

*Walter Block***Public finance texts cannot
justify government taxation:
A critique**

In virtually all economic sub-disciplines, practitioners of the dismal science are exceedingly desirous of avoiding normative concerns, at least in principle. These are seen, and rightly so, as extremely treacherous. Being only human, they do sometimes stray off the path of positive analysis; but when they fall off the wagon in this manner, if at all, it is done relatively cautiously, and infrequently. There is one blatant exception to this general rule, however, and that is the field of public finance. Here, in sharp contrast to the usual practice, not only is normative economics embraced, it is done so with alacrity, and without apology. That is, most textbooks on the subject start off with one or several chapters which attempt to justify taxation on moral, efficiency, and other grounds. This occurs in no other field.

Why would tax experts differ so widely from their counterparts in labour, capital, trade, theory, history, growth, mathematics, econometrics, and so on in the degree to which they resort to normative considerations? Although this can only be speculative, one reason may be that none of the other disciplines in economics depend, for their every existence, on a set of ethical presuppositions. That is, one may analyse, say, the minimum wage law, without taking any moral stance on it; the conclusions of the study are invariant to the ethical perspective. But in the case of tax policy, this is not so nearly as often. There is no doubt that much can be done in the field of public finance, in a completely value-free manner. One can analyse the different effects of regressive, proportional, and progressive taxes, or compare the effects on resource allocation of taxes on sales, income, or wealth. However, if any of these policies are to be justified on their own, and not in contrast with others, non-economic considerations must be brought to bear. The analyst, that is, must step out of his role as economist.

Now this would be a perfectly reasonable path to follow. If this were done, public finance texts would come in two volumes: the first dedicated to exploring and justifying the philosophical preconditions for taxation, the second discussing tax itself. But this is not the pattern which has emerged. One explanation is the division of labour. But if this were so, public finance writers would merely cite the relevant philosophical literature, and get on

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directly with their main business. A better explanation is that they wish to have their cake and eat it too: to maintain their role as economist, all the while stepping out of it in order to place their enterprise on a moral foundation. Hence, their resort to normative economics.

It will be my contention that much of the analysis emanating from the field of public finance is substandard, and comes about because the usual professional proscriptions against morality-mongering are ignored. Three of the leading Canadian textbooks will be scrutinized in this regard, because texts are the most highly distilled repository of the thinking prevalent within a discipline. They are Auld and Miller, *Principles of Public Finance* (AM); Musgrave, Musgrave, and Bird, *Public Finance in Theory and Practice* (MMB); and McCready, *The Canadian Public Sector* (McC). The present analysis shall also consider Wolf, *Markets or Governments*, in some detail, since that study focuses on the precise area of our concerns.¹

The state

At the very outset of their book, MMB attempt to justify the existence of government intervention in the economy. Under the heading "Need for Public Sector"² these authors ask: "Why is it that in a supposedly private enterprise economy, a substantial part of the economy is subject to some form of government direction, rather than left to the 'invisible hand' of market forces?" Among the seven justifications they adduce is the claim that³ "the contractual arrangements and exchanges needed for market

1 A.L. Auld, and F.C. Miller, *Principles of Public Finance: A Canadian Text* (Toronto: Methuen, 1982); Richard A. Musgrave, Peggy B. Musgrave, and Richard M. Bird, *Public Finance in Theory and Practice*, first Canadian edition (Toronto: McGraw-Hill Ryerson, 1987); Douglas J. McCready, *The Canadian Public Sector* (Toronto: Butterworths, 1984); Charles Wolf, Jr., *Markets or Governments: Choosing Between Imperfect Alternatives* (Cambridge, MA: MIT Press, 1988).

2 This terminology, although highly typical, is somewhat misleading. Political economic reality can indeed be divided into two distinct realms. They are, respectively, the economic or market sector, where interaction occurs on a voluntary basis, and the state or government arena, where coercion is the underlying motif. (If you don't believe that force is the essential element in relations between the individual and the state, try not paying your taxes, and see what happens.) To characterize the former as the private sector, and the latter as the public sector, is deceptive. This is because the firms in the market, while privately owned, are also invariably open to the public, for the precise purpose of serving the public. That, after all, is the way to earn profits. The market is every bit as much "in the public interest" as is the "public sector," if not more so. This equation of state enterprise with the "public sector" is thus an implicit claim that the distinguishing feature of the government is its "public-ness." It is not. On the contrary, the essential element of state activity is its use of initiatory violence against non-aggressors. This being the case, public sector terminology can best be interpreted as an attempt to cover an iron fist with a velvet glove.

3 This is repeated almost word for word by McC, coupled with a whopper of an Argument from Authority (p. 5): "It goes without saying that the contractual arrangements and exchanges required for a perfect market operation cannot exist without a governmental, legal structure to protect both individuals and firms and enforce contracts. Adam Smith himself called for government involvement in the legal structure."

operation cannot exist without the protection and enforcement of a governmentally provided legal structure" (p. 4).

This claim is highly problematic. Consider international trade, where contractual arrangements of this sort occur every day. Yet there is no protection or enforcement of a governmentally provided legal structure that applies to such exchanges. There cannot be, in the absence of a world government with authority over the trading parties, each from a different country. The only extant and even remotely viable candidate for such a role is the United Nations. But that organization – more of a debating society than anything else – is far from being able to provide a legal structure for the nations of the world. If these institutional arrangements do not exist internationally, they can hardly be *necessary* domestically, however accustomed to them we have become.

Perfect competition

Market failure

The next argument for government intervention is lack of perfect competition. State MMB: "The claim that the market mechanism leads to efficient resource use (i.e., produces what consumers want most and does so in the cheapest way) is based on the condition of competitive factor and product markets. This means that there must be no obstacles to free entry and that consumers and producers must have full market knowledge. Government regulation or other measures are needed to secure these conditions" (p. 4).⁴

Perhaps the most problematic statement of this view is given by McC: "Although economists like to regard the marketplace as an efficient allocator of resources, there are reasons why the market sometimes fails, and *once market failure occurs, an alternative system of allocation appears justified*" (p. 29, emphasis added).⁵ But this is a *non sequitur*. Just because one alternative is

4 AM echo this sentiment exactly (p. 2), as does McC (pp. 4, 5). Let us stipulate for the sake of argument that these economists are correct; e.g., that due to the failure of the unfettered market to approach the conditions of perfect competition, resources will be misallocated, and wealth reduced below levels otherwise attainable. Does it logically follow, as a purely technical issue, that it is therefore *justified* for government to intervene, even on the assumption that by so doing it could improve matters? Not a bit of it. This cannot be shown in the absence of normative considerations. For the alternative claim is that regulation, or government ownership, is an infringement upon individual liberty and private property rights. Thus, even if their violation can enhance wealth, it still should not be undertaken. How can such an argument be refuted without recourse to normative economics?

5 However, to be fair to McC, he does maintain (p. 6): "Most of these arguments reflect market failures of one type or another, but to argue that government is justified in attempting corrective measures in no way constitutes proof that government will improve the performance of the economic system. Errors can occur in the public as well as the private sector." Whether this correct statement exculpates the one cited in the text is for others to say. We can only maintain that the two McC views appear to contradict one another.

imperfect does not mean that the other is perfect. Granted, for the sake of argument, that the market is imperfect. Does it follow from this that the government is perfect? Hardly. Has it been proven by this stipulation that state intervention would improve matters? Not at all. It is certainly compatible with market "failure" that any governmental attempts at alleviation will instead worsen the situation.

The Chicago Bulls had a great basketball team in 1991–1993. Yet, sad to say, they were imperfect. Michael Jordan, by far the best of their players, missed hundreds of shots (wide open ones too!) during the regular season, and in the playoffs as well. According to the "logic" of this argument, since Chicago was imperfect, their opponent must have been better. If so, the opposing team should have beaten them. But in the event, the Bulls prevailed, and won the National Basketball Championship in these three years. As we all know, although this particular team was imperfect, the others deviated from perfection by an even greater amount.

In like manner, even granted the market is imperfect, it is still illegitimate to deduce from that fact that bureaucratic regulation is either perfect or even an improvement upon economic freedom. A more sensible rendition of this situation is provided by Wolf:

The principle justification for public policy intervention lies in the frequent and numerous shortcomings of market outcomes. Yet this rationale is only a necessary, not a sufficient, condition for policy formulation or for government intervention. The comment made a century ago by the British economist Henry Sidgwick can hardly be improved upon: "It does not follow that whenever laissez faire falls short government interference is expedient since the inevitable drawbacks of the latter may, in any particular case, be worse than the shortcomings of private enterprise" (p. 17).

Contrary to Wolf, however, the Sidgwick comment *can* be improved upon. What is this "laissez faire falling short" business? Laissez faire, or free enterprise, or capitalism, or the free market, is simply a system wherein people have the economic freedom to engage freely, without government interference, in commercial activities with each other (given a suitable starting point of private property rights). As such, the only claim made in its behalf is that trade (whether of money for hours of work in the labour market, or of money for goods in the consumer market, or of money for resources, equipment, and intermediate goods in the factor market, or of one good for another as in barter) enhances the welfare of both parties in the *ex ante* sense. That is, if I trade you my tie for your wrist watch, the only reason either of us agrees to engage in this transition is because of the expected (monetary or psychic income) gains.⁶

6 There is no doubt that after the exchange is consummated, either or both of us may come to regret our action, although the usual presumption, especially for regularized or repetitive dealings, is that both parties gain in the *ex post* sense as well as in the *ex ante*.

That is all that is promised by laissez faire. It is not the fault of the market that our technology is only as developed as it now is, and not as it will be in five hundred years. It is not the fault of capitalism that our IQs are not higher than they are. It is not the fault of free enterprise that information is not more widespread than it is. It is not the fault of economic freedom that land, labour, and capital are not any more mobile⁷ than they are. It is not the fault of laissez faire that there are indivisibilities in nature. It is not the fault of free markets that it is cold in the Arctic and hot in the Sahara. All that can be said – as the Soviet experience so eloquently attests – is that no alternative system can do any better to overcome any of these shortcomings. When used in this manner the perfectly competitive model is a fraudulent one. It first posits or defines an impossible situation, then notes that reality diverges from it, and from this deduces that an alternative (government intervention) is preferable. Nonsense.

What of the claim that bureaucratic regulation can improve upon market results? If anything, the evidence is overwhelmingly opposed to this belief. Consider rent control, minimum wages, marketing boards, tariffs, zoning, occupational licensure, crown corporations, government land ownership, anti-combines, central banking – the tip of the iceberg of government "contributions" to economy. Each of them was initially set up, presumably, to correct some "defect" or other in the market. (According to the public choice school, however, each of them were inaugurated to enhance the "rent seeking" behaviour of special interest groups.) And yet in every case the "cure" has proven to be worse than the "disease." The unravelling of the Soviet experiment with communism has shown, if anything can, the error of this philosophy. As people in that country are now in the process of learning (a lesson which has so far eluded many of our textbook writers), there are no "market failures"; on the contrary, government failure is ubiquitous. When the latter is substituted for the former, this is a recipe not for improvement but for disaster.

Monopoly

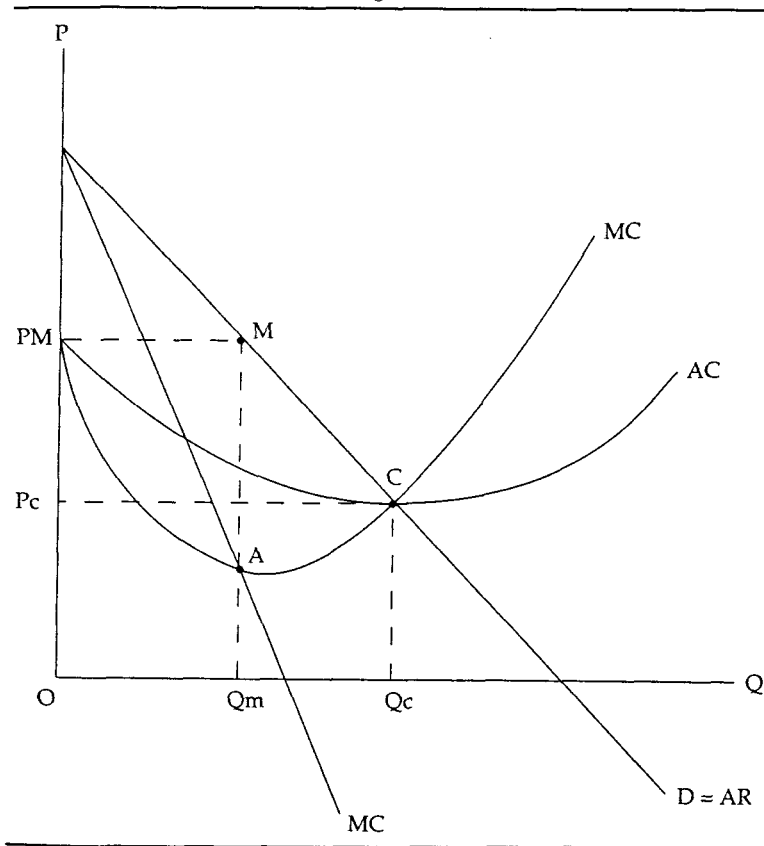
Perhaps no charge of market failure has captured the imagination of gullible assistant professors so much as that of "monopolization." According to MMB, "there are situations – also referred to as 'natural monopolies' – where a competitive market cannot function because larger firms can produce at a lower cost, and ultimately a single firm tends to supply the entire market.

7 In the view of McC (pp. 34, 35) "Productive resources are often immobile. When resources are not free to move to their most efficient location, the private sector is restricted in its ability to allocate resources in an efficient manner. For this reason, programs such as paying moving assistance ... for those who move closer to the location of their jobs are quite in order as they improve the mobility of productive resources." This is but a variant of the market-is-imperfect-therefore-its-opposite-must-be-an-improvement argument.

Without government intervention, profit-maximizing behaviour by the resulting monopoly would entail too little output at too high a price" (p. 680).

In the classic illustration of this statement (see Figure 1), the perfectly competitive firm will charge (P_c) and produce (Q_c) at the level where the marginal cost curve (MC) intersects a demand or average revenue curve ($D = AR$). This is considered socially optimal, since all additional units cost more than their value ($MR > AR$), while any lesser production would be worth more than its cost ($MC < AR$). The monopolist also engages in marginal cost pricing; but since he is a price maker, not a price taker, the marginal

Figure 1.



revenue curve he faces (MR) lies below the demand curve. At the point at which he produces (Q_m), the value of additional units (AR) is greater than their cost (MC); thus, the famous "dead weight loss" triangle (AMC).

There are so many things wrong with this scenario that it is difficult to know where to begin. For one thing, due to economies of scale, it is likely that industries composed of thousands of small firms would have costs far higher than depicted in this diagram; there is no warrant for assuming that they share the same cost curves. For another, the costs of the anti-combines authorities, and those of the firm used in opposing them, might be far greater than the dead weight loss. But these are superficial objections, which implicitly assume the validity of the theoretical framework. More radically, we can object to the whole exercise on the ground that cost curves are inherently subjective; they consist of opportunities foregone.⁸ As such, third parties, such as the Anti-combines Branches, are never in a position to ascertain them.

Another violation of economic theory committed by this analysis is the fallacy of comparing utility interpersonally. According to this perspective, one person, the firm, is "withholding" production from another, the consumer, even though it is worth less to him than to the latter. But how can we know that, unless we are allowed to compare the utility of the seller with that of the (thwarted) buyer? The very idea of placing, on one diagram, a curve which purports to show the utility of the purchaser (D), alongside a curve which purports to indicate the (loss of) utility of the vendor (MC , AC) is itself contrary to the strictures against interpersonal comparisons of utility.⁹ In addition, the dead weight loss triangle (AMC) is an embodiment of cardinal utility. It is an attempt to measure not merely a physical entity, but rather an amount of utility. Yes, the triangle has actual value dimensions: price multiplied by quantity. But this is superficial. In its most meaningful interpretation, dead weight loss is the dollar value of the loss in utility due to monopoly. Therefore it must be an aspect of the

8 Strictly speaking, of the next-best opportunity foregone, when the economic actor chooses the course of action which seems to him at the time to be optimal. See James M. Buchanan, *Cost and Choice* (Chicago: Markham, 1969).

9 Suppose that quantity refers to the number of fights per year undertaken by a boxer, such as Riddick Bowe. Q_c might indicate fifteen fights per year, and Q_m twelve. The distance $Q_m - Q_c = 3$ depicts the number of units of product that the monopolist is "withholding" from the public. The triangle symbolizes the loss of utility imposed on his potential customers by Riddick with this nefarious action. How can this scenario not contravene the prohibition against interpersonal comparisons of utility? According to the analysis, the champ (at the time of this writing) gets less utility by withholding than he could confer on boxing fans by engaging in three extra fights per year. But how can we ever know that the value placed on leisure by Bowe is of less value than the enjoyment that would be obtained by sports fans in watching the three additional exhibitions per year? We cannot. We can only fool ourselves into thinking that we do by comparing utility interpersonally and arbitrarily deciding that we have lost out.

discredited cardinal utility. The point is, there are simply no units of utility, or "utils." This is an entirely fictitious measurement. Since dead weight loss cannot be calculated in any other dimensions, it, too, must be invalid.¹⁰

Then there is the problem of economic hypocrisy. Government grants of privilege (licences, permits, patents, protections) are the source of monopoly. It comes with particular ill grace to propose the state as the opponent of monopoly, all the while functioning as its very source. Given anti-combines, the government is in a position to create monopoly with its one hand, while with its other presumably to rip it down.

If the logic of the argument is wanting, no less so are the public policy prescriptions. Pity the poor monopolist. If he charges more than his competitors, he can be had up for "profiteering," or "gouging." If he charges less, he can be considered guilty of engaging in "ruinous" or "cut-throat competition." Nor will charging the same amount as everyone else establish his innocence. For now he opens himself up to the indictment of "collusion," or "price fixing."¹¹ Another element of almost complete arbitrariness can be found in the definition of an "industry." If it is defined narrowly – for example, limited to colas – it will be easy to find monopoly based on four firm concentration ratios. On the other hand, if it is defined so as to include all sodas, or, better yet, all soft drinks, or, even better, all beverages, then it will be more and more difficult to discern high concentration ratios. Which is correct, the narrow or the wide perspective? The answer is, there is nothing in all of economic theory upon which we can make any such determination. Given this, it would be far more reasonable to define monopoly in terms of restrictive entry (a monopoly of *government*)¹² than

10 Not only does this neoclassical analytic framework assert that Bowe's leisure is of less importance than the fan's enjoyment. To add insult to injury, it purports to indicate the exact amount of the difference: the triangle. It is sometimes said that economists make predictions to show they have a sense of humour. The same must apply, in spades, to such cardinal measurements.

11 We in the west like to lord it over our counterparts in what used to be the Soviet Union. But under anti-trust, things are not so different. Consider the following joke. Three prisoners in the Gulag were comparing notes on their criminal histories. The first said, "I was imprisoned because I arrived at work late; I was accused of cheating the state out of my labour." The second noted, "I was incarcerated for coming to work early; I was arraigned for brown-nosing." Whereupon the third mentioned that he came to work exactly on time, but was found guilty of owning a western wrist watch.

12 A large amount of initial investments – advertising needs, requirements to attract a big labour force, physical resources, etc. – are not artificially imposed entry barriers; they are based on the economic realities of specific situations. In contrast, government threats to incarcerate or fine competitors (the US post office, marketing boards, etc.) are indeed barriers to entry. See Dominick T. Armentano, *The Myths of Antitrust* (New Rochelle, NY: Arlington House, 1972); Dominick T. Armentano, *Antitrust and Monopoly: Anatomy of a Policy Failure* (New York: Wiley, 1982); Donald Armstrong, *Competition vs. Monopoly* (Vancouver: The Fraser Institute, 1982); Walter Block, *Amending the Combines Investigation Act* (Vancouver: The Fraser Institute, 1982);

on the basis of industrial structure. And if this sensible step were taken, it would be clear that monopoly is not a market failure, but rather a failure of government.

Decreasing cost industries

MMB state: "... the government supplies goods which cannot be provided efficiently by private firms because production is subject to decreasing costs ... Although government regulation is one alternative, the existence of decreasing costs implies that the firm would suffer losses if forced to operate where price equals marginal cost. Thus, the government may prefer to render the service itself, and a public enterprise is substituted for the regulation off the private firm" (p. 680).

In view of McC, "in imperfect competition ... it is impossible to have decreasing average cost at the optimal point of social allocation. When average costs are decreasing at the point where marginal cost is equal to average revenue, the *social optimal quantity* cannot be produced at a profit" (pp. 32, 33).

Were there ever any such cases, it would not follow that government action (a takeover, a subsidy) would enhance economic welfare. First, there are the pragmatic reasons for this contention. The state is likely to waste thousands of dollars propping up commercial inefficiency on the grounds of supporting decreasing cost industries for every dollar which reaches its target. Further, given political realities, tax dollars will support pork barrel companies in provinces with large electorates, or powerful representatives. This argument, moreover, is particularly unconvincing at a time when the world economy is reeling from a surfeit of government interference in markets (for example, hothouse cucumbers). To maintain that there are theoretical possibilities for positive government action, and that therefore resources ought to be devoted to ferreting these out, is to close our eyes to the entire Soviet and East European experience.

Secondly, there are the more elegant objections. If all tariffs and trade barriers were disbanded, this might well convert several decreasing cost industries in various nations into one or two where demand was sufficient to bring a firm into the increasing cost areas of production. More radical still, the problem of decreasing cost industries is, at bottom, a problem of insufficient demand. As such, it is one solved, traditionally, by entrepreneurs. When the horseless carriage, pet rock, computer, and hula hoop were first brought to market, the demand for them was insufficient to make their production an economically viable option. Luckily, there were no decreasing cost industry subsidies available for them. Instead, their manufacturers were

Walter Block, "Austrian Monopoly Theory – a Critique," *Journal of Libertarian Studies* 1, no. 4 (Fall 1977), pp. 271–79; Murray N. Rothbard, *Man, Economy and State* (Los Angeles: Nash, 1970).

forced to try to increase the demand for these items, so that production could take place in the upwardly sloping sections of the cost curves. They did so by advertising, by product improvement, and so on. There is no reason to protect entrepreneurs in the present day from the necessity of these tasks.

What the argument comes down to is that if the government subsidizes an industry characterized by decreasing costs, certain economies can be attained. But again this viewpoint fails to deal with the interpersonal comparison of utility issue. For these subsidies will require that additional taxes be raised. In order to prove that the subsidy will be of net economic benefit, it is not sufficient to point out that resources will be misallocated in its absence, and properly allocated in its presence. It is also necessary to maintain that the gains, so derived, will be greater than the additional losses in utility suffered by the taxpayers. And this cannot be done without resorting to the intellectually bankrupt concept of interpersonal comparisons of utility. If the claims were true, moreover, it would be possible to interest the general citizenry in donating funds for this purpose, in order to receive a share of the increased income from the firm involved. From the fact that advocates of this argument are seeking coercive income transfers, and not voluntary investments from the general public, we can deduce that even on their own premises, the benefits from the subsidy are less than the costs to the taxpayers.¹³

Knowledge

In order for the marketplace to be free of the charge of imperfections in the neoclassical view, information must be "free" or at least "equally available." According to Wolf, "where consumers do not have equal access to information about products and markets, where information about market opportunities and production technology is not equally available to all producers ... market forces will not allocate efficiently and the economy will produce below its capacity" (p. 26).¹⁴ Big deal. This is yet another manifestation of the market-is-imperfect argument. One could make the analogous argument to "prove" that dirigisme is subject to intractable problems. One

13 The argument for subsidies in decreasing cost industries is similar to that in the case of infant industries. In both contexts it is maintained that government investment can improve matters – but without reckoning on the loss in utility suffered by those forced, through taxation, to foot the bill. In both cases entrepreneurs could have made the investments – either to push out the demand curve to the right, or to move along the cost curves until economies are achieved, respectively – but the government is being called upon, instead, to undertake the necessary investments. And in both cases, if "success" is achieved, it is the private interests who will gain.

14 States McC: "In most models perfect knowledge of the market by both producers and consumers is assumed" (p. 34).

would merely substitute "socialism" for "market forces" in the above quotation. The point is, *any* system will be handicapped to the degree it lacks knowledge. But every system known to an imperfect mankind is so cursed. What public policy logically follows from this? None.

Actually, Wolf's claim is false, even on its own neoclassical grounds. Strictly speaking, there is no necessity that information be equally available to all; as long as it is spread around on at least *one* side of the market, competition can still occur. Consider the axiom that wages tend to equal marginal revenue productivity. Why should this be so? Because if workers are paid less than this level, they can seek higher remuneration elsewhere. An employee who can produce at the rate of \$10 per hour, but who is paid only \$6 per hour, would represent a profit opportunity. Any employer would be willing to hire such a worker who showed up on his doorstep.

But suppose that the relevant information is not spread equally amongst market participants. Assume that only employers, not employees, are even aware of wages, profits, marginal productivities. Contrary to Wolf, this is still sufficient to ensure the tendency of wages to equal productivity. Now, under our supposition, no underpaid employee will quit his job, seeking to better himself. But underpaid employees still represent unexploited profit opportunities for employers, who, according to our assumption, are very much aware of these phenomena. They will seek out such workers themselves. For example, the employer will offer \$6.01 to the employee in question, reasoning that it is better that he profit to the tune of \$3.99 per hour than that the present employer "exploit" the worker at the rate of \$4.00 per hour. But another employer will come along and offer the worker \$6.02, for the same reason. Where will the process end? When wages are close enough to \$10.00 to make it unprofitable for still other employers to search for underpaid workers and transport them to their own factories. Nor is this process of theoretical interest only. It is the motivating force, for instance, in the attempt of California and other US growers to go to Mexico to entice the "wetbacks" to pick their crops.¹⁵

Patents are another interference with the market usually justified on grounds of enhancing knowledge. It is Wolf's contention that "the purpose of the patent restriction is to enhance incentives for technological improvement, thereby contributing to dynamic efficiency in the long run" (p. 27). In analysing this claim, we must first be clear that the author is correct in conceding that the patent *is* a restriction on economic freedom. This is so, because, under this system, a person may have independently invented a

15 It is a great source of amazement that Cesar Chavez, the most significant opponent of this move to price poor Mexicans out of the market (because they are in competition with his own unionized workers) should be widely applauded by the so called "progressive forces" who pride themselves on taking the part of the underdog.

new procedure, but if his papers reach the patent office five seconds after someone else's, he will legally be prevented from using the product of the sweat of his brow. And yet, if there is any ethic associated with free enterprise, it is that all people should be free to do whatever they wish with their own persons and property, provided only that they do not infringe upon the equal rights of everyone else to do precisely the same. But using one's own hard-worked-on invention cannot possibly be in violation of the rights of the individual who also created it, but was fortunate enough to arrive at the patent office five seconds earlier. Each inventor worked independently, bringing into existence something that would not have occurred but for their own efforts; both should be entitled to the fruits of their labour.¹⁶

What is Wolf's reason for defending this restriction on entry into the market? In his view "The presumption is that the long-run gains, due to enhancement of incentives and the resulting impetus to dynamic efficiency, will exceed the short-term losses resulting from diminished allocative efficiency." But this is too facile by half. First, why is this the presumption? One would have thought that agnosticism would have been the best stance to adopt in the face of such imponderable and incommensurable deliberations. Secondly, it is not just a matter of weighing future gains against present losses; it is by no means clear that there will be any long-run gains at all. For not only do patents misallocate resources in the short run, they also preempt (or at least reduce the incentives of) other would-be innovators from engaging in follow-up work. This tends to have a chilling effect on future technological change. Further, on the assumption that Wolf is correct that patents lead to long-run gains, he has failed to anticipate the objection that this scheme might lead to an *over*-investment in research and development.

Externalities

If the public finance textbook authors we are considering can be characterized as being highly concerned with imperfect competition as a market failure which justifies government intervention, this applies even more so with regard to their attitude towards externalities.

Here is the contribution of MCC on this matter:

The basic difference between the demand for "public" goods and the demand for "private" goods is the benefits of the public goods are available to many individuals and not limited to one particular customer who purchases the goods, as is the case for private goods ... (T)he benefits derived from one person's consumption of a social good are available at the same time to all others without exclusion ...

¹⁶ The way the market protects the property rights in technological improvements is through copyrights (Rothbard, *Man, Economy and State*, pp. 652-60). These are voluntary contracts between the inventor (each of them, in the case we are considering) and all who purchase the machine. As such, they are entirely compatible with the ethic of *laissez faire*.

Externalities arise that lead to *market failure*, and then require action by the public sector. These externalities arise because action by one economic unit causes a gain or loss in either consumption or production by other noninvolved economic units. Clearly, the initiator of the action will not pay the external costs or receive the external benefits unless there is some form of coercive body to allocate either the costs or the benefits (pp. 6, 7).

In the view of Wolf:

Where economic activities create "spillovers," whether benefits or costs, that are not, respectively, appropriable by or collectible from the producer, then market outcomes will not be efficient in the allocative sense ... Since these external benefits or costs do not enter the calculations upon which productive decisions are based, too little will tend to be produced where the externalities are (net) benefits, and too much where they are (net) costs, compared with socially efficient output levels (p. 20).

And according to MMB, "(The market) cannot function effectively if there are 'externalities,' by which we mean situations where consumption benefits cannot be limited and charged to a particular consumer or where economic activity results in social costs which need not be paid for by the producer or the consumer who causes them" (p. 43).

With this plethora of charges, it sounds as if at least some of them would be valid criticisms of the market. But this is not so. The main problem is that the detractors fail to take into account the role of private property rights in dealing with all such problems. Yes, there are externalities, in the modern economy. They are ubiquitous. But they stem from a lack of private property rights; when these are incorporated into the analysis, the externalities are internalized. They disappear.

For example, consider the ordinary street light lamp post. This is said to be an externality because no one is charged – indeed, no one *can* be charged – for its use, and yet all passersby benefit from the light it provides. Bosh and tush. The only reason this externality exists is because the streets themselves are not privately owned. When they are, as in the case of shopping malls or private streets such as exist in condominium developments,¹⁷ the magic of the marketplace converts them from public to private goods. Either the shopping mall owner can charge for provision of these services, or he provides them as a loss leader in order to enhance the overall attractiveness of the entire project. No one claims that the light fixtures in a private store are externalities; the only reason the street counterpart is so considered is that analysts have failed to appreciate the role of private property rights.

¹⁷ Walter Block, "Public Goods and Externalities: The Case of Roads," *Journal of Libertarian Studies* 7, no. 1 (Spring 1983), pp. 1-34; Hans Hoppe, *The Economics and Ethics of Private Property* (Boston: Kluwer, 1993), ch. 1.

Sometimes city parks are considered to be "external economies" or "positive externalities." This is because, presumably, they provide benefits to pedestrians and to owners of adjacent real estate (in the form of enhanced property values) neither of whom can be billed for these benefits. However, before the park is set up, only the owner has knowledge of its future whereabouts. He can, then, buy up the surrounding properties before their value has been enhanced by his park. As for the pedestrians, they can be charged for sidewalk use, as we have seen.

But suppose the park owner cannot buy up *all* the property that will increase in value due to the installation of this amenity.¹⁸ Will this not mean that resources will still not be optimally allocated? This is our old friend, the argument from perfectionism. *Of course*, the market is imperfect. All endeavours known to mankind are necessarily characterized in such a fashion. But as we have seen, this is not sufficient to establish that any non-market system is preferable.

Another flaw in the externality argument against the market is that it is internally self-contradictory. Our public finance textbook writers urge the adoption, on this ground, of government activity to supplant that of the market. But the free rider argument applies to government itself.¹⁹ The state, in their view, is nothing less than a vast generator of positive externalities. It is responsible for peace, justice, wealth, curing the business cycle, perfect allocation of resources, and other good things too innumerable to mention. The problem is, Why on earth should anyone establish a government in the first place? If I do so, you'll free ride on my efforts; so I won't establish a government. But if you do so, I'll free ride on yours; so, for the same reason, you won't establish one. Do we need a meta-government to overcome this "market" imperfection? If so, we are involved in an infinite regress, for why should anyone want to establish that super government?

Still another flaw is the fact that one man's meat is another man's poison. Who says that the street lamp is a *positive* externality? It's none at all for the blind man, and a *negative* one for those allergic to light. In like manner, national defence is an external diseconomy for the pacifist, not a benefit. This is our old friend, the objectivist fallacy. As we have seen, likes and dislikes are profoundly subjective. Utility is ordinal, not cardinal; and it is certainly not comparable, interpersonally. And yet that is precisely what is involved in the claim that *x* is a positive externality, or that *y* is a negative externality. It is no such thing, unless all tastes are alike.

18 He can make purchases under assumed names, so as to reduce the rate at which prices will be driven up in response to his buying. He can forestall "holdouts" by acquiring options.

19 Jeffrey Hummel, "National Goods vs. Public Goods: Defense, Disarmament and Free Riders," *Review of Austrian Economics* 4 (1990); Hans Hoppe, *Praxeology* (Auburn, AL: Auburn University Press, 1988).

Now let us consider some other examples mentioned by the critics. McC (p. 6) mentions water pollution, AM (p. 2) cites as the classic examples of pure public goods defence, clean air, and lighthouses. And according to Wolf, who also mentions research and development in this context, "the Galbraith stance against the market also draws support from anecdotes about such negative market externalities as atmospheric pollution, airport noise, advertising billboards, and the depressingly low quality of commercial television" (p. 3).

Clean air and water may be dismissed out of hand as examples of externalities. They no more illustrate cases where "partaking of the benefits does not reduce the benefits available to others" than does clean land. The only difference between air and water, and land is that government recognizes private property rights in the latter, but not the former.²⁰ There are laws against trespass on the land. If I take my garbage and dump it on your front lawn, I am liable to all sorts of legal penalties and sanctions. However, if I first incinerate my refuse, and then send it over to your very same front lawn in the form of half-burnt soot particles and ash, the law on the matter, at least until very recently, was very different. This is why air and water seem to exemplify externalities, while land does not. Yet it is easy to see that if we reversed things – that is, subjected air and water-borne pollutants to the laws of trespass, and private property, but *refused to do so on the land*, then economists would point to clean land, not clean air and water, as the externalities case for government intervention. Then we could say, along with AM, "Any *land* that is 'cleaned up' will become available to everyone, and because those who would initially incur the cost of cleaning the *land* cannot charge for their service, it will not be undertaken. The government must provide for it if it is desired." The equivalent statement about water and air²¹ would be just as nonsensical as this one about land appears, if we were to reverse our legal treatment concerning them.

Contrary to McC, there is no question of providing clean water for all but one of the downstream communities. With private ownership of rivers and streams²² everyone will both want and be able to obtain clean water. It is

20 For further reading on the philosophy of private property based free market environmentalism, see Walter Block, *Economics and the Environment: A Reconciliation* (Vancouver: The Fraser Institute, 1990); Ronald Coase, "The Problem of Social Cost," *Journal of Law and Economics* (October 1960); Morton J. Horwitz, *The Transformation of American Law: 1780–1860* (Cambridge: Harvard University Press, 1977).

21 Water is scarce, and therefore can be privatized. But this does not yet apply to air. Strictly speaking, we refer not to air, nor even to clean air; rather, the point is that those who contaminate the air can be interpreted as violating the property rights in land of the owners where the pollutants finally settle.

22 Walter Block, "Institutions, Property Rights and Externalities: The Case of Water Quality," *Agriculture and Water Quality: Proceedings of an Interdisciplinary Symposium*, Miller, FitzGibbon, Fox, Gilham, and Whiteley, eds., Guelph Centre for Soil and Water Conservation (Guelph: University of Guelph Press, 1992), pp. 191–208.

no more likely that if it is left to the market to allocate clean water, there will any more over-production of pollutants than in the case of milk.

The less said about the lighthouse as an example of externalities, the better, in order to save embarrassment to those who utilize it. It is a source of amazement that anyone would still cite this case after the publication of Coase's work on this subject.²³

But national defence is still alive and kicking, at least from the neck down. In fact, it is probably exhibit A in the case for government intervention on the grounds of externalities. But it, too, collapses like a house of cards upon analysis. Contrary to most commentators on the subject, it is indeed feasible to restrict the benefits of defence to those who have paid for it. Perhaps not "perfectly" or "costlessly" as might be required by some, but this is feasible nonetheless.²⁴ All that need be done is to give a tag to those who have paid for this service, and announce that all people without such tags are henceforth to be considered "fair game." That is, the defence forces, whoever they are, will not prosecute or try to capture those who violate their persons or property rights, or lift a finger to in any way protect them from violence.

Now consider airport noise. Contrary to Galbraith, and to Wolf, the market can solve this issue as well. The reason it has not yet so far done so is that the laissez faire system has not been allowed to work. In this view, homesteading plays a pivotal role in the initial determination of property rights. In the Lockean version of this philosophy, one legitimately obtains ownership to land by "mixing one's labour with it." But noise, too, is a way of properly acquiring property. Suppose an airport sets up shop in an otherwise deserted area. The runways and buildings occupy a circle with a diameter of one mile, but the attendant noise spills over onto a larger circle, with a diameter of two miles. In such a scenario, the airport acquires the ownership rights to the small, inner circle, as well as the easement right for its noise in the larger circle. People are free to build homes in the outer ring, but cannot object to the noise emanating from the airport, because the latter firm owns the right to engage in that act. Thus, the externality is internalized. On the other hand, if the homes were there in the outer ring first, they would be considered to have homesteaded the right to quiet domesticity. If an airport wanted to establish itself in the centre of this area, it could only do so if it either bought the noise rights from the homeowners, or made sure that the sound created by takeoffs and landings was confined

to its inner small circle. If the noise disturbed the homeowners, it would be guilty of trespass. But in neither case is there an externality. This is entirely a product of failure to define private property rights in a consistent manner.

Some people like advertising billboards and some do not. Under public highway ownership and management, there is no way to maximize welfare. This is a case of government failure. But under private ownership, there is a solution. One road owner will allow many billboards, another a small amount, and a third, none. Then the market will sort itself out, as profits and losses are visited upon the various firms in accordance with how well they satisfy consumer tastes in this and all other regards. There is no more of an externality problem here than there is with regard to the question of how restaurant owners should decorate their walls. With Rembrandts? Beatle posters? Blank walls? Lots of decoration? Very little? Who knows? Who cares? The market automatically takes care of this problem. However, were government to own and manage restaurants, then the externality problem of wall decorations would arise. Galbraith and Wolf could wax eloquent about this "market failure." The point is, once again, the entire "problem" arises because of failure to allow private property, not because of anything intrinsic to the market.

Subjectivity also applies to commercial television: some people like it, others do not. As for those who complain about its "depressingly low quality," this is yet another instance not of market failure, but of failure to allow markets. The commercial TV airwaves are not *owned* by ABC, NBC, or CBS. Rather, the airwaves have been defined as a public good. As such, ownership has been vested with the government; the rights to broadcast are held temporarily, and reviewed every few years. Imagine if book publishing were organized under such socialistic principles. That is, no one could own paper, ink, or printing presses; instead, these would be loaned out to three or four firms for a few years at a time, renewal dependent upon whether the output was "in the public interest," as determined by the government. Is there any doubt that book publishing would quickly become a "vast wasteland"? Publishers in this scenario would aim only at bestsellers and bodice rippers, the sort of thing that Galbraith and Wolf would see as of "depressingly low quality." Publishers could not afford to alienate the general public by coming out with books on Shakespeare, or Mozart, or economics, or even the efforts of Galbraith and Wolf. This is because the public interest would be equated to the tastes of the lowest common denominator. Specialty concerns would be no more acceptable than they are on commercial TV at present.

Educational externalities are the reddest of red herrings. Academics, such as the authors of public finance textbooks, can be expected to see great spillover benefits emanating from higher learning. But the average person, forced to pay taxes so that finishing touches can more than proportionately

23 Ronald H. Coase, "The Lighthouse in Economics," *Journal of Law and Economics* 17 (1974), pp. 357-76.

24 People cannot be "perfectly" or "costlessly" precluded from the enjoyment of even what are considered by neoclassical economists to be private goods. It costs resources, for example, to make sure that only those who have paid for the movie are admitted to the theatre, that only those who have paid for the bread actually receive it.

be put on the children of the rich, look at this with great bemusement. They hear of professors extolling the virtue of marxism, feminism, homosexuality, seizing the dean's office, deconstructionism, atheism, hatred for patriotism, lack of free speech for conservatives, and goodness knows what else, and in their view any externalities which come about as a result are strictly of the negative variety. We're not just talking about a few pacifists here. As indicated by the continual failure of school bond issues, it is distinctly possible that the majority of people see the spill-over effects of education as negative. When William F. Buckley states to wildly receptive audiences that he would rather be ruled by the first two thousand people in the Boston telephone book than by the Harvard professoriat, he is tapping into this widely held perception.

MMB have a slightly different slant on social goods, based on rivalrousness and excludability (pp. 44, 45) and use the following diagram to summarize their analysis:

CONSUMPTION	EXCLUSION	
	feasible	not feasible
rival	1	2
non-rival	3	4

For them, case 1 indicates private goods, where exclusion is feasible (it's easy to charge a price), and consumption is rival ("A hamburger eaten by A cannot be eaten by B"). The market can work here and there is no need for government intervention. This is not so in the other three situations. Cases 3 and 4 depict conditions where consumption is non-rival (neither A nor B interferes with the use of the good by the other), so that whether or not exclusion is feasible (case 3, the broadcast) or non-feasible (case 4, "air purification, national defence, street lights"), exclusion *should not* occur, since marginal costs are zero, and thus this would be inefficient. In case 2 (the crowded city street) rivalry has been achieved, but due to our *inability* to exclude,²⁵ there is again market failure, for unless we can prevent non-payers from road use, we will be swamped with free riders. To put this in

²⁵ MMB are in error on this point. They cite William Vickrey's suggestion that electronic devices could be used to monitor the street use of automobiles, but dismiss this as only of "eventual" usefulness. But Vickrey made his suggestion in the early 1960s; since then, the universal product code has been used for everything from groceries to toys. The reason the streets, roads, and highways have not been privatized has little to do with technology, and much to do with the sort of philosophy promoted by MMB: that the state is efficient, and the private sector, not. This is tragic, in that over four thousand people die in motor vehicle accidents each year in Canada and there is good reason to believe that privatization would sharply reduce this needless death toll.

other terms, the market failure in cases 3 and 4 is basic, intrinsic, and necessary: rivalry has not been attained, and never can be. In contrast, the market failure in case 2 may be characterized as superficial or temporary: could we but realize exclusion (a technological problem according to MMB) the market can indeed work, because once we achieve it, it is efficient for it to be used.

Nor have the other authors of leading Canadian public finance textbooks failed to point to non-rivalry as an elemental source of market failure. Only instead of characterizing the problem as one of non-rivalry, they have more heavily utilized the language of zero cost pricing. McC says: "Some goods exhibit short run marginal costs that are zero ... Allocational efficiency would require that the price of the good be zero" (p. 33). And according to Wolf, "efficient use of resources at any point in time requires that prices of outputs be equal to marginal costs ... Many firms in market economies, ... frequently - and perhaps typically - do not set prices equal to marginal costs" (p. 117).

This is an exceedingly compelling argument. The non-rivalry-zero cost pricing doctrine is a carefully thought out defence for the interventionist position. One is almost tempted to agree with it. The only problem with it is that it proves too much. Contrary to MMB, Wolf, and McC, non-rivalry and zero marginal costs are by no means limited to the public sector; the concepts apply to ordinary private sector goods as well. Therefore, instead of illustrating these doctrines with a product typically assigned to the public sector, let us do so with something usually thought of as private.

Consider a half-filled movie theatre. This, too, is a paradigm case of failure to price at zero marginal costs, or, to use the MMB terminology, an instance of non-rivalry. Once the set-up costs are covered (rent and taxes for the real estate, payment for the projectionist, electricity, and so on) it costs nothing to admit an additional patron.²⁶ Viewer A no more interferes with the amenities accorded viewer B in the theatre than occurs in the cases of the two users of the uncrowded bridge, or the two listeners of the broadcast. According to the prescriptions of the public finance theorists, the socially optimal price of the movie ticket ought to be zero. Needless to say, it is impossible to run a profit-maximizing business, let alone any private firm, on this basis.

But this *reductio ad absurdum* applies to far more than movie theatres. At first glance, it pertains to all products where the customers sit in a theatre, or watch a performance. This would include, at the very least, circuses, ballets, operas, orchestra performances, football, basketball, baseball and

²⁶ Alternatively, we borrow a leaf from MMB (p. 44) and say, "But though the marginal cost of admitting additional users is zero, the cost of providing the facility is not. This cost must be covered somehow," presumably through tax revenues.

There is an entirely different way to demonstrate the *reductio*. Consider this item from the *Vancouver Sun* on 20 December 1992, entitled "Pasta Santa":

Approximately 200 homeless hungry people have been invited to Christmas Eve dinner at Anton's Pasta Restaurant at 4260 East Hastings in Burnaby. General manager Raffaele Sclaretta said the restaurant will be closed to the public that day and 15 staff members have volunteered to cook for and serve the guests. Suppliers including Coca Cola, dairies, bakers, poultry and pasta companies are donating food. "This is our year at giving something to the community. Next year, we'll challenge other restaurants to do the same," Raffaele said.

Notice anything wrong here? This man may be a competent restaurant manager, but as an economist he is no more than on a par with MMB. Anton's "gives something to the community" *every day* of the year that it is open, not just on the one occasion they cater only to the poor. If it weren't for this Pasta Restaurant (and hundreds of other such shops in the community) the lives of the local people would be far less enjoyable than they are at present.

Every private enterprise gives off consumer surplus. This is an externality. Therefore, all firms embody instances of spill-overs. True, in the never-never land of perfect competition, full information, millions of firms, homogeneous products, and so on, production takes place until the point where no consumer surplus is derived from the marginal unit. But even in this case there is still consumer surplus derived from all the intramarginal units. And when equilibrium has not been attained, the marginal unit brings in consumer surplus as well. This external benefit simply would not exist had it not been for the existence of the firm (or the factor of production). It is a necessary concomitant of trade. This is yet another reason why there are no purely private goods. MMB's alternative no. 1 is thus a null set. If so, we can again "prove" that government should operate everything, something even Stalin couldn't attain.

We have shown, at least to our own satisfaction, that the *reductio* works. If we take the analysis used by the public finance theorists on "public" goods and instead apply it to private goods, we must arrive at the same conclusions: there are no truly private goods; economic efficiency requires full and complete socialism. Everything must be provided by the state. But we are by no means limited to the use of this *reductio* in defending the market. Their argument "proves" too much, but only if we are victimized by it. Let us now focus on the fallacy they commit.

The "logic" of zero cost pricing is, Why shouldn't the movie owner be forced to seat intramarginal persons for free (once all fixed costs of the enterprise have been paid)? If the owner isn't forced to do so, there is a case

hockey games, universities, lectures of all sorts, radio and television, parks. This applies as long as there is less than 100 per cent occupancy — a virtual truism in all these cases. It applies to other amenities where there are vacancies: hotels, motels, apartment houses. Why not allow people to visit half-filled hotels for free, or at most charge them just for changing the towels and the sheets? After all, when the facility is half-full, guests A and B are in a non-rivalrous position with regard to one another.

But we have barely begun to scratch the surface. What of perishables? Consider that hamburger MMB spoke of, the one where "A hamburger eaten by A cannot be eaten by B," the archetypical private good. What are its marginal costs? Well, this depends entirely upon the time frame on which we focus. Before the hamburger is made, the costs are significant. They include the cost of the meat, the bun, the fixings, the land, labour and capital necessary to gather the raw ingredients together in one place (transportation, insurance) and to cook them (heat, energy). Nor must we neglect the omnipresent transaction costs associated with bringing the burger to the hungry consumer. But that is all beforehand. Now consider the costs after the burger is cooked at a fast food restaurant and placed on the shelf. Amazingly enough, all these significant costs have disappeared! The marginal costs of *this* hamburger are zero. If anything, the costs have now become negative, since if unsold, they will have to be thrown out, and this costs money. As such, the rivalrous nature of this private hamburger has been lost. According to the logic employed by MMB, then, the burger is no longer a private good; not it is a "public" good.

But if a hamburger can be turned into a zero marginal cost "public" good,²⁷ then so can anything else under the sun. The same analysis applies to piling up large quantities of any consumer or intermediate good: cars, computers, canoes, or steel, sassafras, and salmon. At the point of sale, the owner has no use for the product whatever, apart, that is, from his own consumption use. But how many potatoes can the potato farmer eat himself? How many shoes can the shoe manufacturer wear? If no one buys them, and he must dispose of them, their value is not even zero.

The analysis offered by the public finance textbook authors is thus a recipe for full and complete socialization of *all* goods and services, on a scale, if anything, even greater than that practised by the Soviets, even under the "good old days" of Stalin and Lenin.

²⁷ These goods have no alternative costs. They will be non-rivalrous when we consider the seller and one buyer. However, since they are economic scarce, they will not be non-rivalrous vis-à-vis one potential consumer and another. This, however, is irrelevant to the point at issue: whether it is "efficient" for production to take place in the private sector or not. According to internal coherence of the MMB argument, the case is still compelling for "public" production, for as we have seen, there is no rivalry between producer and consumer. It is only in the case of distribution, where efficiency calls for price exclusion, for there is still rivalry between one consumer and another.

where resources aren't rationally allocated. Something which costs nothing (the movie ticket for the empty seat) and has value (the patron wants to see the movie if he can do so at a free price) does not get conferred on anyone. A mutually beneficial deal (or at least a Pareto Optimal deal that benefits one party without hurting the other) nevertheless is not consummated. There is nothing guaranteed to make a neoclassical economist froth at the mouth as much as a conceivable opportunity for increasing utility not addressed by the market.

We can employ common sense, or the insights of laissez faire economics, to see the fallacy of this idea. First of all, since this is not a voluntary transaction, it is by no means clear that there are no costs involved. For example, the theatre owner might resent the presence of a non-paying attendee. This might be a psychic cost, impossible to verify empirically. Since costs are subjective, it is not clear the half-empty movie theatre is an example of a zero marginal costs, and of the non-existence of rivalry between producer and consumer. For that matter, given the subjectivity of costs, it cannot be shown that there are any cases where the market fails to promote or maximize utility in this manner.

Merit goods

If nothing else, the concept of "merit goods" is a public relations success of vast proportions. Our authors could have characterized those items for which they wanted to promote subsidies or special protections as "our favourite goods," or some such. Had they done so, their scheme would have blown up in their faces. No one would have paid them much mind, dismissing the idea as that of yet another special interest group – not a financially motivated one, but rather one which acts out of ideological purposes. In the event, however, they hit upon a brilliant ploy: they called their pet projects and favourite commodities "merit goods," thus enfusing them with a spurious objectivity. And the rest, as they say, is history. At least in the upper reaches of the halls of academe, this justification for government intervention is actually seriously deliberated upon by otherwise thoughtful scholars (see MMB, pp. 7, 72, 73, 291).²⁸

28 AM state: "'merit' goods ... could be supplied by private business firms but are supplied by government, since the market system would not produce the socially desirable output because of the presence of externalities or imperfect knowledge. Examples of 'merit' goods are ... health services – because individuals may not be aware of the benefits from health services" (pp. 2, 3). The only justification vouchsafed to us by AM is that "individuals may not be aware of the benefits." But there are so many things about which individuals are unaware. If this were taken seriously, given imperfect knowledge, it could again justify government involvement in every jot and tittle of the economy on this ground. As for government intervention in health concerns on externalities grounds, if this were so, we would long ago have had compulsory testing and either quarantines or special markings for those afflicted with the HIV virus.

It is long past time to point out that the emperor has no clothes; that this is nothing more than a rather cunning attempt at ideological rent seeking. The problem is, anyone can prove anything he wants, using this argument. For example, it is possible to entertain the very opposite: why not deem liquor the merit good (it enlivens parties, allows people to forget about their problems) and milk the demerit (cholesterol, and all that). True, a nutritionist is liable to blanch at this characterization, but as far as economics is concerned, or even ethics, neither side of this debate can attain any sort of victory.

Does the MMB claim reside in the realm of normative or positive economics? Seemingly not the former, for it offers no reason to suppose that it is moral, or virtuous, to coercively limit consumption of alcohol, presently an entirely legal commodity, and to force some people to pay taxes to support the milk habits of others.²⁹ If it is the latter, this has been compellingly criticized, at least with regard to education. In that case, Musgrave's argument is that "the advantages of education are more evident to the informed than to the uninformed, thus justifying compulsion in the allocation of resources to education."³⁰

In response, West and McKee reply: "(The) merit want argument, in terms of positive theory, has now clearly been falsified. The reason, of course, is that more than three generations have already ensued and universal free and compulsory education is still with us."³¹

It is also possible to employ the *reductio* in response to Musgrave. The advantages of *anything* are more evident to the informed *about that particular issue or event or commodity*, than to those who are uninformed. For example, I am more informed than the general public about chess, karate, handball, violin playing and swimming, because those happen to be my particular hobbies. I am therefore, according to the logic of the merit goods argument, in a position to inflict my views on society, at least as far as these activities are concerned. If Musgrave is correct about education and milk, I should be able to force taxpayers to support my hobbies through subsidies, and to prevent, or at least retard, engagement in other endeavours such as baseball, trumpet playing, jogging, fencing and surfing, which I hereby label as demerits.

29 Further, this argument gives elitism a bad name. It is one thing to assert the superiority of the educated. This may be "politically incorrect," but it is true, at least in the limited sense that the educated are indeed superior in at least one thing – namely, in the amount of education they have undertaken. But it is quite another matter to declare, as does Musgrave (see below), that the educated elite have the right to impose, by force, their views on the rest of us. From whence does this right spring? From value free economics? Hardly.

30 Richard A. Musgrave, *The Theory of Public Finance* (New York: McGraw-Hill, 1959), p. 14.

31 Edwin West and Michael McKee, "De Gustibus Est Disputandum: The Phenomenon of 'Merit Wants' Revisited," *American Economic Review* 73, no. 5 (December 1983), p. 1114.

Another difficulty is the arbitrariness of the instances offered by MMB. What about chocolate and ice cream, hang-gliding and boxing? Surely they are all harmful, in some sense or other. Should we penalize these as demerit goods? Alternatively, there is spinach and broccoli, dressing warmly and brushing one's teeth after each meal. Should the government promote these "merit" activities? (We're talking about doing this for adults, here!) There are those amongst us, call them perverts if you wish, who would gladly reverse the aforementioned merit and demerit characterizations. How can we say them nay? Since there are no clear principles offered for such a determination, we are at sea without a rudder.

How does the doctrine of merit wants relate to the issue of democracy? At first glance, there would appear to be a downright contradiction between the two. If people are smart enough to pick their leaders, how can they not be able to spend their family budget's without "help" from their political masters? MMB give some evidence of concern: "The concept of communal needs (which underlies the doctrine of merit goods) ... carries the frightening implications of dictatorial abuse" (p. 71). But this does not go far enough. It is not just dictators we need to worry about. There is also the totalitarianism of the majority, dictating minute choices over our everyday lives. In any case, Musgrave was far less worried about this problem: "While consumer sovereignty is the general rule, situations might arise, within the context of a democratic community, where an informed group is justified in imposing its decisions upon others" (1959, p. 14).

In conclusion, it is difficult to see how any economist who sees value freedom as an important part of the methodology of the profession can embrace the concept of merit goods.

Equity

The pursuit of equity furnishes us with yet another instance of our authors chasing the will o' the wisp. AM state:

Without government intervention, the distribution of income would depend upon who owns the various factors of production and the price they command in the market. There is nothing to say that this distribution, even if determined by perfect competition in product and factor markets, is the most socially desirable distribution. Governments must attempt to determine the consensus of the population as to whether there should be more assistance to the lower-income groups, and if so, who should bear the burden of higher taxation to provide this assistance in a situation where there is an unequal pattern of income distribution (p. 3).

There are several difficulties with this rendition of the problem. First we are given no independent measure of "socially desirable distribution." Yet without it there would appear to be no way to determine unambiguously whether the income distribution which arises from market activity is "desi-

table" or not. Secondly, even if we were given this independent measure, it would appear difficult to reconcile this with value-free economics. How does one deduce what should be from what is? Thirdly, why resort to a "consensus of the population"? This is rarely done in economics. We do not commonly ask the public how to solve the business cycle, how to cure inflation, how to maximize wealth. Why should an exception be made in the case of equity? Are we economists not the professionals, the experts? Why call in the hoi polloi? Fourthly, there is a conflation between equity and equality, as shown by the unaccounted for asymmetry. According to AM, "governments must attempt to determine the consensus of the population as to whether there should be more assistance to the lower-income groups." But why not to the *higher* income groups? Is it a fact of nature that equity always requires a move toward *more* equality. Is *less* equality ever equitable? The implicit premise in AM is that the two concepts are indistinguishable. But this is nonsense; equity and equality are very different; why else would we have the two separate words? If one wants to argue that they are the same, the minimal burden of proof would at least be to supply reasons for this conclusion. This is not done.

McC's contributions to this discussion move us further ahead, but only slightly:

... there are always some persons unable to exist in the market structure, either through disabilities of one sort or another, or because they lack advantages in education, upbringing, and the like. In earlier times, the accepted method of dealing with these persons was by way of religious and charitable organizations of one sort or another. It is now generally accepted that government must play some role in distributing income and wealth to coincide with the humanitarian values of our society (p. 5).

There are grave difficulties with this contribution as well. Charity, whatever its drawbacks – and none are mentioned here – is at least part and parcel of the system of *laissez faire* capitalism. It is a commercial interaction, after all, between consenting adults. True, these "earlier times" have given way to modern times. Nowadays our welfare system creates dependency, promotes crime, fosters illegitimacy and family breakup. Wolf scathingly points to the "failure to realize that expanded welfare programs, such as Aid for Families with Dependent Children, although intended to provide help for poor families, might have the subsequent effect of seriously weakening the structure of the family" (p. 41).

Why is this an improvement, given that family breakup leads to crime, poverty and other indices of social disarray? Also true, "it is now generally accepted that government must play some role in distributing income and wealth ... " But this unfortunate fact should not even be relevant to economic analysis, much less a decisive factor. It is positively weaselly to hide

behind "general acceptability," and to substitute this for serious analysis. It is almost as if, given the sad record of AFDC, McC cannot bring himself to defend government intervention in this area.

McC is clearly unhappy with the state of distribution in Canadian and other modern societies. He correctly acknowledges, however, that it "depends" upon factor endowments. This leads to an interesting speculation. Suppose, just suppose, that we did not have it within our power to change the distribution of wealth, but only to alter the pattern of initial endowments. That is, for some reason we could not redistribute purchasing power, but could do so for IQ, beauty, endurance, persistence, charm, musical and athletic talent, and all of the other human attributes that together determine the variance of income. Would we do so? The result would be a situation that would make the one depicted in *Brave New World* look like a Libertarian nirvana, but based on McC's comments, he would appear to be logically committed to welcoming such a spectre.

How, then, does this treatment represent an improvement over that afforded us by AM? In two regards. First, McC concedes in a crystal clear manner that value judgments play a critical part in the determination of equity. Unfortunately, he does not conclude from this that the economist, qua economist, has absolutely no role to play in this determination. Had he been of that view, he would scarcely have included this topic in his book on public finance. Secondly, his discussion of the concerns of economists about income distribution has the virtue of depicting it accurately along the lines of worry over style changes in hemline lengths (initially, focus on adequacy of income at the lower end of the income scale; then, on relative income positions; after that, on excessive incomes at the top of the scale; finally, trying to determine a tolerable minimum level of income) and not as a serious scientific endeavour.

And what has Wolf to add to our deliberations? There is one aspect of his analysis that is vastly preferable to that of AM, McC and MMB: his willingness to consider the merits and demerits of imperfect markets and imperfect governmental institutions vis-à-vis one another. This is a distinct advantage over the other commentators, who all too often compare perfectly functioning benevolent state organizations with what they are pleased to see as highly imperfect markets. Wolf's contribution to the discussion of equity focuses, reasonably enough, on the role of private charity. Unfortunately, he categorizes such efforts under the rubric of non-market activity, alongside those of government.

Although government is the largest member of the nonmarket sector, the others (foundations, universities, and nonproprietary hospitals) are numerous, vast, and growing. The behaviour and deficiencies of those other nonmarket organizations should be included in a comprehensive theory of nonmarket failure that can high-light similarities and differences among them, as well as permit suitable

comparisons to be made between the market sector and the nonmarket sector (p. 6).³²

There is a certain amount of truth to the Wolf position. After all, neither governments, nor private charitable activities, are market driven. Neither relies upon prices, profits, buying and selling. However, in lumping them together, Wolf makes it awkward to evaluate the benefits of the laissez faire capitalist system, which very much includes philanthropy, but not necessarily the state. Charity, it must be repeated, is part and parcel of the complex of voluntary interactions; governments, taxes and regulations hardly qualify.

Notwithstanding the above, when it comes time for him to criticize the institution of private charity, he does so from a perspective which sees this as *market failure*:

... it is theoretically correct to consider distributional *inequity* as an example of market failure. From this perspective, income distribution is a particular type of public good. An 'equitable' redistribution does not result from freely functioning markets because philanthropy and charity yield benefits that are external to, and not appropriable by, the donors, but are instead realized by society as a whole. Left to its own devices, the market will therefore produce less redistribution that is 'efficient' (that is, socially desirable), because of the usual 'free rider' problem associated with externalities, public goods, and incomplete markets (pp. 28, 29).³³

But this externalities defence of the welfare state is open to many telling criticisms. Wolf says in effect that he (and others) is distressed by the sight of poverty, and we must perforce believe him. He is known the world over as an honourable and trustworthy man. Strictly speaking, however, as social scientists, we have no business doing any such thing. For the argument must rest on its own internal logic, and on the evidence that can be put forth in its behalf, not on the sterling personality of its advocate. Let us then assume that the claim was not made by this reliable person, but rather by

32 Later on in his analysis, Wolf sees this relationship as "complex ... difficult and ambiguous" (pp. 87-91).

33 Wolf continues: "Another perspective for viewing distributional equity is quite unrelated to market failure in the strict sense. From this perspective, the equilibrium redistribution previously referred to may be quite inequitable in terms of one or another ethical norm. Even if the market could surmount the narrow type of 'failure' discussed above, its distributional outcome might still be socially and ethically unacceptable from the standpoint of one or more such norms. On these grounds, the distributional outcomes of even perfectly functioning markets can be justifiably criticized." Much as it pains me to appear to defend "perfectly functioning markets," this last statement of Wolf's does not logically follow the foregoing. The distribution arising from market interaction can only be justifiably criticized if the ethical norms to which Wolf refers are themselves valid. But no such proof has been even considered, much less offered. In any case, to do so would be to take us far afield from the realm of (positive) economics.

anyone at all. Then our more natural professional scepticism would kick into high gear. We would not accept mere assertion; rather, we would demand proof. For example, the person who makes this claim might be studied to see if he demonstrates the truth of it through action. How can he do so? One way would be for him to contribute to charity. From that act the outside observer could deduce that he prefers a world in which the lot of the poor improved in this way to one in which it is not. This the articulator of the argument says he will not do, at least not to the same degree, unless everyone else can be made to go along. So not only does he fail to demonstrate a preference for rescuing the poor from poverty, he purposely refuses to do so, even when specifically invited. Thus there is no real indication that he is indeed distressed by the sight of poverty.

Let us grant this unproven and logically unprovable contention, just for the sake of discussion. Why does the argument lead to the conclusion that poverty must be alleviated? If it is a negative externality, perhaps it should instead be prohibited. Instead of seeing *helping* the poor as an external economy to be encouraged, we could with equal logical rigour interpret *being* poor as an external diseconomy to be punished. Let us illustrate this with an example. Suppose that someone were to claim that he was distressed not by the sight of poverty, but by a very different occurrence also described by a word beginning with a "p" and ending with a "y," namely pornography. This person, too, would be benefited equally whether I or someone else pays for its elimination. In the debate over pornography, no one seriously advocates that society should band together, raise money through taxes, in order to *pay off* the pornographers. Rather, opponents propose *banning* it. But what is sauce for the poverty goose should be sauce for the pornography gander, if we are to be consistent. Both are claimed to be negative externalities. They cannot be treated in so vastly a different manner without justification; and none is offered by the argument. So what might follow from this line of reasoning is that poor people should be punished, or banned, or deported; alternatively, it follows with equal logic that pornographers be subsidized, if they agree to desist.

This, of course, will open up a can of worms. For it would now be in the interests of many people to declare themselves as pornographers, so as to take advantage of the subsidy. Can this be justified? Just as in the case of poverty, there are probably some people who not only enjoy it, but (perverts!) even derive an external economy from its usage by other people. If so, and who can deny this possibility, perhaps, then, we should subsidize pornography. Ah, the results to which we are led by this theory.

But there are still other difficulties here. One man's meat is another man's poison, as we have seen. Some people may be distressed by the sight of poverty, but others might relish this state of affairs, perhaps as a means of lording it over others. Giving welfare to the poor, then, might promote the welfare of the men of good will, but it will reduce that of the misogynists

amongst us. Since there is not and cannot be any scientific method of making interpersonal utility comparisons, we cannot rigorously conclude that welfare programs unequivocally improve the well-being of society as a whole.

Then, too, with this perspective, there is a great difficulty of accounting for the generous amount of charity that does indeed take place, given governmental efforts in this regard. For, according to the theory, we are all going to refuse to help the poor unless everyone does so. Why, then, in a society where government gives a historically unprecedented amount of money to the poor, are people still making charitable contributions? There should be little or none according to the externalities argument, but on the contrary there is much private giving. There is also the difficulty of explaining the level of private charitable contributions made before government began its activity in this field. According to Wolf's theory, donations then should have been virtually non-existent, as we each all wanted to contribute but were waiting for someone else to do it so that we could free ride on their efforts, or would only do so if given an assurance that everyone else would do so too. The point is, we have overwhelming evidence suggesting that people do not wait for the assurances that others will give before doing so themselves. On the contrary, they give in any case, and they give generously, even when they know that others will *not* give as generously, or indeed, give at all.

One way to comprehend this state of affairs is to realize that the externalities, should they exist, can be internalized through the operation of a free society. This is done in many different ways. People are given buttons to denote their contributions. Those without them are looked down upon. High society patrons hold charity balls. It is of great importance, in some circles, to be invited. But guest lists are highly correlated with charitable giving. Making a contribution, especially a highly public one, is good advertising for businessmen. This must be a large part of the explanation of the endeavours, not to say the very existence, of groups such as the Rotary, the Elks, the Moose and similar institutions. People of a religious persuasion are convinced that helping the poor in this vale of tears can help square their accounts in the world to come. This motivation, too, is hardly compatible with the Wolfian account we are contemplating. As well, the standing of businessmen who are part of the religious community is heavily dependent upon charitable contributions to this quarter.

Even if all of these objections were somehow countered, the argument does not suffice to establish anything like the welfare state now in existence. It is vulnerable to all sorts of *reductios*. For example, this argument applies as much to foreigners as to domestic citizens. Are we more distressed by the abject poverty of Canadians than we are by that of Ethiopians or Bangladeshis? Most people are probably not. In some sense, there really *are* no poor people in Canada, at least not as this phrase is used in the latter two

countries. So if our distress is correlated with the degree of misery, virtually all of our tax money devoted to poverty fighting will be used up for foreigners; none will be left over for our fellow countrymen. And yet our welfare system most certainly does not include the poorest people in the world. On the contrary, it focuses almost entirely on the relatively well-off "poor" people in Canada. This can hardly be explained on the grounds that we are distressed by poverty.

Another *reductio* concerns the level of welfare payments. Some people, perhaps not Wolf, are distressed not merely by the sight of poverty, but by the sight of inequality of income and wealth. In their view, nothing less than absolute egalitarianism is "distressful." If these arguments justify coercive taxation in order to "help" the poor, then they also justify anything that anyone else finds distressful, such as the absence of egalitarianism. But why stop here? Why just equality of money income or physical wealth? Why not equality of some rather more important things, such as intelligence, beauty, musical talent, on the assumption, of course, that it was physically possible to redistribute such things. There is simply no stopping point to the argument if someone would just come forward and announce himself "distressed" about the absence of absolute equality of such characteristics.

While we're at it, we might as well contemplate the fact that Hitler was, presumably, distressed at the existence of Jews. What follows from this? Absolutely nothing, as long as we reject this argument in behalf of the welfare state. But if we accept it, then we must accept all sorts of conclusions, such as one about Hitler's desires, that can best be characterized as belonging to a moral swamp. For example, if we accept the basic premises, then we are forced to ask whether Hitler would have eliminated the Jews if and only if everyone else contributed their fair share to this undertaking (in which case, according to the argument, government intervention to this end would have been justified), or if he would have exterminated them entirely at his own expense (in which case state, super-state, or world government action would not have been justified).

So much for Wolf. Can MMB further our quest to get to the bottom of the equity issue? Starting out on a high note, they concede that Pareto optimality can play no role: "This criterion ... cannot be applied to a redistributive measure which by definition improves A's position at the expense of B's and C's." As well, they admit that "the answer to the question of fair distribution involves considerations of social philosophy and value judgement" (p. 10). Most important, MMB recognize that interpersonal utility comparisons are fraught with logical dangers: "it is ... impossible to compare the levels of utility which various individuals derive from their income" (p. 11).

With a base as sound as this, it is hard to believe that they would come to grief. Nevertheless, unfortunately, this is precisely what occurs. For in

almost their next mention of the topic they are busily drawing two-person utility frontiers and social indifference curves (p. 53). So quickly did the "impossibility of comparing the levels of utility which various individuals derive from their income" vanish down the memory hole.

Their other contribution to our deliberations consists of a defence of the principles of benefit and ability to pay, for determining "equitable" taxation. But a moment's reflection will convince us that both are iniquitous, not equitable at all. This can be shown by applying the two precepts to any other area of life beside the relationship between the citizen and the state. First, let us ponder about the benefit principle: "Each taxpayer contributes in line with the benefits which he or she receives from public services" (p. 209). But according to the theory adumbrated by MMB themselves, there is no way to be sure that taxpayers – any one of them, let alone all of them – actually benefit from so-called public services.

In their view: "But where the benefits are available to all, consumers will not voluntarily offer payments to the suppliers of social goods. I will benefit as much from the consumption of others as from my own, and with thousands or millions of other consumers present, my payment is only an insignificant part of the total. Hence, no voluntary payment is made" (p. 6). And again: "The crucial fact (is) that social goods are provided without exclusion. Because of this, consumer preferences for such goods (the value which they assign to successive marginal units of consumption) will not be revealed voluntarily" (pp. 48, 49).

MMB simply assume, without any proof whatsoever, that consumers do indeed gain from social goods. But what kind of grounding for the economic science of public finance is that? An unsupported assumption, hanging in the air, with no foundation. And, as we have seen, there is reason to believe that at least some members of the public (pacifists) might well be *hurt* by some "public" goods (defence.) They concede that there is no way, as in the private sector, for consumers to reveal, or demonstrate, their positive preferences for these so-called public goods. In the absence of any evidence in behalf of their contention, the only rational conclusion is a healthy scepticism.

But doesn't the government provide services? Even though people will not reveal their preferences for these goods, don't we know – "in our hearts" – that they do indeed provide benefits? Suppose that there is a holdup man, with a philosophical streak. In the past, he has been stung with the allegation that he is a no-good, parasitical, anti-social creature. He feels so guilty about these charges that he confers no benefit upon his victims, that he decides to do something about this lacuna. The next time he pursues his calling, he gives out a rusty paper clip to each, as he relieves his victims of their hard-earned money.

The obvious objection to this scenario is that it is not enough to give out "benefits," even if we stipulate that everyone recognizes paper clips to be

a "good." (There are no "pacifists" in this case, by assumption.) Also necessary is that people value the item they are given more highly than the money they give up in order to get it. Thus, further required is that they *agree* to this transaction, else how on earth can we ever tell that they valued the paper clip more than the money taken from them?

But this is precisely why the philosophical robber fails to salve his conscience. And it shows that the MMB theory cannot be maintained. In each case, the robber and the government, what is missing is the *acquiescence* on the part of the victim/taxpayer.

Now, let us appraise ability to pay: "Each taxpayer is asked to contribute in line with his or her ability to pay" (p. 210). How would this principle work in the area of consumer purchases? Right now, when Rockefeller and a poor man buy a loaf of bread, they pay the identical price. In the fiscal context, this would appear as a very severe regressive "tax." In contrast, on the assumption that Rockefeller is one million times richer than the poor man, if the latter paid \$1 for the loaf, Rockefeller would pay \$1 million under the ability to pay assumption. The problem with this scenario, at the very least, is that if it were carried out consistently over all people and all goods and services, our economy would have been reduced to one of absolute income equality. Rockefeller's budget would enable him to buy no more cars, bicycles, fishes or loaves of bread than would that of the poor man. All people would have identical standards of living. Apart from the pragmatic difficulty (what would be the point of trying to become rich?) this result would only be satisfactory to those whose concept of equity meant strict equality.

Take another example. Our thief (who has now been metamorphosed into Robin Hood) robs from people in proportion to their wealth; he takes much from the rich, and little from the poor. Or, to make him even more palatable, he steals only from the rich, in proportion to their wealth. Say what you will about such a robber, it is difficult to see why his actions could best be characterized as equitable. This is theft, pure and simple. The only reason Robin Hood can be successfully depicted as being on the side of the angels is not because he plunders the rich, but because he does so to people who were thieves themselves. If a modern-day Robin Hood burglarized Jane Fonda, Bjorn Borg, Madonna, Magic Johnson, Riddick Bowe, Steven Spielberg, Woody Allen and Arsenio Hall – all exceedingly rich people – he would not be seen in a positive light at all.

Growth and development

According to McC, "There is an argument that government should be involved in the economy because public valuations of future (relative to present) consumption will differ from private values. Typically, the time horizon perceived by an individual is extremely short, with the resultant rate of discount being relatively high. A reasonable case can be made for

government valuing the future at a higher rate than individuals would, and therefore, the discount rate used in valuing consumption of goods and services would have to be lessened" (p. 5).

MMB agree with this assessment: "Individuals are said to suffer from 'myopia,' so that, in arranging their private affairs, they underestimate the importance of saving and overestimate that of present consumption. Hence, the consumers' time discount is too high and government should correct this error by applying a lower rate" (p. 169).

Note, first, that neither of the authors comes right out and claims that private time preference rates actually are too high. Each maintains this position in the passive voice: "There is an argument that ..." "Individuals are said to suffer from 'myopia' ..." Perhaps this is because a more forthright statement of the view would open them up to questions of proof, or evidence, or standards, something these claims cannot withstand. In plain point of fact, there are no criteria put forth to determine the truth of these assertions, any more than could be offered to back up the view that, for example, people prefer too many peas and too few carrots, or that consumers err in demanding excessive amounts of chocolate ice cream, and insufficient quantities of vanilla. Time preference rates, the choice between saving and investment, is a subjective matter; and in tastes, there is no disputing. None of the veneer of objectivity mentioned by these public finance writers is able to undermine that cold hard fact. Further, even if it can somehow be shown that the market's desire for present consumption is intemperate, it by no means follows, as we have seen, that government can or "should correct this error."

Moreover, the average newspaper reader's experience with the public and the private sectors is the diametric opposite to the contentions of these economists. Consider the following Canadian Press story, entitled "Basic services breaking down fast: Politicians slash re-building budgets":

Parts of Vancouver were left without running water in December 1986 after a blowout in a 60-year-old water line. Water pressure in Nepean, Ont., is so low, residents can barely water their lawns and flush their toilets at the same time. Saskatoon doesn't have a secondary waste-treatment plant, so sewage with toxin levels above provincial standards is simply pumped into the South Saskatchewan River. One third of Edmonton's streets need to be rebuilt.

These are just a few examples of the sorry state of Canada's municipal infrastructure – a word for the concrete, pipes, and pavement most city dwellers take for granted.

Unless something is done soon, officials say, people had better get used to turning on taps with nothing coming out, or getting stranded on broken-down buses, or having to fix their cars because of damage caused by potholes. Municipal leaders complain senior governments aren't paying their share for capital projects that are too costly for cities and towns to cover with their limited tax bases.

'Infrastructure is not politically sexy,' said Jim Knight, executive director of the

Federation of Canadian Municipalities. 'Politicians would rather spend money on something less costly and visible. It's not that easy to get short-term political benefits out of long-term capital projects.'³⁴

But Canada continues to spend heavily on welfare, multiculturalism and other activities that can only be characterized as short run in focus, at least compared to what is commonly characterized as the social overhead capital mentioned above. In contrast, private entrepreneurs rarely eat up their seed corn. Mall owners do not commonly make superficial improvements – flowers, decorations, painting – while neglecting the basics of plumbing, carpentry and cement. If they did, they could score brownie points in the short run, but would be subject to bankruptcy in the long term. Nor is it difficult to imagine that if sewers, streets and water provision were privatized, their new owners would direct more attention to basic capital goods provisions and less to fripperies.

If anything, then, our public finance theorists have got things exactly backwards; if there is any difference between government and market in this regard, it is not at all that the latter is too present-oriented. It is the very opposite: the time horizon of the politician rarely stretches past the next election, in a few years' time. When the bill comes in for capital improvements, he will likely be retired, or in jail, or in higher office; so, why worry about these things now? It is almost as if economists repeat their contentions concerning time preference rates by rote: they learned them at the knees of their teachers, and they go on repeating them no matter how strong the evidence to the contrary.

Let us follow up in some detail on MMB, since they are the most thorough in their analysis of social discount rates:

Next come several arguments related to the welfare of future generations. One argument is that people are too greedy and do not care sufficiently about the welfare of those who follow them. If they did, they would save more so as to leave future generations with a larger capital stock and hence higher level of income. The government, as guardian of future generations, can offset this by using a lower rate of discount and investing more. Saving is viewed as a merit good. This may be a decision faced by the planning board of a developing country, which must choose between more rapid development and an early increase in the level of consumption (p. 169).

Another can of worms is now opened. Again, no objective criterion is proffered to determine the "proper" level of greed;³⁵ nor is it possible to

do so. What is the evidence for the declaration "government is the guardian of future generations"? Who says? No one in any future generation ever elected any member of any present parliament. If the government represents anyone, it is surely the *present* generation, the one that elected it. And if anyone now living "represents" future generations, it is surely their (future) parents, men and women now in early childbearing ages. We have already seen the fallacy of merit goods, but as to "the planning board of a developing country," this is a contradiction in terms. To the extent that a nation really is developing economically (Hong Kong, Singapore, South Korea) this is precisely the extent to which it has eschewed planning boards (another contradiction in terms, all on its own). And to the extent that a nation really has a planning board (well, call it a "chaos board" for accuracy) – for example, many of the nations of Africa and South America, the "People's" Republic of China, North Korea, Vietnam, Cuba, the Soviet Union and Eastern Europe up until a few years ago – this is precisely the extent to which it is not developing economically. This is the extent to which, and precisely why, it is on the way to becoming an economic basket case. It is perhaps easy to see this now, from the present vantage point, from which we can easily see the move of socialism toward the dustbin of history. Perhaps it is harsh to criticize MMB for not being able to foresee this development. However, there have been scores of economists – hitherto all but ignored by the mainstream neoclassicals – who have been writing along these lines for many years now.

Stability

Still another reason offered by our public finance theorists for government intervention is the need for economic stability. Unemployment, inflation, the business cycle, recessions, depressions are all seen as "market failures." As usual, whenever reality is anything less than perfect, it is the state which must come riding to the rescue, in their view.

In the words of AM: "Maintaining high employment and price stability is a relatively 'new' goal of the public sector, coming into vogue only at the end of World War II. Since the demise of the classical view that involuntary unemployment cannot exist in a competitive economy, there emerged the view that the government, through its use of taxation and expenditure,

conclusion on the discredited notion of (intergenerational) equity. Secondly, they still call for government intervention into the economy. This is problematic because they do so if the present generation is "too greedy," and they also do so if the present generation is not greedy enough (due to the fact that future generations will be richer than they because of improved technology). In other words, the verdict is in: market failure, the need for government intervention; the only open question is whether there is too much or too little greed. Talk about angels dancing on the tip of a pin.

³⁴ *Vancouver Sun*, 24 December 1991, p. A7.

³⁵ To be fair to MMB, they do note that "with technical progress raising future productivity, the capital stock needed to sustain the consumption standard may fall, calling for a higher discount rate" (p. 169). But this admission is marred in two ways. First, they base their

could influence the level of aggregate demand and thus employment and prices in the economy" (p. 4).

To be fair to AM, they do note that "in recent years, however, the traditional approaches to fiscal policy have been criticized, and the role of government in this area questioned" (p. 4). However, this is mere window-dressing. When push comes to shove, there we find AM back at the old lemonade stand, pushing their interventionistic nostrums. For example: "In Canada, one goal of regional incentive programs is the reduction of unemployment, and in this case, the assumption may be that a job directly created by the project means one less unemployed person in the region either because an unemployed person has been hired or the vacancy created by the hiring of an employed person is ultimately filled by someone unemployed" (p. 35).

MMB are far more modest with regard to their claims for the state apparatus in this case than with any other. Perhaps experience has taught them something. They start out, however, as per usual: "Fiscal policy is needed for stabilization, since full employment and price level stability do not come about automatically in a market economy but require public policy guidance. Without it, the economy tends to be subject to substantial fluctuations, and it may suffer from sustained periods of unemployment or inflation" (p. 12).

This calls out for reply, and the reply is obvious. Full employment and price level stability do indeed come about automatically in a market economy. The reason we have not experienced them is that we have not yet had the privilege of attaining a fully free market (not a perfectly competitive economy, a very different entity). On the contrary, government intervention has been the order of the day. Under *laissez faire*, any incipient tendency toward even the slightest bit of involuntary unemployment will be met by a fall in wage rates, which will solve the problem. There will be no government-mandated unemployment insurance, welfare, minimum wages, unions as we have known them to prop up wages and ensure continued joblessness. Likewise, under a pure 100 per cent-backed gold dollar, inflation will be eradicated once and for all.

Even granting MMB that full employment and price level stability do not come about automatically in a market economy, one may not blithely conclude, as they do, that "fiscal policy is needed for stabilization." Moreover, how substantial are "substantial fluctuations," and how sustained are "sustained periods of unemployment or inflation," compared to what government fiscal policy has brought us?

It would take us too far afield to engage in a full-blown macroeconomic analysis. Suffice it to say that Keynesianism, the main bulwark of macroeconomic interventionism, is now almost in total disarray. There are commentators who claim that the Great Depression of the 1930s was due to monetary mismanagement by the Fed, a governmental, not a private, agency, which

allowed the money supply to collapse by about one-third, in the period of a few short months. The rational expectations school has claimed that no intervention is required, as the market can anticipate, and act so as to stymie it. According to the Austrian theory, the business cycle is caused not by lack of aggregate demand, but by the initial boom or inflationary bout, where resources are misallocated along the structure of production (too many capital goods, relatively speaking, too few consumer goods); the recession or depression is actually a cleansing return to economic rationality.³⁶

But whichever theory captures the imagination of the profession, one thing is clear: the old Keynesian snake oil no longer has the magical power it once possessed. It modelled the government along the lines of a driver, and the economy, a car. When it ran too fast (inflation) the public policy prescription was to hit the brakes (budget surpluses, lowered rate of monetary growth); when it ran too slowly (recession, depression, unemployment), the advice was to hit the gas pedal (budget deficit, print more money). But the advent of inflationary depression hit this theory like a lead balloon. What could be done when both the brakes and the gas were indicated?

Also clear is the fact that government has been, on net balance, a force for destabilization, not stabilization. The best date to measure the onset of heavy government macroeconomic policy is, contrary to AM, with the advent of the Fed in 1913, not the Second World War. One can easily look at the variance of economic activity in the roughly eight decades before and after this point in time. It is clear that the gold standard of the nineteenth century, coupled with more or less conservative policies toward budget balance and the role of the state, managed to "iron out" the peaks and valleys of depressions and booms to a far greater extent than the Keynesianism of the twentieth century. Even MMB have now been forced to admit that "unemployment and inflation – as we have painfully learned in recent years – may exist at the same time. To hold that public policy is needed to deal with these contingencies does not preclude the possibility that public policy, if poorly conducted, may itself be a destabilizer" (p. 12). But if so, why not even *consider* the possibility that it may be better to have no public policy at all, except one of supporting *laissez faire*. Evidently, this is too large a jump for MMB.

Conclusion

We have followed the analysis of several of the leading textbook writers in public finance, and have found it wanting. What follows from our perspective? Simply this. That this sub-specialty should borrow a leaf from all

36 Ludwig von Mises, *Human Action* (Chicago: Regnery, 1963); Rothbard, *Man, Economy and State*.

others, and either eschew normative economics altogether, or else find a better basis upon which to justify its value-laden conclusions. The former would be vastly preferable, given the advantages of specialization and comparative advantage. If the public finance theorists were to confine themselves to positive economics, and leave the ethics to the philosophers, this field could take its rightful place among all others in the economics profession. It might be less sexy – leaving out discussions of such concepts of equity, merit goods and all the rest – but what it would lose in terms of heavy breathing it would more than make up in the form of solid economic analysis.