On Fairness and Needs in a Free Enterprise Economy

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March 2010

I. Introduction

Fairness is notoriously difficult to define and yet volumes have been written about it. Regardless of political views, many seem to think that important aspects of fairness are captured by the socialist/Marxian phrase, "From each according to his ability, to each according to his needs." Free enterprise is often thought to fail in this regard, where it is claimed that the needs of the less fortunate are ignored and profit and self interest triumph. Proponents of this viewpoint contend that this implies a role for government intervention to temper, limit, or "provide a conscious" for market outcomes, thereby improving the fairness of the allocation of resources. This usually entails some sort of government tax and expenditure program, where the relatively wealthy are taxed in order to provide resources to the poor.

This paper takes the converse view. Even if one accepts that the above phrase captures notions of fairness, we suggest that governmental organizations will have a difficult time implementing this notion and that there are a set of market-based organizations that are likely to have better success at doing so.

The above Marxian phrase suggests that in order to be fair, we ought to redistribute toward those with the greatest needs from those of higher ability. At the outset, let us note that economists often find the term "need" to be vacuous. For example, one can ask whether water is a need. In most times and places, it is not a need on the margin. Much of the water we consume – e.g., washing dishes, bathing, lawn watering, industrial processes – has nothing to do with sustaining life. The same applies to other "needs" such as food, clothing, and shelter. Additionally, people often trade off one of these "needs" for other "non-needs," e.g., forgoing the purchase of a shirt (clothing) in order to spend more on movies. In using the term "need,"

this paper will depart from technical economics and adopt the more common usage that need refers to something important in one's life.

For most of the paper, we consider fairness, at least in part, as being related to how well resources are allocated to those in need. Before turning to that line of analysis, though, we consider one other concept of fairness: that rewards should be related to merit. This discussion is in section II of the paper. On the metric of merit, markets are quite fair since high productivity is highly rewarded. Section III of the paper returns to the "needs" conception of fairness and reviews the usual model of the profit-seeking firm and self-serving consumers.

Section IV of the paper observes that free enterprise economies are comprised of various types of organizations, many of which do not seek to maximize profits. These include nonprofit charities, clubs, churches, civic groups, circles of friends, and families. The goals of these organizations reflect the variety of the individuals that comprise them, but most involve a concern for the needs of others. These various nonprofit organizations supplant or exist alongside for-profits in many sectors of the economy, including the provision of religious services, the arts, hospital services, and child rearing.[1]

A fundamental difficulty of any organization, private of public, in trying to allocate according to need and inducing payment according to ability is to identify those individuals who are of greater need and those who are of higher ability. Failure to adequately do so results in many errors and defeats the purpose of the organization. This problem is especially acute where needs are complex and involve more than income. Also, when allocating goods to recipients without payment, one encounters the moral hazard problem of overuse of the good. This may

[1] The term "nonprofit" organization is used in this paper to refer to the type of organization discussed in this paragraph and not in its legal sense.

lead to a dependency by recipients on organization; something the latter may wish to discourage. These issues are discussed in section V.

Section VI turns to an analysis of how private organizations deal with these problems. It is noted that in most cases, these organization engage in close interactions with potential recipients in order to assess their needs. For example, from a close relationship to their children, parents determine whether their child really benefits from having the latest fashion in shoes or is better served by doing without. From repeated contact with a homeless man, workers at a shelter can assess whether the man needs a meal or some counseling. Also, nonprofits frequently require a quid pro quo for their services, so that the recipients of a meal at a shelter may be required to attend a religious service and children who get an iPod are expected to behave. Thus, there is a nonmonetary price that recipients pay for what they receive and providers of the service presumably gain utility from this. This establishes a market for nonmonetary exchange, where recipients undertake actions that providers value (e.g., attending a religious service) in exchange for receiving a good or service. This is one way that overuse and dependence by recipients is limited. A supply and demand analysis of this market is introduced in this section.

Government organizations that attempt to allocate according to need face the same problems but are unlikely to address them as successfully as the private sector. Public organizations typically do not engage in the close, personal interactions with potential recipients to assess complex needs and do not expect a quid pro quo for services provided. Moreover, they are unlikely to have strong incentives to do so. Funding by tax dollars insulates public organizations from the competition for financial support that serves as an incentive for private organizations. This is discussed in section VII of the paper. Using supply and demand analysis, it is shown how a government program that effectively lowers the nonmonetary price to

recipients increases the quantity demanded and reduces private sector supply. Because long run elasticities are larger than those in the short run, these effects are smaller in the short run than the long run. Thus, any presumably negative effects of the program on creating dependency, reducing private charity, and expanding the government budget are initially small, but larger in the future. If there is any political shortsightedness, this may make these programs quite politically popular but difficult to undo once in place.

Section VIII concludes the paper. There are conditions under which government provision on the basis of need may not be as problematic as in others, for example, where the assessment of needs is obvious and where the elasticity of demand by recipients is low. However, the private sector in a free enterprise economy normally has advantages over public organizations and is underrated regarding its efficacy in providing for the needs of individuals and in its fairness while the public sector is overrated in these respects.

II. Does Fairness Involve Merit?

Without delving into a deep discussion of fairness, consider the following issue concerning markets and fairness.[2] Should merit should be accounted for regarding fairness and rewards? Casual empiricism strongly suggests that it is widely held that it should. Is it fair that the individual who works hard to produce more goods and services be rewarded the same as one who is slothful and produces little? Most probably would not think so.

Thus, if a strong correlation of rewards and productive effort is an important aspect of fairness, then free enterprise does very well regarding fairness. Markets provide substantial rewards for those who produce more products that consumers want, or better products, or products at lower prices. To be sure, luck and raw ability can play roles in monetary payments received in the marketplace. For example, without any effort, owners of Anaheim, California

[2] Also considered by Heyne (2008).

real estate reaped great rewards when Disney decided to locate there. But it is equally sure that effort, training, conscientiousness, and similar exertions are important in supplying marketplace consumers with goods they value. The rewards that come with this are therefore merit based.

Some might also argue that one can get ahead in the marketplace by cheating buyers or engaging in related fraudulent activity. There are market-generated incentives to limit this, but they do occur. But this sort of activity really is outside the delineation of free enterprise. Free enterprise involves voluntary actions and exchange. Fraud is a deliberate failure by one party to follow through on his/her part of the exchange, going counter to what the other party agreed to. Proponents of markets understand this and advocate market-supporting legal infrastructure – e.g., contract law, anti-fraud statutes – that seeks to prevent it.

III. Profit-Maximizing Firms and Self-Serving Consumers

The profit-seeking firm is sometimes regarded as one of the hallmarks of free enterprise. This model of supplier behavior is long-ensconced in the economics profession's teaching of principles and more advanced microeconomics. The sole pursuit of profit, presumed to be the goal of these firms and an accurate predictor of their behavior, is thought by some as leading to unfairness. Firms charge the same prices to individuals regardless of income, need, or any other characteristic. Any resulting profit is kept by the firm's owners, presumably used to further their own interests.

Another alleged hallmark of free enterprise is the self-interested consumer. In many of our models, consumers are entirely self serving, buying goods only of the basis of their own desires. Goods end up being allocated to those who are willing to pay. The result seems to be an allocation that is devoid of concern for the needy.

However, even the case of totally self-interested parties, this is not necessarily the case. One reason is that pricing and property rights require that we implicitly pay attention to the desires of others. In competitive equilibrium, prices provide information about others' wants. The market price represents the marginal valuation of the good to consumers. In deciding whether to acquire a good, a consumer compares his/her valuation to the market price, so is implicitly comparing to other individuals' valuations. The concerns of others, as reflected in the market price, are accounted for. Those who have a greater "need" for certain goods will have a higher valuation and be more likely to acquire the good. For example, those who jog for their health have a greater valuation for running shoes, those with colds value decongestants more, and those with larger families value bigger homes more. Of course, these purchases are constrained by income, but "needs" still matter in the allocation of goods and services. However, it is the income constraint and lack of income by some individuals – so their "needs" are not reflected in the marketplace as much as others – that generates concern with fairness.

It remains the case, though, that the above-noted and widely-used assumptions of the underlying motivations of demanders and suppliers in the market generate much unease about the fairness of free enterprise outcomes.

IV. A Broader View of Humans and Other Private-Sector Organizations

The typical model of the competitive market discussed in the previous section is an abstraction intended to understand and explain certain market phenomena. However, it is well recognized – by economists as well as others – that human beings have broader concerns than profit, money, and their own selves. Self interest and a desire for money should not be neglected as parts of the human character, but overwhelming evidence shows that people value other things, too, including the "needs" of others. Many of our behaviors illustrate this, such as

charitable donations, care for our children and friends, and volunteer efforts for various causes. A wide variety of organizations and institutions have developed in conjunction with these types of activities. These include nonprofit charities, clubs, churches, civic groups, circles of friends, and families. The goals of these organizations reflect the variety of the individuals that comprise them, but most involve a concern for the needs of others.

Each of the above named organizations is as much a part of a free enterprise economy as are for-profit firms. For-profits firms assist consumers, for a fee, in obtaining the goods and services that they wish to purchase. They emerge without diktat in response to consumer demand. Similar comments apply to other organizations. For example, nonprofit homeless shelters arrange for the shelter of homeless because, in part, there are a large number of individuals wish to donate money to see that this occurs. Clubs form because of people's desire to gather for the purpose of interaction centered on a commonly shared interest. Families form in part from a desire to procreate, but also to have close, intimate relationships with mutual caring and assistance.

Each of these emerges on its own in a free enterprise economy where organizations are free to start up and will survive if they serve their stakeholders' interests adequately well. In fact, nonprofit and for-profit organizations can (and do) compete for serving the same objective. The nonprofit form of organization has "won" this competition and attains a dominating presence in many settings and shares the marketplace with for-profit organizations in others. For example, the provision of religious services is almost entirely composed of nonprofit organizations. Many art museums and other art-related organizations are nonprofits. Hospitals are a mix of nonprofit and for-profit institutions. In the market for childcare services, there are a

large number of both for-profit and nonprofit providers, and a great deal of child rearing occurs within a different sort of nonprofit institution – the family.

The circumstances under which various forms of organizations, including nonprofits, are likely to occur is the subject of a significant literature. Important examples are the work of Fama and Jensen (1983a), Hansmann (1996), and Glaeser and Shleifer (2001). Delving into the details of this literature is beyond the scope of this paper. For our purposes, however, it is important to note that the nonprofit organizations discussed above frequently allocate goods *not* based on their users' willingness to pay. They often attempt to allocate based on users' "needs." Similarly, nonprofits organizations often try to gain payment from those who have a greater "ability to pay." The market selects these types of organizations over for-profit institutions in many situations.

V. Some Fundamental Problems

When an organization attempts to allocate its goods and services based on "need" and induce payment according to "ability," it encounters several fundamental problems. These apply to private organizations, as well as government efforts along similar lines.

A. The Information Problem

The basic information problem faced by this type of organization is how to assess the needs of potential recipients and the ability of potential payers. Failure to adequately do so puts outcomes at odds with the objective of the organization, i.e., those obtaining the goods are unlikely to be the most "needy" and those paying may not be the most able. Allocation by some other rule may actually serve the organization better.

To illustrate this issue regarding needs, consider an example from Heyne (2008). A bus driver pulls up to a bus stop, takes on passengers and begins to pull away with a near capacity

load of riders. As the bus moves off, someone runs up and waves wildly for the driver to stop and let him/her board. Is it fair for the driver to do so? Is the driver helping a needy person? To adequately assess this, the driver would have to know many details of tardy person's and the passengers' lives. What are the consequences for the late arriver if s/he has to wait until the next bus relative to catching this bus? Suppose that if the driver stops for the late party and there is a two-minute delay. This is two minute delay for the numerous other riders. What are the consequences for them? This may cause missed connections and/or late arrivals to meetings, appointments, or other engagements. Stopping for the late party is not necessarily helping the neediest person. To make a "fair" decision on whether to stop for the late party, the driver ought to consider all the consequences for each passenger and weigh them against each other. Not having detailed knowledge of the parties involved, this is an impossible task. A simple anonymous rule may work better. In this example, the anonymous rule is that one acquires a ride by arriving at the bus stop on time.

The analogous situation in a more traditional market setting is in the following example. Suppose an altruistic grocery store owner would like to allocate the food to those most in need. To do so, s/he would have to evaluate the life situations of the thousands of customers, determine who is most needy then allocate the groceries accordingly. Knowing the details of the lives of the customers simply is infeasible. Rather than attempting to allocate on the basis of some mistaken assessment of need, the grocer may find it more appropriate to use a simple rule: those willing to pay the going price obtain the food.

Similar comments apply to any attempt by the grocer to induce payment according to ability. Assessing the ability to pay of each of the thousands of customer is a task that the grocer

is not likely to succeed at. Attempting to base payment on erroneous determinations of ability would be self defeating.

B. Income, Need, and Ability

A simple way to assess needs and ability is to use income as a proxy and rely on its presumed positive association to ability and its negative relationship to need. Income is easier to measure that underlying need and ability. Indeed, this presumably is the reasoning behind many government tax and expenditure programs where high income people are taxed and the low income are subsidized. Using income as a proxy for ability, or an inverse one for need, leads to another set of problems, however. Though the above noted relationships of income to need and ability may hold, they are far from perfect. As is well known, income does not necessarily correspond to ability or, inversely, with need. Those with high income may have achieved it through hard work despite modest ability. Some with low income may be highly able but still be low earners due to a desire for leisure, nonmonetary rewards, or to laziness. Redistribution based only on earned income does not do so carefully on the basis of ability and need. In additional, there is the well-known incentive problem. Those who earn high incomes who are taxed have less incentive to work; those with low income who are subsidized have less incentive to work.[3] Lower overall wealth is the outcome, with less to redistribute to the needy.

C. The Complexity of Need

There is another set of problems related to the first two. Human needs are often extend well beyond cash assistance or the purchase of goods and services. Very often, those in unfortunate situations may not simply need some cash or groceries, but are best be served by emotional support, spiritual guidance, advice, having a sounding board, someone to commiserate

[3] The incentives for each group depend on the interplay of income and substitution effects, but as long as the amount taxed equals the amount of the subsidies, the income effect, on average, is absent and one is left with the substitution effect to work less.

with, or someone to be accountable to. Similarly, though most able to give are not necessarily those with the highest incomes. Personality traits such as the ability to offer sympathy, to engage in nurturing, to provide discipline, leadership, or inspiration can matter much more that earning ability when giving emotional support to those who need it.

Judging needs and abilities regarding the above traits is well beyond observing cash income. Because these traits are often very difficult to ascertain, we are back to the original issue discussed above: the difficulty in assessing needs and abilities makes it very hard to allocate and induce payment on those bases.

D. Moral Hazard and Dependence

When good and services are given away, this invariability induces consumption beyond what it otherwise would be. Naturally, those who "do not need" the good will be tempted to acquire it at the zero price. This is the familiar moral hazard problem. It creates two issues.

One is that the greater use of the good or service increases the required resources to support the enterprise. For these organizations to survive, there must be a way to limit this additional use. Second, the additional use may create a dependence that is counter to the goals of the organization. For example, free meals at a shelter may induce some people to come to rely on them and reduce efforts to become self supporting in this regard. Those providing the support to shelter most likely do not wish to encourage this type of behavior.

In an ordinary market setting, a dollar price is charged for the good, generating funds for its provision and establishing a disincentive for overuse. However, in the setting of the nonprofit organizations we are discussing, requiring dollar payments is no longer allocating by "need" and is anathema to the goal of the organization. Other means to deal with this problem are required.

VI. Assessing Needs, Quid Pro Quos, and the Market for Nonmonetary Exchange

It seems clear that many of the nonprofit institutions discussed above freely depart from allocating goods based on willingness to pay and payment based on productivity. Families do not compensate children according to the value of their services rendered nor charge them for meals, transportation, housing, tutoring, and the myriad of things a family provides. Friends often come to the assistance of one other without compensation. Churches help members in need with tangible and intangible goods and collect from others in the church. Charities for the poor provide cash, goods, and counseling to the needy and collect payment from those who wish to support them. In short, there are a host of free enterprise institutions that knowingly and willingly attempt to allocate according to need and gain payment according to ability in a non-coercive manner. Consider the ways which these organizations operate to deal with the fundamental problems discussed above.

A. Assessing Needs and Abilities

Recall that one of the fundamental problems that arise in organizations of this type is the assessment of needs and abilities. Some of those with low income have the ability and skills to earn higher incomes if given the appropriate motivation. Also, needs are frequently more complex than simply requiring more cash or food and can be emotional in nature. Often, nonprofit organizations attempt to look deeply into potential recipients' characters. This can be through close, emotionally intimate, face-to-face interactions. Does the homeless man simply need a meal? Or can he earn a decent living with some guidance, friendship, and someone to hold him accountable? Workers at the homeless shelter engage in interactions to collect this information and make these assessments. Does a friend who lost a spouse need cash to pay the rent for a month or just some sympathy? Friends find out and take appropriate action. Does the

child who did poorly on an exam need a tutor or more discipline to motivate work? Parents have intimate knowledge of their children through repeated interaction and make this and similar judgments.

Thus, many nonprofit organizations specialize in obtaining this detailed knowledge of individuals and allocate resources accordingly. The information problem noted above is overcome with close, repeated interactions. The knowledge gained in this manner also assists in dealing with the moral hazard problems of overuse and dependence. Evaluation of each potential recipient's status and motivations enables one, to some extent, to screen out those who are not appropriate for receiving the assistance, e..g., those who are could easily obtain the good by other means or who are becoming overly dependent.

B. Quid Pro Quos

The typical nonprofit institutions are not simply one entity giving goods and services to another. Almost invariably there is quid pro quo. There are expectations of recipients of the assistance. Giver and recipient are engaged in a nonmonetary exchange. In families, children are often given video games, TVs, and cell phones by their parents, but they are not free. In return for their use, children are expected to behave in certain ways, e.g., do their school work, be nice to their parents and siblings, eat their vegetables, and the like. For someone who gets help from friends to move their residence or just advice and commiseration, there is an implicit expectation for them return the favor for others in the group. Homeless shelters have certain expectations those who are provided with, food, shelter, and counseling. Often, these entail being sober, behaving in a polite manner, helping clean up, and engaging in some religious activity.

In short, there is a nonmonetary price for goods and/or services "given" to recipients. The price is a nonmonetary action or activity that recipients "pay." Though payment is not in cash, it carries some disutility to recipients.[4] Also, the payment is something providers gain utility by the recipients undertaking. For example, those receiving food at a shelter may be required to attend a religious service. This is carries disutility to recipients and is the nonmonetary price to them. However, those providing the meals gain utility from recipients' attending a service and serves as the nonmonetary compensation to providers.

Also, this nonmonetary price serves as a check on the moral hazard of overuse and dependence by recipients. The nonmonetary price limits consumption by recipients and does so without impinging on their budgets. The latter is especially important regarding programs administrated to the poor.

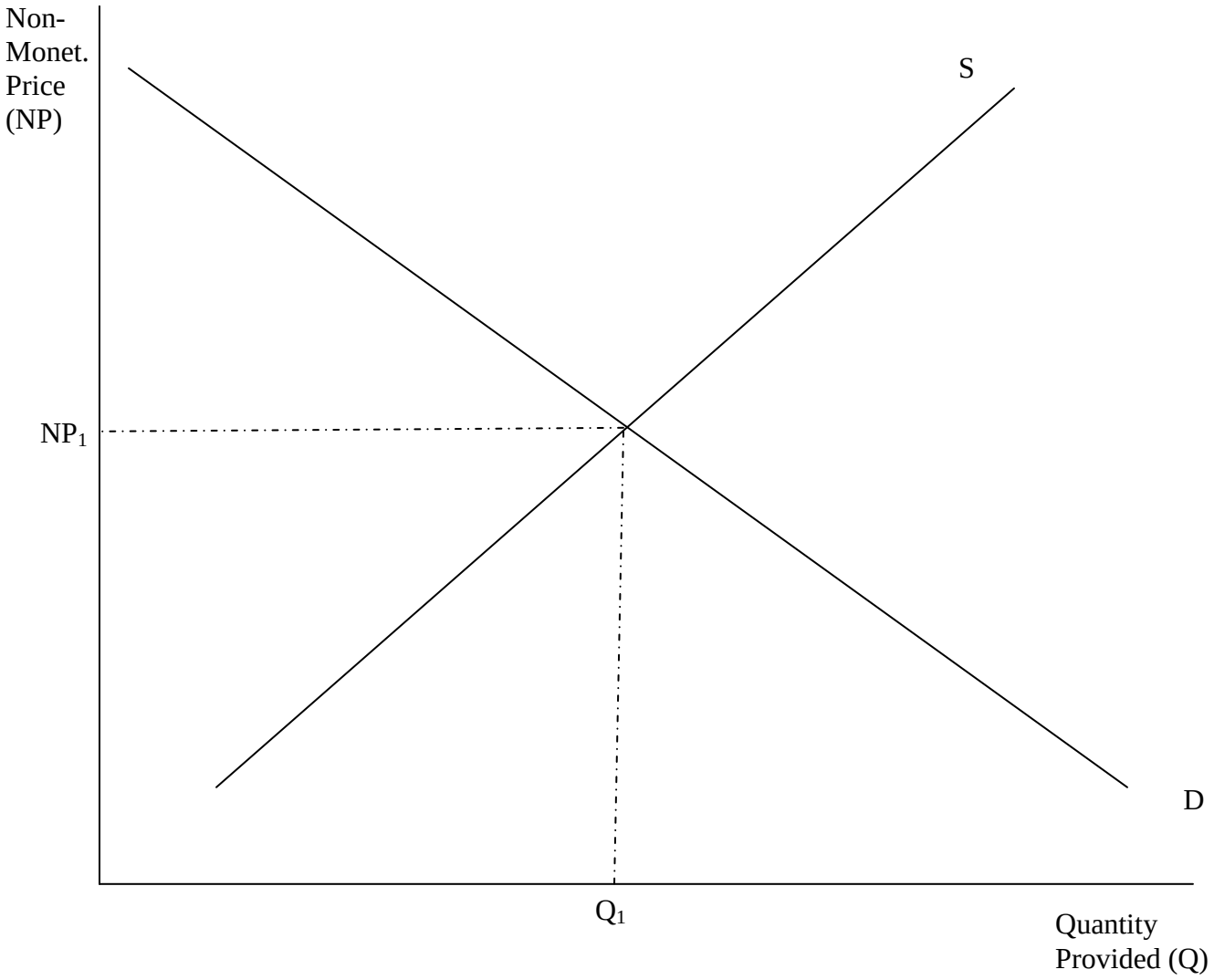
C. The Market for Nonmonetary Exchange

We can think of the above as a market regarding nonmonetary exchange and analyze it in with a modified version of supply and demand analysis. First, consider the example above, where a homeless shelter assesses its "customers" and determines what individual get, say, food, a night's stay, and a counseling talk. There is some nonmonetary activity that is expected in return for receipt of these services. As with any other good, there is a downward sloping demand curve. The greater the nonmonetary payment for food, shelter, and counseling, the lower the quantity demanded. This is illustrated in Figure 1.

In Figure 1, the horizontal axis represents the quantity (Q) of the good or service provided to recipients and the vertical axis is the nonmonetary price (denoted NP) asked in return. The curve D represents the demand curve as discussed above. There also is a supply

[4] Those giving the goods and services normally feel that the "payment" is good for the recipient in the long run, e.g., making children behave well may be disliked by children at the time, but inculcating good habits is good for them in the long run.

Figure 1



relationship similar to that in the usual market setting. Though the nonmonetary price paid by recipients is not a cash payment to providers, it is something that the latter value being done. The higher this price, the more providers will offer to recipients. This is the upward-sloping supply schedule denoted S. As in the usual market setting, there is an equilibrium quantity and (nonmonetary) price, denoted Q_1 and NP_1, respectively.

VII. Government Programs

A. Problems With Government Provision

Many government programs are established with the presumed intent of helping the needy and these efforts are funded by taxing those with higher incomes. Examples of large federal programs of this type include food stamps, housing assistance, and a variety of job training programs, while large federal/state collaborative programs include Medicaid and Temporary Assistance for Needy Families (TANF). Each of these, and programs like them, face of the above discussed problems associated with allocating according to need and requiring payment according to ability. There is much to suggest that these problems are not dealt with very well. There are good reasons why this is to be expected.

For the most part, eligibility for these programs is based on income. Payment of taxes to support them also is based on income. As noted above, needs and ability are likely to have correlations with income, but the correlation may not be that strong. Much deeper exploration is needed to truly ascertain need which, as discussed above, can be quite complex and involve emotional issues and not simply cash. However, government offices that administer these programs do not engage in intimate, face-to-face interactions with potential recipients with the intent to assess their true character and needs. Additionally, there are essentially no quid pro quos. There may be costs such as filling out paperwork and standing in line, but there typically are few, if any, expectations regarding the behavior of the recipient as a condition for receiving the good or service in question.[5] The result is twofold: a failure to identify true needs and a greater use of and dependence on the program. These are generally at odds with helping the needy.

[5] Perhaps an exception to this is TANF. States are expected to require schooling, training, or work effort to receive cash assistance. Also, unemployment insurance programs usually have a requirement that recipients engage in active job search, but this apparently is not well enforced.

Moreover, there is unlikely much incentive for government-operated programs to engage in the careful assessment of needs nor in the requiring of quid pro quos. Program administrators are not rewarded for this careful assessment. Thus, they do not have the knowledge of who needs what, nor the incentive to acquire it. Similarly, program administrators have little incentive, and usually have little discretion, to impose a quid pro quo on recipients. Dollars to support the program are from tax revenue and do not come from the providers themselves nor from voluntary donors who feel strongly about "the cause" and can withdraw funding and apply other pressure in seeking a particular type of assistance and nonmonetary price.

Nonprofit organizations may also have similar problems in motivating the managers and employees to engage in the appropriate assessment and to charge the suitable nonmonetary price. This is likely to be especially true of large organizations, e.g., United Way and Red Cross, where the donors to the organization are not its managers and may be far removed from any direct involvement. This is an issue directly analogous to the principal-agent problem that stockholders of a large corporation face who are not part of management nor associated with the operations of the corporation. There is a large literature on how corporations deal with this problem and some of those ideas apply to nonprofit organizations.[6] An important point here is that there is competition among nonprofits for donors. Donors seek some type of screening on needs and quid pro quos to be established. To compete for donors, it is in the interests of the nonprofit organization to establish procedures and provide evidence to donors that they are indeed doing what donors desire.[7] Though these processes are imperfect, they are likely to induce a substantial degree of conformity of the organization's actions to donor wishes.

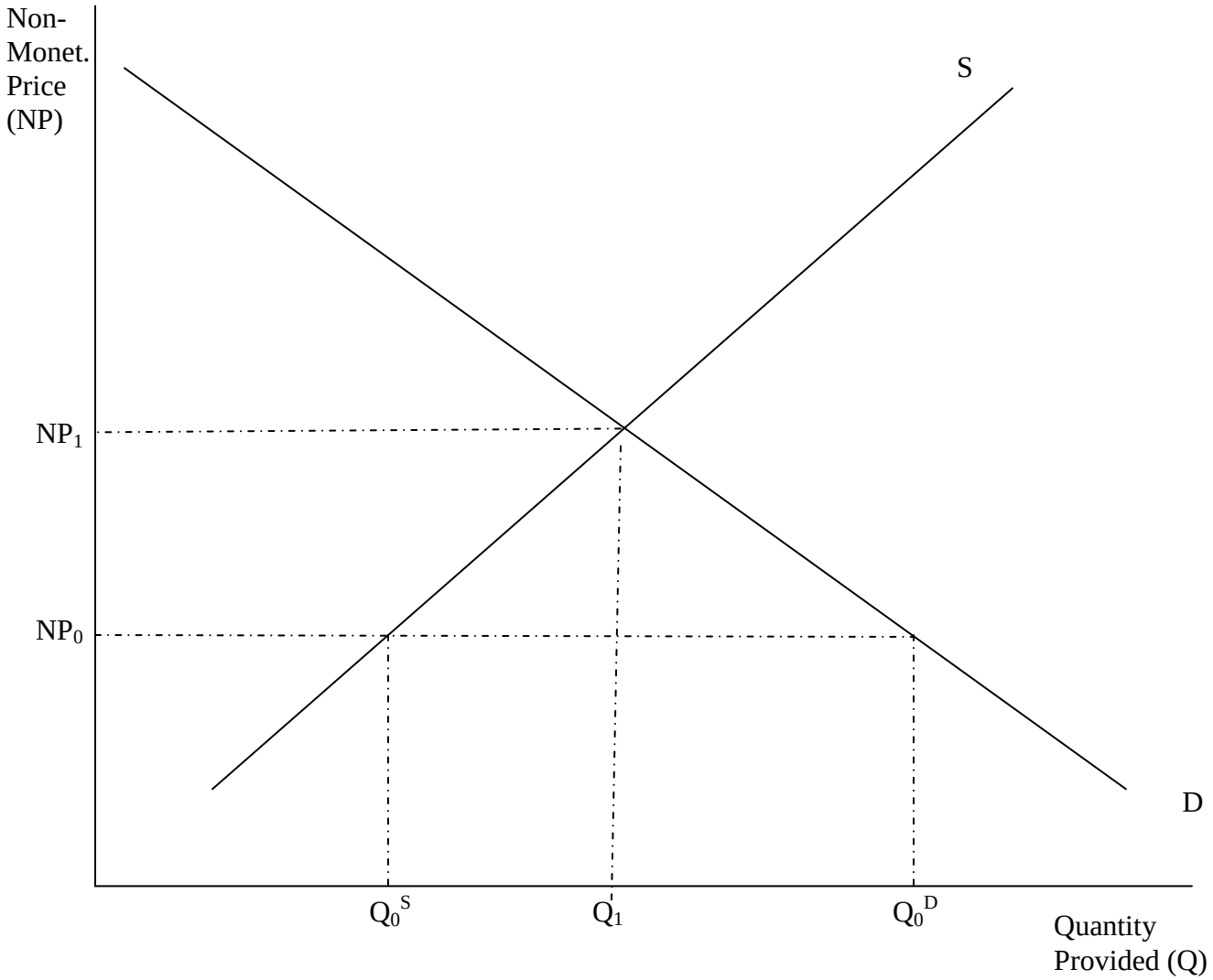
[6] See Fama and Jensen (1983b) for a discussion of how corporations deal with this issue and Glaeser (2002) on similar issues regarding nonprofit governance.
[7] See Castaneda, Garen, and Thornton (2008) for evidence on the effect on nonprofits of competition for donors.

Because the source of funds for government programs is tax dollars, potential supporters cannot withdraw their money if dissatisfied with the program and so there is not a similar competitive process to induce conformity with supporter wishes.[8] Thus, the above described forces will largely be absent for government run operations. The result is that there is no careful assessment of need and no price charged for receipt of goods and services provided. Those obtaining the good are much less likely to be truly needy and, because of the lower price, more will be utilized.

The outcome can be illustrated with our supply and demand model. To do so, consider Figure 2. Figure 2 replicates Figure 1 but adds some additional material. One interpretation of a government program is that it essentially lowers the nonmonetary price of obtaining the good in question. Suppose that this lowers price to NP_0 and the government program supplies to the market all that is demand at that price. Private providers must charge this same price, or its equivalent, or will not serve any recipients. The result is that the quantity supplied by the private sector is now Q_0^S. The quantity demanded at the lower price is Q_0^D and the government program supplies the balance of demand not provided by private providers, $Q_0^D - Q_0^S$.

[8] Dissatisfaction with government programs is expressed via lobbying efforts and voting. Both of these have free-rider problems, hampering their effectiveness. Also, voting usually occurs regarding a candidate representing a whole platform of issues. Thus, a vote cannot be targeted specifically at one program, blurring the signal it gives. Though the relation between a program's popularity and the votes its political supporters obtain probably is positive, it is much weaker than for voluntary support for particular programs. Another avenue by which there is competition regarding government-operated programs is Tiebout (1956) competiton, where individuals move to the locale providing their desired level and type of government programs. This, too, has its limits and is not applicable to federal programs.

Figure 2



B. The Short Run, the Long Run, and the Transitional Gains Trap

Two related issues that often arises in the context of government assistance programs are the issue of dependence and Tullock's (1975) transitional gains trap. Dependence increases as individuals adjust to the availability of the program and come to use it more and rely on it. This

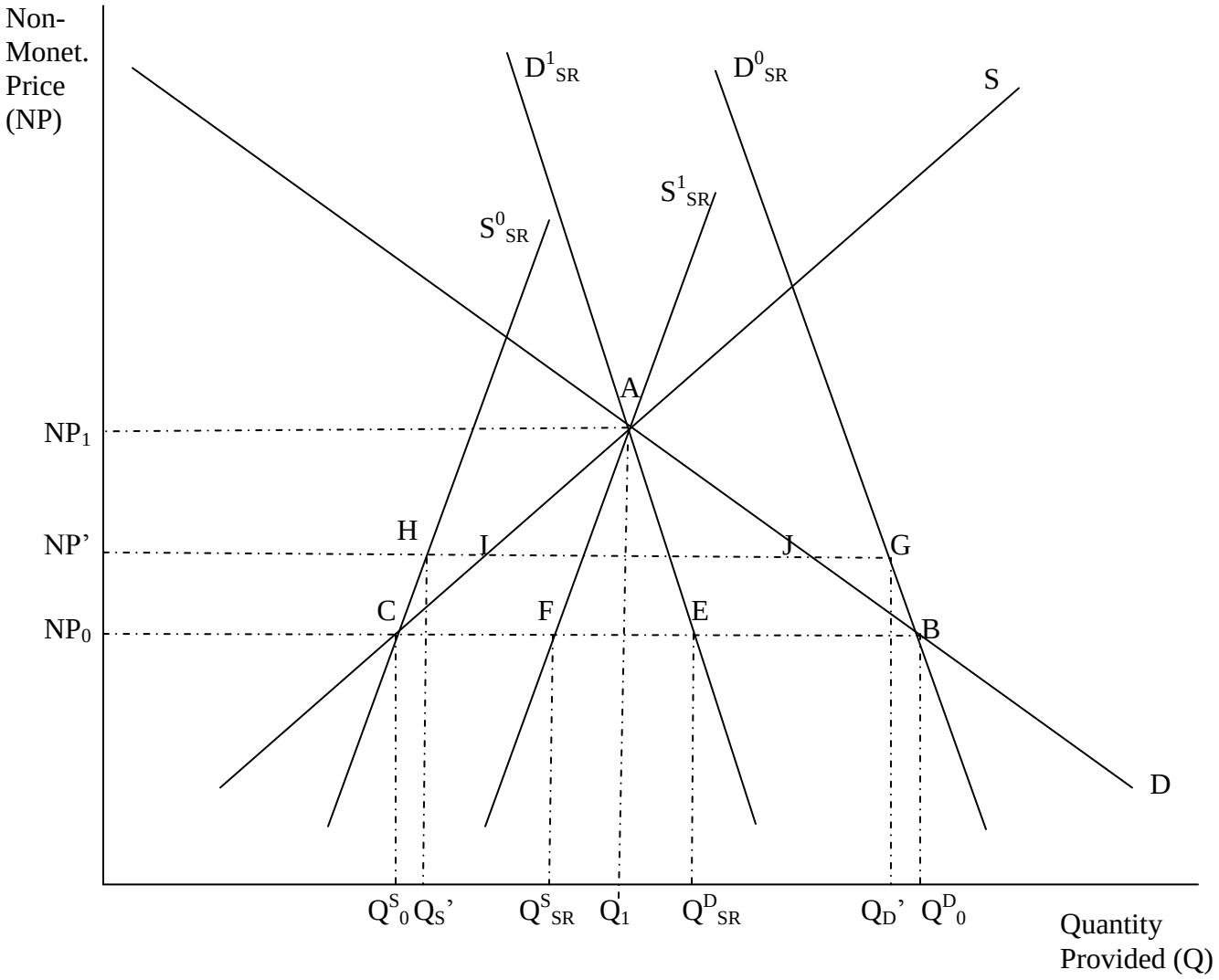
is essentially the long-run elasticity of demand for use of the program exceeding the short-run elasticity. Because of this, the short-run outcomes of a program can seem quite favorable, but after the long-run adjustments, the effects are less attractive. Transitioning back toward the original equilibrium by reducing the program can be politically difficult because the short-run gains are small, despite having larger and desirable long-run effects. As a result, starting programs may be easier than stopping them, even if they are not working as desired. This is discussed by Clark and Lee (2008) regarding government income-assistance programs and can be easily illustrated with the supply and demand analysis developed here.

In Figure 3, we illustrate the equilibrium in the market for nonmonetary exchange as previously. Point A is the equilibrium without a government program and points B and C show the equilibrium for private demanders and suppliers with the government program in place. These are as in figures 1 and 2. Suppose that the demand curve D and supply curve S are the long-run relationships. Consider starting without a government program at point A and implicit price NP_1 and then initiating a program, pushing the implicit price to NP_0. Because both suppliers and demanders do not adjust immediately to the new situation, both the short-run demand and short-run supply going through point A are less elastic than their long-run counterparts. Let them be given by D^1_{SR} and S^1_{SR}.

The short-run effect is that quantity demanded rises modestly to Q^D_{SR}, quantity supplied falls slightly to Q^S_{SR}, and the amount provided by the government program is relatively small, given by the horizontal distance of segment EF. Any concerns about dependence by recipients, withdrawal of services by the private sector, and government budgetary commitments seem quite minimal. In the long run, however, demanders and suppliers adjust to the new environment and we move to the long-run equilibrium at points B and C. Each of these concerns becomes much

greater: there is more use and dependence by recipients, a larger reduction in private provision, and a much larger government presence and budgetary commitment. Thus, if there is any shortsightedness in policy making, such a program is likely to be very popular when implemented, but lose its popularity later.

Figure 3



If this long-run equilibrium is undesirable to policy makers and there is a desire to cut all or part of the government program, transitioning away from this equilibrium can be politically difficult. To see this, suppose that policy makers take steps to reduce the size of the program by raising its implicit price to NP'. In the short run, recipients and providers will move along their short-run demand and supply curve running through points B and C, respectively. These are given by D^0_{SR} and S^0_{SR}.

The immediate outcome is point G for recipients and point H for private providers. Despite the cut in the government program, there is barely a reduction in usage, a minimal increase in private supply, and so barely a reduction in government presence. Thus, in the short run, the cut in the program has little effects, making it politically unpopular. This is true despite the long run effects being much larger, at points J and I for demanders and suppliers, respectively. Assuming that it is desirable to reduce dependence, increase private provision, and reduce government commitments, the long-run consequences are substantially better than those in the short run. Yet with political shortsightedness, there will be a lot of political opposition in the short term, making it difficult to enact and sustain the cut in the government program.

VIII. Conclusion

Attempting to allocate resources based on need raises a whole host of issues, including the assessment of needs and controlling the moral hazard problem of overuse and dependency when goods and services are "free." Yet despite these problems, and despite claims that the free enterprise system neglect needs and is fundamentally unfair, private sector organizations and institutions have emerged that seek to undertake this type of allocation. They may operate as a complement to, in lieu of, or alongside the for-profit firm that is the standard of classroom models.

The above raised issues are dealt with in the private sector by the organizations engaging intimate, face-to-face interactions with potential recipients to screen out those who are not in true need, with expectations of quid pro quos for services provided, and from competition for donors and participants for support. The public sector institution is likely to be less successful in controlling these problems. They tend to be rule driven, where screening out potential recipients on non-income basis is not allowed and quid pro quos are not expected. Thus, the public organization does not have the information to allocate based on need and the lack of a nonmonetary price can raise the likelihood of dependency. Given that public sector programs do not face competition as in the private sector, there also is a lack of incentive by the government organization to undertake these activities. Given this, government programs would be least problematic relative to the private sector when there is less need for careful screening to determine need and when the elasticity of demand for use by recipients is very low. This perhaps is the case things such as natural disasters or accidents that cannot be anticipated and are difficult to avoid.

Nothing in economics or in a free-enterprise economy declares that organizations must be profit seeking or that individuals care only about themselves. Indeed, many organizations in a free-enterprise economy are organized otherwise. It seems that the private sector's ability to meet the "needs" of individuals and act in a "fair" manner is greatly underestimated and underappreciated and the converse holds for the public sector.

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