ONE

Introduction

Society attempts to solve problems through different ways of cooperation. Markets are a form of cooperation: within firms, between producers of final goods and their outside producers, and between firms and consumers. Democratic government is a form of cooperation. Each form of cooperation can substitute for or complement the other. For example, government or markets can provide urban bus transportation, primary education in schools, and other services. Interacting as complements, government may set up a cap-and-trade system for reducing pollution and then let market forces operate within that system; government may pass along some of its tax revenues to nonprofit organizations for the provision of services to the poor or the sick; and the like.

With input from the economics profession, preferences of voters, and actions of policymakers, the United States continues to experiment with alternative forms of government and market cooperation, as complements and substitutes, to solve critical economic problems. Unfortunately, we currently are in a moment during which the public's faith in both capitalism and economists is at a low point.[1] One reason for this is that neither appears to have done much to reduce the growth in income inequality that began in the 1970s. Another reason is that macroeconomists did not prepare the public for the Great Recession and could only partially soften its blow.[2] The result is that many Americans, especially younger adults who are struggling financially, are quick to reject market solutions.

However, this is a serious mistake. Regardless of what people think our public objectives should be—reduce inequality, stimulate long-term growth, slow climate change, or eliminate COVID-19—markets will be a critical part of the solution. It also is a mistake for people to think that, because they do not like what capitalism is currently doing for the poor and they would prefer a more progressive policy agenda, it would be a bad idea to use market forces to, for example, help improve the quality of public schools or urban transportation. Similarly, economic nationalists who do not like what free trade and immigration are doing to employment in certain industries and would prefer a stronger industrial policy and higher tariffs should not overlook the benefits market forces provide American workers and consumers. Finally, those with some background in economics should realize that although macroeconomics is criticized by some as faith-based because it struggles to develop an analytical model that can explain and help stabilize the economy's fluctuations, microeconomics is grounded in a widely-accepted corpus of economic theory and has accumulated a voluminous body of empirical research that assesses the effects of public policies to solve economic problems.

What economic problems do economists try to solve? A popular caricature of economists is that they always are laissez-faire and that they oppose redistribution. Although some economists are neutral on or do oppose redistribution, many conduct research on and favor government interventions to reduce economic inefficiencies such as abuses of monopoly power and negative externalities. Still other economists believe that objectives besides economic efficiency are important and necessitate redistributing income to, for example, reduce poverty. I incorporate those perspectives by summarizing the economic problems economists try to solve as consistent with American citizens' goals of: (1) maximizing their material quality of life, (2) having a chance to succeed, and (3) obtaining a decent quality of life should they face hardships, either because of the adverse household circumstances in which they were born or because of unexpected shocks.[3]

To facilitate analysis and maintain consistency with the accumulated body of research, I interpret the first goal in practice as creating an economic environment where sufficient market competition exists; consumers and workers make informed choices; negative externalities are reduced efficiently; innovation is incentivized in accordance with cost-benefit considerations; and socially desirable public goods are provided. I interpret the second goal in practice as preventing employers from discriminating against specific individuals or groups when they make hiring and promotion decisions and preventing education admissions committees from discriminating in favor of or against specific groups of applicants. Finally, I interpret the third goal in practice as providing resources to keep households' standard of living above the poverty level and providing household members with merit goods—that is, as introduced by Richard Musgrave (1959), goods that individuals or society should have on the basis of some concept of need rather than on an ability and willingness to pay.[4]

I am not aware of previous research that has indicated how to broadly characterize the goals to organize analysis and synthesize findings. Thus, I refer to the first goal and its elements, which are generally associated with economic efficiency, as economic goals, and I refer to the second and third goals and their elements, which are generally associated with economic redistribution, as social economic goals, or social goals for short.

In some cases, economic and social goals cannot be neatly compartmentalized. For example, the provision of subsidized education may be justified as accomplishing a social goal because US society believes it is a merit good. But it also could be justified as accomplishing an economic goal because it generates positive externalities through a better educated workforce that helps increase society's material quality of life. Government and market actions also may affect both goals simultaneously. Nonetheless, I distinguish between the two goals because economists use different theoretical benchmarks to assess performance. Economic goals are achieved by government interventions or market forces to produce efficiency gains, which are characterized as potential Pareto improvements;[5] social goals are achieved by government interventions and market forces to satisfy a particular goal at minimum social cost, although the goal may not produce an efficiency gain.

THEORY AND PRACTICE

Government interventions and market forces both seek to accomplish economic and social goals. However, a branch of economic theory known as welfare economics—the study of how to allocate resources to improve social welfare, which is a function of efficiency and distribution—devotes considerable attention to identifying when markets are likely to work effectively with minimal government intervention and when they are likely to fail without government involvement. The classic examples of market failure to accomplish economic goals that motivate government intervention include the abuse of monopoly power, natural monopoly, imperfect information, externalities, and public goods. Those types of market failures generate a loss in economic efficiency. Markets may not generate an efficiency loss but still may fail to accomplish social goals that require government intervention to redistribute income when households live in poverty, individuals experience discrimination in various markets, and merit goods are not provided to the public.

Welfare economics problems are often assessed in a static setting—for example, a firm has abused monopoly power, markets have failed, and government intervention, not market forces, is required immediately to address the problem. Little attention is paid to whether the government addresses the problem. However, my perspective is that welfare economics problems should be assessed in a dynamic setting because market forces can change over time to address economic and social goals—for example, the firm that abused monopoly power is eventually challenged by innovative new entrants and its market share plummets. In contrast, government behavior is static and suffers from status quo bias, meaning that policymakers rarely change their policies over time to address economic and social goals; for example, by the time the government has proposed a remedy to address the monopolist's abuse of its market power, the one-time monopolist may be struggling to survive in the industry.

A dynamic perspective also facilitates a long-run view of welfare economics where technological change plays a critical role. Consider firms that produce a product but pollute the air while doing so. Government intervenes with a command and control policy to force the firms to reduce their pollution, but the policy is inefficient because it causes the firms to reduce their production by an excessive amount, such that the benefits from cleaner air are less than the value of the reduced output. Decades later, the firms adopt a new technology that enables them to produce their output without damaging the environment. Importantly, markets often have considerable potential to help address economic and social problems even if they are not currently doing so, and that potential should not be dismissed out of hand.

Table 1-1 summarizes the different approaches, which may succeed in theory and sometimes in practice, that government policymakers and markets take to accomplish economic and social goals. To accomplish economic goals, markets rely on the actions taken by private firms and individuals; technological advance enables those agents to improve the effectiveness of current actions or to take new actions that improve market performance. For exam-

TABLE 1-1. Market and Government Approaches to Pursue Economic and Social Goals

Goal	Market Approach	Government Approach
Economic goals		
Promote competition	Firm entry and exit, price and non-price strategies	Antitrust and regulatory policies
Enable consumers and workers to make informed decisions	Advertising, brand names, and other sources of information, including from third parties	Information policies and regulations
Reduce negative externalities	People and firms adjust to reduce the costs they incur and impose on others*	Command and control policies and fees
Encourage innovation by people and firms	Financial incentives and financing	Patent protection and various R&D contests and laboratories
Provide public goods	Private investment and cooperatives	Expenditures on services and infrastructure
Social goals		
Reduce poverty	Firm training, wage policies, and charitable giving	Various policies and programs
Ensure fairness in labor markets	Competition	Antidiscrimination laws and regulations
Provide merit goods	Private market alternatives, such as online education	Taxes to fund expenditures on various programs
Encourage socially beneficial immigration	Hire skilled and unskilled foreign workers legally	Laws governing the path to citizenship

*With defined property rights, other market approaches include, for example, tradeable pollution permits.

ple, new technologies can spur additional competition, increase the amount and availability of useful information, reduce negative externalities, stimulate new innovations, and encourage firms to invest in projects that benefit the public. In contrast, government entities institute regulations and spend public funds to accomplish economic goals. This does not imply, for example, that private investors can necessarily succeed in providing public goods efficiently and that government regulations can reduce externalities efficiently.

Firms and individuals also take actions to help achieve social goals; technical advance can enable those actions to be more effective, as well. Government's approach is to enact new laws and fund new social programs that are financed by taxpayers.

THE DEBATE

As noted, government and market approaches to address specific economic and social goals may not be effective in practice, which is why the optimal mix of market and government approaches often is debated as the nation goes through political and economic cycles. Currently, the public and the policymakers do not appear to have much faith in markets. At the same time, the public seems resigned to expanding the role of government despite its negative views of politicians and political institutions.

However, the debate generally does not account for the accumulated empirical evidence on the efficacy of market forces and government policies to accomplish the nation's goals. This book fills that gap by synthesizing the available evidence and by arguing that, in contrast to current dissatisfaction with markets, American society has gained ground when government has allowed markets to help accomplish the aforementioned economic and social goals, especially when government policies have made little progress in achieving those goals. I further argue that society could gain even more ground if government removed constraints, which would enable markets to play a greater role in the process (Caplan 2019).

Notwithstanding my belief in the efficacy of markets, the available evidence does not support the view that market forces could always improve on government performance and that all government interventions should be dismantled. But the vast inefficiencies in government policy that I summarize explain why it is socially desirable for the mix of government and market approaches to change and why it is important for policymakers to be more cognizant of the actual and potential accomplishments of market forces. Policymakers may then be more willing to accept that, because of technological advances, new sources of competition, and more enlightened thinking about the private benefits of addressing social problems, times change and markets may be able to help solve economic and social problems they could not help solve in the past.

A simple illustrative example of markets helping when government performs poorly occurred when Amtrak, a heavily-subsidized government corporation, broke down en route to Washington, DC, and failed to provide food for its stranded passengers. In response, a proactive hungry passenger placed an order on his cell phone with the closest Domino's Pizza, and the deliveryperson leaped over an embankment, found the passenger's railcar, and delivered the pie.[6]

Similarly, an example of market forces helping discipline firms that behave poorly occurred in April 2017 when United Airlines violently expelled a paying passenger because United had overbooked the flight. As pointed out by Antony Davies and James Harrigan (2018), within twenty-four hours, United's stock plummeted by a quarter of a billion dollars because investors dumped the stock in anticipation of a consumer boycott of United, and within days, several airlines announced they would end their practice of overbooking flights.[7] How did the government respond to United's behavior? Congress took a month to schedule hearings to investigate the matter and then took no further action.

I do not wish to convey the impression that the current lack of faith in markets and capitalism is shared by all Americans. We live in a time of heightened political differences, which often take the form of overly intense prior beliefs about the characteristics of markets and government and the appropriate policies to enhance economic and social goals. Accordingly, the next chapter assesses alternative perspectives on markets and government, and then clarifies the scope and content of my analysis.

The remainder of the book is divided into four parts. Part I examines the evidence on government policy inefficiencies in attempting to accomplish economic goals to set the stage for the discussion about the evidence on markets helping improve on government actions and on additional ways markets could provide help. Part II reviews the evidence on government policy inefficiencies in attempting to accomplish social goals to, again, set the stage for a discussion of the evidence on markets helping improve on government actions and on additional ways markets could provide help. Part III synthesizes the evidence for both goals on government policy inefficiencies and explanations of them, and on markets helping government and additional ways markets can help. The broader implications of the evidence for economic growth and inequality are also discussed.

This book was completed during a global pandemic that appears to have originated in China in late 2019 and spread throughout the United States at the beginning of 2020. The novel coronavirus is still affecting the entire world in ways that have been unimaginable; however, it has not changed the important themes of this analysis. In fact, it has reinforced them. The pandemic has required government action—stay-at-home orders, incentives to develop safe and effective vaccines, and rules about individual travel—and it also has required the power of market forces—private firms to develop those vaccines, and employers to find new ways to work in an uncertain environment. This once-in-a-century, unfortunate event has presented an unanticipated opportunity to subject the major findings of the book, which show markets assisting government, to a "robustness test" of whether they have helped government during the pandemic.

In Part IV, I conduct this test. In a post-coronavirus world, the importance of markets helping government should gain greater prominence as society reconsiders their respective roles. I conclude the book by taking a proactive approach that stresses the importance of increasing our reliance on market forces to help solve the nation's economic and social problems in light of the evidence synthesized in Part III that indicates markets can and have provided considerable help—help that should be greatly appreciated because it is very difficult to identify the source(s) of government inefficiency that could guide reforms to significantly improve government performance.

I suggest the role of markets helping government potentially could be increased if the United States government formed a major commission composed of academics, policymakers, and business people to explore how market forces could provide greater help to government to address economic and social problems and to provide specific recommendations, including conducting policy experiments. Hopefully, policymakers would find the advice useful for reforming policy that would help the US better accomplish its economic and social goals and would regularly reconvene the commission along the same lines in the future.