Market Failures, Government Solutions, and Moral Perceptions

Dwight R. Lee and J. R. Clark

It should be obvious to even the casual observer that both markets and governments fail—neither comes close to achieving perfection. Externalities, both positive and negative, are the most common explanation for market failures. The undersupply of public goods, for example, is seen as a market failure, and is the direct result of a positive externality being generated when a person contributes to a public good which, by definition, benefits others whether they contribute or not. Similarly, excess pollution is seen as a market failure resulting from the negative externality of people imposing uncompensated costs on others by emitting pollutants into the environment. But externalities are just as commonly the result of government activity as they are market activity. For example, many government transfers are best seen as negative externalities motivated by the desire of politically influential groups to benefit at the expense of others.

Yet when problems that capture public notice arise, the default response is almost always expanding government power to correct what are depicted as market failures. This is true even when the problem is largely caused by government policies (as in the case of the Great Recession) or entirely by government policies (as in the case of restricted competition in public education, K–12). Indeed, market failure is often used to justify government corrections when

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Dwight R. Lee is the William J. O'Neil Professor of Global Markets and Freedom at Southern Methodist University, and J. R. Clark holds the Scott L. Probasco Jr. Chair of Free Enterprise at the University of Tennessee-Chattanooga.

markets are working exactly as they should—for example, when government action is brought against a firm for expanding its market share at the expense of its competitors by providing better products or lower prices or both (antitrust). And market failure is often blamed for problems caused by the absence of markets (pollution problems) or when market arrangements have been greatly distorted by government interventions (medical care).

This is not an argument against an important role for government. Civil society and free market prosperity depend on government securing our liberty by protecting our persons and property against violence and theft, providing basic infrastructure and public goods unlikely to be privately provided, and enforcing the rules of private property and voluntary exchange that allow people to pursue their own objectives and solve most of their problems in productive cooperation with each other. But government's proper role is a limited one. Unfortunately, when people see problems as the result of market failures that require government corrections, the limits on government action quickly begin to erode.[1]

The tendency to favor government corrections to perceived market failures is not because people are unaware of government failures. Government failures in the form of poor outcomes and corruption are commonly reported in the news, possibly with as much frequency as market failures. The difference is that market failures are typically seen to be an inherent result of a process motivated by self-interest. On the other hand, there is a strong tendency for people to see political action as motivated primarily by concern for the public interest, with government failures more likely to be aberrations resulting from inevitable mistakes or, at worse, a few dishonest and venal politicians. Indeed, it is common for people to argue that electing more public-spirited and caring politicians would improve government, but one seldom hears anyone arguing that putting more public-spirited and caring CEOs in charge of our corporations would improve markets.

[1]For example, for many an all-purpose market failure is the violation of "social justice" which, though vaguely defined, is seen to demand government correction. But once the door is open for government to correct deviations of social justice rather than prevent clear injustices, a pattern of transfers and privileges quickly emerges in response to political influence and special-interest demands that has no clear limit and seldom has anything to do with justice (see Dorn 2012).

The Standard Public Choice Explanation

Economists explain the different performance of markets and governments in terms of the different incentives embodied in their underlying processes, not in terms of the public-spiritedness of the relevant decisionmakers. They also explain the choice between the two alternatives—market performance and government performance—in terms of the incentives people face to favor one over the other. Public choice economists have developed arguments to explain why those incentives are such that the alternative that creates the largest social value in a particular situation is not always the one seen as most appealing by political decisionmakers.

Consider the explanation for the appeal of government "solutions" to correct market "failures" based on standard public choice arguments. Government solutions are seen to address problems directly in ways that are easily seen, and to be structured so that much of the benefits are concentrated on members of organized interests who greatly appreciate them, while the costs are widely dispersed, and therefore largely unnoticed. So even when the benefits are less than the costs, as is often the case, the incentives to support government solutions are strong and the incentives to oppose them are weak. In contrast, market solutions address problems indirectly by imposing discipline on, and removing privileges from, politically influential groups. The benefits of ending a government subsidy, for example, are widely dispersed and therefore largely ignored, but the costs are highly visible and concentrated on a special interest group with whom the public may sympathize. Governments are then often seen to succeed even when they fail, and markets seen to fail even when they succeed.

There is obviously much to be said for the public choice explanation. But there are situations in which government solutions trump market solutions even though they are opposed by well-organized interests, the costs are high and visible, and the outcomes are publicly unpopular. The purpose of this article is to consider an explanation for the emphasis on market failure relative to government failure in political decisions that supplements the public choice explanation. The explanation is based on (1) the *belief* that moral concerns are more important than most economists realize, and (2) the *argument* that those concerns are far more important in political decisions than in market decisions. The *belief* is inspired by Joseph Schumpeter's

([1942] 1950: 137) observation that "the stock exchange is a poor substitute for the Holy Grail." The *argument* is based on the connection between the decisions people make and the personal consequences they experience being more tenuous with political than with market decisions. To lay the groundwork for the explanation it is useful to consider two types of morality: magnanimous and mundane.

Magnanimous and Mundane Morality

In a recent article in this journal, we described "magnanimous morality" as intentionally helping others and making a sacrifice to do so (Clark and Lee 2011). This morality was extremely useful during most of human existence when one's survival depended on the mutual support provided within small tribes of hunter-gatherers, and it manifests itself in all of us through a strong emotional identification with groups containing those with whom we share common experiences, understandings, and beliefs.[2] Magnanimous morality is still useful. It provides the foundation for the most meaningful relationships and experiences in our lives and clearly serves as the appropriate moral guide when dealing with the relatively few people we care about and have sufficient knowledge of their particular circumstances and concerns to effectively assist them personally.

Only quite recently in human history has a much less personal morality become useful to our well-being, one that allows us to interact in mutually beneficial ways with multitudes of people without having any personal concern for them or possessing knowledge of their individual circumstances or concerns. We referred to this as "mundane morality" (Clark and Lee 2011). This morality consists primarily of obeying rules that are generally beneficial, such as those that are essential to the proper functioning of Adam Smith's "invisible hand"—namely, the rules of private property and voluntary exchange. Although when applied to market behavior this morality is essential to the well-being of literally billions of people, and to the hope of improving their well-being and expanding it to billions more, it has little emotional appeal in comparison to that of magnanimous morality.

[2]This identification has a dark side in the form of hostility toward other groups. See Lee (2012) for a discussion of this hostility and how it is moderated by markets.

Compared to magnanimous morality, which is achieved only by accepting positive duties to help others, mundane morality has little emotional appeal. Mundane morality is really nothing more than abiding by the traditional "rules of just conduct," which, as Hayek (1978: 36) points out, "are negative in the sense that they normally impose no positive duties on anyone, unless he has incurred such duties by his own actions." As opposed to magnanimous morality that is motivated by the intention to provide particular benefits to particular people, mundane morality (like just conduct) "is not concerned with the results that a particular action will in fact bring about" (Hayek (1978: 39).

Also, the mundane morality of the market is frequently seen as encouraging behavior that is immoral by violating every tenet of magnanimous morality. As is clear from Smith's ([1776] 1981: 456) discussion of the invisible hand, we *unintentionally* do more to serve *the public* interest (no one in particular) through the invisible hand of the market when we pursue our self-interest (no personal sacrifice required) than if we had intended to do so.

Much of the opposition to markets is rooted in what is seen as the immorality of market motives, which is often seen as a primary source of market failure. For example, consider the following comment by Robert Reich (2008: 38):

> The best deals we can get in the market place may come at the expense of our neighbors' jobs and wages. Great deals . . . frequently come at the expense of our Main Streets—the hubs of our communities—because we can get lower prices at big-box retailers on the outskirts of town. As moral actors, we care about the well-being of our neighbors and our communities. But as consumers we eagerly seek deals that may undermine the living standards of our neighbors and the neighborliness of our communities.

Reich gets very close to interpreting shopping at big-box retailers as a market failure because markets motivate us to ignore our moral concerns for "the well-being of our neighbors and our communities." However, he is clearly focusing on magnanimous morality and ignoring completely the importance of mundane morality. Surely, Reich realizes that "our neighbors and our communities" would be far worse off without the mundane morality that makes possible the global market coordination on which big-box stores and their low prices depend. But most people do not realize that. Rather, they see morality primarily in terms of magnanimous morality and are easily persuaded that markets are morally deficient, to the point of failure, by arguments such a Reich's.

The Moral Appeal of Seeing Market Failure Successfully Corrected by Government

Even when there is no market failure, the widely perceived lack of morality in markets can be easily interpreted as causing such failure. It is doubtful though that the perception of morality-based market failure would favor government attempts to correct that failure if the political process were not widely perceived to be morally superior to markets. Such a perception is certainly encouraged by political rhetoric, which relentlessly emphasizes that government action is motivated by good intentions and achieves noble purposes through personal sacrifice and concern for others. Such rhetoric resonates emotionally with large numbers of people who achieve moral satisfaction by discarding any doubt about its truth.

This moral satisfaction takes us back to the tenuous connection between people's decisions and their personal well-being when making political decisions as opposed to market decisions. This difference explains why political decisions are influenced by the emotional appeal of magnanimous morality far more than are market decisions, with this difference being most striking when comparing majority voting with market purchases. Given the extremely low probability that an individual's vote will determine an election's outcome, the expected cost of voting for a policy (or for a politician who claims to support that policy) is effectively zero—even if the voter's share of the cost is very high if the policy is enacted.[3] Thus, the person who believes that a policy proposal would achieve a noble objective, can see voting for it as *intending* to help others by *making*

[3]The low probability of a vote being decisive is the basis for such important public choice concepts as rational voter ignorance, rational voter apathy, and expressive voting. Tullock (1971), Brennan and Lomasky (1993), Caplan (2007), and Brennan (2008) have developed the concept of expressive voting, in which we are primarily interested in this article, and discuss important implications of it. The first suggestion of expressive voting that we are aware of was made by Buchanan ([1954] 1999: 80).

a significant personal sacrifice at effectively zero cost. In other words, voting makes it possible to achieve a sense of magnanimous morality at a bargain rate.

This bargain obviously cannot be realized without the voter managing to believe two contradictory beliefs: that voting for the policy is a significant sacrifice, and that the cost is effectively zero because of the miniscule probability that her vote is decisive. This is known as "cognitive dissonance." Numerous psychological experiments suggest that people are good at reducing cognitive dissonance by ignoring the contradiction, or rationalizing it away, when it is in their interest to do so.[4] And the interest to do so can be quite large since most people place a high value on their sense of morality.[5] This also means people will value a belief system that expands the number of opportunities to experience a sense of magnanimous morality at low cost. For many, such a belief system is one that sees large numbers of market failures that can be corrected, at least theoretically, by government action, while making it easy to ignore evidence that this theoretical possibility is likely to be undermined by systemic government failures.

There is evidence for the emotional appeal of the factors on which we base our explanation of a perceptual bias that exaggerates the occurrence of market failures and the ability of those failures to be corrected by government. This evidence is anecdotal, but based

[4]One of the early experiments on cognitive dissonance reduction was performed by Festinger and Carlsmith (1959).

[5]One might think that an increasing number of voters do not have to concern themselves with cognitive dissonance to see voting as a bargain. Those are the voters who are paying little, if any, of the taxes needed to pay for the social welfare programs from which they benefit. Of course, even the approximately 48 percent of voters who pay no federal income tax, pay other taxes. But according to Eberstadt (2012: 74–75), the lowest three income quintiles in 2004 paid less in taxes (federal, state, and local) than they received in government transfer benefits, with the benefit/tax ratio for the lowest quintile being 6.82. Unless voting for those benefits provides low-to-no-taxpaying voters a sense of psychic satisfaction (hopefully not moral satisfaction), it is highly unlikely that they receive any financial payoff from their votes. Only if the government benefits result from a one-vote majority, in which case each voter who favored the benefits would be a decisive voter, would any of the low-to-no-taxpaying voters receive any benefit from voting for them. This result is completely consistent with most low-income voters favoring higher government benefits. But unless they overestimate the likelihood of extremely-low-probability events by far more than indicated by their purchases of state lottery tickets, the motivation has to be something other than the financial payoff from their votes.

on the personal experiences of many public choice economists. Certainly we, and we suspect most others who have studied public choice, have attempted to explain our political insights to people we have met at social gatherings by pointing out that the effect of their vote on the outcome of any but very small local elections is effectively zero. The hope is that the reaction will be one of interest coupled with a desire to hear more. This hope is almost always disappointed. About the best reaction one can expect is a reasonably polite argument that starts with "What if everyone believed that?" More likely there is a quick end to the conversation, often initiated by a less than flattering comment directed our way. The reactions are much the same when we have attempted to explain to someone that the noble-sounding policy he voted for, such as a minimum wage increase to help the poor, import restrictions to help American workers, or anti-price-gouging laws to help victims of natural disasters, harms the very people he intended to help.

Almost no one likes being told that his vote provides no noticeable support for the policies he voted for, or if those policies are enacted they will harm the very people he wanted to help. And those whose sense of magnanimous morality from voting depends on the belief that their votes represent an intentional and meaningful personal sacrifice to achieve moral objectives are, we suspect, the most offended by these and other insights of public choice economists.

Conclusion

The tendency for market failures to be seen as the result of systemic flaws while government failures are either ignored or seen as aberrations is a major source of government expansion and waste. We have considered how moral perceptions can explain this tendency, which results in government action being widely accepted as the default response to market failures, real or imaginary. Standard public choice also explains this response, but the inclusion of moral considerations extends our explanation to circumstances that are seen as irrelevant to the standard explanation.[6]

[6]Some of the influence of what we have referred to as magnanimous morality has found its way into public choice analysis in the work done on expressive voting. But that work does not consider mundane morality. It therefore does not consider the distinction between the two moralities, or examine how the different emotional appeals of the two moralities favor government action over market action.

For example, as opposed to the standard view, voting in favor of a government proposal on the basis of the (magnanimous) moral satisfaction received can become more attractive to a voter as the cost to him increases, *if the proposal is enacted*. The voter's expected cost of voting "yes" increases by a *tiny* fraction of the increased amount he will have to pay if the proposal is actually passed, with the fraction equaling the increase in the enactment cost times the probability his yes vote will decide the election's outcome. On the other hand, the value of the voter's moral sense of sacrifice from voting for the proposal (given a reduction in the cognitive dissonance as discussed earlier) can increase by a much larger (even if still absolutely small) fraction of his increased cost if it passes. This is not a violation of the law of demand. The demand curve for feeling moral is downward sloping, but the tiny increase in the price of a sense of morality is more than offset by an outward shift in the demand curve caused by the additional sense of personal sacrifice.

Also, when policy proposals are strongly supported by voters, powerful interest groups will often recognize that they cannot prevent those proposals from being enacted even though they would very much like to do so. In such situations, the best course of action is to pretend to support the pending legislation, and then use political influence to have it written and enforced in ways that minimize the harm to them. This influence of organized interest groups often reduces the effectiveness of legislation at achieving the moral objectives intended by those voting for it. It is obvious that members of such interest groups are less influenced by magnanimous morality when exercising their political influence than are voters when voting. But it would be a mistake to assume that the members of interest groups are any less magnanimously moral than are voters in general.

The willingness of interest groups to put their private interests ahead of the interests of others can be explained entirely in terms of relative costs. As opposed to the decision of a typical voter regarding a policy, the political decisions an organized group makes regarding a policy in which it has a concentrated private interest can significantly increase its chance of being enacted, and alter the effect of the policy if it is enacted. So if the interest group uses its influence in favor of the policy promoting a noble social objective rather than serving its narrow private interest, the cost to the group will be high. It is worth recognizing that individual members of the interest group are likely to vote for a policy if they feel it is the moral thing to do, even though it will harm the group. They do so because the *expected cost* to each member will be extremely small. Thus, their behavior is fully consistent with the standard public choice principle that individuals have the same regard for their private interests whether they are making market or political decisions. Their decisions differ in the two settings because the costs they face differ (see Brennan 2008).

Finally, unpopular results from government action do not necessarily reduce the favorable view that many have of that action. After an election, voters have very little motivation to examine the influence special interests had on the details and consequences of the legislation for which they voted. Standard public choice analysis can explain this in terms of rational voter apathy and ignorance, although the former is typically used to explain why voters do not vote and the latter is used to explain why they are poorly informed on the issues when they do vote. Willful voter apathy and ignorance might be better terms for describing voter behavior after they vote, given our discussion of the resentment many voters have to public choice insights suggesting their voting reflects far less morality than they like to believe it does.

Whether it is laziness or willful apathy and ignorance that explain why few voters follow up their votes to examine the consequences of legislation they voted for, casual observation is often all it takes to conclude that the noble objective they thought the legislation would achieve remains unachieved. There are a number of explanations for such disappointments, such as the legislation being sabotaged by special interests, political action being inherently counterproductive as a means of achieving the intended objective, or achieving the objective being either impossible or possible only at an exorbitant cost. However, the most satisfying explanation for voters motivated by magnanimous morality is likely to be that the problem is another example of a market failure that can best be corrected by more government.

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