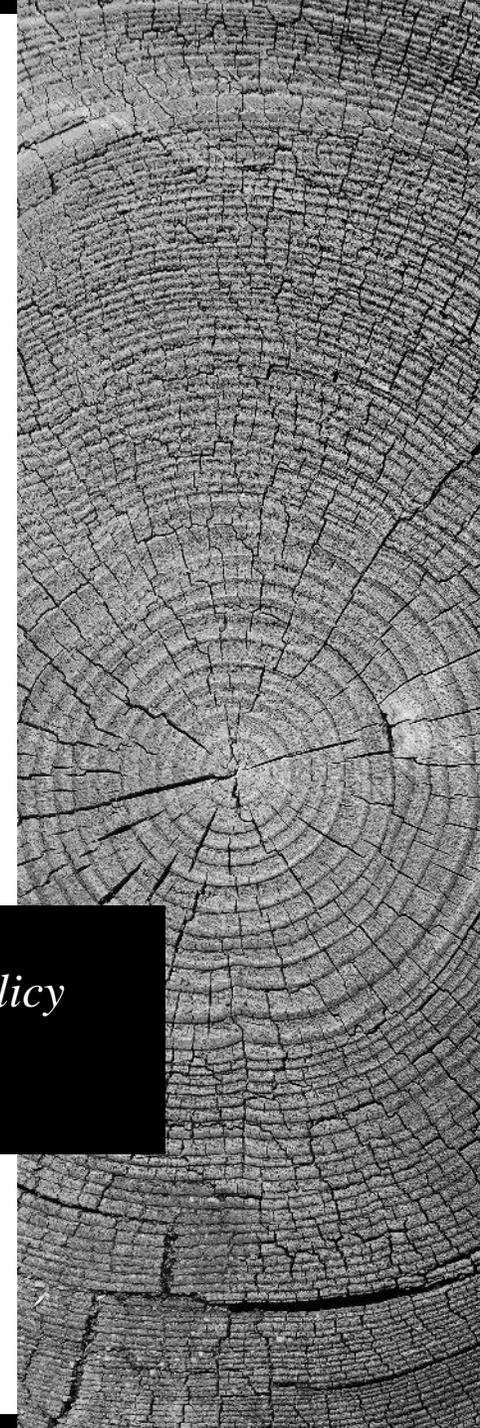




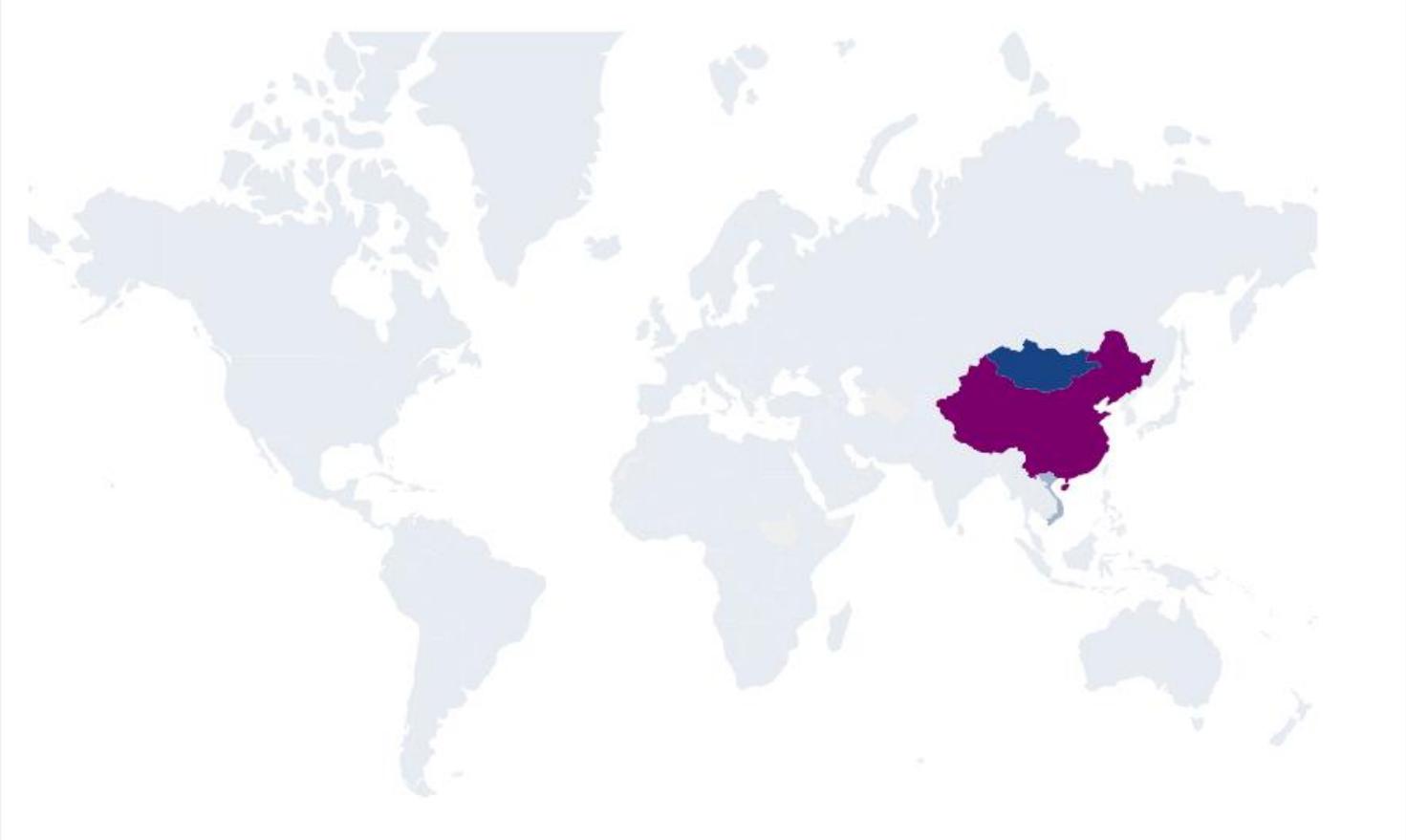
THE PROPER ROLE OF GOVERNMENT IN A MARKET SOCIETY

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Introduction to Public Policy
FSPPM



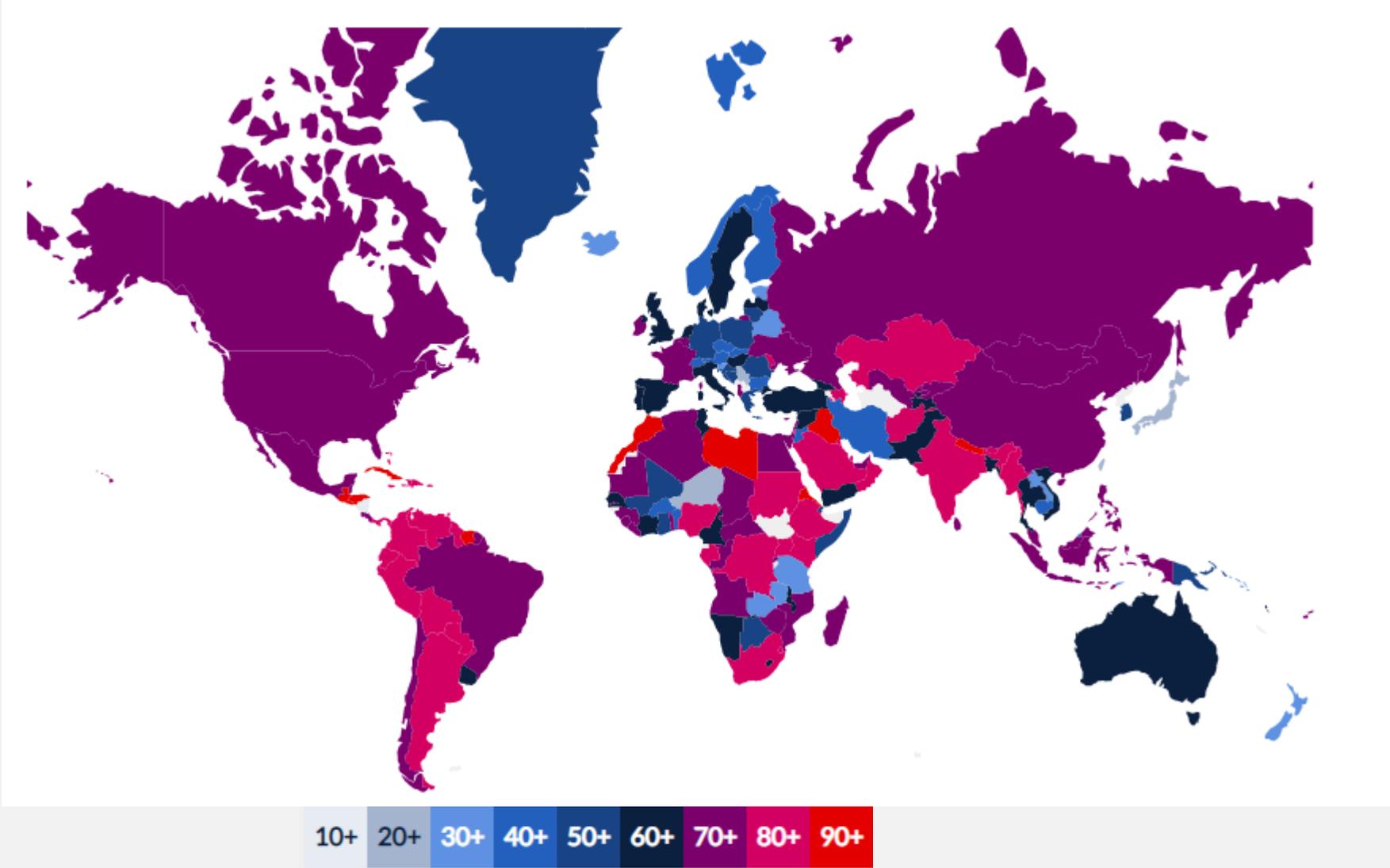
WORLD COVID-19 LOCKDOWNS, FEB.1, 2020



Source: Oxford Covid-19 Government Response Tracker

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

WORLD COVID-19 LOCKDOWNS, JUNE 7, 2020



DID GOVERNMENTS ACT APPROPRIATELY?

All but essential economic activity was stopped in most of the world at the peak of the Covid-19 pandemic

- Economic output was sacrificed for the well-being of the citizenry—but on what basis?
- Minimize irreversible damage
- Protect the most vulnerable
- Reduce the risk of chaos and disorder
- Higher net benefit with temporary lockdowns than without



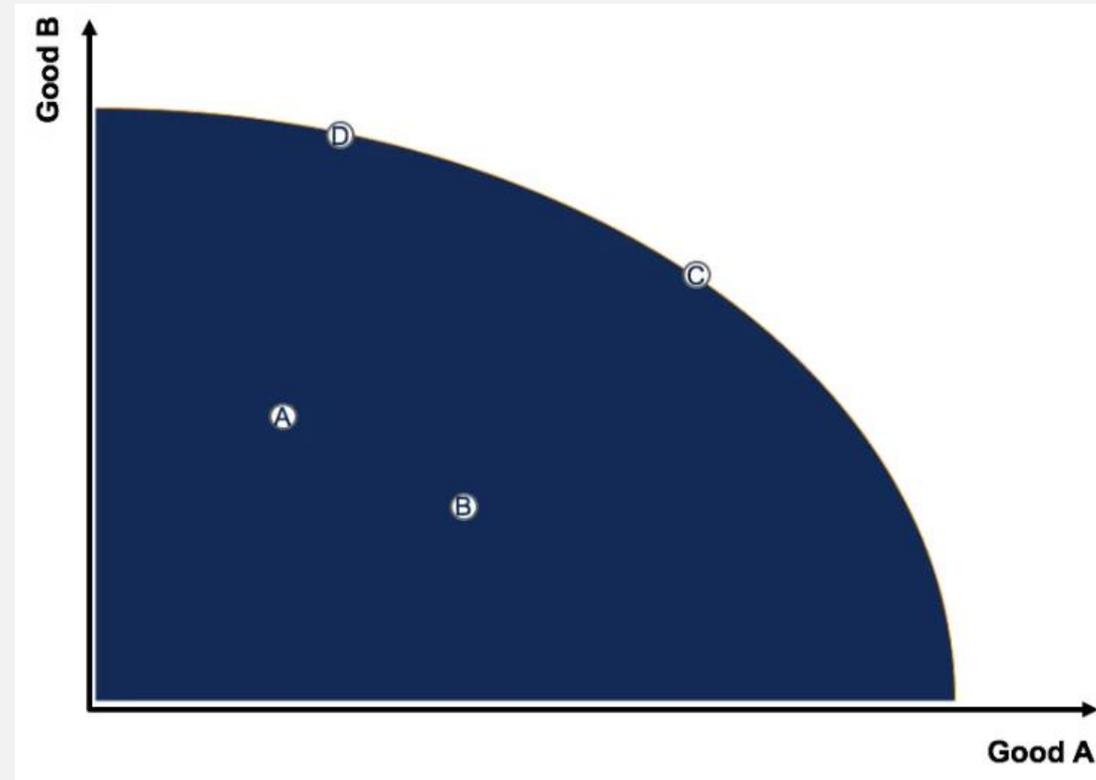
GOVERNMENT AND THE WELL-BEING

- Well-being as protection → from external threats, disasters
- Well-being as “welfare” → the market voluntarily arrives at an efficient allocation of goods and services to maximize well-being
- Well-being as income → the main job of the government is to increase Gross Domestic Product
- Well-being as social justice →
 - John Rawls: Society should choose the outcome that improves the well-being of its worst-off member
 - Amartya Sen: Well-being as the ability to realize one’s human potential
- Well-being as a fair process, not a fair outcome → Robert Nozick
 - Well-being demands the least possible state intervention
 - State action still needed to create and enforce fair rules
 - Equal treatment under the law (no aristocracy or Untouchables)



PARETO OPTIMALITY: THE FIRST THEOREM OF WELFARE ECONOMICS

- If the distribution of resources is efficient if reallocation cannot make one person better off without making someone else worse off.
- If the economy consists of two goods, and there are two consumers, which points are Pareto efficient?



- If people are free to trade, the market will produce an efficient outcome (the invisible hand)
- Distribution should be left to market except in certain circumstances

CONDITIONS TO ACHIEVE A COMPETITIVE EQUILIBRIUM

- 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 goods and services, including markets for goods and services in the future and markets to hedge risk
- Individual property rights are complete and enforceable
- All 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 BUILD THE INFRASTRUCTURE OF THE MARKET

- Establish and enforce property rights, and adjudicate between competing claims
- Laws and regulations governing production and exchange accepted as reasonable and impartial (rules of the game)
- Supply public goods necessary for the market to function (roads and bridges, public education)
- Promote fair competition among sellers of goods and services and prohibit anti-competitive behavior
- Compel market participants to adhere to minimum standards of disclosure and integrity
- Protect market participants and others from exploitation and abuse
- Precise characteristics of market infrastructure will differ from place to place—there is no set of “ideal” institutions valid everywhere.



GOVERNMENTS ACT WHEN MARKETS ARE IMPERFECT

- To provide or subsidize public goods (public parks, national defense)
- To reduce or eliminate negative externalities (pollution) and encourage positive externalities (education)
- To control monopoly power
- To subsidize or provide goods and services that the market cannot provide (incomplete markets)
- To force businesses and individuals to disclosure relevant information



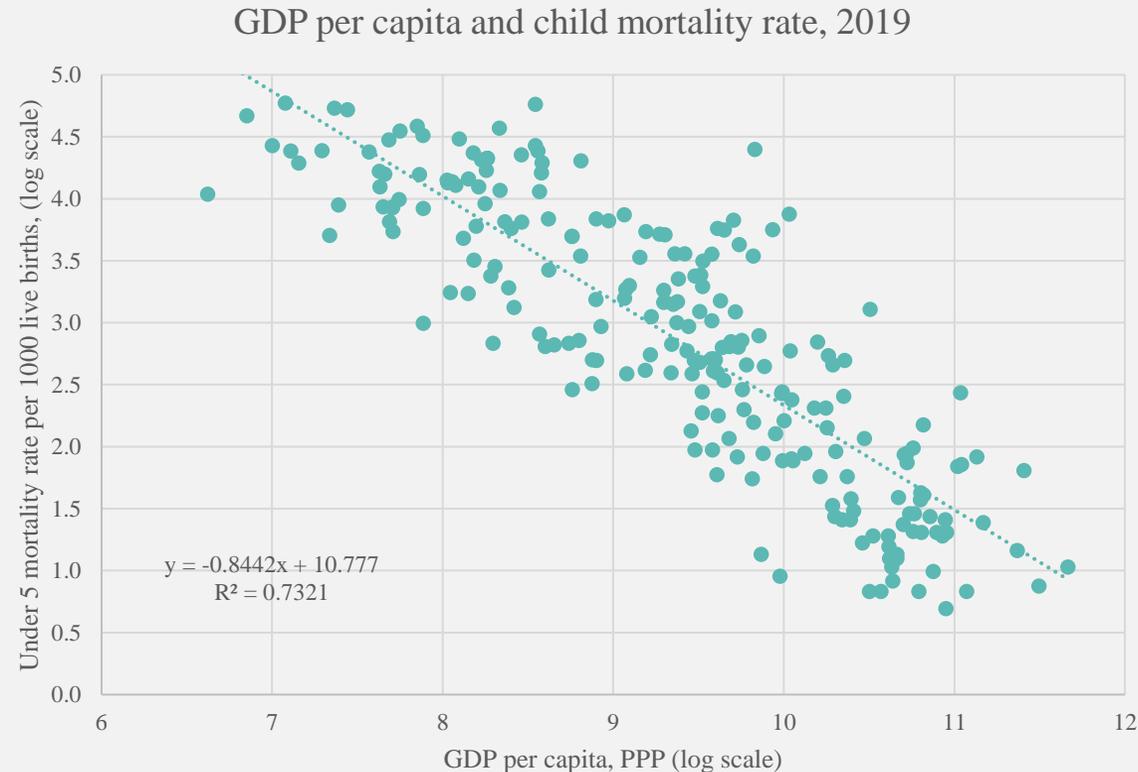
MARKET OUTCOMES MAY BE EFFICIENT, BUT THEY MAY NOT BE:

- **Fair:** The pareto solution may be efficient but unequal
 - The political system (not the market) must determine how much inequality is tolerable in a good society
 - If rich countries can pay more for Covid-19 vaccines, should they get them first?
- **Ethical:** Businesses should not be allowed to make toys that are dangerous to children
- **Socially desirable:**
 - The market underproduces “merit goods” that have positive social effects (universal broadband, higher education)
 - The market overproduces demerit goods like alcohol and tobacco
 - The market underproduces “protected goods” that would disappear if not supported by the government (arts and culture, biodiversity)

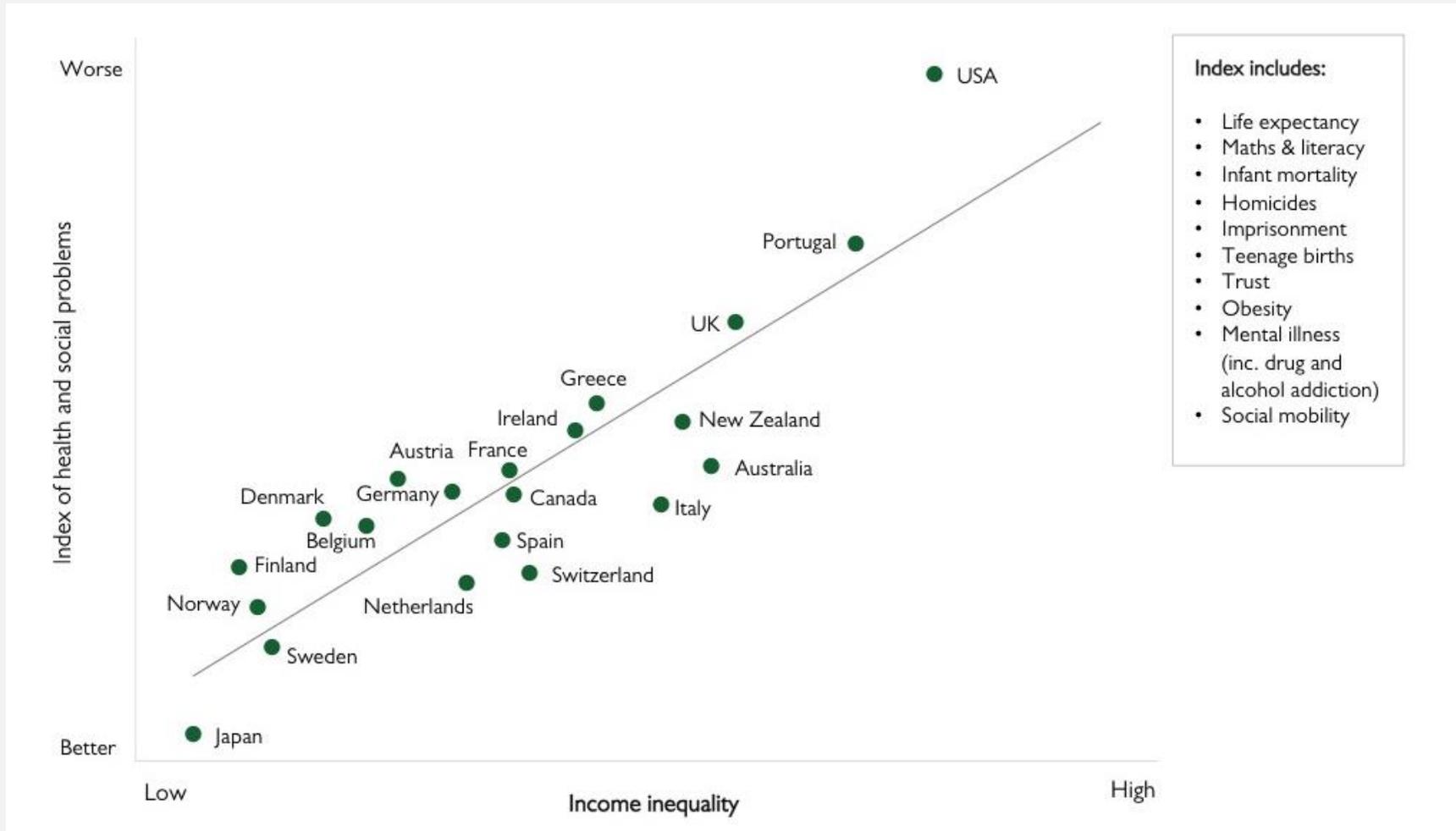


INCOMES AND JOBS: THE GROWTH IMPERATIVE

- Government acts to achieve rapid growth of incomes
- Income closely associated with other social goods
- Well-being closely associated with access to stable, well-paying jobs.
- Left to their own devices, do markets achieve rapid growth of incomes and jobs?



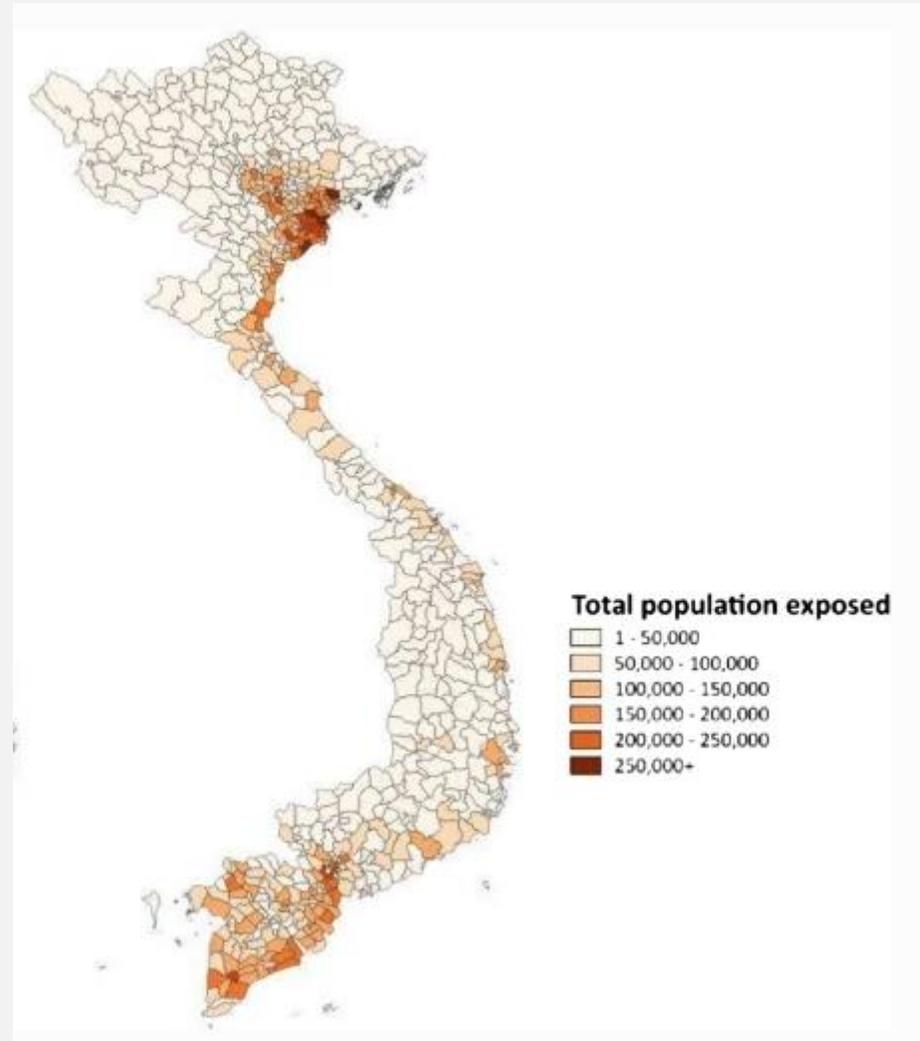
WELL-BEING AS EQUALITY



Source: Wilkinson & Pickett, *The Spirit Level* (2009)

WELL-BEING AND SUSTAINABILITY

- Intergenerational well-being: what do we leave to future generations?
- Irreversible damage to the natural environment
- Non-substitutable natural resources
- 65 million people in Viet Nam at risk of flooding and other adverse weather effects due to climate change



Bangalore, Smith and Veldkamp 2019

INSTRUMENTS OF GOVERNMENT ACTION

- Fiscal and monetary policy
- Direct production of goods and services
 - Infrastructure, water and sanitation and other public goods
 - Essential services like health and education, merit goods
 - Goods and services not provided by the market, natural monopolies
- Taxation and subsidies
- Social welfare and social protection
- Legal system, rules enforcement, courts, mediation and arbitration
- Regulation (competition, environment, labor, monopoly, disclosure)
- Defense, diplomacy and border protection
- Promotion of national values, customs and traditions



GLOBALIZATION AND THE ROLE OF GOVERNMENT

- Globalization is based on the idea that market outcomes are superior to government outcomes → replacing government rules with market principles
- Lower trade barriers (tariffs and quotas), free movement of capital across borders (but not free movement of people!)
- Difficult to achieve global regulation analogous to national regulation (environment, labor, disclosure) so there is a danger of a “race to the bottom”
- Erosion of state sovereignty as multinational companies and wealthy individuals use tax havens and evade national jurisdictions
- Erosion of social solidarity as the wealthy opt out from national obligations and government reduce support for the poor and vulnerable



PROPER ROLE OF GOVERNMENT

- No model is appropriate everywhere and at all times: changing ideas about the role of government in history and different cultures
- Globalization as an experiment in deregulation and proliferation of market principles
- Have we reached the highwater mark of globalization?
- Covid-19 and climate change changed the way we think about the role of government?

