POLITEIA

A FORUM FOR
SOCIAL AND ECONOMIC THINKING

Irwin Stelzer

Good for the Public!
Competition, technology and the shrinking state

Address Series

POLITEIA:
A Forum for Social and Economic Thinking

Politeia commissions and publishes discussions by specialists about social and economic ideas and policies. It aims to encourage public discussion on the relationship between the state and the people. Its aim is not to influence people to support any given political party, candidates for election, or position in a referendum, but to inform public discussion of policy.

The forum is independently funded, and the publications do not express a corporate opinion, but the views of their individual authors.

Good for the Public!

Technology, competition and the shrinking state

Irwin Stelzer

POLITEIA

2006

First published in 2006
by
Politeia
22 Charing Cross Road
London WC2H 0QP
Tel: 020 7240 5070 Fax: 020 7240 5095
E-mail: info@politeia.co.uk
Website: www.politeia.co.uk

Address Series No. 17

ISBN 1 900 525 80 1

Cover design by John Marenbon

Printed in Great Britain by:
4 Print
138 Molesey Avenue
West Molesey
Surrey KT8 2RY

THE AUTHOR

Dr Irwin Stelzer is Director of Economic Policy Studies, Hudson Institute in Washington and a columnist both in the US and in London where he writes for *The Sunday Times*. His academic career has been mainly in the US, where he has taught at Cornell University, the University of Connecticut and New York University. He has written widely on economic, regulatory and antitrust law subjects.

Good for the Public! Competition, technology and the shrinking state is the edited text of the address by the author to mark Politeia's 10th anniversary in November 2005

.

Divided Ambitions

This paper should be viewed as a thought experiment – offering a rebuttable thesis that might stimulate the thinking of people more expert in these areas than I am. The thesis is this: two conflicting forces are at work: political forces point to an expansion of the role of the state, while at the same time technological trends are making it possible to shrink that role and exalt the individual.

The best indicator of the division of labour between the state and the individual is the portion each claims of the nation's total output of goods and services. The greater the role we assign to the state, the more of our resources we must make available to it to perform the functions that fall to it, or are grasped by it. It does no good to demand that the state care for us when we are ill and when we are old; when we have infants and when we have ageing parents to tend to; or that it provide facilities when we want to hop into our cars or on to trains; or that it marshal resources when we decide that our interests require intervention in far-away nations – and then complain when the bills come in, and the bureaucrats are hired to carry out our wishes. What Adam Smith called "the profusion of government" is as often driven as much by the demand side of the market as by the supply side. Which is a fancy way of saying what a cartoon character once pointed out, "We have met the enemy and he is us."

This is not to deny that the supply side – the providers of government services – creates continuous pressure to expand its role. Every bureaucrat is convinced he needs more money and a larger staff; every politician has yet another regulation he feels he must enact; every public service worker feels oppressed if deprived of above-inflation wage increases and a generous pension. All covet an ever-larger slice of the national pie – being no different in that desire from those in the private sector.

But in the battle for shares of the wealth of nations, the UK public sector seems to be winning. The best indicator of the relative roles of the state and the individual – the portion of the national income claimed by each – tells us that the state in Britain is expanding its role rapidly relative to that of the individual, with consequences suggested by David B. Smith in the pamphlet he prepared for Politeia some four years ago.[1] Projections of a reversal of this trend are no more credible than projections of NHS spending that assume that its huge bureaucracy will live within its already generous budget.

A Dual State? Expanding and Contracting

There are, of course, certain public goods that only government can provide, national defence and a healthy environment being the most easily identified because they are all encompassing – you can't prevent global warming in London without also preventing it in Blackpool, alas.

But it is more than the need to provide public goods that is driving the expansion of the state: the reasons need another paper. The question to which I confine myself here is whether the direction of public policy, which is expanding the state, is out of line with technological possibilities, which might be making it possible to shrink it.

Start with the fact that we live in a world in which the there seems to be no political will to prevent the expansion of the category of goods and services that are classified as public goods. The Left thinks it correct for government to provide healthcare, education, transport, childcare, parental leave, job training, pensions and a host of other services. The new leadership of the Tory Party agree with this list. In Britain Conservative politicians are unwilling to do more than trim the rate of growth of the state – if that – for fear that they will be seen by voters as mean. In my country, 'compassionate Conservatives' have proved to have a rather expansive notion of what the state can, and must, do for the individual. In short, we have reached a point where there seems to be no limit to the list of public goods. This should come as no surprise: as Charles Murray points out in his wonderful *What It Means To Be A Libertarian*[2], the concept of a public good is "elusive" indeed, and has come to be "used so loosely that it can mean anything someone thinks is good for the public."

Enter technology. Is it possible that technology might trump politics, and create a counterforce to the pressures to expand the state? Consider the possibility that we can now reduce the role of the state (1) by pricing goods and services that we once lacked the means to price; and (2)

---

1 David B. Smith, *Public Rags or Private Riches? High Public Spending Makes Us Poor*, Politeia, 2001.

2 Charles Murray, *What It Means To Be A Libertarian*, Broadway Books (New York), January 1997.

by imposing taxes that we once lacked the means to levy, and that such prices and taxes will force consumers to confront all of the previously uninternalised costs associated with their consumption decisions. This makes it possible to "get the prices right" – a prerequisite to sensible policy – and let the consumer, rather than the state or a regulator, decide how a nation's resources should be allocated.

Let me digress for a moment, for reasons I shall make clear shortly. For a long time there were many industries that we considered to be natural monopolies – electricity and gas utilities, postal services, water supply and telecommunications being the most notable. After all, who wanted competing companies operating at sub-optimal cost levels, and digging up the streets, or running electricity cables and telephones hither and thither, or building parallel piping systems. But we learned not too many years ago that many of these natural monopolies were not so natural after all: that technological advances had shrunk the economies of scale in electricity generation; created alternatives to Ma Bell and BT and, indeed, to wired telephony; and to the post (think of faxes and the Internet), and made it possible for water users to shop around for supplies. In short, what once were natural monopolies are now highly competitive businesses. Industries that once required the long arm of government to protect consumers, can now rely largely on the invisible hand.

Is it possible that there is an analogy here to the problem of defining the role of the state, and shrinking the ever-growing list of public goods? Take the thorny issue of healthcare. No one can deny that the state has a role to play when we are faced with epidemics – it alone can provide pesticides to deal with dangerous mosquitoes, since if a private company attempted to assume that function it would immediately be faced with a host of free riders who could, and would, benefit without contributing to the cost.

But neither can anyone reasonably deny that, whatever the means selected for paying for healthcare services, the state need not be the sole provider of those services, as Vito Tanzi suggested in the Politeia pamphlet in which laid out the path to 'A Lower Tax Future'[3]. Any economies of

[3] Vito Tanzi, *A Lower Tax Future: The Economic Role of the State in the 21st Century*, Politeia, 2004.

scale are not so extensive as to result in a single provider, or even in so small a number of providers as to confer monopoly power, assuming that the competition laws are enforced. This fact is now so obvious – indeed, it is now obvious to all save those with an ideological or self-interested reason for remaining blind – that monopoly provision by the state can no longer be justified: it has proved as inefficient as an economist would expect any unaccountable, unchallengeable monopoly to be.

Shrinking the State: Technology and Competition

Technology: The Tool of Change

It is also obvious that the growth of technology, by making it possible for healthcare providers instantly to exchange and access information about patients, enables patients who so wish to move from one provider to another without significant loss of the advantages of continuity of attention and treatment. In addition, technology has made readily available to patients a great deal of knowledge about the competence of alternative providers (think of WebMD), and the variety of treatments available to them. This latter advance in communications technology should put paid to the argument that government knows best, that patients are incapable of knowing how to select an appropriate treatment, that what government officials call "information asymmetry" is an ineradicable fact of life, with the provider so much more knowledgeable than the user of the services that the user's wishes should be disregarded.

What once might (only, might) have been true no longer is. Technology has made available so many ways in which patients can inform themselves, ranging from Internet services (again, technology liberates) through second opinions, through over-the-Net conversations with other patients, that there is no longer any reason to say "no" to those who want to exercise choice, leaving those who prefer to have their providers choose courses of treatment for them free to do so.

Where, then, does the concept of an informed consumer, with information sources made newly available by technology, leave the state? The short answer is, "With less to do." Consider Burger King. The chain has announced that its consumers prefer calorie-laden, highly salted burgers, egg sandwiches and other products, over what we are told are the healthier products favoured by the government bureaucracy. So that's what Burger King intends to give them, to the consternation of the food police.

The reasonable arguments in favour of government intervention to ban the sale of these unhealthy products, especially to children, are two: consumers do not know just how lethal the Burger King products are, and that if they do eat themselves into the hospital, taxpayers must bear the cost of their treatment.

Therein lies the public policy challenge we must rely on Politeia to meet. If we are to maximise freedom of individual action and choice, we must develop policies that meet both of these reasonable arguments.

First, consumers must have easy access to information about the personal consequences of their choices. That carves out a permissible role for government: to require full disclosure, when market pressures fail to produce it, in hamburgers as in shares. That's the easy part: devising cost-effective means of full disclosure of contents and consequences is the harder, and less glamorous, part. Burger King posts the content of its offerings on the web: is that sufficient? Must special means be developed to reach the affected population, which may have less well-developed access to technologically sophisticated means of communication? One way or another, policy must take advantage of the fact that technology now allows us to substitute government provision of information to consumers for edicts about what consumers should be allowed to eat.

Second, the costs of individual decisions must be internalized – borne by the consumer, rather than imposed on society. As technology makes it possible for individuals who benefit from a public service to be charged directly for that service, and to know the costs and benefits of their consumption decisions, the number of goods and services that can be classified as "public goods" shrinks. Or, at least I think it is possible that is the case.

I leave to Politeia the specific policies that can accomplish these objectives. Here are a few suggestions. Compulsory labelling of the contents of what we are about to wash down with a fizzy drink solves the first problem (just as, for example, labels on cigarette packets do); a tax on foods that are liable to drive up healthcare costs, so that the eater pays society for the costs he is most probably (we can't be more definite than that) imposing on it, would solve the second. (I suggest such a tax with considerable fear and trembling, because to provide this or any Chancellor with an excuse to raise taxes is not something one should undertake lightly, even when accompanying that suggestion with another: reduce other taxes so as to make any tax that forces the internalisation of costs revenue-neutral.)

The twin policies of information provision and internalisation of costs combine to reduce the role of the state. Just as competition make it unnecessary to regulate markets, so when consumers have access to good information, which technology makes easier and less costly by the day, and have to pay for any costs they impose on society, which technology makes more possible by the day, the need for direct government control or the use of general taxation to fund various programmes is reduced.

That's why we should be grateful that technology now makes road pricing possible – the tolls charged, if they cover the cost of using the roads, especially at peak times, should provide a revenue flow sufficient to attract private capital to the industry, and reduce the need to have the state, notorious for its wasteful contracting procedures, fund road construction.

And that's why pollution taxes and permit trading, also made possible by new technologies, are such a good idea – they impose the costs on the creator of the pollution, relieving society of those costs and making the polluter curtail his activities. No need for detailed rules, telling entrepreneurs how to operate their factories. And a vigorous market in permits minimises the costs of pollution abatement. It seems that computerised trading, along the lines of those used by stock and futures exchanges, and instant communication of current prices are capitalist tools in the fight for a greener world.

A Fair Wind for Competition

To information and intelligent taxation, those who would diminish the role of the state should add competition. We have learned from experience in the power industry, the gas industry, the airline industry, and the telecoms industries that competition does a better job of allocating resources than do government regulators – assuming that we accept as fair the distribution of income that underlies the market's distribution of goods and services. (That's another subject for another paper.) No need here to repeat Adam Smith's reasons for concluding that competition forces the various market players to offer quality goods at reasonable prices, lest they lose business to rivals.

That's why monopolists fight so hard to preserve their positions. The NHS resists competing with private providers; state schools are appalled at the notion of tuition vouchers that would free parents to choose between state- and private-provided education; the BBC fought tooth-and-nail to preserve its monopoly of television services; BT tried – some say is still trying – to keep competitors off its network.

Once again, we might be seeing instances in which technology is working to decrease the need for state intervention. We needed the state to protect us from monopoly suppliers of gas and electricity; we don't need it now that new technologies have made possible competition in the generating and, for example, the metering sectors of these businesses. We needed the state to protect us from the rapacity of monopoly telephone companies; as new technology whittles away that monopoly power – indeed as we enter an era in which the cost of calling is affected neither by distance nor time – we can rely on ourselves to select the mix of service quality and price that is most suited to our individual needs. As technology puts an end to spectrum scarcity, the possibility of eliminating the BBC's state-granted monopoly of access to viewers' – and, increasingly, non-BBC-viewers' – purses becomes a reality.

I could go on – technology has made possible, and ineptitude by the state made necessary, the privatization of a portion of the police function: we now rely on sophisticated alarms to protect our homes and cars, rather than state-provided police.

Let me conclude by noting that the conflict between the state, which naturally expands, and the people, who want both freedom and protection, takes on different forms in different decades. It may be that in the future the balance will tilt against the big state as technology becomes the tool of change and monopolies are challenged by competition.

Subscribe to Politeia's Publications!

For £40 a year (£35 by standing order) you will be sent all our pamphlets for the year covered by your subscription and, if you wish, others in print at half the cover price. You will also be notified of Politeia's conferences and events to which, whenever possible, you will be offered admission at reduced rates. More information can be found on our website: www.politeia.co.uk

The Secretary, Politeia, 22 Charing Cross Road, London, WC2H 0QP.
info@politeia.co.uk

•

A Selection of Recent and Related Publications

Reforming Public Spending: Great Gain, Little Pain
Ludger Schuknecht and Vito Tanzi £5.00

Policing Matters: Recruitment, Training and Motivation
A. Howlett Bolton, A. Burden, T. Caplin , D. Ramsbotham, K. Rutherford, C. Woodhead Edited by *S Lawlor* £7.00

Providing for Pensions: Savings in a Free Society
Tim Congdon £5.00

For Better, or For Worse? The Economic Record of the Labour Government
Warwick Lightfoot £5.00

Let Freedom Prevail!
Liam Fox. £3.00

Working in Harness: Parliamentary Government and the Role of the Lords
Thomas Strathclyde £3.00

Saving Savings: How to Promote Personal Investment
Charles Jackson £5.00

The Pensions Predicament
Paul Thornton £5.00

A Lower Tax Future?
Vito Tanzi £5.00

Voting on the European Constitution
Daniel Hannan £7.00

Comparing Standards: Teaching the Teachers
D.Burghes, S.Lawlor, J.Marenbon, B.Moon, A.Smithers, C.Woodhead £10.00

Mounting Costs: Regulation, Employment and the British Labour Market
Nicholas Boys Smith £7.00

Auditing the New Deal: What Figures for the Future?
Oliver Heald and Mark Waldron £7.00

How Savings Damage Your Retirement
Frank Field £7.00

Towards a Low-Tax Welfare State
Tim Congdon £7.00

Labour's Return to Tax and Spend
Warwick Lightfoot £5.00

The EU Constitution: What it means for me
David Heathcoat Amory £3.00

Criminal Negligence:
How Current Policies on Crime, Policing and Punishment fail the Nation
Robin Harris £9.00

Building More Homes
Richard Ehrman and Crispin Kelly £7.00

Pensions Systems: The EU and Accession Countries Lessons for the UK
Chris Daykin £7.00

Working for Benefit
Hugh Sykes £5.00

ABC: A Balanced Constitution for the 21st Century
Martin Howe £5.00

The conflict between the state which tends to grow, and the individual who seeks freedom, is not new. But popular demand also fuels the growth of government and the political will to resist seems to have been abandoned.

Is the state therefore destined to grow? Dr Irwin Stelzer is not convinced. A number of forces may challenge big government, especially competition and technology. No longer need the state be the sole provider of services such as healthcare. And technology, which promotes greater and more economic individual choice, can also curb the expanding state.

POLITEIA

£3.00