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FULBRIGHT SCHOOL OF
PUBLIC POLICY AND MANAGEMENT

The Proper Role of Government in a Market Society

Introduction to Public Policy
Fall 2023



World Covid-19 Lockdowns on February 1, 2020



- In the initial stages of the Covid-19 pandemic, only three countries imposed social distancing measures
- Only China had imposed strict lockdown measures



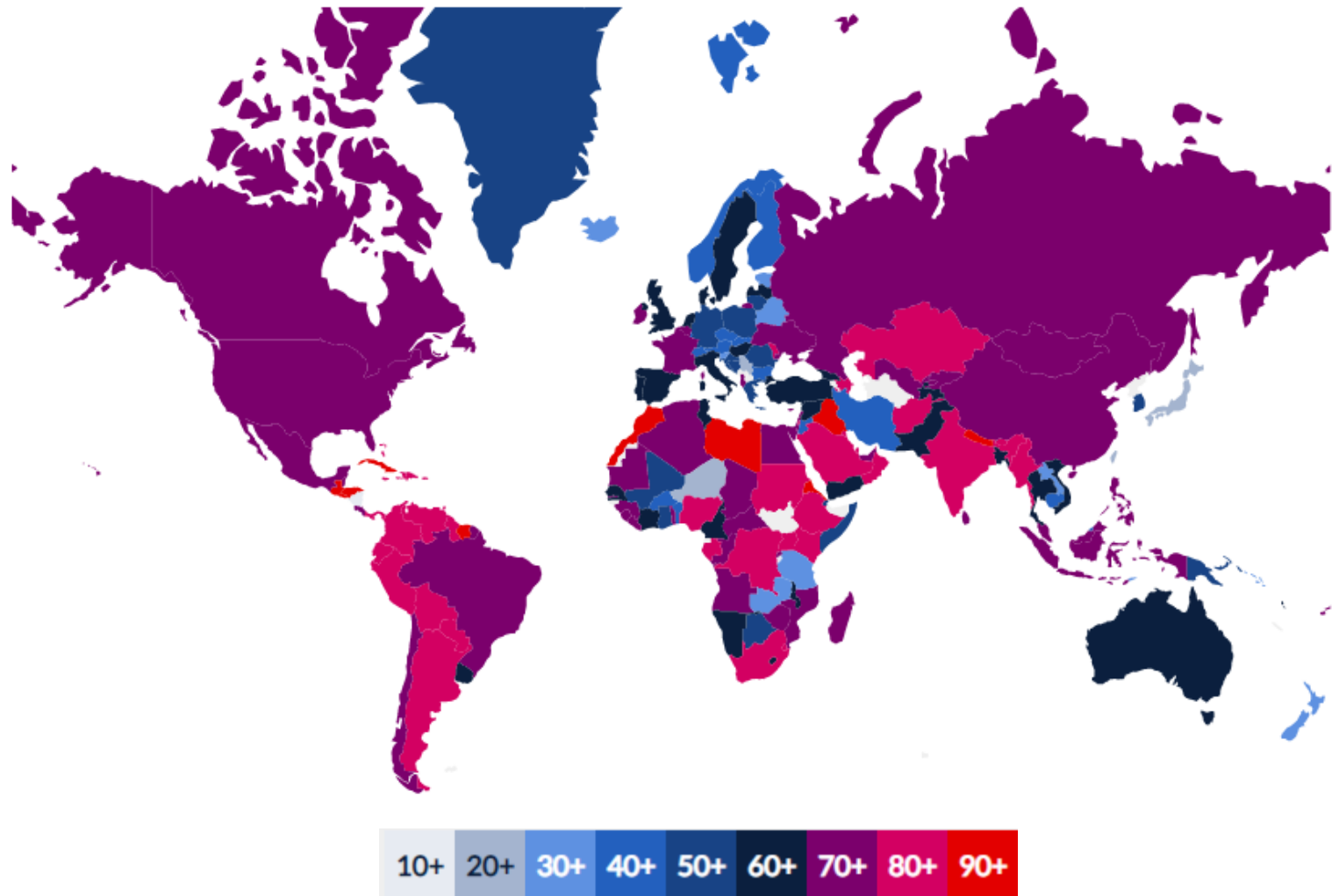
Source: Oxford Covid-19 Government Response Tracker

<https://covidtracker.bsg.ox.ac.uk/>



World Covid-19 Lockdowns on June 7, 2020

- Four months later, most of the world had imposed strict social distancing measures
- Limitations on gatherings, workplace closures, travel restrictions
- Mandatory mask wearing was a political flashpoint in the United States
- Contact tracing in many countries raised privacy issues
- Mandatory vaccination programs sparked opposition when incorrect information on side effects spread through social media



Did government overreach?



- Incomes sacrificed for health
- Concern to protect vulnerable people (elderly, infirm)
- Prevent collapse of health care systems
- Required restrictions on personal freedom, including public acquisition and use of personal information



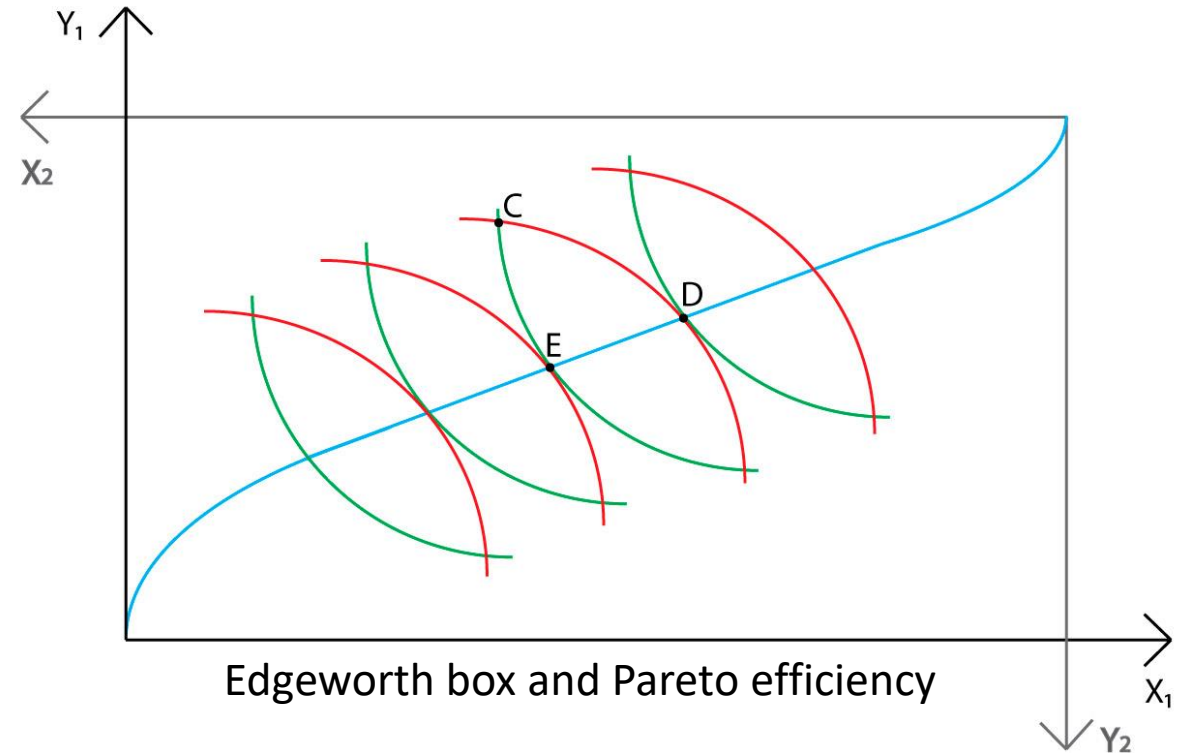
Competing ideas of well-being and its measurement

- Well-being as income: Growth of Gross Domestic Product (GDP)
- Well-being as welfare: Satisfaction of individual preferences
- Well-being as social justice: Equal opportunity and equal outcomes
 - John Rawls, *A Theory of Justice*: Society should choose the outcome that improves the well-being of its worst-off member
 - Amartya Sen, *Development as Freedom*: Well-being as the ability to realize one's human potential
- Well-being as personal liberty
 - Robert Nozick, *Anarchy, State and Utopia*: Reduce government intervention to maximize freedom
 - State action is only needed to create and enforce fair rules and a level playing field
 - Equal treatment under the law (no aristocracy or Untouchables).



Pareto Optimality: The First Theorem of Welfare Economics

- An efficient redistribution of resources can leave no one worse off
- In an economy of two goods and two consumers, all efficient trades would coincide with the contract line
- Consumers will not consent to a level of utility that leaves them worse off
- Competitive market ensures an efficient equilibrium
- Distribution should be left to the market except when the conditions are not met for free exchange



But the conditions required to achieve a competitive equilibrium cannot be met in practice



- No individual producer or consumer is large enough to affect the market price of goods and services (no monopoly)
- Producers and consumers have complete and costless information about goods and services
- Markets are complete, covering all goods and services, including markets for goods and services in the future and markets for risk
- Individual property rights are complete and enforceable
- Producers and consumers are perfectly rational in the sense that they have only one aim—to maximize utility—and they can readily identify the actions required to achieve this aim
- People know their preferences and their preferences are consistent (if I prefer A to B, and prefer B to C, I must also prefer A to C)
- There are no externalities (unintended effects on third parties of consumption and production decisions)



Governments must act to build market infrastructure

- Governments establish and enforce property rights, and adjudicate between property rights claims
- Laws and regulations governing production and exchange must be accepted as reasonable and impartial
- Governments supply the public goods needed for the market to function (roads and bridges, electricity, water, courts, police, schools, etc.)
- Governments can identify and put a stop to anti-competitive behavior
- Governments compel market participants to adhere to minimum standards of disclosure and integrity
- Governments protect market participants from exploitation and abuse (unfair labor practices)
- Market infrastructure differs from place to place—there is no set of “ideal” institutions appropriate everywhere.



Governments act when markets are imperfect

- Provide or subsidize public goods → goods that are non-rivalrous and non-excludable (public parks, national defense)
- Reduce or eliminate negative externalities (pollution) and encourage positive externalities (education)
- Check the formation of monopolies
- Subsidize or provide goods and services that the market cannot provide, or cannot provide efficiently, like health insurance (incomplete markets)
- Compel businesses and individuals to disclosure information about products and services



Efficient outcomes are not always the most desirable

- Efficient outcomes may be unfair
 - Society chooses the acceptable level of social inequality through the political system, not through the market.
 - If rich countries can pay more for Covid-19 vaccines, should they get them first?
- Efficient outcomes may not be ethical
 - Purdue Pharma did not warn patients that opioid pain relievers are highly addictive
 - Charging high prices for petrol, water and hotel rooms after a major storm
- Efficient outcomes may be suboptimal from the perspective of society:
 - Not enough “merit goods” have positive social effects (universal broadband, higher education)
 - Too many “demerit goods” like alcohol and tobacco
 - “Protected goods” would disappear if not supported by government (arts, biodiversity)



Globalization and the proper role of government

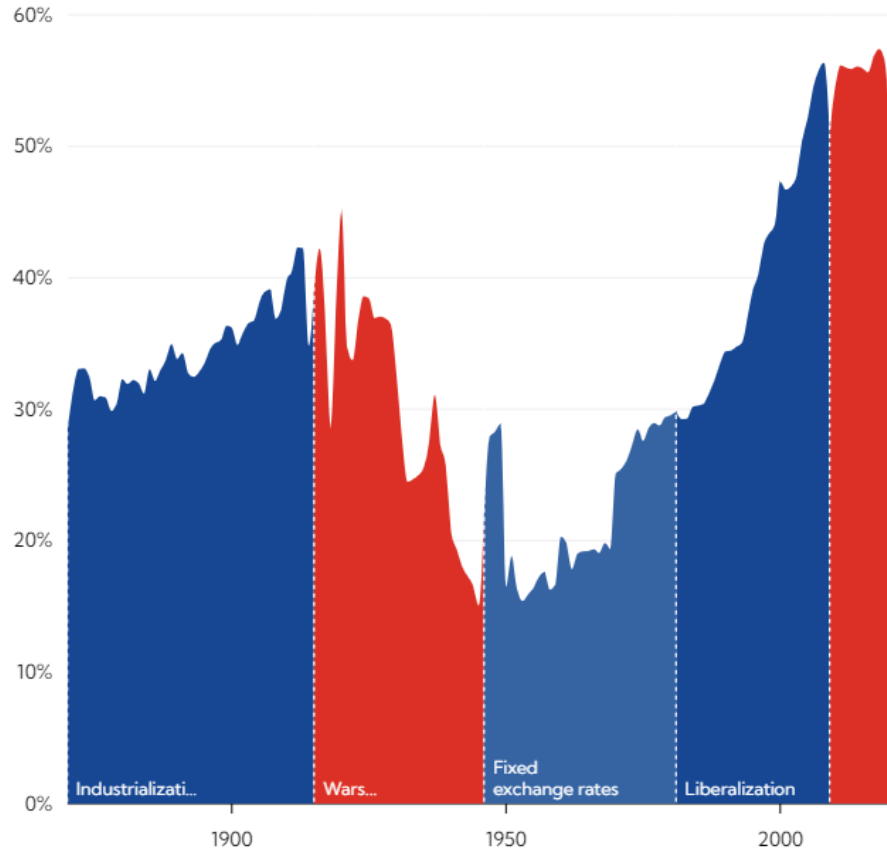
- Globalization has substituted market outcomes for political outcomes around the world
- Relaxation of restrictions on trade and finance
- Harmonization of rules to reduce political discretion
- Results in more efficient outcomes: Specialization and comparative advantage
- Participation in trade has been equalizing to the extent that production creates steady jobs
- Race to the bottom: Fear that competition for inward investment leads to relaxation of environmental and labor standards
- Decline in government revenues as companies and individuals use tax havens
- Erosion of social solidarity as the rich see themselves as global citizens





Have we reached peak globalization?

Sum of imports and exports as share of GDP



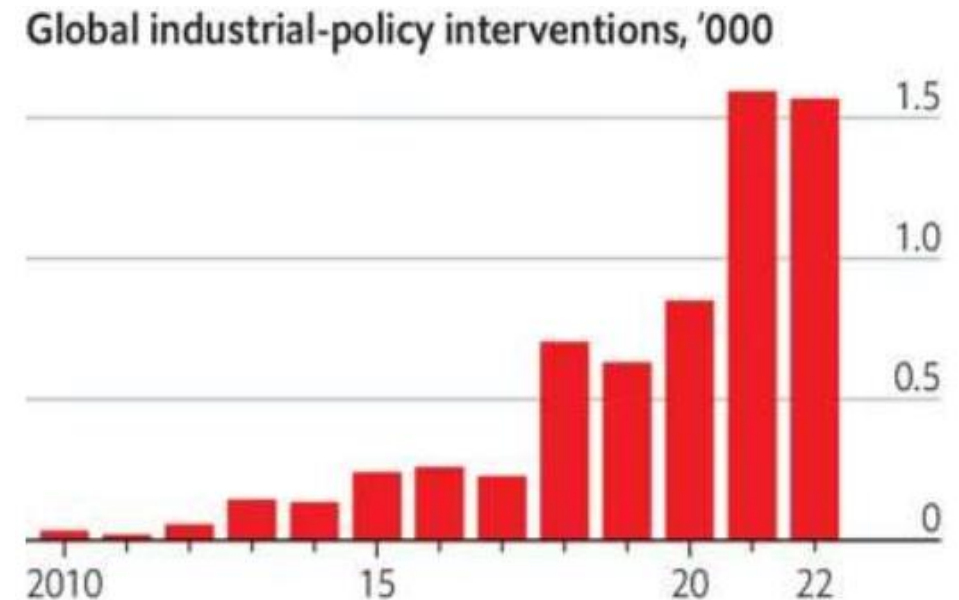
Source: International Monetary Fund

- “Slowbalization” following Global Financial Crisis of 2008
- Rich country voters were the big losers from globalization and the financial crisis
- Rising trade tensions between US and China: Technology wars
- Russia-Ukraine conflict
- Global trade negotiations abandoned in favor of regional groupings and bilateral FTAs



New industrial policy: a larger role for government?

- Pandemic, Ukraine conflict, climate change heightened concerns that globalization had reduced economic and human security.
- Rising protectionism, investment in science and technology.
- Subsidies and domestic content rules for strategic industries like microprocessors.
 - Chips Act: US Subsidies for semiconductor manufacturing
 - Inflation Reduction Act: US subsidies for renewable energy
 - Green Deal Industrial Plan: EU subsidies for microelectronics
 - Production-linked incentives: India provides subsidies for solar and batteries





Designing industrial policies

- South Korea's Heavy Chemical and Industry program 1973-1979, subsidized credit to boost exports
- Played a critical role in South Korean industrialization (Lane 2022).
- "Made in China" helped China achieve dominance in renewable energy industries.
- India's "production-linked incentives" encouraged imports and re-exporting of mobile phones.
- Subsidies not tied to performance generally fail.
- Job creation in capital tech-intensive industries favors the rich, while consumer goods will be more expensive.
- Developing countries cannot afford the level of subsidy offered by rich countries.



The proper role of government is a political, cultural question

- Trade-off between efficiency and equity
 - Providing electricity to remote rural areas is inefficient because the cost of delivery is much greater than the willingness to pay.
 - Governments subsidize access to electricity to improve the quality of life of rural people.
- Competing conceptions of well-being
 - Northern Europeans are willing to pay more tax in exchange for infrastructure and public services
 - Americans tend to favor lower taxes and limited government
- Approaches to risk and security
 - Vulnerable groups often value security more than income, passing on activities that deliver higher returns but imply more risk
 - Agricultural communities that shun new technologies to stick with what they know.



Impact of climate change on the role of the state

- The world has woken up the dangers of failing to limit global warming to 1.5 degrees in the form of extreme weather and sea level rise.
- Climate change is a global crisis on the scale of the Great Depression and World War II.
- Mitigation and adaptation will require mobilization of trillions of USD in investment, in renewable energy, construction, trade, transportation, manufacturing, agriculture, forestry and fisheries
- Behaviors and habits of citizens will have to change, requiring a combination of incentives and government directives.
- The business environment will change: some industries will disappear (capital destruction), new ones will arise; government will use a combination of incentives and direct intervention in markets.