EXCERPTED FROM

Public Policy: Perspectives and Choices

THIRD EDITION

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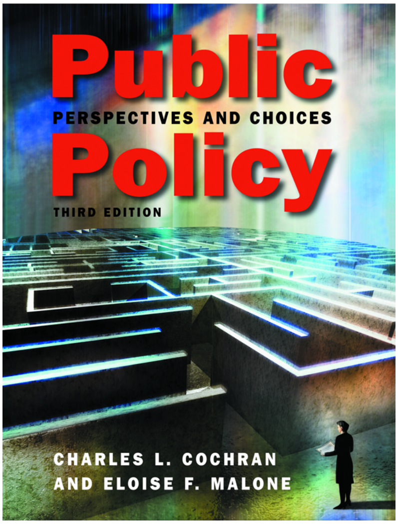
ISBN: 1-58826-375-4 pb



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CHAPTER 1

Basic Concepts in Public Policy

We begin this book by introducing you to the vocabulary of public policy. The following pages define concepts students need to know to understand the policy process. The driving force pushing public policies comprises **scarcity*** and **rational self-interest**. In a diverse society that embraces different values and points of view, interests collide and compromises are unavoidable. The policy analyst must deal with practical questions of who will gain and who will lose by any given policy. Will government intervention improve on a market solution? How are policy choices made without compromising values important to society in general?

What Is Public Policy?

Public policy emerged as a prominent subfield within the discipline of political science in the mid-1960s. In a broad sense, the analysis of public policy dates back to the beginning of civilization. Public policy is the study of government decisions and actions designed to deal with a matter of public concern. Policy analysis describes the investigations that produce accurate and useful information for decisionmakers.

Policy Analysis as a Subfield of Political Science

The social sciences emerged from the humanities and the natural sciences during the latter part of the nineteenth century. The commitment to the methods of the natural sciences, with their concern for methodological and analytical rigor in the study of human behavior, has been critical to the development of social science.

*Key concepts are indicated in **boldface** on first definition in the book.

Social scientists share the conviction that rational scientific methods can be used to improve the human condition. The scientific method began to be applied to a wide range of social activity, ranging from the efforts of Frederick A. Taylor's studies on scientific management to the politics of the Progressives. Legislation in the Progressive era was delegated to "experts" in such new and presumably independent regulatory agencies as the Federal Trade Commission and the Federal Reserve Commission.

Positive policy analysis and value neutrality. Although the social sciences emerged in an environment of social reform, by the early twentieth century there was a general retreat from any sort of policy advocacy. The social sciences in general adopted a value-neutral position under the guise of scientific objectivity. Scientific thought is probably one of the most prestigious activities in modern life. And those engaged in policy studies from a variety of social science disciplines were attracted to the idea that their studies would be more scientific if they eliminated values and merely focused on social behavior. As a result, many policy studies were confined to empirical descriptions. Such studies may prove useful in a variety of ways.

Positive policy analysis. Emphasis on value-free policy analysis is referred to as **positive policy analysis**, which is concerned with understanding how the policy process works. It strives to understand public policy as it is. It also endeavors to explain how various social and political forces would change policy. Positive policy analysis tries to pursue truth through the process of testing hypotheses by measuring them against the standard of real-world experiences. Positive policy analysis usually deals with assertions of cause and effect. A disagreement over such analysis can usually be resolved by examining the facts. For instance, the following is a positive statement: "If the U.S. government raises interest rates, then consumers will borrow less." We can check the validity of this statement by measuring it against real-world observations. Other positive policy statements, such as "If long-term welfare recipients were required to finish their high school education as a condition of continuing to receive their welfare checks, a high percentage would develop employable skills and become self-sufficient," may be tested by setting up an experiment within a state. The results may confirm or refute the statement.

The attempt to become more scientific by excluding values has several major effects. First, by narrowing the focus to largely empirical studies, it reduced the relevance of policy analysis for policymakers, who must be concerned with preferred end-states such as "reduced ethnic antagonisms." Second, it reduced the importance of values in policy debates by shifting the discussion to cost-benefit analysis or the appropriate way to test a hypothesis. Finally, by glossing over the normative issues, the field of values was abandoned to business interests and social conservatives. Applying models based on market efficiency while ignoring issues of "justice and fairness" played into the hands of business interests and social conservatives, who never stopped touting the values of right to property, and the virtues of self-reliance, independence, thrift, and hard work.

Normative analysis. The Great Depression and Franklin Roosevelt contributed to a major change in policy approaches. The Roosevelt revolution swept aside any suggestion that promoting the general welfare could be divorced from normative goals. Nevertheless, there were many of the New Deal who preferred to think of themselves as a rather elite group of experts engaged in administering programs remaining above petty partisan bickering. Until the depression, during which 25 percent of the labor force was unemployed, many thought that unemployment was a personal problem, not a matter for government action. The Roosevelt administration changed that perception by fighting excessive unemployment through a variety of government policies. Government planning during the New Deal gave great impetus to operations research, systems analysis, and cost-benefit analysis as techniques for efficient management. After World War II, debates within the social sciences forced a search for more inclusive policy models. During the Kennedy administration new techniques such as the Planning, Programming, and Budgeting System (PPBS) were used by the "whiz kids" brought into government service by Secretary of Defense Robert McNamara in the Pentagon.

The applied orientation of these techniques in the Department of Defense earned public recognition and acceptance of policy analysis while it encouraged debate among social scientists that they should become more active contributors to policy analysis and policymaking.[1] The techniques noted above, along with survey research, had wide applicability not only in public policy, but also in private industry. The result was increased debate between those in the social sciences who wished to maintain a more theoretical approach of positive analysis and those who wished to see the policy sciences applied to society's problems. In 1966, Hans J. Morgenthau, a well-known political scientist, summed up the views of those in favor of applying quantitative techniques to achieve practical outcomes, in a statement that could just as well apply to all the policy sciences:

> A political science that is neither hated nor respected, but treated with indifference as an innocuous pastime, is likely to have retreated into a sphere that lies beyond the positive or negative interests of society. The retreat into the trivial, the formal, the methodological, the purely theoretical, the remotely historical—in short, the politically irrelevant—is the unmistakable sign of a "noncontroversial" political science which has neither friends nor enemies because it has no relevance for the great political issues in which society has a stake.[2]

David Easton, in his presidential address to the American Political Science Association in 1969, signaled this momentum when he called for a "postbehavioral" approach that used techniques, methods, and insights of all relevant disciplines in dealing with social issues.[3]

Policy analysis, with a view toward resolving public issues, is *prescriptive* rather than *descriptive* when it recommends action to be taken rather than merely describing policy processes. It is referred to as **normative policy analysis**. Normative policy analysis is directed toward studying what public policy ought to be to improve the general welfare.

Normative analysis deals with statements involving value judgments about what *should* be. For example, the assertion that "the cost of health care in the United States is too high" is a normative statement. This statement cannot be confirmed by referring to data. Whether the cost is too high or is appropriate is based on a given criterion. Its validity depends on one's values and ethical views. Individuals may agree on the facts of health care costs but disagree over their ethical judgments regarding the implications of "the cost of health care."

It is important to be aware of the distinction between positive and normative policy analysis, and not to substitute the goals or methods of one for those of the other. This is because the value of policy analysis is determined by the accurate observation of the critical variables in the external environment. Only an accurate rendering of factual relationships can indicate how best to achieve normative goals. For example, a normative view that we should improve the educational system in the United States does not indicate how to achieve that goal most effectively or most efficiently. If we have limited resources to add to the education budget, how should we spend the funds? Would higher salaries attract more capable teachers? Should we extend the school year? Should we improve the teacher-to-pupil ratio by hiring more teachers? Should we add alternative educational programs? Only a rigorous study of the costs and benefits of various alternatives can indicate a preferred solution. In a republican form of government such as our own, such questions are settled by voting and through decisions made by those elected to run the institutions of government.

Frequently, however, normative statements can be used to develop positive hypotheses. Generally, most people do not feel strongly about the value of a capital gains tax cut. Their support or opposition to such a change in the tax law depends on a prescriptive belief about a valued end-state. Many politicians press to reduce the federal tax on capital gains. They argue that a reduction in the capital gains tax would increase incentives to invest in the economy and thus fuel economic growth. However, computer estimates have shown that this change in the tax structure would reduce government revenues after several years and raise the federal deficit. Estimates also have shown that upper-income groups would receive a significantly larger per capita benefit than would other income groups. The result of these estimates, when publicized, was an increased popular perception that the tax cut would be "unfair." Republicans have had difficulty in pressing the proposal for this reason.

In the decision to study public policy, there is an implicit ethical view that people and their welfare are important. We must try to learn about all the forces that affect the well-being of individuals and of society in the aggregate. The desire to improve the current system is the basis for public policy. To achieve that goal, students of public policy must first understand how the current system works.

In democratic societies, the decisionmaking authority is characterized by varying degrees of decentralization. When decisionmaking authority is distributed between different power centers, such as the different branches of government—executive, legislative, and judicial as well as local, state, or national levels and including various interest groups and the general public—no single group's will is totally dominant. Policy analysts therefore study how the actors in the policy process make decisions: how do issues get on the agenda, what goals are developed by the various groups, how are they pursued. Political elites must share power. They often differ concerning not only which problems must be addressed, but also how they should be addressed. The policy that results is often the result of different powerful groups pulling in different directions. The outcome often differs from what anyone intended. Policy analysts therefore study how individuals and groups in the policy process interact with each other.

Policy analysts also attempt to apply rational analysis to the effort to produce better policy decisions. Thus, through empirical and rational analysis, a body of research findings opens up the possibility of policy analysts providing valuable input to promote the general welfare.

Decisions and Policymaking

Public opinion polls confirm that people worry about their economic well-being more than any other concern. People worry about educating their children and meeting mortgage payments. They worry about the high cost of health care, the needs of an elderly parent, the threat of unemployment. These concerns cut across age groups. Students worry about finding a job when they graduate, paying their rent, making insurance payments. Many people express concern for economic problems like federal budget deficits, taxes, and inflation. Many are increasingly aware that personal well-being is somehow related to broader social trends. This relationship is the domain of public policy, though few really understand how the public policy process works or how it affects them personally.

Public policy comprises political decisions for implementing programs to achieve societal goals. These decisions hopefully represent a consensus of values. When analyzed, public policy comprises a plan of action or program and a statement of objectives, in other words, a map and a destination. The objectives tells us what we want to achieve with policy and who will be affected by policy. Public policy plans or programs outline the process or the necessary steps to achieve the policy objectives. They tell us how to do it. For example, a newly proposed public policy for national health care would include an objective statement explaining why a health care policy matters, along with a detailed health care program or procedure. The program might be "managed competition," or perhaps a "Canadian single-payer" program. Usually the program stage provides the "moment of truth" and people are forced to face up to the values and principles they espouse.

Ultimately public policy is about people, their values and needs, their options and choices. The basic challenge confronting public policy is the fact of scarcity. We cannot have everything we want. Unfortunately, available resources are limited, while for practical purposes human wants are limitless. Scarcity is an ever-present attribute of the human condition. The combination of limited resources and unlimited wants requires that we choose among the goods and services to be produced and in what quantities. Because of scarcity, government may intervene to ration the distribution of certain goods and services thought to be in the public interest. Thus, because of scarcity, there is a need for governmental organizations (such as the Departments of Education, Energy, Defense, Health and Human Services, and Treasury) to allocate resources among competing potential users. Conversely, if there were no scarcity, we would not have to make choices between which goods or services to produce.

Poverty and *scarcity* are not synonymous. Scarcity exists because there are insufficient resources to satisfy all human wants. If poverty were eliminated, scarcity would remain, because even though everyone might have a minimally acceptable standard of living, society still would not have adequate resources to produce everything people desired.

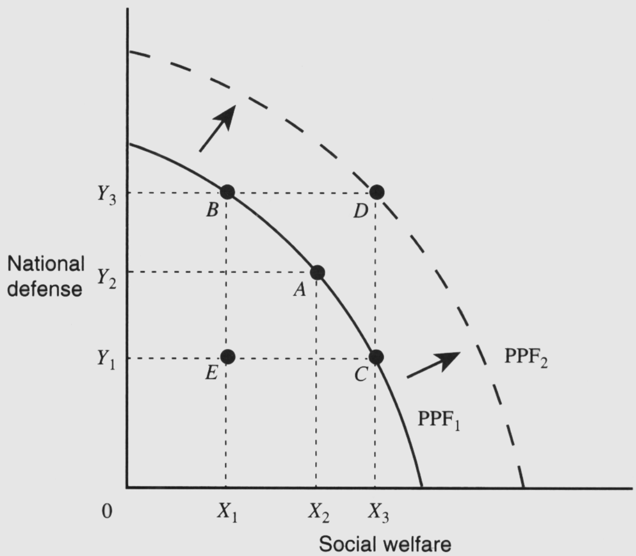
Opportunity Costs

Public policy focuses on the choices individuals and governments make. Because of scarcity, people and societies are forced to make choices. Whenever we make a choice, costs are incurred. When the unlimited wants of individuals or society press against our limited resources, some wants must go unsatisfied. To achieve one goal, we usually have to forgo another. Policy choices determine which wants we will satisfy and which will go unsatisfied. The most highly valued opportunity forfeited by a choice is known as the **opportunity cost**. This cost equals the value of the most desired goods or services forgone. In other words, to choose one alternative means that we sacrifice the opportunity to choose a different alternative. For example, when you decide to enroll in college rather than get a job, the opportunity cost of college includes not only the cost of tuition and other expenses, but also the forgone salary.

People grouped in societies face different kinds of choices. The opportunity cost of any government program is determined by the most valuable alternative use. One tradeoff society faces is between national defense (guns) and social goods (butter). A fixed amount of money, say $100 billion, can be used to buy military goods, or an equivalent amount of social goods (education or health care), but it cannot be used to purchase both goods simultaneously. A decision to have more of one good is also a decision to have less of other goods. Another policy tradeoff society faces is between a cleaner environment and more income. Laws requiring reduced pollution result in higher production costs, which simultaneously squeezes profits, puts a downward pressure on wages, and puts an upward pressure on prices. Laws to reduce pollution may give us a cleaner, healthier environment, but at the cost of reducing corporate profits, and workers' wages, while raising costs for consumers.

The saying that there is no such thing as a free lunch indicates that, because of scarcity, choices must be made that preclude other alternatives.[4] This may seem an obvious point, but many often assume that there is a free lunch. For instance, many people speak of "free public schools" or the need for "free medical care" or "free highways." The problem is that "free" suggests no opportunities forfeited and no sacrifice. This is not the case, however, as the resources that provide education, health care, or highways could have been used to produce other goods. Recognizing that we face choices with tradeoffs, as individuals and collectively in society, does not tell us what decisions we will or should make. But it is important to recognize the tradeoffs in our choices because we can make astute decisions only if we clearly understand the options. The opportunity cost principle can be illustrated. Figure 1.1 summarizes the hypothetical choices in what political economists call a **production possibilities curve** (PPC). This production possibilities curve, or **production possibilities frontier** (PPF), provides a menu of output choices between any two alternatives. Think of it as a curve representing tradeoffs. It illustrates the hard choices we must make when resources are scarce, or the opportunity costs associated with the output of any desired quantity of a good. It also illustrates the indirect effect of **factors of production**, defined as land, labor, and capital. Our ability to alter the mix of output depends on the ease with which the factors of production can be shifted from one area to another. For example, with the collapse of communism the government shifted some production from the defense industry to the civilian sector.

Figure 1.1 Production Possibilities Curve



In Figure 1.1 the economy is at point A but conservatives want to pull it to point B while liberals prefer point C, resulting in a political struggle. Both could get the quantity they want through economic growth (point D). Even at point D, both soon find that their wants are greater than the scarce resources available. And the tug-of-war would soon begin on the new PPF. Keep in mind that points on (not inside) the production possibilities frontier indicate efficient levels of production. When the economy is producing at point A, for example, there is no way to produce more of one good without producing less of the other. When a policy decision moves the production from point A to point B, for instance, society produces more national defense but at the expense of producing less social welfare.

The economy cannot operate outside its production frontier with current resources and technology. It is not desirable to operate inside the frontier. Note that point E is a feasible output combination but not a desirable one. Why? Because by moving to point B, for instance, the economy could produce as much social welfare as at point E, but it could also produce considerably more national defense. Or by moving to point C, more social welfare could be produced without sacrificing the production of defense. Production at point E means that the economy's resources are not being used efficiently.

As we move more factors of production from the production of national defense toward social welfare, we must give up ever-increasing quantities of defense in order to get more social welfare, and vice versa. This is so universal a phenomenon that it is referred to as the **principle of increasing costs**. It states that the opportunity costs of producing additional units of one good increase as more resources are used to produce that good. Or, stated differently, in order to get more of one good in a given period, the production of other goods must fall by ever-increasing amounts.

Production potential is not fixed for all time. As more resources or better technology becomes available, production possibilities increase. As population increases, the number of potential workers increases production possibilities. An improvement in the quality of the labor force, such as through improved education or investment in new plants and equipment, can also increase production possibilities. The outward shift of the PPF is at the heart of an expanding economy. This also means a reduction of opportunity costs and a potential increase in an overall standard of living.

The points along the production possibility curve or frontier indicate that many bundles of goods can be produced with the same resources. Consequently, movement along the PPF demonstrates that most changes in public policy are modest or **incremental** shifts. Policy changes are usually, but not always, relatively small, and are typically made with current conditions in mind. Hence the best predictor of what the federal budget will be next year is the current budget. The decision to change the budget is made **at the margin**. Essentially, decisions at the margin mean that we focus on the effects of small changes in particular activities. Policymakers usually consider marginal not total benefits and costs, and as a result we are not faced with all-or-nothing choices. An important principle for anyone studying public policy is the significance of **marginal analysis**. Marginal analysis is a decisionmaking process that is concerned with the additional benefits that a plan of action will provide and the additional costs that will be incurred. A policy analyst would recommend that a proposed action be taken if and only if the marginal benefit of the action exceeds the marginal cost.

Studying the PPF helps us see that choosing what mix of goods and services to produce is the essence of public policy considerations. A nation may face a guns-versus-butter choice in a period of high threats to national security, and environmental protection versus health care might come to the fore in peacetime. Shifts outward in the PPF represent growth; however, the production possibilities curve says nothing about the desirability of any particular combination of goods and services. To understand this, we have to know more than what choices have been made. We must also know why and how individuals and groups make choices and who benefits.

Social Choice

Resource scarcity sets up the conditions for social choice. It is important to emphasize that choices are ultimately made by individuals. The press may report that "the Congress passed a bill" or that "a divided Supreme Court decided," but these are summary expressions of a group decisionmaking process. Actually a majority of the individual members of Congress voted for a bill, or a majority of the individual members of the Court decided a case before it. The mechanism for aggregating individual choices to arrive at collective decisions is democratic majority rule. The democratic process translates the private interests of individual human beings into group decisions. Interested individuals freely express their preferences and decide, in the aggregate, what the public policy decision will be. However, as we shall examine later, public opinion and the voting process may provide very weak guidance to political elites.

While individual choice is the basic unit of public policy analysis, there are often situations in which we treat an organization, such as a government agency, a lobbying group, or even a family, as a "black box"—a gadget whose output is known even though its internal workings are not completely known. Mechanisms such as television sets or computers are, for most, black boxes. In the public policy realm, in some instances, we will open the black box to examine exactly how and why certain individual and group decisions are made. It is of crucial importance that, as students of public policy, we understand what goes on within the black box of the "political system." We need to know how policy is produced within the institutional processes of the political environment and how voters, interest groups, and political parties behave.

More important, public policy originates in our understanding of the public interest. Appealing to that public interest is difficult because it mirrors the disagreement among competing concepts of social morality and justice. In many situations there may be no conflict between acting in one's self-interest *and* the interest of others, or the common good, simultaneously. More frequently, however, if people act in their narrow self-interest, it becomes impossible to achieve the common good. A healthy public spirit, the social form of altruism, sometimes referred to as "social responsibility," is essential for a healthy democracy. A willingness to accept the general interest as one's own is what President John Kennedy referred to when he said, "Ask not what your country can do for you, but what you can do for your country."

Social Justice

Normative policy analysis is concerned with how the individual justifies the use of state authority to pursue one purpose rather than another. Because self-interest inevitably conflicts with the interest of others, it is impossible to achieve an absolute moral consensus about appropriate government policy. A fundamental problem is that the U.S. polity lacks a practical agreement on the meaning of justice. The result is that conflict and not consensus is at the center of modern politics and public policy.

To illustrate the problem, consider a controversy between two individuals. One individual, Joan, is concerned with what she believes is the arbitrary nature of the distribution of wealth and income. She is particularly distressed over the accompanying inequality of power between those with considerable wealth and those without. She concludes that the poor are virtually powerless to improve their condition, while the wealthy are able to increase their wealth and power with ease. The great inequalities in wealth and power are considered unjust by Joan. She concludes that government efforts to redistribute wealth in the direction of the poor through taxes are demanded by simple justice. This help by government activity will lead to greater individual freedom and justice. Joan therefore decides to vote for political candidates who support such taxes and her notion of justice.

The second individual, Robert, has worked hard to achieve certain goals in life. These include financial independence that permits him to purchase a house, to travel, to send his children to college, and sufficient investments to permit a comfortable retirement. He now finds his goals jeopardized by proposals to raise taxes to reduce the deficit and to provide housing for the indigent. He regards these policies that threaten his goals as unjust because they deprive him of his financial resources against his will. He believes that justice demands the full entitlement of each person to the fruits of his or her own labor, and that each individual should have the complete rights to use and control them.

If the economy is growing rapidly enough, Joan's projects may be implemented without threatening Robert's goals. In that case they may both vote for the same political candidates. But if the economy is stagnant, and either Joan's or Robert's policies must be sacrificed to the other, it becomes clear that each has a view of justice that is logically incompatible with the other. In such cases each will use their competing concepts of justice to promote incompatible social goals.

John Rawls received considerable attention for his treatise *A Theory of Justice,* in which he addressed the question of what constitutes a just distribution of goods in society.[5] He held that principles of just distribution may limit legitimate acquisition. If applying principles of just distribution requires a redistributive tax or the taking of property through eminent domain, that acceptance of the taking of property is the price that must be paid to achieve a broader justice in the community.

Robert Nozick argued in his book *Anarchy, State, and Utopia,* in response to Rawls, that each individual has a right in justice to the product of his or her labor unless or until that individual chooses to give some part of it to another person (or to a central authority for redistribution).[6] If the result of individual acquisition is a gross inequality between individuals, justice requires that the disparity be accepted.

The price to be paid for justice in each definition must be paid by another group. Neither of these contending principles of justice is socially neutral.[7] U.S. culture has no accepted rational criterion for deciding between rights based on lawful entitlement versus claims based on need. However, Rawls and Nozick both suggest rational principles to appeal to the contending parties. Some, like Rawls, define justice in relation to an equitable distribution in society. For them, justice is based on a consideration of the present-day distribution. Justice should have priority over economic efficiency. This leads them to an appeal against absolute entitlement. Others, like Nozick, argue that legal acquisition of wealth and income in the past is alone relevant; present-day distribution is irrelevant.[8] They appeal against distributive rules to a justice based on entitlement.

Neither Rawls nor Nozick refer to what is deserved based on justice. But concepts of what is deserved or merited are implied. Nozick argues that individuals are entitled in justice to their wealth and property, and not that they deserve this wealth and property. However, groups supporting this position invariably argue that they are entitled to what they have acquired through their efforts, or the efforts of others who have legally passed title to them. Rawls protests on behalf of the poor that their poverty is undeserved and therefore unwarranted. The child born to the migrant worker is no less deserving than the child born to a family of wealth and privilege. Rawls called this the "natural lottery."

The debate over taxes further illustrates this difference in values between Rawls's distributive justice and Nozick's entitlement theory. The modern opposition to any tax increases or government expenditure policies originates in the strongly negative attitude toward taxation among those who must pay them. Taxes, they argue, are paid primarily by the haves, while benefits accrue primarily to the have-nots. Many of the more fortunate members of society oppose all taxation, but their opposition to the redistribution of wealth through tax policy is not put so crudely.

A concern for liberty, the requirements of justice, efficiency, or the virtues of **laissez-faire** (noninterference) are the most frequently cited justifications. Indeed it is perhaps naive to expect the privileged to respond sympathetically to policies that transfer resources from themselves to others, particularly since there is no community consensus on virtue. The affluent attack government as an arbitrary, profligate liability that is held in check only by relentless attention to its defects. Those with the temerity to promise increased services for the needy are promptly labeled “big spenders.” The Rawls-Nozick philosophical debate is an extension of the economic and political rift between different groups in society. Not only is there no value consensus in public policy, but modern political competition is a less violent form of civil war.

Politics and Economics

How societies decide to utilize their scarce resources is determined by a variety of factors. Along with values, they include the history, culture, socioeconomic development, forms of government, and economic organization of those societies. The classic definition of **political science** is a study of “who gets what, when, and how in and through government.”[9]

Consequently, politics involves the struggle over the allocation of resources based on the values of the society. Public policy is the outcome of the struggle in government over who gets what.[10] **Economics** has been defined as “the science of how individuals and societies deal with the fact that wants are greater than the limited resources available to satisfy those wants.”[11]

These definitions of the two disciplines of political science and economics have a great deal in common. Both are concerned with studying human behavior in competition for scarce resources. **Public policy** exists at the confluence of these disciplines (see Chapter 2). As such, any definition of public policy will reflect these origins. Most definitions of public policy are rather imprecise and we will offer only a working definition. For our purposes, public policy includes actions of government to convert competing private objectives into public commitments, and includes decisions not to take action. Public policies are purposeful decisions made by authoritative actors in a political system who have the formal responsibility for making binding choices among societal goals.[12] Public policy is a form of government control usually expressed in a law, a regulation, or an order. Since it reflects an intent of government, it is backed by an authorized reward or incentive or a penalty.

The assumption voiced in the Declaration of Independence that individuals create government to secure their rights poses a paradox in contemporary U.S. public policy. Men and women can advance their individual freedom only by giving up the anarchistic freedom of no government. Government policy must be coercive and constrain the individual in order to promote the general welfare and secure order and predictability. People organize out of a fear of uncertainty.

Public Policy Typology

One practical means of categorizing policies is based on the method of control used by policymakers. Control can be exerted through patronage, regulatory, and redistributive policies.[13]

Patronage policies (also known as promotional policies) include those government actions that provide incentives for individuals or corporations to undertake activities they would only reluctantly undertake without the promise of a reward. As distinct from policies that threaten punishment for noncompliance, this kind of policy motivates people to act by using "carrots." Not surprisingly, it is the recipients of the rewards who often convince the government to subsidize individuals or corporations to act. These promotional techniques can be classified into three types: subsidies, contracts, and licenses.

The use of **subsidies** has played a central role in the history of the United States. Alexander Hamilton wrote in his *Report on Manufactures,* one of the first policy planning documents in the administration of George Washington, that subsidies for U.S. business should be provided by "pecuniary bounties" supplied by the government. Subsidies to business quickly became commonplace in the United States, ranging from land grants given to railroad companies, to cash subsidies for the merchant marine fleet, for shipbuilders, and for the airline industry.

Other subsidies to businesses have included loans to specific companies like the Chrysler Corporation or the more recent savings and loan "bailout." Subsidies have also been provided to individuals through such policies as land grants to farmers in the nineteenth century, or through the current tax deductions allowed for interest on home mortgage payments.

Subsidies are typically made possible through the largesse of the U.S. taxpayer. Since the cost is spread out among all the population, each person bears only a minuscule portion of the whole cost. There is little opposition to these kinds of subsidies, yet the threat of their removal can arouse intense reactions from their recipients, for whom their loss could entail significant financial hardship. Because subsidies are often attacked as "pork-barrel" programs, every effort is made to tie such projects to some "high national purpose" (such as military defense).

Contracts are also an important means of promoting particular policies. Contracts can be used to encourage corporations to adopt certain behaviors, such as equal employment opportunity, which they might otherwise find burdensome.

Through **licenses**, governments can grant the privilege of carrying on a particular activity. Licensing allows corporations or individuals to conduct a business or engage in a profession (e.g., a licensed pilot) that without the license is illegal. Licensing allows the government to regulate various sectors of the population and, indirectly, the economy.

Regulatory policies allow the government to exert control over the conduct of certain activities. If patronage policies involve positive motivation (the use of "carrots"), then regulatory policies involve negative forms of control (the use of "sticks"). The most obvious examples of regulation techniques include civil and criminal penalties for certain behaviors. The immediate example that comes to mind is regulating criminal behavior. Other forms of conduct are regulated, not to eliminate the conduct, but to deal with the negative side effects. For example, a public utility may provide a community with the "desired good" of electricity, but it can also seek monopoly profits. The conduct of the utility is "regulated" rather than "policed" in a criminal sense, in that the company is given an exclusive license to provide electrical energy to a given geographical area, but in return the government holds the right to regulate the quality of service and the rates charged.

Other forms of regulatory policies that generate more controversy include environmental pollution, consumer protection, or employee health and safety concerns. Tax policy often may have as its primary purpose not raising revenue but regulating a certain type of behavior by making that behavior too expensive for most individuals or companies to engage in. By taxing a substance like gasoline, tobacco, or alcohol, the government encourages a reduction in the consumption of these products. Likewise, "effluent taxes" may raise the price of goods and services that pollute, which encourages companies to reduce their pollution to reduce or avoid the tax.[14]

Some environmentalists are critical of the use of market mechanisms to control pollution, even though they may reduce pollution efficiently. They feel that pollution is morally wrong and a stigma should be attached to the deed. If market mechanisms alone are used to reduce pollution, it is increasingly perceived as morally indifferent, a good to be bought or sold in the market like any other good. Environmental policy is thereby transformed from an expression of the current generation's trusteeship responsibility over the environment for future generations, to an area where economic self-interest is the guiding standard. Regulatory decisions frequently reallocate costs for those affected. Unlike promotional policies that provide only benefits, regulatory policies are usually thought of in terms of winners and losers. The losses they cause are as obvious as their benefits.

Redistributive policies control people by managing the economy as a whole. The techniques of control involve fiscal (tax) and monetary (supply of money) policies. They tend to benefit one group at the expense of other groups through the reallocation of wealth. Changing the income tax laws from 2001 to 2003, for example, significantly reduced the taxes of upper-income groups compared to other income groups in society, although some of those at the very bottom were taken off the tax roles altogether. The result was a decline in the middle class.[15] Since those who have power and wealth are usually reluctant to share those privileges, redistribution policies tend to be the most contentious. Many past policies aimed at redistributing wealth more equitably, even when initially successful, faced severe obstacles in their long-term viability. The most obvious examples are those of the Great Society and War on Poverty programs of the 1960s. Programs with widely distributed benefits, such as Social Security, have enjoyed more success, because of the larger number of people with a stake in their continuation.

Fiscal techniques use tax rates and government spending to affect total or aggregate demand. Each particular approach to taxing or spending can have a different impact on the overall economy, so political entrepreneurs often propose or initiate policies with the goal of achieving specific impacts. For example, in the late 1980s, President George H.W. Bush, faced with a sluggish economy in an election year, proposed a policy of stimulating the economy by cutting taxes to increase demand (and thereby employment). He also proposed cutting taxes on capital gains, a policy that would have benefited primarily higher-income people, with the claim that it would encourage real investment.[16]

Monetary techniques, used by the Federal Reserve Board (the "Fed"), also try to regulate the economy by changing the rate of growth of the money supply or manipulating interest rates (for more on this see Chapter 6).[17]

Basic Economic Systems

If political science is the study of who gets what, when, and how, then public policy may begin by examining the current state of affairs of who already has what, and how it was obtained. There are three basic types of economic organization. The oldest form of economic organization, with only a few examples still remaining throughout the world, is the traditional economy. **Traditional economies** are those in which economic decisions are based on customs and beliefs handed down from previous generations. In these societies the three basic questions of *what, how,* and *for whom* to produce are answered according to how things have been done in the past. Today, in countries like Bolivia, the peasant economy outside of a city like La Paz is predominantly traditional.

Command economies (also known as planned economies) are characterized by government ownership of nonhuman factors of production. Since the government allocates most resources, it also makes most of the decisions regarding economic activities. In socialist economies, for example, the government may own most resources other than labor. Governments then decide what, how, and for whom goods are to be produced. Such governments generally follow policies resulting in wages being more evenly distributed than in capitalist economies.

Pure market economies (also known as capitalistic economies) are characterized by private ownership of the nonhuman factors of production. Decisionmaking is decentralized and most economic activities take place in the private sector. In a market economy, *what* to produce is left up to entrepreneurs responding to consumer demand. *How* to produce is determined by available technology and entrepreneurs seeking the most efficient means of production in order to maximize their profit. And *for whom* the goods are produced is determined by consumer demand, or "dollar votes": if you have the money you can buy it. Prices are the signals in a market economy for what and how to produce goods.

In command economies the government determines to whom the goods will be distributed. In theory this occurs according to "one's needs." In practice it has often been charged that what is produced is distributed according to political or party loyalty. In a market economy, on the other hand, to whom the goods are to be distributed is again ignored by the government and public policy. The goods are distributed to those having what can be labeled as "rationing coupons" (dollar bills). If you have sufficient dollar bills, you can purchase whatever you demand in the marketplace: food, cars, health care, education, or homes. If you do not have these rationing coupons, the system will not recognize your needs, since entrepreneurs respond only to those having the means to demand (i.e., those willing and able to pay for the good in question). Thus, members of a pure market system with no government intervention would have to be willing to watch people starve to death in the streets, unless those starving could prevail on some private charity to provide minimum support.

Of course, the real world is much more complex than these simple definitions indicate; there are no examples of pure capitalism or pure command economic systems. While there are some examples that are closer to the definitions than others, it is not possible to draw a line between pure capitalism and pure command (or socialist) economies and place countries squarely on either side.

Mixed capitalism combines some features of both types of economic organization. It is a system in which most economic decisions are made by the private sector, but the government also plays a substantial economic and regulatory role.

Clearly, economic systems that rely on command are significantly less efficient than those that rely primarily on the market. Most noteworthy in this regard is the former Soviet Union, which became notorious for shoddy goods, shortages and surpluses in the market, absenteeism among the labor force, and an overall lack of innovation in products and production techniques. Former Soviet president Mikhail Gorbachev finally proclaimed that he supported the dismantling of the command economy in favor of mixed capitalism. Today, most countries that undertook planned economies have abandoned this system in favor of mixed capitalism.

While command systems are very inefficient, pure market systems do not allocate resources in a way that most people are willing to tolerate. Hence mixed capitalism in the United States, and increasingly in the rest of the world, is the basis for an increasing number of politico-economic organizations. John Maynard Keynes (see Chapter 6) was the theoretician of a partnership between government and private enterprise. In Keynesian economics, government is responsible for initiating policies that lead to full employment, while ownership of the means of production, as well as profits, remain in private hands.

The perceived legitimate public policy role for government is much greater in those countries that are emerging from command economies, or other varieties of socialism, than in countries living under a mixed capitalism that evolved from more libertarian origins, such as the United States. The U.S. political and economic system begins with a bias in favor of a laissez-faire attitude, which has come to mean a minimal role for government in private lives and distributional policies.

This is significant because, as we shall see, the existence of certain public policies that are taken for granted in many nations (such as a system of national health care) may be challenged by many in the United States as not being the legitimate domain of government.

Why Governments Intervene

While markets are usually the most efficient way to organize economic activity to provide goods and services, there are some exceptions to the rule. Sometimes market forces do not work as the theory would suggest. Policy analysts use the term **market failure** to refer to those situations where the market does not allocate resources efficiently.

The market mechanism works well as long as an exchange between a buyer and a seller does not affect a bystander, or third party. But all too often a third party is affected. Examples are everywhere: people who drive cars do not pay the full cost of pollution created by their vehicles. A farmer who sprays his crop with pesticides does not pay for the degradation of streams caused by the runoff. Factory owners may not pay the full cost of smokestack emissions that destroy the ozone layer. Such social costs are referred to as **externalities**, because they are borne by individuals external to the transaction that caused them. In these cases, the government may improve the outcome through regulation.

Markets also fail in the face of excessive power through oligopolies or monopoly power. In such instances the invisible hand of the market does not allocate resources efficiently because there is little or no price competition. For example, if everyone in a town needs water, but only one homeowner has a well with potable water, the owner of the well has a monopoly and is not subject to competition from any other source of drinking water. Government regulation in such cases may actually increase efficiency.

The market mechanism does not distribute income or wealth fairly. The market system certainly does not guarantee equality. To the contrary, the market ensures inequality, since one source of its efficiency is to be found in the way that it distributes rewards and penalties. Many believe that the market is overly generous to those who are successful and too ruthless in penalizing those who fail in market competition. Thus capitalist markets provide for great opulence to exist next to abject poverty and may reduce overall economic efficiency. The goal of many public policies is to provide a system that is closer to our ideas of social justice than capitalism provides (see Chapter 7).

A final area in which the market fails to perform adequately is in the provision of what policy analysts call **public goods**. Consumers in the marketplace express their collective answer to the question of *what* to produce by offering to pay higher or lower prices for certain goods, thus signaling their demand for those goods. The market mechanism works efficiently because the benefits of consuming a specific good or service are available only to those who purchase the product. A **private good** is a good or service whose benefits are confined to a single consumer and whose consumption excludes consumption by others. If it is shared, more for one must mean less for another. For example, the purchase of a hamburger by one individual effectively excludes others from consuming it. If the purchaser shares the hamburger with someone else, the portion shared cannot be consumed by the purchaser.

Certain other products in our society do not have the characteristic of private goods because they never enter the market system, so the market does not distribute them. These public goods are indivisible and nonexclusive—that is, their consumption by one individual does not interfere with their consumption by another. The air from a pollution-free environment can be inhaled by many people simultaneously, unlike a hamburger, which cannot be consumed simultaneously by many individuals. No one can be excluded from the use of a public good. You can be denied the use of your neighbor's swimming pool, but you cannot be denied the protection provided by the nation's national defense network. If the national defense system works, it defends everyone under its umbrella whether they have contributed to its purchase or not.

Another characteristic of public goods is that policy regarding them can be provided only by collective decisions. The purchase of private goods depends on an individual decision as to whether to spend one's income on hamburgers or swimming pools. But it is not possible for one person to decide to purchase national defense, dams, or weather services. The decision or agreement to buy a public good, and the quantity to buy, is made collectively. There are few examples of pure public goods, but clean air and national defense come as close to meeting the definition as any. Other examples of public goods, though they do not meet the criteria as clearly, include police protection and education. Police protection generally provides a safer environment for everyone living in an area, even if one does not contribute to the purchase of that protection. Education is a similar good. The primary beneficiary of an education is the person educated. However, there are secondary benefits to society that result from a better-educated work force. Moreover, the amount of education allotted to one person does not affect the amount left over for others. The same could be said for highway space or the administration of justice.

The communal nature of public goods leads to a major problem in public policy known as the **free rider**—someone who enjoys the benefits of someone else's purchase of a public good while bearing none of the costs of providing it. If two people both will benefit from national defense, good public education, or clean air, the question arises as to who should pay for it. Each individual has an incentive to avoid payment, hoping to take a free ride on other people's "purchase." As a result, all parties will profess little interest in purchasing the good, hoping others will step forward, demand the good, and pay for it. This is a rational response for individuals with limited resources. Everyone will benefit from the good by more than their proportionate cost, but they would benefit even more if others paid the entire cost. Thus the good will not be purchased unless the government makes the purchase and requires everyone to pay his or her fair share through mandatory taxes.

How do we determine how many and what mix of public goods the government should purchase? By relying on a specific means of public decisionmaking: voting. Because voting is a very imprecise mechanism that limits us to a "yes" or a "no" for candidates, it does not make any distinctions regarding the myriad of issues that must be acted on collectively. Nor does it register the intensity of preferences by various individuals or groups. Therefore, we sometimes find ourselves with an oversupply and sometimes with an undersupply of public goods.

Some conservatives tend to believe that certain public goods could be treated as private goods and brought into the market system, reducing the role of government. For example, tolls could be charged on all roads and bridges for their maintenance. This would limit the building and repair of highways to the amount of demand expressed by those paying the tolls. An admission fee to public parks might be charged to cover the services they provide—a fee that could simultaneously reduce congestion while funding maintenance and even development.[18] Public libraries could charge fees for their services to provide the budgets needed for salaries and the purchase of books and materials. Public transportation systems might charge fees necessary for them to operate profitably, or reduce their service and provide only the amount demanded by those paying the fares. According to conservatives, other areas of government operations could also be reduced through privatization. For example, the operation and maintenance of prisons could be contracted out to private companies rather than being managed by public employees.

The privatization of public goods and services in this manner would certainly result in their being produced, more or less, as if they were private goods. However, there are many difficulties associated with this approach. First, there are the technical difficulties of making some public goods private. How do we make national defense a private good? Also, this approach offends our sense of justice and equity. Do we really think that national or state parks should exist to be enjoyed only by those with sufficient income to pay for their upkeep?

Imperfect Information

The market system is built on the assumption that individuals are rational and do not act capriciously, and that they have roughly accurate information about the market. Without adequate, correct information, people cannot make decisions in their rational self-interest. In fact, most people do not have adequate information to make rational decisions. Developing or finding the information has a significant opportunity cost associated with it. Very few people have the resources or time to do a complete research job.

Information, then, can be considered a public good, or a good with **positive externality**. Once the information is provided, it can be shared by any number of people. Once in the public domain, it is impossible to exclude anyone from using it.

Manufacturers of consumer products, such as cigarettes, do not have an interest in advertising the health hazards associated with the use of their products. But ignorance about those hazards can be reduced by informing consumers, through mandatory labels on cigarette packages, that smoking is dangerous. The manufacturers may still advertise their cigarettes. But the mandatory labels attempt to mend omissions in the market system by introducing information so that individuals can make better choices.

Many people believe the government has a role in researching and disseminating various kinds of information relevant to consumer choices. For instance, the government might investigate and publicize information about the safety of different consumer products such as cars, drugs, food additives, microwave ovens, and other potentially dangerous products.

There is a debate regarding how this remedy for market failure should be applied. If one accepts the proposition that the individual is the best judge of his or her own welfare, then one may argue that governmental actions should be limited to the provision of information. The government, having produced the information, should not regulate the behavior of individuals, according to this view. Once people have been supplied with all the relevant information, they should be permitted to make their own choices—to consume dangerous substances (e.g., to purchase tobacco products) or to purchase potentially dangerous products. Only if the risks extend beyond the user—meaning that **negative externalities** exist involving third parties—may there be an argument for expanding the role of government beyond providing information. For example, those in favor of the right to a smoke-free work environment argue that the spillover effect of inhaling secondary smoke is hazardous to nonsmokers' health.

This view of the informational role of government is not followed consistently in practice. For example, the Pure Food and Drug Act prohibits the sale of certain harmful products but does not provide the option of informing consumers of a product's harmful effects.

Equity and Security

Public goods, externalities, and ignorance all cause resource misallocation. They result in the market mechanism failing to produce the optimal mix of output. Beyond a failure of *what* to produce, we may also find that *for whom* the output is produced violates our sense of fairness.

These are situations, however, when markets fail to achieve the ideal economic efficiency. In a very literal sense, in fact, markets always "fail" because economic efficiency is a fabricated definition based on a normative model of how the world *should* be. Market failure indicates that supply and demand forces have resulted in a mix of output that is different from the one society is willing to accept. It signifies that we are at a less than satisfactory point on the production possibilities curve. Some cases of market failure are so extreme, and the potential for corrective public policy action is sufficiently available, that most people would support some form of governmental intervention to achieve a better output mix. Because of these limitations, no country relies exclusively on the free market to make all of its socioeconomic policy decisions.

Not everyone agrees that turning the decisionmaking over to the public policy mechanism of government constitutes a good solution. Many people believe that governmental processes to alter production choices or to redistribute goods and services do not promote efficiency. Therefore, in their view, whatever the deficiencies of market mechanisms, the market is still to be preferred over government intervention in matters of distribution.

In general, the market mechanism answers the question of for whom to produce by distributing a larger share of output to those with the most rationing coupons (dollars). While this method is efficient, it may not accord with our view of what is socially acceptable. Individuals who are unemployed, disabled, aged, or very young may be unable to earn income and need to be protected from such risks inherent in life in a market economy. Government intervention may be sought for income redistribution through taxes and programs like unemployment compensation, Social Security, Medicare, and Temporary Assistance for Needy Families that shift those risks to taxpayers as a whole.

Redistribution of income to reduce inequities also falls under the theory of public goods because it adds to public security. Without some redistribution, we could expect more muggings and thefts to occur as people sought to escape the consequences of poverty. Moreover, leaving inequalities of wealth solely to market mechanisms would produce the phenomenon of the free rider again. Some individuals would no doubt contribute to charities aimed at reducing poverty, and everyone would benefit from somewhat safer streets. But those who did not so contribute would be taking a free ride on those who did.

Society is therefore forced to confront tradeoffs between the inefficiencies of the market system and views of justice and equity. For example, policies implemented in the 1960s to provide welfare benefits for unemployed women with dependent children were criticized for breeding dependency on government "handouts," so they were changed during the Clinton administration. Bill Clinton's welfare reform increased incentives for finding gainful employment and penalized those who failed to try. Critics of the reform claim that in solving one problem, it created others, like the need for affordable day care and access to transportation. Proponents of the reform argue that it reduced the incentive to save money for retirement, which, although more risky and less predictable than a policy of "forcing" people to save money for retirement, provided capital formation for greater economic growth.

Every society has to deal with the question of what constitutes an equitable distribution of income. It is clear that no government policy is neutral on the question. Income distribution tends to reflect the biases of governments, ranging from traditional laissez-faire to planned economies. The political process by which any society governs itself must ultimately decide what constitutes an acceptable inequality of wealth and income.

Although government *can* improve on market outcomes, it is by no means certain that it always *will*. Public policy is the result of a very imperfect political process. Unfortunately, policies are sometimes designed as a quid pro quo for campaign contributions. At other times they merely reward society's elites or otherwise politically powerful individuals. Frequently they are made by well-intentioned political leaders forced into so many compromises that the resulting policy bears little resemblance to the original proposal.

A major goal of the study of public policy is to help you judge when government action is justifiable to promote specific ends such as efficiency or equity, and which policies can reasonably be expected to achieve those goals and which ones cannot.

Conclusion

The crux of all our public policy problems is to be found in the hard reality of limited (scarce) resources. The free market has proven a superb device for efficiently producing goods and services, based on individual rational self-interest. Problems of scarcity, which are universal, require intervention. This suggests that solutions, whether left to market forces or government intervention, reflect values. There are a variety of possible solutions reflecting the biases and choices of the individuals proposing them.

People face tradeoffs when they make choices. The cost of any action, whether individual or collective, is measured in terms of what must be given up. People as well as societies tend to make decisions by comparing their marginal costs against their marginal benefits. People and societies will adjust their behavior whenever incentives change.

It is important to keep in mind that although markets are a good way to organize many of society's activities, there are several areas where markets fail or produce outcomes unacceptable to society's collective values. In those cases, government can improve on market outcomes. Government efforts to relieve market imperfections (failures) by public policy may also be flawed, however. The question is whether government, which was created to "promote the general welfare," will provide solutions that will be less imperfect than market mechanisms.

Government may be the only actor that can improve market efficiency or alter economic and social costs, risks, and income distribution in a positive way. Some argue that these problems can be solved, but that most solutions mean someone must accept significant economic losses. No one willingly accepts a loss. So people struggle to veto any solution that would impact negatively on them, or at minimum have the cost transferred to someone else or another group. The effect is to produce "veto groups" waiting to aggressively fight any proposed public policy that would result in a loss to their position. Often, the political struggle that results causes a larger cost than gain for those attempting to effect the change. The result is often political and economic paralysis.

However, not all public policy solutions must be **zero-sum solutions**, where one group's net gains must be offset by another group's losses. There are non-zero-sum solutions, which usually involve increasing economic growth so there is more for everyone. But even this solution requires the intervention of government in the form of industrial policies, and many people see this as just another effort to have government provide a remedy no more promising than any the market itself can provide. The major economic competitors of the United States, including both Japan and Germany, have incorporated industrial policy as a key component of their public policies, but it is a controversial issue in the United States.

Questions for Discussion

1. If society desires health care and a clean environment for everyone, why does the free market not provide it?
2. Explain how scarcity, choice, and opportunity cost are related and make public policy inevitable.
3. Give several examples of significant tradeoffs that you face in your life. What are the major considerations in your decisionmaking?
4. Should you consciously think about your values and goals when analyzing important tradeoffs and choices that you face? Why?
5. Explain the difference between self-interest and selfishness. How is it possible for some self-interested behavior to be selfish while other self-interested behavior may be altruistic?
6. Explain why policymakers should consider the importance of incentives.
7. Is reliance on the market to resolve policy issues inherently conservative, or is it inherently progressive?
8. Explain the different types of economic organization and how they answer the questions of what, how, and for whom to produce.

Suggested Readings

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Notes

1. Robert A. Heineman et al., *The World of the Policy Analyst: Rationality, Values, and Politics* (Chatham, N.J.: Chatham House, 1990), p. 17.

2. Hans J. Morgenthau, "The Purpose of Political Science," in James C. Charlesworth, ed., *A Design for Political Science: Scope, Objectives, and Methods,* Monograph no. 6 (Philadelphia: American Academy of Political and Social Science, 1966), pp. 67–68.

3. David Easton, "The New Revolution in Political Science," *American Political Science Review* 63 (December 1969): 1051–1061.

4. The statement is accurate when referring to the market in the long run. However, it is not necessarily true in the polity in the short run. There are many public policies in which taxes paid by some people are redistributed to provide benefits for others. For example, middle-income taxpayers may provide funds for food stamps for the poor. Those providing the largesse for others usually want spending reductions, while the recipients of the benefits favor more resources.

5. John Rawls, *A Theory of Justice* (Cambridge: Harvard University Press, 1971).

6. Robert Nozick, *Anarchy, State, and Utopia* (New York: Basic Books, 1974). This work is primarily a response to John Rawls. The extension of Nozick's thought leads to a view that the only form of economic life compatible with individualism is laissez-faire capitalism. Nozick's position is in the tradition of writers in the anarcho-capitalist tradition. His response to Rawls has attracted more comment than the writings of others with similar views.

7. See Alasdair MacIntyre, *After Virtue: A Study in Moral Theory,* 2nd ed. (Notre Dame, Ind.: University of Notre Dame Press, 1984), esp. chap. 17, "Justice as a Virtue: Changing Conceptions," for an excellent comparison of the theory of John Rawls and Nozick's countering view.

8. Nozick's critics point out that his thesis assumes that legitimate entitlements can be traced back to rightful acts of earliest acquisition. Based on that criterion, however, there are few legitimate entitlements, as most property has been inherited from those who originally used force or theft to steal the common lands of the first inhabitants.

9. Harold Lasswell, *Politics: Who Gets What, When, How* (Cleveland: Meridian Books, 1958).

10. Thomas R. Dye, Harmon Zeigler, and S. Robert Lichter, *American Politics in the Media Age,* 4th ed. (Pacific Grove, Calif.: Brooks/Cole, 1992), p. 2.

11. Roger A. Arnold, *Macroeconomics* (St. Paul, Minn.: West, 1996), p. 6.

12. See Larry N. Gerston, *Making Public Policy: From Conflict to Resolution* (Glenville, Ill.: Scott, Foresman, 1979), pp. 4–6. See also Jay M. Shafritz, *Dictionary of American Government and Politics* (Chicago: Dorsey Press, 1988), p. 456.

13. See Theodore Lowi, "American Business, Public Policy, Case Studies, and Political Theory," *World Politics* (July 1964): 677–715. See also Theodore Lowi, *The End of Liberalism: The Second Republic of the United States* (New York: W. W. Norton, 1979).

14. Taxation for the purpose of discouraging certain conduct or eliminating certain activities is often opposed on the grounds that the affluent can buy the right to behave in a manner that is prohibitive to the less wealthy. The charge is correct in that the affluent may be less deterred by the higher price of gasoline, alcohol, tobacco, or other products that cause pollution, than will the poor, who may be eliminated from the market by the repressive features of the tax. However, exercising the right to buy the products will make the wealthy poorer. It should also be pointed out that, by discouraging the purchase of certain products, public health should improve and the environment should become cleaner. The repressive nature of the tax may also be beside the point if the extra amount that the affluent pay exceeds the value we place on the harm caused by alcohol or tobacco consumption, or if a cleaner environment caused by less consumption of gas or other products that cause pollution results in the transference of real income to the population as a whole.

15. See Richard Morin, "America's Middle-Class Meltdown," *Washington Post,* December 1, 1991, p. C1. Reporting on several studies, Morin stated that "the boom years of the 1980s were a bust for fully half of all Americans. At the same time, the safety net of social programs for the nation's poor was replaced by a safety net for the rich, speeding the decline of the middle class."

16. A **capital gain** is the realized increase in the value of an asset. **Real investment** refers to the accumulation of real capital, such as machinery or buildings, rather than financial investment (which refers to the acquisition of such paper instruments as bonds).

17. The Federal Reserve System's control over the money supply is the key aspect of U.S. monetary policy. The Fed has three primary levers of power. The first concerns the reserve requirement. The Fed requires private banks to keep some fraction of their deposits in reserve. The reserves are held in the form of cash or as credits at its regional Federal Reserve Bank. By changing the reserve requirement, the Fed can directly affect the ability of the banking system to lend money. The second lever concerns the Fed's discount rate; the Fed changes the cost of money for banks and the incentive and ability to borrow. The third and most important lever involves the Fed's open market operations, which directly alter the reserves of the banking system. When the Fed buys bonds, it increases the deposits (reserves) available in the banking system. If the Fed sells bonds, it reduces the reserves and restricts the amount of money available for lending.

18. See, for example, Dan Bechter, "Congested Parks: A Pricing Dilemma," *Monthly Review* (Federal Reserve Bank of Kansas City), June 1971. Overcrowding at public parks may reflect a distortion in the recreation market by charging too little for their use. It is suggested that such low pricing amounts to a misallocation of resources. Raising the price would help "clear" the market and relieve congestion. If the price of visiting national parks were increased, more people would substitute other leisure activities.