

CHAPTER 5 — BINARY INTERVENTION: GOVERNMENT EXPENDITURES

CHAPTER SUMMARY

There has been little economic *analysis* of government expenditure. Although in the real world the two are always mixed, we may conceptually distinguish between *pure transfers* and *resource-using* expenditures.

All subsidies transfer income from the efficient to the inefficient and distort resource allocation. They lower overall production by (1) diverting energies into “rent seeking” and (2) lowering the incentives to produce.

Government agents spend funds in order to achieve their ends, and hence all government spending is *consumption*, not investment. No government service can be “free” because of the scarce resources involved, but by charging low (or zero) prices, the government causes shortages and conflict. It is vain for the government to run an enterprise “on a business basis,” for the government enterprise raises its funds through coercion.

Socialism refers to government ownership of the “means of production.” The U.S. is more socialistic than generally believed, because of government loans (or guarantees) to business. The U.S.S.R. was less socialistic than generally believed because it relied on market prices from abroad and black markets internally.

Ownership is the ultimate control and direction of a resource. The public cannot “own” a park or a school building. Even government officials do not truly own resources at State disposal, because they enjoy only temporary control. In contrast to popular belief, politicians are inherently shortsighted and tend to use resources too quickly. Private owners, on the other hand, can always sell their property for its capitalized value, and thus will exploit it at the optimal rate.

Democracy refers to majority rule, but in the “classical” sense it means majority decision on policies, whereas in the “modern” sense it usually means majority decision on rulers (“representatives”) who then decide on actual policies.

The principle of democracy is riddled with contradictions. Can the people vote to *end* a democracy (either by moving to dictatorship or ushering in a totally free market)? “Democratic socialism” is infeasible, because the government ultimately decides on how many resources go to various propaganda efforts, and can determine the occupations of the opposition leaders.

There is also the more fundamental question: Why is democracy supposed to be so good? There are countless historical examples of the public making ignorant and evil decisions. It is also far from obvious that democracy is an effective means to check the growth of State power.

Simon Kuznets originally measured the size of government production by taxes paid, operating on the analogy with consumer expenditures for a private good or service. The problem is that taxpayers do not *voluntarily* give their funds for such “services.” The Department of Commerce instead calculates on the basis of the total “cost” of a given program, and hence the bigger the government deficit, the more it is “serving” the community.

CHAPTER OUTLINE

There has been little economic *analysis* of government expenditure. Although in the real world the two are always mixed, we may conceptually distinguish between *pure transfers* and *resource-using* expenditures.

1. *Government Subsidies: Transfer Payments*

All subsidies transfer income from the efficient to the inefficient and distort resource allocation. They lower overall production by (1) diverting energies into “rent seeking” and (2) lowering the incentives to produce.

2. *Resource-Using Activities: Government Ownership versus Private Ownership*

Government agents spend funds in order to achieve their ends, and hence all government spending is *consumption*, not investment. No government service can be “free” because of the scarce resources involved, but by charging low (or zero) prices, the government causes shortages and conflict.

It is vain for the government to run an enterprise “on a business basis,” for the government enterprise raises its funds through coercion. Not only does this distort the incentives, it also makes it impossible for the State personnel to serve the desires of their “customers.” Even if a State enterprise allows competition, and buys factors and sells output in an open market, its initial capital was raised by coercion and hence gives it an unwarranted advantage. Finally, if someone *really* wants the enterprise to be run “on a business basis,” then he should favor complete privatization!

3. *Resource-Using Activities: Socialism*

Socialism refers to government ownership of the “means of production.” The particular form of government (democracy, monarchy, etc.) and the particular ideology (fascist, communist, etc.) are irrelevant to the *economic* analysis of socialism. The U.S. is more socialistic than generally believed, because of government loans (or guarantees) to business. The U.S.S.R. was less socialistic than generally believed because it relied on market prices from abroad and black markets internally.

4. *The Myth of “Public” Ownership*

Ownership is the ultimate control and direction of a resource. The public cannot “own” a park or a school building; the citizen who believes otherwise should try setting policies or selling his aliquot ownership share.

Even government officials do not truly own resources at State disposal, because they enjoy only temporary control. In contrast to popular belief, politicians are inherently shortsighted and tend to use resources too quickly. Private owners, on the other hand, can always sell their property for its capitalized value, and thus will exploit it at the optimal rate.

5. *Democracy*

Democracy refers to majority rule, but in the “classical” sense it means majority decision on policies, whereas in the “modern” sense it usually means majority decision on rulers (“representatives”) who then decide on actual policies. Although in principle democratic governments can be more or less laissez-faire, economics does have something to say about institutional biases.

The principle of democracy is riddled with contradictions. Can the people vote to *end* a democracy (either by moving to dictatorship or ushering in a totally free market)? “Democratic socialism” is infeasible, because the government ultimately decides on how many resources go to various propaganda efforts, and can determine the occupations of the opposition leaders.

The implementation of democracy is also riddled with problems. In a representative government, the delimitation of voting districts is completely arbitrary. National government and democracy are likewise inconsistent, because the only non-arbitrary pool of voters is the world population.

Besides these practical questions, there is the more fundamental one: Why is democracy supposed to be so good? There are countless historical examples of the public making ignorant and evil decisions. It is also far from obvious that democracy is an effective means to check the growth of State power.

APPENDIX
THE ROLE OF GOVERNMENT EXPENDITURES
IN NATIONAL PRODUCT STATISTICS

Simon Kuznets originally measured the size of government production by taxes paid, operating on the analogy with consumer expenditures for a private good or service. The problem is that taxpayers do not *voluntarily* give their funds for such “services.” The Department of Commerce instead calculates on the basis of the total “cost” of a given program, and hence the bigger the government deficit, the more it is “serving” the community. For a more accurate approach, economists ought to first calculate Net National Product and then subtract either total government taxes or expenditures, *whichever is higher*.

NOTABLE CONTRIBUTIONS

- Rothbard's rejection of the Keynesian concept of government "investment" (p. 1259) relies on a praxeological understanding of means and ends.
- Rothbard advances many novel objections to democracy (pp. 1279-1291), most of which would be dismissed as unworthy of response by "serious" scholars because they are so fundamental.

TECHNICAL MATTERS

- The "ballots instead of bullets" justification for democracy (p. 1287) was one held by Mises, and relies on the insight of David Hume that *all* governments ultimately rest on the consent of the governed. Since the majority will ultimately achieve its desired government through revolution if necessary, Mises argued that periodic elections are essential to preserve the peace. (There is thus no presumption here that the majority of voters are likely to make wise decisions.) Rothbard's somewhat facetious analysis (pp. 1287-1291) is simply taking this justification at face value. In other words, Rothbard is questioning whether democratic elections really *do* give us "what would have happened anyway," without the need for bloodshed.
- By saying that the Commerce Department uses the "cost" of a government program as a proxy for level of output, Rothbard simply means that they use *expenditure* (rather than Kuznet's *taxation*) as the measure. This too is vitiated because of the failure to link consumers with payment. On the market, a firm's expenditures on resources are *not* related to the satisfaction of consumers *if the firm is suffering a loss*.

STUDY QUESTIONS

- (1) If government poor relief encourages poverty, why wouldn't private charity do the same? (pp. 1257-1258)
- (2) If a politician gives a subsidy to a firm as a means to achieve a consulting position in four years, would that be *investment* from a praxeological viewpoint? (p. 1259)
- (3) Why can't government enterprises use the rule of marginal cost pricing to guide their decisions? (p. 1267)
- (4) What are the "command posts" controlled by the State? (p. 1270)
- (5) There are many suggestions for how private owners could, say, maintain adequate stocks of fish in lakes. Why can't the government just take those ideas and implement them? (p. 1278)
- (6) Why is "direct democracy" once again feasible? (p. 1284)
- (7) Why does Rothbard argue that a consistent democrat should favor supremacy of the executive? (p. 1285)
- (8) Couldn't the defender of representative democracy claim that voters are ignorant on the issues but can choose wise leaders? (pp. 1285-1286)
- (9) Why can't government statistics test economic theory? (p. 1292)
- (10) Why does Rothbard include transfer payments in his deduction from NNP? (pp. 1294-1295)