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AN EQUAL SAY AND AN
EQUAL CHANCE FOR ALL

When Public is Better

The Efficiency Case for the Visible Hand

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Introduction

The premise of the libertarian view of economics that has dominated public policy and public discourse at least since the era of Ronald Reagan and Margaret Thatcher is that markets work more efficiently than governments. This is asserted both as true by definition and also by example. Government is said to be cumbersome, bureaucratic, subject to pressure group influence and political corruption, averse to innovation, and so on. Markets, by contrast, are lean, subject to competitive pressures, and have other natural mechanisms that maximize efficiencies.

And yet the most costly economic failures of recent years have been those of the market. The financial collapse, a pure product of market mispricing of risk, cost the economy tens of trillions of dollars in just a year. Imagine the outcry if government squandered money on that scale! Global climate change, which Lord Nicholas Stern famously termed "history's greatest case of market failure," is the result of systematic underpricing of carbon pollutants by markets. It will cost the economy in the tens or hundreds of trillions of dollars.

In addition, the process of deregulating and privatizing is often afflicted with the same kind of wasteful corruption that conservatives attribute to government. When public services are contracted out, the corruption and inefficiency is typically the result of contractors seeking to game the system.

GGI The Gordon Gamm Initiative

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Markets, especially in realms where there are public goods or externalities, are famous for loading up transactions with extra middleman costs. Our health system, for example, spends more than any other, and beneficiaries get a lower share of those expenditures than in any other wealthy country because of the costs extracted by middlemen.

There is the related problem of accountability. Government accountability is not perfect, but private contractors to government often capture the agencies they nominally serve and find ways to hide their true costs and profits, leaving neither political nor market forms of accountability.

Libertarians attribute to governments and their political clients "rent-seeking" behavior, the economists' term for pursuit of monopoly profits by governments or their political clients, taking advantage of the fact that government is a kind of monopoly. But libertarians have the emphasis wrong. It is the business sector that typically uses government to pursue monopoly profits by using political influence to rig the rules. In the private sector, even when there is no government contracting, pursuit of monopoly profits is rampant. The more government fails to regulate, the more such rents are extracted—because of the political and market power of first-mover and incumbent firms, the deception and opacity in many actual markets, and the plain information asymmetries between seller and buyer (an insight for which Joseph Stiglitz shared the Nobel Prize). So inefficiency is often not competed away; on the contrary, incumbent power cumulates. "Corrections" periodically occur, not in smooth, minute-to-minute adjustments of price, quantity and product quality, but in abrupt massive collapses or corruption scandals. Government—taxpayers—then must mop up the damage.

Libertarians contend that since government is subject to regulatory capture and rent-seeking by both bureaucratic and private actors, it's best just to leave things to markets. James Buchanan (the conservative economist, not the president) actually won a Nobel Prize for this argument, which he rendered as a tautology—true by definition—not by recourse to evidence.

But that conclusion is far too facile, for there are systematic and costly market failures that can be remedied only by public action. They famously range from the market's tendency to underinvest in public goods, to overspend on pollution that is "free" to the polluter but very costly to society, and the disastrous mispricing of financial transactions. There are also benefits and systems that only government can reliably provide, such as national defense, civil and criminal justice, and a system of property rules for the market itself. The use of government to counteract indefensible market allocations of income and wealth is often invoked for the sake of equity, but in many respects the more powerful argument is that markets fail spectacularly on their supposedly strongest ground—namely, *efficiency*. Markets do not allocate necessary inputs and outputs, goods and services, as efficiently as a blend of public investment and market investment.

Though equality and efficiency are said to be a trade-off—you supposedly need to sacrifice one to increase the other—that is also a myth. There are very substantial sectors of the economy such as health and education where markets left to their own devices fail to allocate sufficient resources, or operate the system with gross inefficiencies, or both. Thus, social provision of health and education increases both equity (more people get educated and get access to health care) and efficiency (publicly sponsored health systems are far more cost-effective than America's largely commercial system; school vouchers have been shown to be less efficient than public schools, adjusting for comparable populations.)

Often, private providers require government guarantees and/or subsidies, which both create moral hazard and necessitate costly supervisory systems that vendors then seek to frustrate, producing an infinite regress of move and counter-move, cost and counter-cost. Medicare, for instance, uses one set of vendors to provide health services, then retains another set of vendors to pay claims, and a third set of vendors to prevent the first two sets from gaming the system, and it then needs more public officials to supervise all the vendors. The health-industrial complex, meanwhile, spends a fortune trying to game the system, requiring even more complex counter-moves by government. As Medicare costs rise, its budget is pared back, leaving it less well equipped to monitor a Rube Goldberg system. But shifting to a market-like system—vouchers—would only leave more opportunity for profiteering, charging more money to the sick, and leaving non-affluent people without adequate coverage. As every other advanced nation proves, it's simpler and more efficient to have a coherent and non-commercial health system. The normal price discipline of supply and demand does not apply to health care to control cost, since consumers and their physicians do not have equal knowledge and patients seldom bargain with doctors and hospitals over price. Health is better understood as a public good.

The debacle with the launch of the Affordable Care Act is an epic example of what occurs when government creates a complex program and then entrusts its design to a private sector contractor—in this case 55 separate contractors.[1] Public administration and accountability, instead of being direct, is delegated and fragmented. Layers of complexity are added. Why did the government contract-out the crucial task of designing the software for healthcare.gov? Because ever since the Reagan Administration, government has been increasingly stripped of core competencies. Some agencies, such as Social Security and the Defense Department, do retain their own, in-house software capacity. Compared to the contractor-dominated Obamacare rollout, Social Security runs like a Swiss watch.

By the same token, education vouchers have failed to live up to their promise. The most careful studies have concluded that vouchers and charters perform no better and often worse than their public school competitors when adjusted for population characteristics.[2] But voucher systems do other damage, by diverting scarce resources from public systems, often into the profits of entrepreneurs, while intensifying the high-stakes testing and "teach to the test" craze. School vouchers often are another instance where more affluent families can supplement the value of the voucher with their own resources and purchase better private education while poorer target families are left with the dregs of the voucher schools.

Libertarians often contend that the cure for imperfect markets is simply more market. If health care is an inefficient quasi-market system, let's just make it more "market-like." Ditto finance. But history shows that when a realm of the economy does not work well as a market, it tends to develop "second-best" forms of accountability—professional norms that limit the predatory impulse, regulatory strictures that compel fairer competition such as anti-trust laws, or financial rules that limit predatory conflicts of interest and illegalize other abuses that are both inefficient and inequitable. Remove those controls in pursuit of a more perfect market and the actual market becomes even less efficient. The General Theory of the Second Best[3] holds that an attempt to shift from a "second best" mixed system of markets and regulation to a supposed "first best" of a purer market can often make things worse.

At this point in the argument, the libertarian reaches for her trump. All right, in *theory* governments can improve on markets, but in *practice* regulation gets corrupted by rent-seeking, capture, and inefficient bureaucracy. Rather than comparing idealized government intervention against real-world markets, as progressives are said to do, we need to compare real world markets with real world governments.

This libertarian argument is seductive, but ultimately unpersuasive. Once we concede that market failure is endemic and that government can improve on the market's allocation of resources on both equity and efficiency grounds, the practical question becomes *how to make government as effective as possible:* How to keep the public sector from being corrupted either by market players or by political corruption (or by both in tandem) so that government can provide forms of regulation and social investment that are both efficient and equitable improvements on laissez-faire markets. Another way of putting that question is: how do we strengthen democratic accountability?

Market Incursions Upon the Democratic Polity

As political democracy has been weakened and private-market actors have been freed from countervailing restraints, a cumulative process has accelerated. Deregulation has not only bred more deregulation. The unleashing of markets, especially financial markets, has concentrated wealth and economic power. That economic power in turn translates into the political power to further weaken regulatory constraints and countervailing democratic rules. The history of the past three decades in one of loosened constraints of finance and weakened regulation of labor markets. The result has been to make the economy no more efficient—often more inefficient—and far less equitable.

The decisions of a highly ideological Supreme Court to allow essentially unlimited money to influence who gets elected is one hallmark of market forces using their political power to intrude into democratic realms that are supposed to be based on "one *citizen*, one vote," not "one *dollar*, one vote." The consequence is not just to warp policy decisions but to degrade the polity itself. The pre-eminence of the market is cumulative in this respect as well. As non-elites see the political system not remedying their economic distress, they lose faith in politics, leaving the field to elites.

One emblem of the power of financial elites is that the collapse of 2008, unlike the collapse of 1929—both the result of laissez-faire excess—was not sufficient to produce a full counter-revolution in public policy. In the New Deal that followed the 1929 economic crash, government substantially regulated capitalism in the public interest, especially financial markets but also labor markets. Post-2008, however, despite the election of a Democratic president and the enactment of supposed reform legislation in the Dodd-Frank Act, Wall Street's basic business model was left essentially intact. Obama's main regulatory appointees were close allies of Wall Street. It is an emblem of Wall Street's continuing hold on the polity that Lawrence Summers, who was an architect of both the deregulation that caused the collapse and of a bailout policy that propped up rather than broke up giant predatory banks, was very nearly appointed to chair the Federal Reserve. Summers' appointment was aborted more because of backlash against his personal blemishes than his ideological viewpoint.

The concentrated economic power produced by laissez-faire thus produces concentrated political power, and the impact of that power is also cumulative.

It produces not only a president and Congress reluctant to alter the prevailing dysfunctional financial system, but blocks other necessary counterweights to the inefficiency and inequity of laissez-faire capitalism. The political influence produces Supreme Court appointees who give

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even more license to money as a form of citizenship, permit barriers to exercise of the franchise, and issue rulings constraining regulation as an incursion on the freedoms of laissez faire. Government's failure to address serious ills then leaves ordinary citizens cynical and less inclined to participate in politics. Recent political science studies, such as *Affluence and Influence* by Martin Gilens,[4] or *The Unheavenly Chorus*[5] by Kay Scholzman et al, have documented the wide gap between the influence exercised by financial elites and by ordinary citizens.

The market's incursion into other realms is, of course, an old story. As works such Michael Walzer's *Spheres of Influence*, Karl Polanyi's classic, *The Great Transformation*, and Margaret Jane Radin's *Contested Commodities* have observed in different ways, because of the power of money and the logic of capitalism, markets tend to encroach upon civic and non-market spheres. Rights, by definition, cannot be alienated; they are benefits of citizenship. Personhood is sacrosanct, and not subject to sale. One of the many outrages of slavery was that it violated that principle. But libertarians tend to treat universal commodification as an ideal. The market's incursion on realms whose logic is inherently non-market, such as the right to vote, impoverishes us as a democracy, and thus makes the polity less able to regulate the market—both in the public interest and in the interest of the market's own efficiency.

Vote-selling and the treatment of money as a form of democratic voice corrodes democracy itself. The selling of body parts or infants for adoption allows market forces into arenas where they don't belong. This issue is as old as the selling of ecclesiastic office (the sin of simony) and the sale of indulgences (entry into heaven), both of which reflected the corruption of the Roman Church and stimulated the Protestant Reformation. The oldest case of commodification of all is prostitution. Libertarians have had a hard time with such issues, because free exchange is not society's ultimate value. Libertarians tend to confuse the *state* with the *polity*. One can favor a relatively smaller or larger state, depending on what functions one wants it to carry out directly; but whatever the size of the state, the citizenry needs a strong and effective polity for democracy to function. Principled libertarians naively pursue not only a weak state but also a weak democracy that is vulnerable to being overwhelmed by commercial influences. Cynical libertarians seek to deliberately weaken the democratic polity so that business elites have an easier time capturing rents.

None of this is to say that governments should do everything, but rather that governments often do things more efficiently and with better distributive outcomes than private corporations or contractors. In numerous everyday producer and consumer markets, supply and demand does work roughly as advertised, though even in those cases government has to define property rights and rules of fair competition, as well as protections against hazardous products that competition itself can't screen out. And in many cases, having government perform a function directly is far better policy than privatizing it or contracting it out—both on efficiency grounds and equity grounds.

Another part of the story that libertarians often leave out is that partially or wholly privatizing a service changes the distributional mix of who can afford to utilize it. "User charges" sound pro-competitive and efficient in theory but if we impose user fees on access to museums or public parks or public universities, poorer citizens are dissuaded from coming. Provide a voucher that only partially covers the cost of decent healthcare or education, and government is colluding in replicating and reinforcing the extremes of the market distribution of income because more affluent people can complement the voucher with their own financial resources. Outsource home care, and a nominal "efficiency" is nothing more than a reduction in the pay of low-wage workers. Turning water from a public good into a commercial product is one way to price a scarce good at a level that discourages overconsumption, but it also makes a necessity more costly to the poor. There are other, better, ways than the price mechanism of discouraging wasteful uses of water. There is a value per se in having oases from commercialism such

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as free public parks and public libraries. The value is partly distributive, but partly civic. It is a pleasure to step into a space like a library where somebody is not trying to sell you something. It is a reminder of the value of civic, class-mixing spaces.

A tour of several policy areas provides vivid examples of why public provision is often more equitable and more efficient than private provision, especially in sectors and areas of policy where markets fail to self-correct abuses, or where public-goods rationales require some form of public subsidy or monitoring. The following examples are meant to be illustrative, not exhaustive.

Contracting Out and Privatizing: The Case of Public Safety

CONTRACTING OUT LAW ENFORCEMENT.

There have been extensive exposés of the abuses of privatized prisons, privatized halfway houses, privatized drug treatment programs, and privatized military functions. Often, the reported "savings" to government come from one of two sources. In many cases, there is a gross deterioration in the quality of the service. The vendor cuts corners in order to maximize profits and shares some of its savings with government as its standards are degraded. The Corrections Corporation of America, a prominent private prison contractor, has been the subject of numerous court orders because its conditions fall below minimal standards of decency.

A second spurious form of savings is in reduced labor costs. As services are privatized, professionalized and accountable civil service employment gives way to less well-trained and compensated casual labor. The "efficiency" or "savings" is really just a shift from labor to capital—from the wages of the employees to the profits of the owners. But looked at as cost-effective provision of service, there is no gain to efficiency at all. Studies of nursing homes, for instance, have shown that the low road of poorly trained and compensated employees incurs hidden costs borne by someone else, such as increased incidence of bedsores that require hospitalization, as well as much higher turnover and training costs.[6]

Privatizing and contracting out basic functions of government, such as law enforcement, also invites corruption. Recently, Governor Chris Christie of New Jersey was found to have repeatedly used his political influence to steer contracts to a corrupt vendor of halfway houses, Community Education Centers, run by a close ally of the governor. An exposé by the *New York Times* found:

Since 2005, roughly 5,100 inmates have escaped from the state's privately run halfway houses, including at least 1,300 in the 29 months since Governor Christie took office, according to an analysis by The Times.

Some inmates left through the back, side or emergency doors of halfway houses, or through smoking areas, state records show. Others placed dummies in their beds as decoys, or fled while being returned to prison for violating halfway houses' rules. Many had permission to go on work-release programs but then did not return.

While these halfway houses often resemble traditional correctional institutions, they have much less security. There are no correction officers, and workers are not allowed to restrain inmates who try to leave or to locate those who do not come back from work release, the most common form of escape. The halfway houses' only recourse is to alert the authorities.

The company first obtained substantial contracts for its "re-entry centers" in New Jersey in the late 1990s, as state financing began increasing sharply. In recent years, it has cited its success in New Jersey in obtaining government contracts in Colorado, Pennsylvania and other states.

William J. Palatucci, who is the governor's close friend, political adviser and former law partner, is a senior vice president at Community Education.

Mr. Christie himself was registered as a lobbyist for the company in 2000 and 2001 when he was a private lawyer, according to disclosure reports that his law firm filed with the state. In early 2010, he hired the son-in-law of Community Education's chief executive as an assistant in the governor's office, according to state personnel records.[7]

"In the real world, the corruption inheres not in government but in the relationship between a crony vendor and a corrupt politician."

In the Platonic, libertarian world, abuses like this don't happen. Markets are simply more efficient than governments, by definition, so contracting-out, a form of marketization has to improve efficiency. If abuses do occur, libertarians contend they are purely government's fault. But even in a perfect libertarian world it is not possible to run a prison system without government. In the real world, the corruption inheres not in government but in the relationship between a crony vendor and a corrupt politician. Having government perform such services directly makes the abuses harder to hide because government is subject to more direct checks and balances. Contracting out criminal justice adds costs, invites corruption, and debases services. Privatized prisons have cut costs only by cutting wages (and enriching corrupt entrepreneurs) and worsening the quality of the correctional system. Much of the cost-cutting is cost-shifting, for the failure of the halfway houses piles costs onto other taxpayers via other parts of the criminal justice system. A perverse "benefit" that results from contracting out is that the existence of the intermediary makes it easier for politicians to deflect accountability. (I didn't do it, the contractor did.) Often, conservative politicians that don't much like government see it as a trough for their allies in the private sector. The story of prison privatization in New Jersey is an epic example, but hardly the only one.

ABUSES BY PRIVATE MILITARY CONTRACTORS.

When the Pentagon and the CIA contracted out various military functions to the private contractor known at the time as Blackwater Worldwide, only part of the rationale was cost-savings. Much of it was "plausible deniability" in cases where private armies resorted to practices explicitly prohibited to the military. Today, some 25 percent of all intelligence expenses are borne by private contractors. Only 40 percent of military contracts are even subjected to competitive bidding, thus undermining the rationale that private vendors produce the benefits of market-like competition. According to an 18-month investigation by Pro Publica, in 2010 for the first time in American history the number of deaths in the ranks of corporate military contractors surpassed the death toll among active duty personnel. These deaths were not counted in the official statistics of casualties. According to the Congressional Research Service, as of March 2011, the number of Pentagon contractor personnel in Iraq and Afghanistan (155,000) exceeded the number of uniformed personnel (145,000) subject to direct military discipline.

The pay levels of some contractors far exceeded those of active duty GIs. After a variety of scandals, the company formerly known as Blackwater reorganized and changed its name to Xe, and then changed its name again to Academi. A staff report prepared for the House Committee on Oversight and Government Reform found that Blackwater billed the government $1,222 per day per guard, "equivalent to $445,000 per year, or six times more than the cost of an equivalent U.S. soldier."[8]

How could Blackwater/Xe/Academi, despite its repeated abuses, continue to get government contracts? Its top officials and directors included Cofer Black, the former head of the CIA's counter-terrorist center, Bobby Inman, former head of both the CIA and the NSA, former Attorney General John Ashcroft, and Jack Quinn, former White House Counsel to President Clinton and Chief of Staff to Al Gore. A libertarian might say that with all of these revolving doors and exploitation of privileged contacts and knowledge, it's government that is corrupt. But even in a libertarian fantasy, national security, inherently, can't be fully privatized. The accountability and professionalization and safeguards against corruption are far more effective if the operation is retained as a public one.

PRIVATE AIRPORT SECURITY AND TSA.

One of the most notorious cases of privatized security that cost the nation dearly was the outsourcing of airport security by the airlines to low-paid, poorly trained employees of slipshod contracting companies. This outsourcing was ostensibly supervised by government. But despite repeated lapses in the era of airline hijacking and the first wave of terrorist attacks during the 1980s and 1990s, pleas to make airport security a public function fell on deaf ears until the catastrophe of September 11, 2001.

Whatever economic savings were realized by the decision to seek security on the cheap were more than wiped out by the costs of 9-11 and its aftermath. The problem was not just careless contractors and poorly trained and compensated employees but the fact that fragmented contracting decisions on an airport-by-airport basis prevented airport security working as a coherent system with consistent, high national standards. Even after the tragedy of 9-11, conservative resistance to allowing TSA workers normal collective bargaining rights delayed implementation of the shift to a public system. To have a privatized system realize the quality and reliability of a public one would incur a layer of supervisory costs that would vitiate any savings.

CONTRACTING OUT SECURITY CLEARANCES.

In the aftermath of two major recent events, the massive leaking of secrets by Edward Snowden and the murderous rampage at the Navy Yard in Washington by Aaron Alexis, also an employee with a clearance, *"Certain public tasks, such as military security, public health and education, do not lend themselves to the market disciplines that make private firms efficient in their quest for profit maximization and cost reduction."*

Congress and the press have revealed details about the shoddy practices of a company known as USIS, which had investigated both men and given them clearances. Despite the obsession with secrecy, government had contracted out the process of assessing who is to be entrusted with vital national security information. It also turns out that many of the practices used by USIS were based on cutting corners in pursuit of quick profit. It was an accidental benefit to our democracy that this contractor allowed Snowden to reveal secrets. Yet one need not sympathize with the immense abuses of the NSA to question the sheer incompetence of the private contractor.

At this writing, it has been revealed that the average time spent on security clearances has dropped from 150 days to under 40 days since 2005; that USIS's financial incentives cause it to rush through clearances, and that USIS has even falsified information in order to complete clearances and get paid. In the case of Alexis, the USIS failed to include a police report, which showed that Alexis had shot the tires of a construction worker's car in what he told the police was an anger-fueled blackout. The *New York Times* reported that at a Congressional hearing in June, "an assistant inspector general in the personnel office, Michelle Schmitz, called the USIS investigation a 'complicated contract fraud case,' and declined to provide further details.[9]

A libertarian might contend that all of this is government's fault. The contracting agencies simply did not do an adequate job of supervising the contractor, monitoring potential conflicts of interest, and so on. If a contractor is determined to commit fraud, they are breaking the law. End of story. But this view asks too much of a government that contracts out vital functions, especially since the stated rationale of the contracting out was to save money. A far more plausible conclusion is that a sensitive function, closely related to government's core mission, is done more competently and efficiently by government directly. The incentives to cut corners, even to the point of fraud, are built into the structure of contracting out an inappropriate function of government.

When such functions are contracted out to the private sector, a few entrepreneurs expect to cash in big, and their incentives are to hire staff just barely adequate to do the job. In government, by contrast, there is a career civil service with professionalism, well-established systems of accountability, and a compressed pay structure. If government is performing merely normally, there are no incentives for rushing through clearances. Government is also subject to reviews by its own inspector generals, by Congressional oversight and the GAO. It is true that there have been past episodes involving leaks by people with high levels of security clearance such as Daniel Ellsberg, but no mass scandals of slipshod or corrupt granting of clearances. While neither system is foolproof, the evidence suggests that performing clearances in-house is superior to contracting out the job.

These structural problems arise not only in areas of sensitive national security information. In many forms of contracting out, the libertarian contention that market-like approaches are invariably superior falls apart because of problems of supervision, corruption, and conflicts of interest. There is also the chronic problem of lock-in, in which a vendor acquires specialized knowledge that makes supervision difficult, and also undercuts the usual system of competitive bidding which is one of the market's main claims to superior efficiency. This problem is endemic in national-security privatization, where there are a limited number of vendors, and many are former high-ranking officials of the military establishment cultivating private sector contacts for future jobs while still in government. Certain public tasks, such as military security, public health and education, do not lend themselves to the market disciplines that make private firms efficient in their quest for profit maximization and cost reduction.

These case studies on contracting out raise the issues not just of efficiency and corruption, but the more fundamental question of when a function of government ought to be inherently public, quite apart from the arguable efficiency of involving a private vendor. Government, of course, purchases a great deal from the private sector. In a mixed economy that does not set out to be socialist, this is at should be, especially for ordinary commodities where competitive bidding can keep the process honest and efficient. However, as we have seen, there are major areas of public goods where public provision is usually more efficient as well as more equitable. In addition, certain basic functions of government ought not to be delegated to the private sector at all, for reasons of citizenship rights and accountability. Police powers are so fundamental to the polity that they don't belong in private hands. Long ago, the state acquired a monopoly on the legitimate use of force and violence. Private armies

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were abolished. Jails became a public function. It is a slippery slope to abuse and corruption when such basic powers are privatized.

Privatization: Efficiency or Hidden Cost-Shifting?

COST-SHIFTING: THE CASE OF AMBULANCES.

In many if not most American localities, provision of ambulance services was once a public function, provided by fire, police, or separate EMT departments. In the 1980s and 1990s, as public budgets came under pressure in the era of the assault on government, local municipalities sought to save money by contracting out ambulance services. Today, in most localities, if you phone 911 in the case of a medical emergency, an ambulance owned by a private company will arrive. The cost will be billed to your health insurance, or to Medicare or Medicaid. However, because the city or town retains some residual liability as the contractor, a fire engine is likely to arrive, too. This is, of course, entirely wasteful and duplicative.

Nor do private contractors provide superior or more cost-effective services thanks to the supposed efficiency of competition. In many cases, there is long-term lock-in of the contractors. Conversely, in large cities that rely on privatized ambulances, it is common to see multiple, redundant ambulance companies incurring overhead costs that are ultimately passed along to consumers in the form of health insurance fees. In the minority of localities that still provide ambulances as a public service, there is no notable difference in what public versus private EMT teams actually do.[10] The public employees do tend to receive better pay than their privatized counterparts. So the "savings" provided by privatized ambulance services are one part cost shifting from taxpayers to ratepayers (largely the same people) and one part gain-shifting from workers to owners. There is no evidence of superior efficiency in the actual provision of the service due to market mechanism, and there are often hidden costs of redundancy.

GENERATIONAL COST-SHIFTING:
THE CASE OF HIGHWAYS AND RAILROADS.

In recent years, there have been efforts to privatize the ownership and maintenance of toll roads. In June, 2006, Mitch Daniels, the former Bush administration official turned governor of Indiana, collected $3.8 billion for the state's treasury from a consortium that included the Spanish construction firm Cintra and the Macquarie Infrastructure Group of Australia. The consortium got to operate the 157-mile Indiana Toll Road for the next 75 years. [11]

The appeal to politicians looking for short run financial windfalls is intense. The politician who is persuaded by the investment bankers to sell off a public asset enjoys a windfall to his budget. Thanks to the one-time infusion of cash, he or she can increase services, lower taxes, and look fiscally responsible. But of course you can't sell off the same public asset more than once. Often, an investment banker such as Goldman Sachs promoting a privatization deal offers a lot of money up-front for a public asset that has been paid for by several generations of taxpayers. The costs are really being shifted forward to future generations of taxpayers and toll-payers (and the headaches to future politicians.)

Once a highway is privatized, the new owners typically increase tolls in order to cover maintenance and their own anticipated returns that have been promised to shareholders, and also cut costs. The investment banker who promoted the deal also takes a large, one-time cut. The new owners may realize some "savings" by cutting labor costs on highway maintenance—but once again this is not a real efficiency gain, only a cost shift from labor to capital. In the case of privatized highways, the added wrinkle is a temporal cost-shift to future generations who would very likely pay lower tolls if the asset stayed in the public sector and the entrepreneur did not have to cover acquisition and profit costs out of revenues. This public infrastructure, of course, has been financed by previous generations of taxpayers and toll-payers, as a public good.

Route I-69, the 8-mile Chicago Skyway, was sold for $1.8 billion, also to Cintra. The new owners doubled charges to motorists in the first six months while subcontracting toll-collection to a parking lot operator, who hired toll collectors at $12 an hour, far less than the previous wage paid to public employees. None of this is a gain to "efficiency"—it is pure extraction of monopoly profits at the expense of both workers and drivers. Critics have pointed out that this brand of privatization can turn public highways into private luxury goods, as they become too expensive for ordinary citizens to use—a familiar distributional shift caused by marketization of a public good or service.

"One might argue that this backdoor privatization is somehow efficient, in that it forces universities to scramble for funds and to compete for tuition-paying out-of-state applicants, and perhaps causes students to value their education more. But the reality is that this form of privatization has drastically shifted the distribution of who gets to attend university"

It is instructive to look at the highway example against the usual libertarian story of inefficient government monopolies. In this instance, it is the private investment banker and the prospective shareholders who are the rent-seekers using their status as monopoly providers. Often they collude with shortsighted public officials, typically with the deal lubricated by campaign contributions. These disguised bribes are another case of market principles intruding where they don't belong—in the corruption of government. One might say that both the privatizers and their politicians are seeking rents—windfalls—but this a far cry from the libertarian tale of government as rent-seeker and market as efficient allocator. In the highway story, market corrupts government to serve the market's rent-seeking. The cure for this sort of inefficient and unsavory privatization is a more robust polity, so that proposals to privatize are evaluated on their merits. In other cases, such as the proposed privatization of the Pennsylvania Turnpike as promoted by Goldman Sachs, elected leaders, in this case Governor Ed Rendell of Pennsylvania, vetoed the proposal.

One of the most notorious cases of private sector rip-offs at the expense of consumers and taxpayers is the privatization of British Rail and the London Underground by the Conservative governments of Margaret Thatcher and her successor John Major. The story is complex and has been the subject of several books. In essence, the Thatcher government decided to sell off major elements of the rail and subway system to private companies. When the companies extracted windfalls and underestimated necessary operating and capital costs, they went bankrupt, leaving government to bail out rail operations. However government sought to recapture some of its costs by drastically reducing service and increasing fares and resorting to a second round of private financing.

When Ken Livingstone, then the mayor of the London and its Greater London Council, challenged Prime Minister Thatcher by proposing to restore the quality of the London Underground by using direct public bonding, citing the New York Subway system, Thatcher retaliated by abolishing the Greater London Council. Today, the London Underground has Europe's most expensive public transit and worst service. This pattern is known in the U.K. as "lemon socialism." Corrupt private entrepreneurs extract windfall gains, leaving taxpayers and ratepayers to socialize the cost of the lemons.

COST-SHIFTING:
THE CASE OF PUBLIC HIGHER EDUCATION.

America's magnificent system of public higher education is the fruit of a farsighted act of government, the Morrill Act of 1862, which set up public universities funded by grants of federal land. For more than a hundred years, the land-grant universities, which include many of our finest great research universities, were virtually free to the student. They had a legacy of a public endowment and were well supported by state legislatures. They enabled millions of young people from households of modest means to become the first in their families to graduate college, and they graduated debt-free. The wide availability of free public higher education made the American workforce more productive and competitive. It is a perfect example of a public good with positive externalities.

Then, beginning in the 1980s, state legislatures faced with contrived budget crises created by bouts of tax cutting, began to save costs by under-funding public universities and shifting university budgets to tuition and fees. By 2012, this stealth privatization had reached a point where the typical "public" university was only about 15 percent funded by public sources. Meanwhile, the Federal government sought to pinch pennies by shifting college aid from grants to loans. Today, the average in-state student total cost of attending a four-year "public" university is $22,261 according to the College Board, and out-of-state students pay close to the cost of a private university—well over $40,000.

One might argue that this backdoor privatization is somehow efficient, in that it forces universities to scramble for funds and to compete for tuition-paying out-of-state applicants, and perhaps causes students to value their education more. But the reality is that this form of privatization has drastically shifted the distribution of who gets to attend university. Today, more students at ostensibly public universities are from affluent families because students from poorer families can't afford to attend. More students from middle class families graduate loaded with debt.

As a bookend to the inequitable stealth privatization of public universities, one can point to the inefficiencies and abuses of privatized provision of student loans. As government support has been reduced relative to rising tuition costs, students have had to rely increasingly on loans rather than grants. Private loan companies, mainly banks and for-profit finance companies such as Sallie Mae, overcharge students and their parents for loans at far above the prevailing interest rate of their own cost of capital. Since the loans are guaranteed against loss by the federal government, this is an epic case of government bearing the risk and the private vendor reaping the monopoly profits. When a reform signed by President Obama substituted direct government loans for government guarantees of private loans, interest costs to student borrowers dropped dramatically. In addition, for-profit student loan companies have been major enablers of the growth of for-profit universities, which have a far higher dropout rate than non-profit or public institutions serving comparable populations.

Public Provision of Public Goods

Private versus public provision of other quasi-public functions, such as postal service, telecommunications, transportation, generation of electric power, research and development and the like, should be evaluated on the merits. In some cases, private provision may introduce cost-saving innovations that government might have been slower to add, but even in these realms the case is far weaker than often proposed by libertarians.

THE EFFICIENCY OF PUBLIC POWER.

In the 1920s, privately owned electric utilities were notorious cases of corruption. Local power companies were private, poorly regulated monopolies. They were owned increasingly by holding companies in pyramids that only the owners understood. These companies both restrained competition and watered the stock of the operating companies, diverting operating income to their own pockets. They "up-streamed" profits to the parent holding company, which in turn was controlled by a handful of people. Because of the complex ownership structure and the accounting manipulation that it permitted, it was impossible for state public utility commissions to fathom true costs, expenses, and profits. Authorized rate increases simply went into the profits of the holding companies. Meanwhile, tens of millions of Americans lacked access to electric power because utility companies did not find it profitable to add service to relatively sparsely populated areas.

With the New Deal, government provided two efficiency-enhancing innovations. First, federal programs like the Tennessee Valley Authority and other public power initiatives such as Rural Electrification Administration co-ops brought cheap and plentiful electricity to rural areas. These public sources of power not only expanded access to electricity but permitted "benchmark" pricing: By comparing public power pricing to private power company charges, regulators could get a more accurate picture of a private company's actual costs as opposed to the claims of its creative accounting. Secondly, the Public Utility Holding Company Act for the first time brought an end to the pyramiding and stock-watering that extracted monopoly rents and raised prices to consumers. Finally, in addition to bringing more accurate pricing than private market actors provided, public power brought electricity to under-served regions at least a generation sooner than private power likely would have. The electrification of rural America has extensive positive externalities, in making farming and transportation more efficient.

The deregulation of electric power beginning in the late 1970s promised increased competition, consumer choice, and declining costs. In practice, the break-up of integrated public utilities provided opportunities for new forms of supply manipulation, price gouging and financial abuses, the most extreme example being the outright frauds committed by Enron. But even when criminal abuses were not committed, the industry rushed to create new forms of consolidation to amass market power, and true retail competition was very slow in coming. As cheaper natural gas came online in the new century, the decline in the consumer price of retail power lagged the decline in the price of fuel, because of the pricing power exercised by newly deregulated monopolies subject to only very limited true competition.

INEFFICIENT COMPETITION:
THE CASE OF PHARMACEUTICAL RESEARCH.

Over 50 percent of all prescription drug costs are ultimately paid for by the government, which is to say by taxpayers. That includes Medicare, Medicaid, the armed services, and insurance coverage for public employees of federal, state and local government. The drug industry contends that its exorbitant prices are necessary to promote innovation. Although private pharmaceutical companies do spend upwards of $20 billion a year on research, the industry is consistently one of the most profitable. And a great deal of drug industry applied research takes a free ride on taxpayer-financed basic research at agencies such as the National Institutes of Health or the National Science Foundation.

There are several gross inefficiencies in the way the system for researching new drugs has evolved. The industry has lobbied for and received extended patent protection to prolong the period during which it can charge extremely high prices. This delays the availability of generic substitutes and intensifies the search for blockbuster new drugs. In practice, much of the research in recent years has been a quest to find "me-too" drugs, that are either very slight (patentable) variations on existing drugs that are about to go off patent, or close copies of drugs marketed

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by competing companies. All of this raises costs of research without adding much if anything to useful new drugs. The FDA estimated that 76 percent of new drugs that it approved in the 1990s were duplicative.

In addition, the intense competition for new drugs has walled off the natural diffusion of knowledge that is essential to scientific advances. Academic researchers on contract to one company are not free to share their findings with other researchers or to publish their work in scholarly journals until the drug company is ready to launch a new drug. The description of the alleged wonders of the new drug is closely controlled by the company. There have been innumerable scandals in which the findings of initial clinical trials have been manipulated or distorted in order to persuade the FDA to approve the proposed new drug. Billions of dollars that serve no efficient economic purpose are also spent marketing competing drugs to physicians and patients.

The economist Dean Baker has calculated that it would be less expensive and more conducive to legitimate scientific advances if we simply financed all pharmaceutical research publicly, and then put the results in the public domain. Peer review panels would evaluate applications for research grants on their scientific merits. Clinical trials would be corruption-free because billions of dollars in profits would not be riding on the results. There would be no wasteful races to patent duplicative me-too drugs. Once a new drug was approved, generic drug companies would be immediately free to manufacture it. Baker calculates the deadweight economic loss from patent protection as roughly $100 billion as of 2013.[12] The cheaper prices to consumers and to the government would cover the additional costs of publicly financed research several times over.

PUBLIC INNOVATION:
THE CASE OF PUBLIC RADIO.

Over the past half century, commercial radio news has gone into a serious decline. Radio affiliates of the major broadcasting networks have gradually cut back their budgets and have largely ceased to generate original reporting. Network and local talk radio, for the most part, is a series of host and caller rants and misinformation. Before the creation of the Corporation for Public Broadcasting in 1967, the "educational," non-commercial part of the spectrum included low-power college stations, religious broadcasters, a few municipal stations and the five listener-supported stations of the Pacifica Foundation, which pioneered listener-sponsored radio in the 1940s.

With the advent of Corporation for Public Broadcasting, National Public Radio, other national content providers, and strong local affiliates, public radio has grown into a major force in news and public affairs broadcasting. Its capacity to do serious, high quality original journalism now rivals that of the best of our newspapers. Public radio has also spawned original, inventive forms of entertainment and cultural programming that commercial radio was incapable of innovating, with shows such as "This American Life," "Car Talk," "Wait, Wait, Don't Tell Me," "It's Only a Game," "Prairie Home Companion," and "The Moth Radio Hour." These programs also include "Marketplace," with its superb coverage of business, which, ironically enough, is superior to any coverage of business on commercial radio. These are no longer niche offerings—they have tens of millions of regular listeners as well as a wide diversity of form, content, genre and viewpoint. Compared to commercial radio, they take their subjects and their audience seriously and are elevating even when entertaining.

After a takeoff generation of deep public subsidy in the 1970s and 1980s, public radio is now mostly self-supporting, based on a mix of listener contributions and minimally intrusive and strictly limited commercial "underwriting." Taxpayer subsidy now amounts to less than 15 percent of public radio's total costs, and continues to shrink.[13] The public subsidy to commercial radio, in the form of the free allocation of public airwaves, is obviously many times that.

The point, for our ongoing argument with the libertarians about the efficient role of public provision, is that *public radio identified a latent market for high quality broadcasting that commercial radio proved unable to serve*. It not only identified the audience, but also incubated an entire new creative cohort to provide the content as well as a habitat where inventive producers could thrive, freed from the short-term forces of profit maximization. They built high quality programming, and the audience came. Market forces evidently could not, and did not, achieve this. Public provision has amplified the free marketplace of ideas. Public radio is far more innovative and less formulaic and bureaucratic than its private-sector counterparts. It's also the case that while some of the managers of the largest stations earn six-figure salaries, nobody gets rich off of this public resource the way buyers and sellers of commercial stations occasionally

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enjoy huge windfalls. There are incentives other than purely market ones and they are sufficient to generate high quality content that finds a large audience.

What is true of high quality public radio is true of a variety of public innovations dating back to Alexander Hamilton's Report on Manufactures. These include early infrastructure improvements that required public subsidies such as canals and railroads, spinoffs of military advances such as radio, advances in aviation, and famously the Internet. In many cases, public subsidy of basic research via the NIH and NSF and large projects such as the Human Genome, facilitated the growth of entire new commercial industries such as biotech.

DEBASING EFFICIENT PUBLIC PROVISION:
FROM FNMA TO FANNIE MAE.

During the Great Depression, as millions of Americans were losing their homes, the Roosevelt Administration invented a suite of policies. Government-insured mortgages through the new Federal Housing Authority. This allowed the long-term, self-amortizing mortgage to become the norm. Government also backstopped thrift institutions through a new Federal Home Loan Bank System, a kind of Federal Reserve for savings and loans and savings banks. Government also refinanced mortgages in or at risk of default, through a new public institution, the Home Owners Loan Corporation, which eventually refinanced one home in five, and when it finally closed its offices it returned a small profit to the Treasury.

The final piece of this suite of policies was the Federal National Mortgage Association, a public corporation that financed its own activities with direct government borrowing. FNMA served as a secondary market for the home mortgage industry. It set standards, bought mortgages, and thus replenished the supply of local lenders' loanable funds. There was no "securitization" in the current sense of repackaging securities according to the supposed degree of risk and no conflicts of interest. Either a loan qualified for FNMA purchase or it didn't. There were only trivial losses. The agency ran smoothly, and the rate of homeownership soared from around 43 percent in the last years of the Great Depression to 62 percent by the mid-1960s.[14]

In 1968, as part of a budget reform, FNMA was moved off the government's books. Congress's intent was not to create a purely private, profit maximizing corporation, but to allow FNMA to go into capital markets directly without its financing needs being included in the budget or counting against the public debt. It was generally understood that the government would continue to stand behind FNMA's securities, and blessed with this tacit guarantee, FNMA continued to enjoy low capital costs and to play its traditional social role of facilitating home-ownership.

But over time, as private markets invented complex, opaque, and highly profitable forms of mortgage securitization and markets became newly fashionable, a new generation of FNMA executives realized that they had a golden goose on their hands ripe for commercial exploitation. FNMA was rebranded as Fannie Mae, long the organization's nickname but now its new, hip corporate name.

By the 1990s, the executives of Fannie Mae were taking advantage of the tacit government guarantee and low capital costs to grab market share from their competitors and manipulating their stock price in order to increase their own compensation. Was this an abuse of government? Hardly—it was an abuse of *privatization*. At first, Fannie Mae, with a remnant of public purpose resisted getting involved with the toxic stew of sub-prime and Alt-A mortgages, but by the early 2000s, Fannie executives worried about losing market share and joined the game just in time to lose hundreds of billions and be bailed out by government.

Today, there are calls to shut down Fannie entirely, leaving the secondary mortgage market entirely to the private market actors who caused the collapse. That would be the wrong lesson, for as the crisis showed, private financial markets cannot be trusted to efficiently and transparently provide secondary mortgage markets. The right lesson would be that public, in this case as in others, is better—better because it is simpler, more transparent, with fewer opportunities for self-serving abuses. The right lesson would be to return to FDR's public FNMA.

GOVERNMENT AS PUBLIC GOOD AND RISK MANAGER.

There are some things that markets simply can't do. As Paul Light's succinct though encyclopedic book, *Government's Greatest Achievements*[15], documents, they include some functions that seem as natural to us as breathing (assuring national defense, advancing and assuring human rights, ensuring safe food and drinking water, organizing the financing of homeownership) to others that are the subject of bitter political contention (increasing workplace health and safety, expanding the right to vote, reducing air pollution, maintaining transparency in financial markets.) But the point is that *markets could not have solved these collective problems* and efforts to have market piggyback on basic government responsibilities in these areas often have the effect of making government less effective and markets less efficient.

Many development economists point out that a clean, accountable government is a huge source of competitive advantage for emergent nations. This is no less true for established economies. Government administers a reliable system of courts, which in turn anchors commercial transactions including private property itself. Public policies of government define and prohibit predatory market conduct—except when corrupted by private players. David Moss's book, *When All Else Fails,* points out that we need government in multiple ways to manage and reduce needless risks. It is interesting and emblematic of the intellectual fashion of the times that Moss, in his title, evidently felt the need to tip his hat to prevailing prejudices: the title suggests a defense of government as a last resort. The substance of the book itself suggests a far more robust necessary role for the public sphere.

In sum, the libertarian view is far too sanguine about the limitations and abuses of real-world markets, and far too dismissive of the salutary role of governments. Especially in those economic realms that have characteristics of public goods, public provision is generally more transparent, accountable, and cost-effective than the involvement of profit-motivated actors. In other sectors of the economy, there is a large role for ordinary commercial competition, but even in these areas, effective government is needed to keep markets honest.

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