

EMBARGOED UNTIL 8.00 PM FRIDAY 6 AUGUST 1999

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REGIONAL CONFERENCE**

**POLITICS, MARKETS AND VOLUNTARY
ACTION: DIFFERENT MECHANISMS,
DIFFERENT ROLES**

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**DUNEDIN
6 AUGUST 1999**

POLITICS, MARKETS AND VOLUNTARY ACTION: DIFFERENT MECHANISMS, DIFFERENT ROLES

In a column in the *National Business Review* in March this year, Rodney Hide led off with the following remarks:

We are social animals. We spend most of our lives doing things for other people and having them do things for us. We spend very little of our time doing anything else. The time we spend on our own, utterly self-reliant, is almost non-existent. We depend on others most of our lives.

It is true that we can barely survive, and hardly flourish, without interacting with other people. We want to associate with others to achieve instrumental ends – producing more food, exchanging goods, developing new technology – but also because we feel a deep need for connectedness, for love and friendship and community.

Rodney Hide went on to point out that there are only three ways you can get another person to do something for you.

The first he called love, as expressed by the habits we practise in our families and with those who are close to us. We take care of children and the elderly and other people who are dependent on us. Voluntary action also includes favours to others without monetary compensation, and these favours may sometimes be reciprocated. We are also motivated by common interests to band together in clubs and community organisations to pursue all manner of voluntary collective endeavours.

The second way of getting people to do things is through trade. Trade is another form of reciprocity in which we exchange one thing for another, usually through a monetary transaction. Thus we exchange money for goods and services that we need, exchange labour for wages, and exchange savings for interest or other investment returns. Trade is a powerful mechanism of cooperation among people who often do not know one another and may live at the opposite ends of the earth.

The third way of getting someone to do something for you is through force. Rodney Hide saw force as contributing nothing good to society. In a private setting this is true, and the use of force against another person to get what you want is unlawful. But for more positive reasons we give the state a monopoly on coercion. We allow governments to use force to protect life and property, pass laws to require compulsory education or allow land to be taken for a road, and regulate aspects of private and commercial life. The legitimacy of many of these coercive powers may be hotly debated, but few deny that some of them are a necessary feature of a free, peaceful and well-functioning society.

Looking at the world in this way helps, I believe, to dispose of some of the myths that too often cloud political debate. It disposes of the idea that an advanced modern society can be 'individualistic' in any meaningful sense – we are indeed all social animals. It disposes of any notion that "everything can be left to the market" to meet social needs. And it provides a much better way of thinking about the role of government and what we want governments to do.

Above all – and this is the issue on which I want to elaborate – it brings out the point that democratic politics, markets and voluntary action are not ends in themselves but rather means to various ends. They are mechanisms that we can use to pursue what each of us wants in life or wants for others. Democratic governments, for example, have no independent resources or capacity to do good; they can do so only by using resources that belong to all citizens. In a sense then, governments are us, and they are our servants not our masters. Markets are not impersonal entities with powers of their own; they are simply the mechanisms people use to trade. Thus markets are also us. And the alternative to politics is not just markets; markets are only part of civil society, which also includes the host of voluntary, non-market transactions we engage in every day. Civil society embraces both commercial businesses and non-profit organisations; it is everything that is not coercive but natural or voluntary. Thus all of civil society is us too. Politics, markets and voluntary action, in other words, are all means by which individual citizens pursue happiness, as the American founding fathers might have put it.

The extent to which societies use each of these mechanisms for pursuing their self-chosen ends varies in time and circumstances. For Robinson Crusoe on his desert island, markets and government didn't come into it. Even when Friday appeared on the scene, one imagines that most transactions were a matter of voluntary reciprocity. With tribes and other small societies, the closeness of bonds meant that many things could still be handled in informal ways, though trade and markets started to enter the picture. In later, more extended societies, governments became necessary to provide a framework of rules within which people could interact productively, and to ensure that certain public or collective goods were provided. In circumstances such as war, markets have been partially suppressed, and much of society mobilised by edict to serve the national interest.

Some people see the family or the tribe as a model for the wider society. However, the things that make a family work – the intimate knowledge of each other's needs and understandings about how resources are shared – do not extend very far. Markets are needed in this situation in order to permit specialisation and allow a rational division of labour. But markets cannot function without rules – in particular, clear understandings about who owns what and how things may be exchanged. In this sense there is no such thing as a free market or 'unbridled laissez faire'. To operate effectively, markets need a set of rules which, at least to some extent, are 'made by government'.

However, just as there is no such thing as a wholly free market, there is no such thing as a wholly political society either. Clearly economic life would rapidly become dysfunctional if we had to rely on voting mechanisms to obtain our daily bread. In the centrally planned economies reliance on government direction for the ordinary decisions of everyday life contributed to their collapse. And at least since Magna Carta, free societies have wanted to place limits on sovereign power and to insist on certain basic rights and freedoms being "retained by the people". At first the battle was to constrain authoritarian rule by kings and queens (especially the power to tax). In modern times, the struggle has been to control the abuse of parliamentary power.

What all this adds up to is the proposition that the essential social problem is to work out what mechanisms are best used for what purposes. We need them all, but each has advantages and disadvantages. Governments can't do everything, so we need markets. Equally, markets can't do everything, so we need governments. And neither governments nor markets can replace the many informal, voluntary associations throughout society. None of these mechanisms is perfect and all-embracing. We have to decide on the best mechanism, or combination of them, to use for the purpose at hand.

The institutions of civil society have many strong points. The clear establishment of property rights, for example, provides incentives to invest and take care. Voluntary exchange – either for love or money – allows people to specialise in what they do best and get some of the things they need through trade with others. Everyone is better off than if they had to be self-sufficient. Markets economise on the use of information – it is embodied in prices that reflect relative scarcities, and does not have to be collected at great cost at the centre. Markets also facilitate choice and competition which are important for freedom, entrepreneurship and productivity.

But civil society also has weak points. Men and women are not angels. They need to be restrained by conventions of morality and the rule of law. Abusive and opportunistic behaviour is a reality. The needs of some of the vulnerable may not be catered for without government intervention. In the market domain, there are problems of supplying public goods which can't easily be charged for, of externalities like pollution where the costs of production fall on others, and of monopoly. These so-called 'market failures' may need to be remedied. Also, markets do not guarantee particular distributional outcomes – some people may not secure what we regard as a decent minimum living standard and may fail to be helped by others.

For their part, political institutions also have strong points. We need governments to protect life, liberty and property, and to facilitate market processes. Without reliable weights and measures and a sound currency, for example, trade is difficult, and standard laws for the incorporation of companies and other business entities reduce the costs of business transactions. Only governments can ensure public

goods such as defence, police and the courts are provided on an efficient basis; moreover, we do not want to give powers of coercion to private parties. We want governments to ban some things that could be traded in markets, such as votes or hard narcotics, and to prohibit transactions such as slavery. Most of us would want governments to provide a social safety net to take care of people unable to care for themselves and not helped voluntarily by others. All this constitutes a substantial agenda for governments; the sensible goal is not to do away with government but to establish its proper functions and to ensure that it undertakes them efficiently.

Just as markets have weaknesses, however, so too do political institutions as mechanisms of choice. For a start, we typically have to vote for only one of several political parties, some of whose policies we like and some we dislike. We cannot signal with our votes how intensely we prefer some things relative to others within our preferred party's bundle of policies. Then we have the problem of holding politicians accountable – a problem that is particularly acute with proportional representation systems of government where deal-making and compromise to form coalitions after elections is almost inevitable. In such systems small, unrepresentative parties can hold the balance of power, but even majority parties can force through decisions with which many people disagree. In turn, elected politicians often have trouble holding the agencies of government accountable for implementing their policies. And as the body of research known as public choice has taught us, politicians frequently pursue the narrow interests of groups which support them rather than the general public interest. These political failures are often more difficult to remedy than market failures. The fact that a fish can't fly shouldn't make us jump to the conclusion that a rhinoceros can do any better.

So we are left with a dilemma. All feasible mechanisms for choices about how we run our lives are imperfect. How do we choose which to use for which purpose, and where to put the emphasis?

As far as the emphasis is concerned, the tendency over the past century has been clear. As Antonio Martino, a former Italian foreign minister, put it in his Sir Ronald Trotter lecture in Wellington last year:

The century that's coming to its end has been the century of the state, a century of dictators, the century of Hitler and Stalin, as well as the century of arbitrary government, and of the unprecedented intrusion of politics into our daily lives – a fascist century. It has produced the largest increase in the size of government in the history of mankind. Just to mention a single, but very significant, indicator: in 1900 the ratio of government spending to gross domestic product (GDP) in Italy was 10 percent, in the 1950s 30 percent, and it is now roughly 60 percent. Similar trends have occurred in most countries.

In New Zealand, total government expenditure was 53 percent of the economy in 1986 and it is projected to be 41.5 percent this year according to the OECD, up from 39 percent in the mid-1990s.

In most countries, however, the government expenditure ratio has stopped growing, reflecting the view that has developed over the past 30 or so years that governments have overreached themselves and that we need to make greater room for markets and voluntary action. Governments are no longer nationalising industries; indeed over the past couple of decades there has been a major worldwide movement to privatisation. Likewise there has been a large measure of economic deregulation in many countries, including New Zealand, although in social and environmental areas regulation has continued to grow. As yet, we have seen little rolling back of state welfare apart from in the United States, but the social problems and costs associated with the welfare state seem likely to loom large on the political agenda of many OECD countries in the period ahead.

What has brought about this change of emphasis? I think the answer is that judgments about the relative strengths and weaknesses of political institutions and civil society have shifted. Economic and public policy research undertaken in recent decades has been influential. Democracy (universal suffrage) can be expected to work better as the electorate becomes more literate and educated and 'sees through' demagogues and economic snake-oil. Some of the problems with markets have turned out to be exaggerated. The problem of monopoly is greatly reduced when markets are opened to competition; the most serious problems of monopoly in New Zealand today are where it is created by statute, as with the single desk producer boards. Problems of externalities are also much reduced where property rights are clearly specified and prices are allowed to reflect true economic costs. Inefficiency

and poor growth caused by high tax rates have encouraged many countries to start to constrain spending.

There is still, however, a level of unease in many countries – certainly in New Zealand, less so in the United States and some Asian countries – about allowing greater roles for the market and civil society. Critics of markets have generally come to accept they are more productive institutions relative to the alternatives. They happily use markets to buy everything from their daily bread to products which inspire wonder and delight. Yet these critics still associate markets with things no reasonable person would like.

Some of these perceptions are, I believe, misplaced. For example, the market is still traduced as the venue for anti-social 'greed'. To be sure, greed exists in all societies, but is it really our daily experience that we encounter rampant greed in our dealings with our corner dairy, general practitioner, employer or landlord? Are efforts by people to increase their incomes fairly described as 'greed'? I have already noted that far from being 'individualistic', participants in markets are utterly dependent on all kinds of social interaction and cooperation. The criticism of individualism can be more fairly levelled at the ethic of entitlement 'rights' that has grown up under the welfare state, whereby actions have been removed from their moral and social context and consequences. This has undermined institutions like the family, churches and charitable organisations.

It is true that markets will not always deliver outcomes that are consistent with our concepts of fairness, or a decent minimum standard of living for all. But we should recognise that civil society has the capacity to cope with some of these problems through voluntary means, and we should not be too quick to come to the conclusion that political institutions always score more highly on fairness grounds. It is, for example, a fact, as the attached chart shows, that freer economies tend to have more equal distributions of income. Despite the alleged commitment to equality in the Soviet Union, in 1939 the upper 11-12 percent of the population accounted for some 50 percent of national income (in the United States the share of the top 10 percent is around 35 percent today). A large part of the income redistributed by the welfare state goes not to lower income groups but to the middle classes. And in the final

analysis, while redistribution on compassionate grounds is a valid government role, wealth creation associated with free and open markets is a far more powerful tool for raising the incomes of the poor.

I have spoken mainly of the economic consequences of the choices we make between politics, markets and voluntary action. But that is by no means the whole story: economics – in the sense of material living standards – is important, but it is not the whole of life. We should also evaluate these choices in terms of other consequences – for example for morality, liberty and peace – and in most cases the relative emphasis points in the same direction. I have mentioned that the moral foundations of a free society can be undermined by state action. As regards economic and personal freedoms, Thomas Jefferson pointed out long ago that "the natural progress of things is for government to gain ground and liberty to yield". Economic freedom is necessary for political freedom. And the prospects for international peace are surely enhanced by trade and commerce, and threatened by state power and a weakening of democratic constraints.

I also believe there are trends at work which will shift the emphasis further away from politics as a mechanism for achieving our goals. There has been a loss of confidence in democratic politics worldwide and in New Zealand, as the recent Massey University study of values, which found that only 16 percent of New Zealanders had confidence in government, confirmed. Globalisation is reducing the pricing power of firms everywhere and breaking down monopoly positions. The solutions to many environment problems are increasingly seen not as requiring greater government regulation but better use of property rights, prices, markets and other incentives to care for and conserve natural resources. Technology is reducing the range of activities that were formerly seen as public goods – private alternatives are mushrooming in areas such as telecommunications, broadcasting and even infrastructural services such as roading. And I suspect that continuing public dissatisfaction with state-provided health and education services is likely to see a far greater role for private alternatives – both for-profit and not-for-profit – in the period ahead.

So my prognosis is that the twenty-first century is not likely to be another century of the state. When we recognise how prone the engine of government is to malfunction, we should not be too demanding about the load we expect it to haul. Since 1993, the ratio of government spending to GDP has fallen in most OECD countries – an historic turnaround. Even though the many beneficiaries of the modern regulatory state will fight tenuously to defend their interests, I suspect the state's role is likely to continue to shrink, with major implications for politics and political alignments in the period ahead.

But that is not the main message I want to leave from this talk. The main message is that we ought to be able to lower some of the political temperature in debates over social problems by recognising the roles that government and civil society both have to play in dealing with them. Those who wish to emphasise the role of markets and voluntary action are not enemies of government. To the contrary, they want to see governments doing the jobs that only governments can do, and doing them well. Maybe these roles will be more modest in the future, as they were only a few decades ago, but that doesn't detract from their importance.

By the same token, supporters of civil society should not be detractors of politics and politicians as a class. At the end of this century, it seems a general disillusionment with politics has set in around the world, especially among young people. That has its good aspects but also its bad ones. We need to be able to attract good people into politics to perform its limited but vital role. We need effective political parties and we need to restore respect for the institutions of government. If we could achieve a consensus involving rather more balanced perspectives on the roles of all our institutions, and on the need for all of them to be nurtured and sustained, I believe we might enjoy more success in dealing with our national problems.