

Are new forms of government intervention justified?

The good, the bad, and the ugly (economic nationalism)

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The world is changing. It seems natural that the way governments pursue their mission should also change. There is an obvious need to adapt to new conditions. And even if the world were to stand still, the current forms of government intervention are often so inefficient and wasteful that change would still be necessary. To take only one example, phenomenal amounts of resources are wasted every year in traffic congestion. Even without globalisation, global warming and continuing urban growth, the case for better interventions to deal with congestion is overwhelming. The fact that traffic congestion may also be a significant contributor to carbon emissions only reinforces the case for better interventions.

To deal with congestion, most city governments try to do something. They often impose quantity restrictions and attempt to implement more or less sophisticated traffic management methods. Although a full treatment of congestion requires a variety of instruments including traffic management, the remedy of choice is a congestion tax. Despite being accepted with near unanimity by transport economists as a fundamental part of any good congestion policy (at least for large cities in rich countries) congestion taxes are conspicuous by their absence. Before 2003, Singapore was in fact the only city of some importance to charge its residents for using their cars in the central part of the city at certain times. Since 2003, successful experiences in London (mainly) and Stockholm have changed the landscape. Recent announcements by Mayor Bloomberg in New York and Temblay in Montreal suggest that taxing congestion is gathering momentum. It is my bet that 20 years from now most large cities of the world will have a tax on congestion in one way or another and that this will be for the better.

It is sad that it took more than 50 years for this type of policy to go from the blackboard to a recognised tool of intervention. This on-going saga highlights the simple fact that there may not be enough policy innovations made by governments. Why? In the political arena, partisans of the status quo appear to be always in a strong position and government bureaucracies, like all bureaucracies, do not welcome change. This conservative bias with government policies is a major issue because improving policy making could have enormously positive effects. In many countries governments tax and spend nearly half their national income and government regulations affect nearly all aspects of economic life.

How could we see progress in policy making? In a nutshell, progress will require common sense, experimentation and evaluation. Common sense is needed because experimenting for the sake of it is unlikely to produce great results. It is not because something has not been tried before that it should be experimented with. Obviously, governments need to do some serious homework before experimenting. In terms of experimentation, federal countries tend to provide a more favourable environment. More centralised countries are in a more difficult situation here since their institutions do not usually lend themselves easily to such things as the implementation of policy on only one part of the country, the gradual phase-in of new measures, etc. On the other hand, if they decide to experiment much more can potentially be learnt from unitary countries because in decentralised countries jurisdictions that experiment with something are often those that have the most to gain from it. This selection bias greatly complicated the ex-post evaluation.

More generally, the design of policy experiments should also be such so that a meaningful ex-post evaluation can be conducted.

Done this way, experimentation will lead to some good and some bad. Hopefully ex-post evaluation will be able to separate the good from the bad and get rid of the latter. Coming back to my traffic congestion example, this is what happened with congestion charging. It was an a priori good idea but no mayor in any large city dared to do anything about it. Ken Livingston experimented with it in London. Despite a number of mistakes such as the choice of a very expensive detection technology, the experiment was broadly viewed as very successful. This was to some extent confirmed by serious studies. Importantly, the mayoral election that followed the introduction of the congestion charge in London was fought on this issue and the main opponent of Ken Livingston was roundly defeated. A slightly different path was followed in Stockholm where a congestion fee was implemented for 6 months in 2006 followed by a (partly) successful referendum later in the year. Congestion charging will resume for good in Stockholm in July 2007. Many cities are now expected to follow.

Public education

Of course congestion charging is an easy case. The theoretical argument in favour of it is very strong and the results in terms of traffic and pollution are for all to see (and even for all to smell). Many other policy innovations are much more complex. Take for instance school vouchers. The idea behind school voucher is to separate the provision of education from its production. There is a very strong argument and an even stronger consensus in most countries that primary and secondary education should be publicly provided. Nearly everywhere, the public provision of education is directly associated with its public production: The government pays for basic education and it does by forcing children to go to particular schools it operates. Anyone who has attended a school-board meeting or who is somewhat acquainted with the way public education is run in most countries knows that public production of education can be terribly inefficient. Having education being provided by a broader set of producers including government, charities, and even for-profit businesses may force schools to compete and improve their quality. The argument here is reasonably strong but certainly not overwhelming. Public production of education is terribly inefficient but a market for schools may even be more dysfunctional. Assessing voucher programmes is very hard as many of my economist colleagues have discovered. This is in part because educational quality is extremely difficult to measure (and may be subjected to all sorts of manipulations). This is also because with vouchers, like with most economic policies, the devil is in the details. Fairness often requires that school should not impose surcharges over and above the voucher and that they should be prevented from engaging in 'cream skimming'. Beyond this, research looking at a number of experiments in the US suggests that minute issues of design about how the voucher programme works also matter a lot. Such complexity makes experimenting more costly and learning from such experiments is difficult and slow.

This process of common sense, policy innovation and ex post evaluation is all very nice in theory but of course we cannot expect it to work perfectly in practice. Vested interests will try to stifle experimentation where it does not suit them and will try to retain ineffective policies that suit them. This is part of life. As said above, experimenting involves some good and some bad. The institutional context in many places will mean that there will be less good and more bad than there should be. Still, provided there is some learning along the road this should lead to some progress.

However, when we talk of new forms of government intervention, what is discussed above does not have much to do with what is really happening. There is a much darker side to new forms of

government intervention. Rather than new policies that should generate some good and some bad with eventually the bad being eliminated, we are talking about 'ugly policies'. These ugly policies are about trying to re-package bad old wines into new bottles. They are about new ways of transferring resources to political friends and harming everyone else. They are about new forms of capture by vested interests and disrespect for the general interest.

Industrial policy

Let me take two examples. Industrial policy in its traditional forms is largely discredited. It does not mean that there is absolutely no case for industrial policy but rather that direct subsidies to promote 'desirable' industries and attempts to create national champions have been tried over and over again in all sorts of ways and shapes with overwhelmingly negative outcomes. In light of the discussion above, there are still a number of industrial policies that might be experimented with or as, suggested by some, the possibility to subsidise industrialists willing to experiment. But, this is not what we are talking about with new forms of industrial policy. Take the new French policy towards clusters (or competitiveness poles as they call them). About Bn\$ 2 dollar are being spent over three years to help particular industries in particular areas. This new policy finds its motivation in the renewed economic importance of regions and cities and the allure of Silicon Valley as an engine of prosperity for Northern California.

However, when we look at the details, what do we see? Well, it is basically a series of governments handouts for a number of successful groups of firms in specific industries and locations. At first sight, it does not look pretty and some further analysis suggests it might be even worse than that. In the least harmful cases, industrial policies try to sow the seeds of future industry leaders. Bad industrial policy tries to favour some firms over others because they expect them to become leaders in the long run. Ugly policies like this one do not pick future winners but firms that have already won and try to make sure that they keep winning. Unfortunately the winners of yesterday are the dinosaurs of tomorrow. Yes it would be nice in France if Lyon could remain a world class centre for video games. But helping Lyon and its industry leader also means a higher hurdle for everyone else. In turn, this may mean slower progress for the industry since the same firms do not remain innovative for ever. There is worse to this story. The key problem with industrial policy (like with many other policies) is capture. Governments often set up industrial policies to reward their cronies and even when governments are well-meaning industrial policies get captured by particular interest groups. Even though one can reward cronies easily, the attractiveness of traditional industrial policies is limited because it is harder to target specific votes or specific jurisdictions since the political system is usually organised along a geographic dimension. People vote according to where they live not according to their sector of employment. Cluster policies when managed nationally like in France make it possible to target resources to particular groups (ie sectors) in particular areas. In a way, this is a great innovation that transforms industrial policy into the ideal pork-handing policy: pivotal groups in pivotal areas can now be targeted with a high degree of precision!

These perverse new forms of government intervention are unfortunately not a French specificity. To take a second example, let us look at what is in the pipeline in terms of energy policy in the US. To reduce emissions and encourage a more efficient use of energy, three approaches are possible. The first is a heavy-handed set of government interventions that would legislate about how much each polluter can pollute. The second is known as cap-and-trade, a system that gives each polluter a target level of pollution (like the first approach) but allows them to sell emission rights if they emit less than their target or buy some if they need to. Normally, the total amount of emission remains fixed. The third is a simple tax on the emissions. Rigid targets are arguably dominated by the other two approaches because they give the same rights to pollute to everyone

regardless of how (in)efficient they are. Then a case can be made that a tax is better than a cap-and-trade system. Cap-and-trade typically encourages polluters to pollute as much as possible before the system is implemented so that they end up with more rights. Second, trying to regulate quantities through cap-and-trade could lead to stronger fluctuations in the price of energy-intensive goods. A simple tax is also easier to implement than a cap-and-trade system. However, unless a miracle happens on Capitol Hill, cap-and-trade will prevail. A tax would mean that the government gets all the surplus and it could use it usefully, be it only to reduce distortionary taxes. Instead, with a cap-and-trade system the main beneficiaries are large firms that have historically polluted a lot. Rather than having to compensate society for their past misdeed polluting industries are offered large rents. It is a new policy to deal with a new problem but the bad old ways are still here.

These are only two (very different) cases in point. One could mention many new proposals that are currently on the table to reduce the rights of foreign companies to buy "national assets". Of course vested interests try to make the definition of national asset as wide and flexible as possible. In Europe, some national governments and particular groups have shown tremendous creativity in coming up with new arguments about why the common European rule should not apply to them.

This debate about new forms of government intervention may seem quite murky and it may not be easy to distinguish innovations that will produce successes and sometimes moderate failures from the ugly policies which will systematically reduce the welfare of most for the benefit of a minority. There is however a simple rule of thumb that is worth keeping in mind. If someone comes with a convincing analysis about a proposal, thinks of it as an experiment, and is willing to evaluate it ex-post and discontinue everything if it fails, the answer should be "why not and let's think about it some more". If instead someone comes saying that the times are changing and in the name of national interest we should be doing X or Y, this person is up to no good. What nearly all ugly policies have in common is an insistence on the national interest and a fiery rhetoric to legitimize some bad policy that will benefit a few.