

WHY FREE MARKETS ARE DIFFICULT TO DEFEND

by D. Eric Schansberg

When posed as a general question, most people are inclined to support free markets and capitalism rather than government control and socialism. They have seen the fruits of "free market" economies and the failures of socialism. They support freedom as a principle and generally dislike the intrusions and bureaucracy of government.

Yet when it comes to specific government programs, the public is frequently enthusiastic about them. And whenever the economy is not running smoothly, the public demands action from the President and the Congress to "do something." By giving explicit or tacit approval to such programs, people reveal that they think government can solve problems better than the market. Thus, people support free markets in general, but support government intervention on particular issues. The free market is difficult to defend against calls for government activism.

The Visible and Invisible Hands

Many people would agree that socialism is a less productive system than capitalism. But socialism has one advantage. To the extent it does work, one can see exactly how

its success was achieved. As a pure economic system, every step between the inputs into production and the final product is controlled by a central planner—the "visible hand" at work. In other words, one can precisely point to how the loaf of bread got to the consumer's table.

Under a free market system, the "invisible hand" is just that—invisible. People pursuing their own interests are guided by the invisible hand of relative prices and inadvertently promote the well-being of society. Few people, if any, are able to enumerate exactly how the market is able to provide consumers with any particular good.

One of the contributions of public choice economics has been to note that costs and benefits are perceived in a similar manner in microeconomic settings. The benefits of individual government programs are as visible as the (albeit limited) successes of socialism as a macroeconomic system. When government creates new jobs through increased spending or preserves existing jobs through some form of protectionism, the additional employment is easy to see and is quickly attributed to government.

In addition, the costs of government activism are difficult to see. With programs that entail additional spending, government may choose to pay for the program with higher taxes now, higher taxes later (deficit

financing), an inflation tax or some combination of the above. The visibility of these "payment plans" differs but all are more obscure than the benefits they bring. The costs of higher current taxes are the easiest to see (and thus the least politically popular)—but even they are subtle. Note that a one-billion-dollar program costs only four dollars per capita; for a family of four with a single wage-earner, taxes increase by only \$1.33 per month. Who would notice another dollar being taken out of his paycheck each month? Further, who will hold government accountable for the jobs that are lost as a result of taxpayers having less disposable income? The one billion dollar loss to consumers will destroy a few jobs in many industries since that money will no longer be spent on dry cleaning and appliances, or invested in new businesses. (See Henry Hazlitt's *Economics in One Lesson* [1946]. In Mr. Hazlitt's words, "the art of economics consists in looking not merely at the immediate but at the longer effects of any act or policy; it consists of looking at the consequences of that policy not merely for one group but for all groups.")

Another way for the costs of a program to be hidden is for government to mandate that firms be responsible for providing it. A government program that subsidizes parents or firms to encourage or allow the parents to stay home with newborns would involve some direct expense. But if parental leave were to become a "worker's legal right," the benefits would still be easy to see and the costs would be nearly invisible. Who would attribute the subsequent long-term impact—some combination of greater unemployment, lower compensation for workers (in terms of other fringe benefits and wages), and higher product prices—to government's activism? These costs are extremely subtle.

The benefits of government programs are easy to see and their costs are difficult to see. In contrast, the benefits of less government involvement—a move toward freer markets—are subtle and its costs are quite visible. Thus it is not surprising that governmental activism is relatively popular.

How Incentives Differ

Economics provides another important explanation for the paradox of why government activism often "wins the day." It turns out that those who receive the relatively large and easy-to-see benefits have incentives different from those who bear the relatively small and difficult-to-see costs.

Suppose that the benefits of the one billion dollar program cited above are split equally by 1,000 people; each will receive one million dollars. Remember that this will cost every citizen four dollars. It is unlikely that they will notice. But even if they did, it is improbable that they would want to devote significant resources either to obtaining information or to fighting the proposal. On the other hand, those receiving a million dollars will go to great lengths to obtain their favor from government. At the very least, they will have an incentive to present eloquently and forcefully the merits of the program (but not its costs). At the other extreme, they might provide disinformation to "rationally ignorant" voters or (at least implicitly) bribe legislators.

Further, the bureaucrats who administer the programs passed by the legislative and executive branches have an incentive to see their programs' scopes and budgets enlarged. They have the same incentive structure as the other "winners."

In sum, there are at least two plausible explanations for the paradox of why people support free markets in general and government activism in specific areas. The visible benefits of government activism are easier to explain than the more abundant but more diffuse benefits of free markets. And due to the different incentives that winners and losers face for any given proposal, the benefits of government programs are more forcefully argued since their proponents will (out of ignorance or deceit) discuss the program only in its most favorable light.

Government programs may be bad economics, but why they are bad economics may be difficult to explain. That is why an effective defense of the free market must be based on moral principle. □

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