



# Incentives: Markets vs. Government

*Concepts, Terms and Topics:*

Protective and Productive Roles of Government; Market Failure, Monopoly, Externalities and Public Goods; Government Failure, Special-Interest Policy, Political Incentives, and Economic Inefficiency

## DAY 1—CLASS DAY



### LOOKING BACK—WEEK 10

Review Homework  
Take Quiz 9



### LOOKING AHEAD—WEEK 11

Let's Discuss—*What Do You Think?*  
Let's Discuss—Final Project DECISION TIME! (optional class activity)  
Let's Do—Stimulus Spending and Crony Capitalism (optional class activity)

## DAY 2

- READ**    **CSE Part 3**    Introduction  
Element 1—Government promotes economic progress...
- WATCH**    *Videos*    *Property Rights and Eminent Domain (4:17)*  
*Is Government Too Big? (4:53)*
- DO**        **Workbook**    Questions 1-6

## DAY 3

- READ**    **CSE Part 3**    Element 2—When monopoly is present...  
Element 3—Public goods and externalities...
- WATCH**    *Video*        *Learn Liberty—Externalities Potato Chip (4:46)*
- DO**        **Workbook**    Questions 7-13

## DAY 4

- READ**    **CSE Part 3**    Element 4—Allocation through political voting...
- WATCH**    *Video*        *Political vs. Market Choices (1:33)*
- DO**        **Workbook**    Questions 14-18

## DAY 5

- READ**    **CSE Part 3**    Element 5—Unless restrained by constitutional rules...
- WATCH**    *Videos*        *Stimulus and Crony Capitalism (4:23)*  
*Pork Barrel Spending (4:26)*
- READ**    **Article**        Politics and Foreign Trade by Dwight Lee
- WATCH**    *Video*        *Trade Restrictions and Crony Capitalism (2:05)*
- DO**        **Workbook**    Questions 19-24



*Once politics becomes a tug-of-war for shares in the income pie, decent government is impossible.*

—Friedrich Hayek

*Everyone wants to live at the expense of the State. They forget that the State lives at the expense of everyone.*

—Frédéric Bastiat



### LOOKING BACK—WEEK 10

Review Homework

Take Quiz 9



### LOOKING AHEAD—WEEK 11

Discuss upcoming *optional* Final Project Presentation: Decision Time!

### Let's Discuss—What Do You Think

According to Thomas Jefferson, “A wise and frugal government, [is one] which shall restrain men from injuring one another, which shall leave them otherwise free to regulate their own pursuits of industry and improvements, and shall not take from the mouth of labor the bread it has earned.” What characterizes a “wise and frugal” government?

*Lorem ipsum dolor sit amet, consectetur adipiscing elit, sed do eiusmod tempor incididunt ut labore et dolore magna aliqua. Ut enim ad minim veniam, quis nostrud exercitation ullamco laboris nisi ut aliquip ex ea commodo consequat. Duis aute irure dolor in reprehenderit in voluptate velit esse cillum dolore eu fugiat nulla.*

Would people be better off if voting was more widely used to determine what goods should be produced and consumed? Why or why not?

*When choices are made by majority voting rather than through markets, the majority or their elected representatives will decide for everyone. With democratic voting, the majority imposes its preferences on the minority. Many individuals in both the majority and minority are forced to pay for many items that they would not have purchased.*

### Let's Do—Optional Class Activity: Stimulus Spending and Crony Capitalism



### CSE Part 3: Ten Elements of Clear Thinking about Economic Progress and the Role of Government

#### INTRODUCTION—

1. What is economic efficiency?

*"Lorem ipsum dolor sit amet, consectetur adipiscing elit, sed do eiusmod tempor incididunt ut labore et dolore magna aliqua."*

2. Public choice is a term that in the last 50 years has become an integral part of economics. To what area of study does the term *public choice* refer?

*The term public choice refers to the study of how political allocation works. Given that government expenditures now constitute 40 percent or more of our national income, understanding how political allocation works is vitally important.*

#### ELEMENT 1—GOVERNMENT PROMOTES ECONOMIC PROGRESS BY PROTECTING THE RIGHTS OF INDIVIDUALS AND SUPPLYING A FEW GOODS THAT ARE DIFFICULT TO PROVIDE THROUGH MARKETS.

3. In what two ways can government promote social cooperation and enhance its citizens' economic welfare?

- *Nemo enim ipsam voluptatem quia voluptas sit aspernatur aut odit aut fugit.*
- *by supplying "a few select goods that have unusual characteristics that make them difficult to provide through markets."*

4. What is the result of government performing its protective function well? Explain why.



*"When this function [protective function] is performed well, citizens can have confidence that they will not be cheated and that the wealth they create will not be taken from them—by either selfish intruders or by the government itself [through high taxes and excessive regulations, or the ravages of inflation]. This protection provides citizens with assurance that if they sow, they will be permitted to reap. When this is true, people will sow and reap abundantly, and economic progress will result."*

5. Why is the provision of a stable monetary and price environment one of the most important productive functions of government?

*Ut enim ad minima veniam, quis nostrum exercitationem ullam corporis suscipit laboriosam, nisi ut aliquid ex ea commodi consequatur.*

6. Why are government projects financed through taxes or through borrowing, difficult to measure in both their costs and their benefits?



*Nemo enim ipsam voluptatem quia voluptas sit aspernatur aut odit aut fugit, sed quia consequuntur magni dolores eos qui ratione voluptatem sequi nesciunt. "Lorem ipsum dolor sit amet, consectetur adipiscing elit, sed do eiusmod tempor incididunt ut labore et dolore magna aliqua."*



### **Property Rights and Eminent Domain** (4:17)

Market activity is based on mutual agreement and voluntary exchange. Government, however, has the sole authority to use force to accomplish its goals. As John Stossel explains, when elected city leaders don't approve of certain buildings in an area, they can deem that area blighted, then use their power of eminent domain to destroy the area and replace it with something else as long as the alternative is in the public interest. Think about how this incentive structure will influence economic and political activity.



### **Is Government Too Big?** (4:53)

Government plays a vital role in the economy. John Stossel explains government's protective function which includes maintaining rule of law, preventing people from attacking each other, and protecting private property. Philosopher Tibur Machan explains how governments substitute their judgment in place of citizen's judgment, and how the founders believed government should be limited to protecting liberty. However, government has grown under every recent president.



### CSE Part 3: Ten Elements of Clear Thinking about Economic Progress and the Role of Government

ELEMENT 2—WHEN MONOPOLY IS PRESENT AND BARRIERS TO ENTRY HIGH, MARKETS WILL FAIL TO ACHIEVE IDEAL EFFICIENCY.

7. When does a monopoly exist?

*"A monopoly exists when there is a firm that is the only producer of a good or service for which there are no good substitutes."*

8. What are two major sources of monopoly and when do they occur?

- *Nemo enim ipsam—"Sed ut perspicatis unde omnis iste natus error sit voluptatem accusantium doloremque laudantium, totam rem aperiam, eaque ipsa quae ab illo inventore veritatis et quasi architecto beatae vitae dicta sunt explicabo. Nemo enim ipsam voluptatem quia voluptas sit aspernatur aut odit aut fugit, sed quia consequuntur magni dolores eos qui ratione voluptatem sequi nesciunt.*
- *Grants of privilege—"government itself is sometimes the source of monopoly. Licensing, taxes that favor one group over another, tariffs, quotas, and other grants of privilege reduce the competitiveness of markets. While some of these policies may be well-intentioned, they protect existing firms and make it more difficult for potential rivals to enter the market, thereby encouraging monopolies and dominant firms."*

9. What should the government do to ensure markets are, and remain, competitive?



*"Ut enim ad minima veniam, quis nostrum exercitationem ullam corporis suscipit laboriosam, nisi ut aliquid ex ea commodi consequatur"*

*And "governments may also prohibit anti-competitive actions such as collusion, the merger of dominant firms in an industry, and interlocking ownership of firms."*

ELEMENT 3—PUBLIC GOODS AND EXTERNALITIES RESULT IN INCENTIVES THAT MAY ENCOURAGE SELF-INTERESTED INDIVIDUALS TO UNDERTAKE ACTIVITIES THAT ARE INCONSISTENT WITH IDEAL ECONOMIC EFFICIENCY.

10. What are two distinguishing characteristics of "public goods" provided by the "productive" function of government?

*Public goods have two distinguishing characteristics: 1) jointness in consumption—provision of the good to one party simultaneously makes it available to others, and 2) Ut enim ad minima veniam, quis nostrum exercitationem ullam corporis suscipit laboriosam, nisi ut aliquid ex ea commodi consequatur?*

11. What are some examples of “public goods” and why are they difficult for markets to provide?

*Nemo enim ipsam voluptatem quia voluptas sit aspernatur aut odit aut fugit, sed quia consequuntur magni dolores eos qui ratione voluptatem sequi nesciunt. Neque porro quisquam est, qui dolorem ipsum quia dolor sit amet, consectetur, adipisci velit, sed quia non numquam eius modi tempora incidunt ut labore et dolore magnam aliquam quaerat voluptatem.*

12. Are all goods provided by the government *public goods*? Why or why not?



*"Many of the goods provided by governments clearly do not have the characteristics of public goods. Medical services, education, mail delivery, trash collection, and electricity come to mind. Although these goods are often supplied by governments, nonpaying customers could be easily excluded and providing them to one party does not make them available to others. Thus, even though they are often provided by governments, they are not public goods."*

13. Define externalities and give an example of one you have personally experienced.



*Exceperunt sint occaecat cupidatat non proident, sunt in culpa qui officia deserunt mollit anim id est laborum.*

*Examples will vary.*



**Learn Liberty—Externalities Potato Chip** (4:46)

When is a potato chip more than a potato chip? What causes externalities and how can they be "fixed"? This clip explains and answers those questions. It also cautions against potential solutions.



### **CSE Part 3: Ten Elements of Clear Thinking about Economic Progress and the Role of Government**

ELEMENT 4—ALLOCATION THROUGH POLITICAL VOTING IS FUNDAMENTALLY DIFFERENT THAN MARKET ALLOCATION.

14. What are four reasons market allocation leads to greater economic progress than democratic political allocation?



*"At vero eos et accusamus et iusto odio dignissimos ducimus qui blanditiis praesentium voluptatum deleniti atque corrupti quos dolores et quas molestias excepturi sint occaecati cupiditate non provident, similique sunt in culpa qui officia deserunt mollitia animi, id est laborum et dolorum fuga. Et harum quidem rerum facilis est et expedita distinctio. Nam libero tempore, cum soluta nobis est eligendi optio cumque nihil impedit quo minus id quod maxime placeat facere possimus, omnis voluptas assumenda est, omnis dolor repellendus. Temporibus autem quibusdam et aut officiis debitis aut rerum necessitatibus saepe eveniet ut et voluptates repudiandae sint et molestiae non recusandae. Itaque earum rerum hic tenetur a sapiente delectus, ut aut reiciendis voluptatibus maiores alias consequatur aut perferendis doloribus asperiores repellat."*

15. What is the “rational ignorance effect”?

*The rational ignorance effect is a term economists use to describe how voters can both be poorly informed and rational at the same time. Knowing that their single vote will virtually never decide the outcome of an election, voters will spend very little time studying the issues and the candidates in order to make an informed choice. Thus voters are poorly informed yet, "their lack of information is rational because an individual's vote is so rarely decisive."*

16. Due to the “rational ignorance effect,” how do decisions made by consumers in the marketplace compare to those made by voting?



*Et harum quidem rerum facilis est et expedita distinctio. Nam libero tempore, cum soluta nobis est eligendi optio cumque nihil impedit quo minus id quod maxime placeat facere possimus, omnis voluptas assumenda est, omnis dolor repellendus. Temporibus autem quibusdam et aut officiis debitis aut rerum necessitatibus saepe eveniet ut et voluptates repudiandae sint et molestiae non recusandae. Itaque earum rerum hic tenetur a sapiente delectus, ut aut reiciendis voluptatibus maiores alias consequatur aut perferendis doloribus asperiores repellat.*

17. How is government failure similar to market failure?

*Et harum quidem rerum facilis est et expedita distinctio. Nam libero tempore, cum soluta nobis est eligendi optio cumque nihil impedit quo minus id quod maxime placeat facere possimus, omnis voluptas assumenda est, omnis dolor repellendus. Temporibus autem quibusdam et aut officiis debitis aut rerum necessitatibus saepe eveniet ut et voluptates repudiandae sint et molestiae non recusandae. Itaque earum rerum hic tenetur a sapiente delectus, ut aut reiciendis voluptatibus maiores alias consequatur aut perferendis doloribus asperiores repellat.*

18. What did the framers of the Constitution include in order to place restraints on the government’s economic role and how have these restraints eroded over time?



*“They enumerated the permissible taxing and spending powers of the central government (Article I, Section 8) and allocated all other powers to the states and the people (Tenth Amendment). They also prohibited states from adopting legislation “impairing the obligation of contracts” (Article I, Section 10). Furthermore, the Fifth Amendment specifies that private property shall not be “taken for public use without just compensation.” Over time, however, Supreme Court decisions eroded these restraints and government control over both individuals and businesses expanded, as did federal control over the states.”*



### **Political vs. Market Choices** (1:33)

Allocation of resources through the political process is fundamentally different from allocation through markets. John Stossel illustrates how voting only allows people to choose among limited options, while markets allow people to choose from many alternatives, selecting only the things they value more than cost (price). How will voting influence the value of the goods and services selected compared to the combination chosen through markets?



### **CSE Part 3: Ten Elements of Clear Thinking about Economic Progress and the Role of Government**

ELEMENT 5—UNLESS RESTRAINED BY CONSTITUTIONAL RULES, SPECIAL-INTEREST GROUPS WILL USE THE DEMOCRATIC POLITICAL PROCESS TO OBTAIN GOVERNMENT FAVORS AT THE EXPENSE OF OTHERS.

19. What is “the special-interest effect”?

*“At vero eos et accusamus et iusto odio dignissimos ducimus qui blanditiis praesentium voluptatum deleniti atque corrupti quos dolores et quas molestias excepturi sint occaecati cupiditate non provident, similique sunt in culpa qui officia deserunt mollitia animi, id est laborum et dolorum fuga.”*

20. What are “logrolling” and “pork-barrel” legislation and how are both used?

*“Itaque earum rerum hic tenetur a sapiente delectus, ut aut reiciendis voluptatibus maiores alias consequatur”*

*“Nemo enim ipsam voluptatem quia voluptas sit aspernatur aut odit aut fugit, sed quia consequuntur magni dolores eos qui ratione voluptatem sequi nesciunt. Neque porro quisquam est, qui dolorem ipsum quia dolor sit amet, consectetur, adipisci velit, sed quia non numquam eius modi tempora incidunt ut labore et dolore magnam aliquam quaerat voluptatem.”*

21. Explain why special interest programs can retard or create a drag on the economy.



*Nemo enim ipsam voluptatem quia voluptas sit aspernatur aut odit aut fugit, sed quia consequuntur magni dolores eos qui ratione voluptatem sequi nesciunt. Neque porro quisquam est, qui dolorem ipsum quia dolor sit amet, consectetur, adipisci velit, sed quia non numquam eius modi tempora incidunt ut labore et dolore magnam aliquam quaerat voluptatem.*

22. Unlike market exchanges, which are win-win activities, “political exchange” activities can be a win-lose activity. List three examples where the business of modern politics has been used to extract resources from the general public in order to provide favors to well-organized voting blocs.



*Answers may vary, but in addition to the sugar program, excepteur sint occaecat cupidat non proident, sunt in culpa qui officia deserunt mollit anim id est laborum. are all programs which bring to light the political power of special interest.*



### **Stimulus and Crony Capitalism** (4:23)

Economics indicates that special interest groups have an incentive to use the democratic political process to gain advantage for themselves while imposing hidden costs on others. John Stossel illustrates how Serious Materials, a window manufacturer, derived subsidies and tax credits that were not provided to other window producers. Given the incentive structure generated by special interest issues, such favoritism is an expected outcome.



### **Pork Barrel Spending** (4:26)

By using the example of a proposed \$200 million bridge in Ketchikan, Alaska, this segment illustrates the ability of special interests to obtain government funding for projects that benefit a small number of people. The irony of the situation is that most of the local residents seem to be opposed to the bridge. Even so, the Alaskan congressman is pursuing the funding. It provides an excellent illustration of the economics of collective decision-making in action.



### **Politics and Foreign Trade** by Dwight Lee

23. Why would even the workers employed by industries that benefit from trade protections be better off living in an economy with completely free trade?

*Excepteur sint occaecat cupidatat non proident, sunt in culpa qui officia deserunt mollit anim id est laborum.*

24. Typically, why don't people realize the costs that are imposed on them through trade restrictions?

*“Ut enim ad minim veniam, quis nostrud exercitation ullamco laboris nisi ut aliquip ex ea commodo consequat. Duis aute irure dolor in reprehenderit in voluptate velit esse cillum dolore eu fugiat nulla pariatur. Excepteur sint occaecat cupidatat non proident, sunt in culpa qui officia deserunt mollit anim id est laborum..”*



### **Trade Restrictions and Crony Capitalism** (2:05)

Democratically elected officials often benefit from the support of special interest groups. Using the case of the steel industry, John Stossel explains the origins of rent-seeking and “crony capitalism.” Well-organized groups that lobby Congress for favors are often able to benefit at the expense of those that are less well-organized. In turn, this bias encourages rent-seeking and adoption of inefficient policies.

