as a public forum.



If Section 230 holds and internet firms offer a town square where millions go to communicate with others and with their public officials – then tech companies cannot place restrictions on user speech. Web portals would be classified as similar to a public library or a major highway traveled by all – and must be open and accessible to everyone.

Elected officials in Washington are debating whether these platforms are private or public goods. Our representatives also receive large campaign contributions from Google and other tech companies, and this will potentially influence their decisions.

The political Left laughs at Republicans who complain about blocking of conservative posts, saying the "Muh Free Enterprise" crowd is fretting about what is ALREADY a free market. They say, "If you don't like it, start your own platform!"

Republicans point out the arbitrary nature of the existing giants' "TOS" rules. Numerous violent and offensive posts are often allowed while selected bloggers and commentators are censored. In other words, the TOS rules are not applied consistently.

Recently, Federal agencies have been accused of working through social media companies to block the speech of political opponents. The *government* cannot arbitrarily block free speech. It's unconstitutional. Asking a "third party" do so is also unlawful. In America, we have free speech and it is considered a fundamental right. Yes, there are limits on speech. For example, you can't yell "Fire!" in a crowded auditorium when there's no fire because people might be hurt trying to escape.

But free speech is broadly protected in the United States. Goofy, offensive, and demonstrably false speech and ideas you dislike are still protected. The ACLU (American Civil Liberties Union) has historically been one of the biggest defenders of free speech for Nazi groups, though recently they've supported some censorship.

The 1st Amendment of the Constitution states, *"Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press; or the right of the people peaceably to assemble, and to petition the government for a redress of grievances."*

Thankfully, communication technologies change rapidly. New apps and services are created every day. If a web-hosting firm denies you a "voice" then competitors spring up, move into the space and provide options for consumers. Do we *really* want the Federal government to regulate our speech platforms as public utilities? Maybe free entry by new providers is the best solution. The world's richest person Elon Musk got into the fray to expand free speech by buying Twitter (now X) and restructuring it.   Now the regulatory fight is about TikTok. Is it a safe and popular app - or a national security risk?

The Laffer Curve

The "Laffer Curve" is a concept that most governments should learn. It is graph that shows that, as the tax rate on citizens go up, the total revenue the government receives goes down!

If you raise the tax rate on citizens from 10% of their income to 95% of their income - you won't get 'more taxes.' Tax collections actually drop!

That is because people's work behavior changes. They will stop working. Or they will work less, take more leisure or retire early.

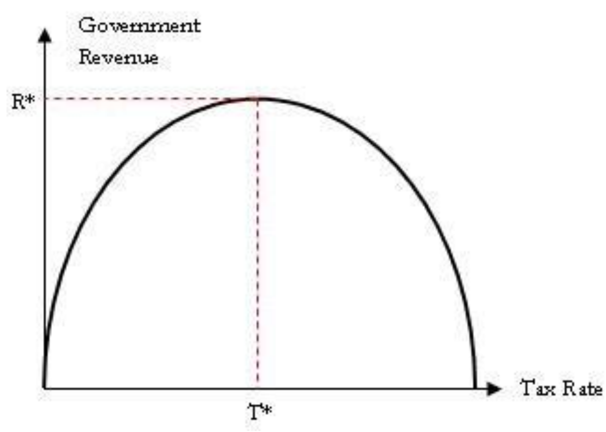
Some will decide to move into the underground economy - the illegal, off-the-books sector.

People won't report income as tax rates rise, or they won't bother taking overtime hours or a second job because they can no longer keep the added income due to higher taxes.

So "raising taxes" or increasing tax rates on all workers won't help the government gain more revenues. After some point, tax collections fall. This happened in Greece. Tax rates got so high, most of the people began working "off the grid" - in the underground or "shadow" economy. 80% stopped filing income taxes. The Greek government can't "tax" money that's unreported. People started doing barter trades so the government couldn't detect it.

The Laffer Curve idea is simple but important. Let's say you are a real estate agent and you make $75,000 a year. You decide to earn more money - $100,000 a year - by upping your overtime hours and improving your sales by taking the time to study use of drones. <u>Suppose the government taxes your added $25,000 of income at 100% rate</u>. What would you do? You would just keep making $75,000 a year! Why work additional hours and gain skills with drones – if it all gets taxed away and you STILL make $75,000? So as tax rates rise rapidly on incomes – people reduce hours worked - or they go underground.

The Laffer Curve looks like this in our economics books. Notice that the Government Revenue (vertical axis) initially rises, but then begins to drop down as the Tax Rate (horizontal axis) heads out toward 100%.



Forced Rider problem

As we said, anyone who does not pay the taxes owed for public goods is called a "Free Rider."

Once they are forced to pay, however, some taxpayers may actually become “Forced” Riders.

Not every government program is viewed *as* a “public good.” Government services are often viewed as public “bads” and some taxpayers become forced riders – forced to pay taxes for programs they may not want or may find objectionable.

National Defense has the characteristics of a "public" good. It is non-rival in consumption and non-excludable. But even in the case of the Military, there are citizens who firmly object to funding a standing army. They are self-described “pacifists” and are opposed to military conflict and the use of taxes for defense. When forced to pay, they identify as “forced riders” who are coerced to pay for something they view to be wrong.

When we force citizens to pay for a government service we assume they are benefiting, but that’s not always the case. This is why the use of taxation to finance government programs is always a tricky issue.

Just about anything that our local, state or federal governments do can be declared a “public good” - and all non-payers labeled as "free riders." Voila! You have a rationale for taxing people to pay for the "service."

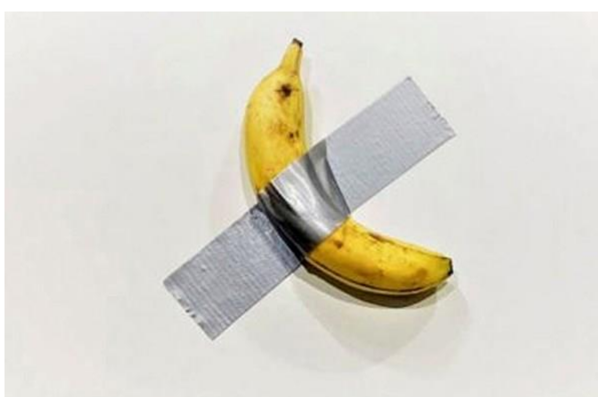
Another example of forced riders - individuals who are vegans and support the concept of animal rights. These citizens strongly object to government funding of any research that involves using lab animals, money that funds zoos, or government “dietary guidelines” promoting meat consumption.

Publicly funded art museums are another case where ‘forced riders’ can arise.   The use of taxes to fund "artwork” that offends or insults some citizens means many taxpayers become forced riders. "Piss Christ," for example, was an public art exhibit funded with taxes. The ‘art’ displayed a crucifix a symbol placed in a jar of urine. Christian taxpayers were outraged.

Below are examples of controversial government-backed art projects.

Andres Serrano, *Piss Christ*, 1987 (color photograph, Museum of Contemporary Art, Chicago)

"Duck" statue made of old tires, looks like dog poo.



“Taped Banana” art exhibit (showed by private dealer–but had ties to govt. programs)
https://cultr.com/news/the-internet-reacts-hilariously-to-duct-tape-banana-art-which-sold-for-120k-at-art-basel/

Corporate Bailouts as Public Goods

Governments spend billions in taxes on items that are not public goods as we have carefully defined them (non-rival and non-excludable). $1 Trillion and rising is spent every 100 days by the Federal government. Half that money is not going for goods such as highway repairs.

Much money is spent giving out subsidies to <u>private companies</u>. When some businesses can no longer cover the costs of selling their goods in free markets, they sometimes seek a bailout (wealth transfer from consumers) through a government program. If customers no longer want your products, that is a sign to change your business model - not "go to the government" and ask for money. This kind of "public spending" is what economists call public sector inefficiency, and the lobbying that goes on is labeled "rent seeking." I call it "government corruption" in a free society.

When I give the government my taxes, I expect <u>something of value</u> in return. Paved roads, bridge repairs, a new court building. A few basic public goods. I do not expect the government to give out "stimulus" money to fish farmers to cover their feed costs or "assistance" to maple syrup producers to pay for their advertising. Those types of expenses are related to private goods and are to be funded voluntarily by end-users of those products in free markets.

$50M in "stimulus" will help fish farmers buy feed

OSAGE BEACH, Mo. (AP) — The United States is about to spend $50 million in stimulus money on fish food to help fish farmers who have been struggling since feed prices jumped 50 percent last year.
The money could provide algae to nourish clam and oyster larvae along the Pacific coast, fill the bellies of tilapia in Arizona and feed catfish, trout and gamefish in the Midwest and South.
Supporters say many fish farms are in already poor areas. They say the money will help keep the farms going and preserve jobs in areas hard hit by the recession and lacking other industries.
Much of the money is likely to end up in Mississippi, Alabama and Arkansas — the nation's largest catfish producers. Catfish accounts for one-third of the nation's $1.4 billion aquaculture industry.

Government Welfare as a Public Good

While the federal government gives out many billions of dollars annually in **corporate welfare** to banks, multinationals, big agriculture firms and airlines, it also provides hundreds of billions in *traditional* welfare payments, called public assistance or entitlement spending.

Tax money given to the poor is argued to provide a social safety net. It is “social insurance” for bad times. It is income insurance we all have available.

Certainly, the goal we share is to minimize (lessen) poverty in our community. But a question economists ask is - what method of delivering welfare assistance best lessens poverty?

Is it a large, centralized government welfare system, or access to well-run local, private charities?

We love to help people. But one problem is, sometimes people take advantage of our kindness. When people overuse charitable help, economists refer to it as **"Moral Hazard."** Moral hazard means, when we are “moral” and offer help, the “hazard” is that people may become dependent and they reduce their effort to become economically independent. Eventually, offers of help can overburden the giving households.

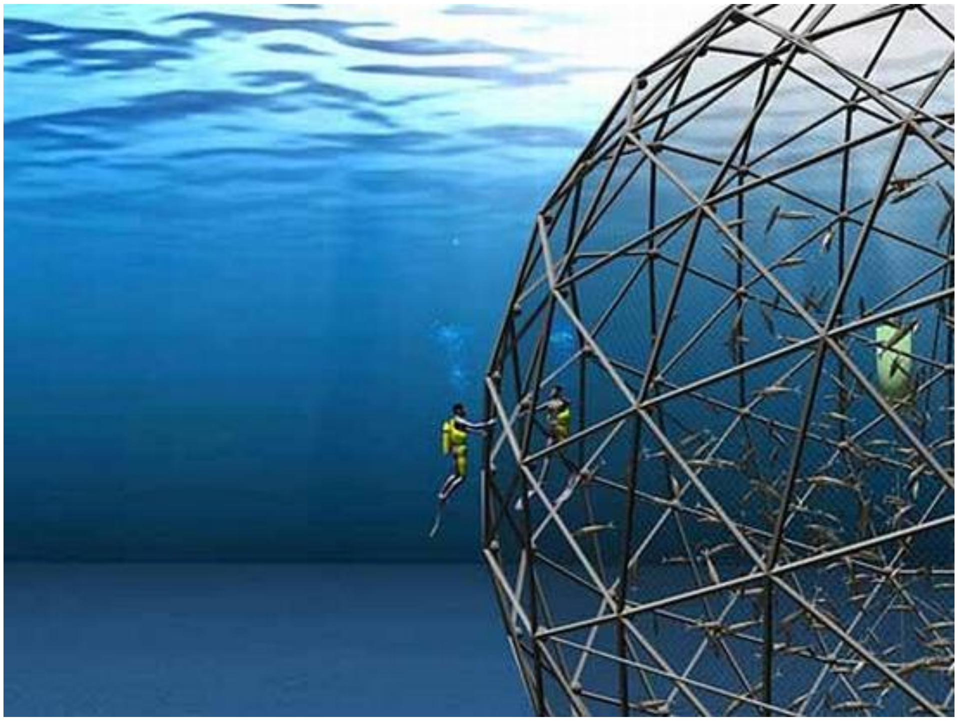
The situation is also sometimes called **“The Problem of the Commons.”** The Problem of the Commons arises when people have access to a shared resource such as “common” grazing field for cattle. If viewed as “public,” people don't act to protect and preserve the grassy field for long term use. Instead, we’ll tend to jump in and use it quickly - before somebody else does.

Migrating fish also show an example the Commons Problem. Migrating fish in the sea are viewed as "public" (commonly used) property. Smart fishermen will tend to rapidly fish out the fish populations before others can acquire them. As a result, migrating fish populations quickly become depleted.

But a solution was found! Economists learned that when private property is assigned and fishermen are given well-defined portions of fishing grounds, individual behavior changes. Individual users will work to husband the resource, manage it, and preserve its productivity.

New fishing technologies in the form of floating nets have recently been developed. The nets allow fishermen to individually farm and harvest migrating fish. Fisherman now efficiently conserve fish populations because they can manage their own **private** stocks in the floating devices called “aqua pods.” Fishermen are incentivized to make a living - while carefully protecing what was previously an overfished “public” resource. Thanks to this new technology, the “problem of the commons has been remedied!

http://www.innovasea.com/ http://www.openblue.com/open-ocean-aquaculture



The Commons Problem (over-usage) and moral hazard are seen with today's government welfare programs. A variety of Federal assistance programs have been arranged to help people to live month to month. People have become dependent on govt. payments - though the money was mostly intended to be ***temporary*** assistance.

As a secondary effect, the programs also harm the incentives of those paying for the public programs. Taxpaying citizens may now be incentivized to work less - and eventually "use the system" themselves. They may become so stressed by their rising tax bills that they quit working, and apply for Medicaid and other government programs.

Federal and State welfare systems are like a "common" resource. Without limitations on use and an understanding of the importance of respecting the taxpaying citizens funding them, these public programs quickly become insolvent. Medicare and Social Security, the two largest federal assistance programs in America, now currently show unfunded liabilities of over $200 Trillion and rising.

Lobbying by special interest groups compounds the government's financing problem. When more and more services are provided "by government" - from food stamps and public housing to cell phones and transportation – increased lobbying takes place by private sector industries wanting *their* goods and services included as part of "welfare" programs. Internet service, pet food, plastic surgery – what's next to be included in 'public' assistance?

Those receiving assistance may often adopt a perspective that they are “entitled” to it - rather than viewing it with gratitude as charity coming from someone else’s work week. Many may even begin lobbying and voting for more "assistance."

Welfare programs are a continuing balancing act. Both sides in the welfare services issue vigorously debate each other during budget meetings.

There is a lot of discussion about government welfare programs. How can working taxpayers possibly afford to fund it all - without deciding to “quit work” themselves?

Can we introduce reforms to financially sustain the system?

President Bill Clinton introduced “workfare” to encourage able-bodied people living on welfare to make efforts to improve themselves for the job market. President Trump revived this policy.

Equally important is to examine past history.

Records show us that in the early 1900’s, a variety of private-sector (non-government) charities were organized and widespread. These groups arose long before President Johnson's costly Great Society and Federal 'War on Poverty' programs.

During the era of “mutual aid” societies, **the poverty rate was actually falling.**

All Americans including working-class minority families were becoming more and more independent - and economically self-responsible.

They were buying private unemployment insurance plans and joining voluntary medical aid groups. They did not use a government "safety net." They were organizing (self-insuring) on their own.

The following two charts show the success of private charities and mutual aid societies in early America.

such as theaters and parks. As Byington put it, the "lodges seek to arouse the sense of fraternity and common interest which otherwise finds little stimulus in the town. . . . There are no unions to give a sense of common interest, and the political organizations are largely dominated by a few gangs. The lodges form really the only clubs."[19]

The Spread of Life Insurance

Studies during the period repeatedly point to the pervasiveness of life insurance ownership among the working class. The Illinois Health Insurance Commission found that 81.9 percent of wage-earning families in Chicago had at least one member with a life insurance policy. Although this tendency declined with income, 73.2 percent of the lowest income class still carried such policies. As with fraternal membership, there was a strong correlation between ethnicity and life insurance. The Slavs of Chicago and Homestead were not only accomplished fraternalists but more likely to purchase life insurance. The correlation between ethnicity and insurance was also high among blacks. In Chicago and Homestead nine in ten black families carried some life insurance, more than any other group, including native whites.[20]

Blacks in other cities demonstrated an equal readiness to purchase insurance. In Philadelphia a study of black migrant families in 1917 showed that 98 percent had policies. Of 348 family heads in Kansas City in 1913, according to Asa E. Martin, only 24 failed to carry insurance, "and in most of those cases the other members of the families held policies." By comparison, Chapin calculated that 7 in 10 black families in New York owned life insurance. This figure is conservative, however, because it apparently omitted fraternal policies.[21]

Fraternal hegemony in insurance did not go unchallenged. Commercial industrial insurance (small burial policies paid on a weekly basis) spread rapidly among the poor. Significantly, two of the three largest companies in this field, Prudential and Metropolitan Life, had evolved from fraternalism. Prudential was originally chartered as a friendly society, while Metropolitan Life initially relied on the Hildise Bund, a German mutual aid association, to collect its premiums.[22]

The rivalry between fraternal and commercial insurance was complicated. The competition was not a simple zero-sum game in which increases in the one led, perforce, to diminutions in the other. Wage earners did not necessarily think in terms of an either/or choice. Many carried some combination of both

DAVID BEITO, FROM MUTUAL AID TO THE WELFARE STATE
BOOK
(2000).

P. 25

TABLE 2.4. Life Insurance Ownership in a Sample of Wage-Earning Families in Chicago, 1919 (1919.)

Ethnicity	Number of Families	Percentage with Policy
Black	274	93.8
Bohemian	243	88.9
German	240	85.0
Irish	129	88.4
Italian	204	57.8
Jewish	218	63.8
Lithuanian	117	79.5
Native white	644	85.2
Polish	522	88.5
Scandinavian	232	75.4
Other	225	75.1

Source: Illinois Health Insurance Commission, *Report* (Springfield, 1919), 223.

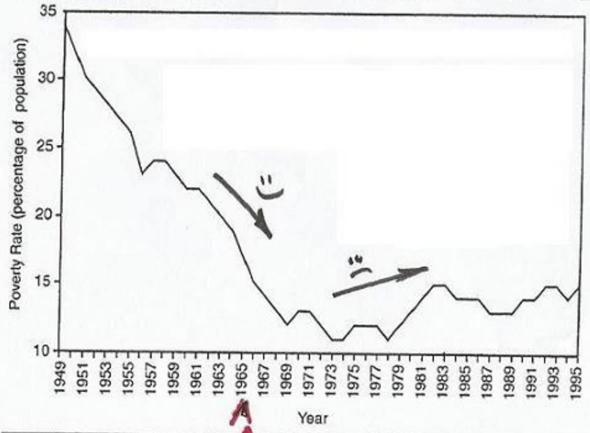
industrial and fraternal insurance. Black families were particularly noted for relying on private companies for industrial policies and fraternal societies for sick benefits. In Chicago 9 of 10 black families had life insurance (table 2.4), but only 1 in 10 (table 2.3) had fraternal life policies. By the same token, more than 4 in 10 blacks in Chicago carried sick benefits. This ratio was higher than that of any other group except Lithuanians, and twice that of native-born whites.[23]

Black families in other cities had similar insurance habits. In 1921 Sadie Tanner Mossell found that 100 black migrant families in Philadelphia, with "few exceptions," carried their life insurance in commercial companies. At the same time, 4 of 10 of these families had either mothers or fathers in "lodges and sick benefit assessment societies maintained entirely by Negroes." This profile also applied to the smaller black population of Kansas City. Asa Martin concluded that nearly "every adult of both sexes, even though he belongs to one or more of the fraternal orders, carries [commercial] insurance also."[24]

The Dread of Dependence

For many poor people the sharing of risk, whether through fraternal or commercial insurance, was an essential precaution against the stigma of charity and

Figure 1.2
POVERTY RATES, 1949–95



SOURCE: Bureau of the Census, Current Population Reports, Series P60, various numbers.

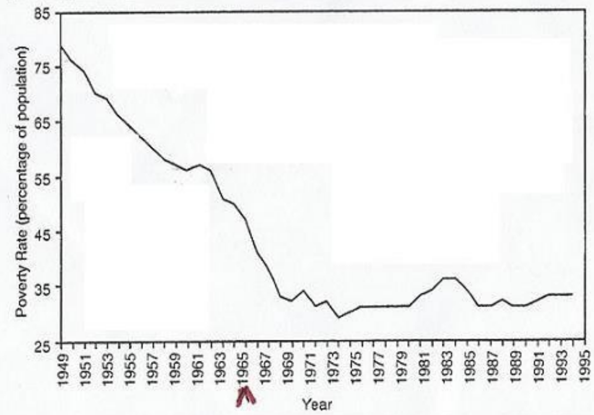
As Figure 1.2 shows, throughout the 1950s and 1960s, before the beginning of the War on Poverty, the poverty rate declined dramatically.[40] However, in the late 1960s the decline began to bottom out, and by 1973 the poverty rate began to rise again. By 1995 the poverty rate had reached pre-1966 levels.

Long-term poverty has also begun to increase. After improving steadily before 1970, and remaining relatively stagnant throughout the 1970s, the proportion of poor moving out of poverty from year to year declined in the 1980s.[41]

[40] Bureau of the Census, Current Population Reports, Series P60-124, P60-140, P60-145, P60-149, P60-154, P60-157, P60-161, P60-166, P60-168, P60-174, P60-180, P60-185, P60-188, P60-189.

[41] Terry Adams, Greg Duncan, and Willard Rogers, "The Persistence of Poverty," in *Quiet Riots: Race and Poverty in the United States*, ed. Fred Harris and Roger Wilkins (New York: Pantheon, 1988), Figure 5.2.

Figure 1.3
POVERTY RATES FOR AFRICAN-AMERICANS, 1949–94



SOURCES: James Tobin, "Macroeconomic Trends, Cycles, and Policies," in *Confronting Poverty: Prescriptions for Change*, ed. Sheldon Danziger, Gary Sandefur, and Daniel Weinberg (Cambridge, Mass.: Harvard University Press, 1994), p. 150; Gerald Jaynes and Robin Williams Jr., eds., *A Common Destiny: Blacks and American Society* (Washington: National Academy Press, 1989), p. 278; and Bureau of the Census, Current Population Reports, Series P60, various numbers.

A look at specific demographic categories shows similar results. Among African-Americans, for example, the decline in poverty through the late 1960s was even more dramatic than the average. In 1949, 75.4 percent of all African-Americans lived in poverty. By 1973 the percentage had declined to 30.5 percent. At that point, it leveled off; it remains virtually unchanged today. Interestingly, not only did the biggest decline in black poverty take place before the advent of the Great Society, it occurred even before the passage of major civil rights legislation. Figure 1.3 illustrates the change in black poverty rates.

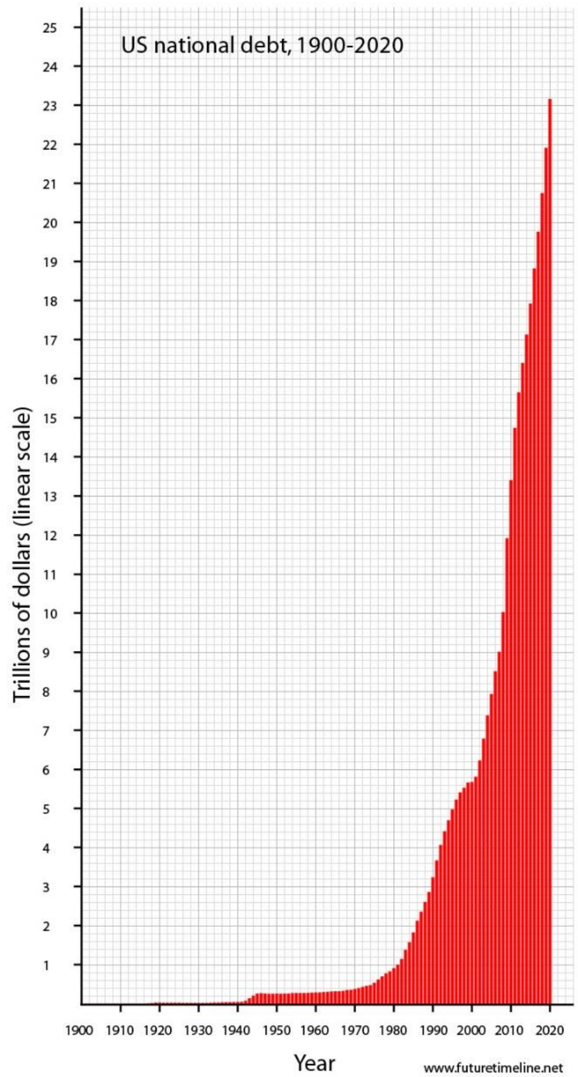
However, that fails to tell the whole story. While the overall poverty rate for African-Americans has remained relatively steady since

We all need a 'safety net.' But that guarantee might be best provided by private insurance each person purchases (as we saw emerging in the 1900s) along with robust voluntary charities that each community arranges, celebrates and carefully manages.

Buying insurance for bad times is each individual's responsibility in a free society. There are many types of insurance one can buy. It is our choice concerning how much or little to buy. From crop insurance for farmers, to catastrophic health insurance for major cancer risks, to apartment insurance for renters. Insurance plans of many types are already available in free markets.

The question remains. Does a massive government welfare system "help" the poor rise and succeed? Or does it incentivize continued poverty, create huge budget demands due to lobbying special interests, and expand growing debt for future generations?

Our government is already in alarming financial trouble - with debts over $35 Trillion and unfunded liabilities exceeding $200 Trillion. It doesn't have more funds to give. We now have a huge "moral hazard" (commons) problem. Young people will have to pay for it. Maybe it's time we try freedom.



Education as a Public Good

Most economists and politicians view education services through high school as a "public good."

When young people obtain the skills needed for lifelong success this enables them to become independent productive citizens. A skilled population boosts economic productivity and provides a "positive externality" for a community and for the entire country.

While education through Grade 12 is primarily financed with taxes, the services can be improved by allowing competition, as we noted earlier.   Choice in education services boosts quality, lowers costs, and provides families with different options which meet the needs of their children.

After high school, citizens also go on to seek higher education. They obtain degrees from colleges, universities or trade schools in a diverse array of vocational and professional fields.

Because post-secondary students are seeking specialized skills - or “human capital” as economists call it – the question of whether these education services meet the definition of “public goods” is worth exploring.

Seeking a specific occupation is a decision involving risk. The discrete skills sought are no longer the “basic skills” of elementary, middle and high school grades.

Investing in a highly differentiated career is much like investing in a small business. The particular career path chosen may or may not eventually be marketable to thousands of paying consumers.

To set up a small business, individuals apply for a loan if the funds they need haven’t been saved. Banks are rational and logical. They want to lend, but only do so if the business plan demonstrates economic value and a potential for success. Profit, loss, and price signals tell lenders where specific goods and services are in short supply and trained specialists will find success.

Although higher ed decisions represent equally risky investments, the market discipline constraining traditional business borrowers is absent. Federal programs such as Pell Grants provide massive subsidies to students in higher education regardless of the degrees or certificates sought.

Consequently, shortages and surpluses develop, and many students secure a college “degree” but find little work.

Nurses, radiologists, welders, civil engineers and tax accountants find themselves in high demand and employers face shortages of these specialties. Graduates in fields such as dance theory, gender studies and haiku find few job openings, take low-skilled entry-level jobs and have difficulty paying back their loans.

Treating all forms of higher education as a “public good” has created significant inefficiencies in the labor market. Some politicians insist we need to go further, however, and offer both “debt forgiveness” and “free college for all” – meaning, paid for by taxpayers. These two policy proposals will only heighten the wasteful public sector spending and economic distortions we have. Teachers’ unions are fine with this but let’s set that aside.

Rather than providing open-ended government loans and subsidies, higher education investments would perhaps be better managed and financed as purely private goods. Commercial lenders will only loan to viable academic prospects. A music degree in accordion playing is likely to be high risk. One would need to convince a lender that the skill has a consumer base sufficient to allow repayment. Cautious private-sector lending reduces in the number of failed majors which turned out to be very expensive hobbies. Fewer graduates will later complain they had to move back with parents due to joblessness once their “degrees” were finished. Employers who have experienced chronic shortages of workers in STEM fields will finally be able to fill those positions.

Some students argue with me, saying "the economy is just bad right now. When the economy improves, I'll find a job with my Social Justice diploma." My response is that the economy is only as strong as the array of skills and careers powering it. If most students initially chose highly-valued majors, the economy would already be "improved," wouldn't it.

Private-sector financing of post-secondary education also produces a more fair fiscal outcome. If students hope to pay back a private loan, they must carefully choose a career which will attract the customers needed. Consumers in free markets spend money based on the value they voluntarily place on various products and services. One does not get to choose one's college major in a vacuum. Customers have a say, too.

Government-backed loans and subsidies force millions of taxpayers to fund specific careers and skills they would never voluntarily use or purchase. If Person A dislikes attending theater and movie productions but is forced to subsidize a Theater major's degree, this reduces the cost which Person B, a theater enthusiast will be paying.

When one person is compelled to fund the private consumer purchases of another, that forced wealth transfer is usually termed slavery. I have exotic birds, but do not expect my neighbor (who dislikes birds) to subsidize my costly avian veterinary bills.

Specific end-users, not millions of unrelated taxpayers, finance the different private goods and services chosen in free markets. When citizens purchase their theater tickets, pet care, or according music, the prices paid include the "human capital" cost of providing them.

In America, everyone is free to pursue a unique career. But not all careers are created equal. Some remain high risk, because consumers remain free to buy the services they value and lenders remain free to reject loan requests they evaluate to be insolvent. As economist Arthur Marget once observed, *"Prices have a job to do, prices must be free to tell the truth."*

Health Care as a Public Good

Many students, professors, and public officials say healthcare should be categorized as a public good.

Like welfare programs for the poor, basic healthcare is considered an essential “safety net” function of government.

Economists observe two challenges with government-provided healthcare services.

First is the Moral Hazard problem (aka, Problem of the Commons) which we discussed.

“Moral Hazard” means when we try to be “moral” and help others, the “hazard” is that millions of citizens may over-use the government services offered. When people perceive that they can get “free” health care, their incentives and personal behavior can change. Citizens become less concerned about getting regular exercise, eating a wholesome diet, or avoiding harmful drugs and dangerous sports and hobbies.

Second, we face fiscal challenges from the supply side. The number of “health-related” services can greatly expand over time. Initially, a few basic industries provide healthcare services using our tax dollars. Eventually however, other “health-related” industries notice this arrangement and more businesses will lobby government officials to insist their products, services and drugs are also “health related.”

From cosmetic surgery to pet care, dozens of normally private-sector goods may be argued important for our health including our “mental health.” Industry groups will lobby for these services to be added to the “comprehensive” public health program. Millions of us, for example, receive emotional benefit from owning a pet dog and walking the dog daily provides physical exercise. So - taxpayer funded pet services for “mental well-being and health”?

With billions being spent every tax dollar is not carefully monitored, and outright fraud can also occur.

> Wasted Money: “Pandemic relief” money spent on hotels, ballparks, ski slopes
> *Associated Press March 23, 2022 — “Thanks to a sudden $140 million cash infusion, officials in Broward County, Florida, recently broke ground on a high-end hotel that will have views of the Atlantic Ocean - and an 11,000-square-foot spa. In New York, Dutchess County pledged $12 million for renovations of a minor league baseball stadium to meet requirements the New York Yankees set for their farm teams. And lawmakers delivered $5 million to pay off debts of the Edward M. Kennedy Institute in Boston… Each is among the dozens of projects that state and local governments across the United States are* ***funding with federal Coronavirus relief money*** *--* ***despite having little to do with combating the pandemic*** *Associated Press found.”*

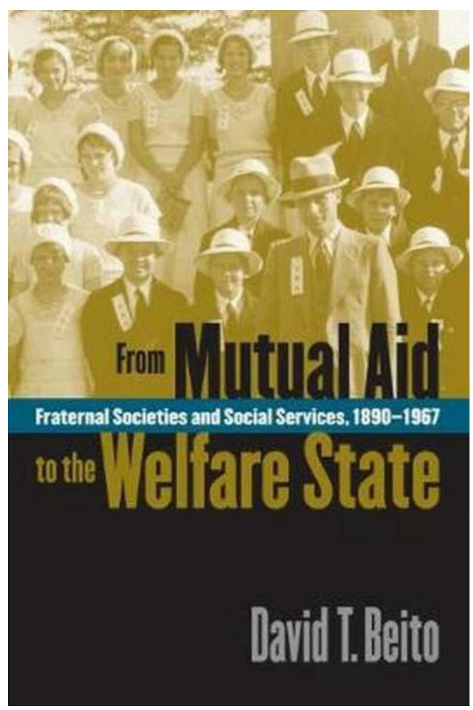
Public health programs are no longer limited to cancer treatments or well-baby care, as many of you think. "Disabilities" payments to to those who do not speak English were pursued by Federal officials, for example.

Government programs lead to financially unsustainable programs due to moral hazard and interest group lobbying. Eventually taxes soar and public debt explodes. The United States today owes over $200 Trillion in unfunded liabilities for programs such as Medicare, Medicaid, and Social Security: https://usdebtclock.org/.

The result is shortages, long waits for care, and rationing of services. A budget problem eventually becomes a failure of human compassion.

The negatives of "add-on" services, reduced incentives, mission creep and exploding costs can be successfully controlled.

One way to avoid the interest-group bloat, corruption, and "moral hazard" is to provide medical and healthcare services to truly needy people by outsourcing these programs to local non-profit charities. The social history book mentioned previously, *From Mutual Aid to the Welfare State* by David Beito details the success of the widespread use of local charitable organizations in the 1900's. Long before the arrival of massive Federal bureaucracies and healthcare agencies, citizens were efficiently managing local "public charity" services in a responsible and compassionate way.



Thanks for reading Lesson 17!