

Government Perpetuates Smog

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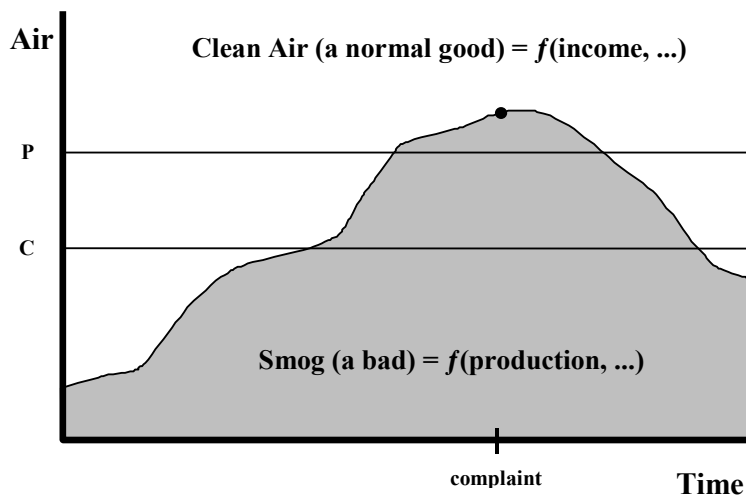
Sometimes a little economic theory can go a long way toward improving our understanding of the world we live in. Bear with me just a little bit this week, as we walk through an important exercise adapted from my textbook *A Primer On Modern Themes in Free Market Economics and Policy* (1999). The book is available through Amazon.com and at www.PolicyOfLiberty.net.

Government planners, like all human beings, have a self-interest motive. They are not altruistic servants of the public interest. Accordingly, “public choice” economic theory suggests that self-interested political actors will be subject to perverse incentives. For instance, planners have a perverse incentive to be ineffective. Governments never lose profits from being poor regulators, but the opposite is likely to be true. If regulation were completely effective at eliminating social problems then there would no longer be a need for it. A regulator or planner who wants to maintain his employment (and we can assume that they do) has an incentive to maintain some minimum levels of social problem in order to preserve his job.

In addition, planners have a perverse incentive to encourage adverse public information that suggests that current regulation is failing. The typical response to this information will be increased calls for government to augment regulation, likely leading to larger budgets and salaries for planners. Thus, planners might perversely view some regulatory failures as successes, while consumers and taxpayers will not concur.

The perverse incentives problem can be illustrated by a hypothetical example of air pollution levels (and regulatory constraints) for a major city. Let us suppose that (1) clean air is a “normal” good that people choose to buy more of as their incomes rise, (2) peoples’ earnings continue to rise over time, (3) all production produces some smog, either directly or indirectly, and (4) that the urban area is growing (along with its production) over time.

Clean air levels constrained by public policy



As the city develops, people will enjoy rising incomes and will be willing to accept higher amounts of air pollution to sustain that income—up to a certain point of contentment C. However, as the level of smog rises above point C, people start becoming concerned, and a few will even become preoccupied, about the smog problem. But most are still willing to tolerate the dirtier air because of the other benefits they have from urban life, at least up to point P. At this smog level P they

become critically preoccupied, although intense complaining might not begin right away. Accordingly, as the smog level surpasses point P, people might not complain or change their smog producing behavior in the short run if they believe that the rise above point P is only temporary. However, once people realize that the level of smog is permanent they will take steps to alleviate the problem. Two options are feasible.

The first option is to simply let entrepreneurs and market institutions develop spontaneously to solve the pollution problem. Since clean air is a “normal” good, people will prefer to buy more of it as their incomes rise. Above point P, people will tend to trade some of their relatively high incomes for cleaner air. Consequently, pollution control experts and entrepreneurs will emerge to meet the demands of consumers, and competition will cause improvements in technology that make pollution abatement increasingly cheaper. Over time, the lower price will mean that more clean air can be acquired by trading the same percentage of income, and the result will be a smog level that continually declines, probably at a decreasing rate. The level of smog might be reduced to zero someday, but it is unlikely because the opportunity cost of doing so will be rising at an increasing rate. Thus, the costs of purity are often sufficiently high to deter people from achieving it. However, it is likely that the level of smog will remain somewhere below point C, where there would be little public uneasiness from smog.

The second option is for voters to demand that proactive public policies be initiated to deal with the smog problem. The “public interest” would be invoked citing both positive rights to clean air and negative rights to protection from the pollution and its negative external costs. Vote-seeking politicians will respond to the demands of voters and SIGs by (1) creating a bureaucracy to “solve” the problem and (2) taxing away incomes to support it. Personal freedom (or utility) will also be diminished by the regulation it generates. The new bureaucrats (and those who consult with them) will probably be experts in pollution abatement, and people will be forced to comply with their public interest objectives. As a result, the level of smog will decline, just as it would under the first option. Once people perceive that the long run level of smog has fallen below point P, they will stop complaining. Hence, bureaucrats will have an incentive, either directly or through the pressure of vote-seeking politicians, to reach that point as soon as possible. When they succeed, voters will be happy with the regulatory effectiveness and will in turn laud the politicians who initiated it.

However, with the level of smog below point P, the bureaucrats are faced with a perverse incentive. If the smog level should drop below point C, social uneasiness would diminish sufficiently far that people would begin to complain more about the taxes and regulation pertaining to the bureaucracy than the smog. People would prefer to have more disposable income and freedom from the smog-induced regulation. Hence, the bureaucrats, who want to keep their jobs and maximize their departmental budgets, will realize the importance of maintaining the smog level above point C, and will choose policies and favor technologies that achieve that goal. Therefore, smog problems will likely be alleviated by public policy (and evidence of urban regulation today often confirms this fact). But public choice theory suggests that smog will never be eliminated or brought to a level below point C in the long run. **Political intervention to eliminate smog problems will simply tend to make an uncomfortable yet tolerable amount of smog a *permanent* part of social life.**