

The Military, War and Government Failure

1. Military/defence expenditure is the canonical case of a public good. National security and defense are by definition collectively consumed.
 - a. I cannot consume more national defense than you, because it is not excludable.
 - b. One could also argue that it is perfectly shareable, though with a geographic spread as big as Canada's, this may be tenuous.
2. Military expenditure is thus a classic publicly financed good. Should it be publicly produced?
 - a. All the examples of public production centered on information problems, such as those in the health insurance industry. These information problems centered on Privately held information that nobody has an incentive to share.
 - i. With insurance, this is private information about risk;
 - ii. With 'experts', this is private information about the quality or value of goods being offered, eg, medical treatment.
 - b. This argument is strong for military personnel
 - i. Think of the incentives of private police forces or paramilitaries.
 - (1) they want to minimise their effort and maximise the stuff for which they get rewarded.
 - (a) eg, private prisons will undercut prisoner food quality to save money because it is hard to observe by outsiders.
 - (2) publicly employed military personnel can:
 - (a) think of their decisions in the long-term, because they can be permanent employees;
 - (b) be indoctrinated to believe in a 'higher purpose'
 - c. This argument is weaker for military equipment
 - i. A lot of military equipment is for materials and equipment, eg fighter jets and helicopters.
 - ii. If the quality of these goods is easily observed, then there is no compelling reason to produce them in the public sector.
3. So, you tend to get publicly funded publicly employed military personnel who use publicly funded but privately produced equipment.
 - a. Military equipment is expensive, and there are few producers
 - b. Because secrecy and security are intertwined, military contracts are often secret.
 - c. So, you have expensive stuff, few possible providers and you can keep the contracts secret.
 - d. This is the origin of the *military industrial complex*.
 - i. Why oh why are billions of dollars disappearing into Halliburton in Iraq?
4. The key here is that governments are run by bureaucrats and politicians, and bureaucrats and politicians are people.
 - a. This feature of governments has not been taken seriously in this course, wherein i have mostly argued the case for government intervention.
 - b. In the background, there is a set of weaknesses of government financing and production, we call these *government failures*.

5. Government Failure: What makes government production and financing difficult?
 - a. Nice little book by Charles Wolf, Jr, *Markets or Governments* says that really we are not choosing between perfect markets or perfect governments, but rather between imperfect markets and imperfect governments.
 - i. This book is **free** from the Rand Corporation, www.rand.org.
6. Discipline
 - a. In private markets inefficient firms are disciplined by bankruptcy. If you run a lousy firm, nobody wants to buy your stuff at what it costs you to produce it; you can't keep expenditures and revenues in line, so you go bankrupt.
 - b. In public firms, such as ICBC and BC Ferries, the discipline of bankruptcy is not present.
 - i. There are good reasons not to allow bankruptcy, typically the very reasons that the firm is in the public sector in the first place. For example, insurance markets are lousy, so letting ICBC go down may expose people to much worse insurers.
 - ii. However, shielding the public firm from bankruptcy also prevents bankruptcy from removing lousy public firms from the playing field.
 - iii. Public firms have a weaker incentive to keep expenditures and revenues in line. For example, higher levels of government can
 - (1) bail out public firms, as the government of Canada did with Air Canada several times before privatising it;
 - (2) give gifts to public firms, as the government of BC did with BC Ferries for the last 4 decades, buying its boats and not charging the corporation for them.
 - c. The lack of discipline implies that lousy government practices can persist, even if they cause inefficiency and money-losing.
 - d. Bankruptcy is a signal that your firm isn't doing well. Other signals are also typically missing in public firms: prices.
 - e. Firms charge prices, and if there is a lot of demand, they may raise those prices; if there is no demand, they may lower the prices. Thus, the price and response to it are important for firm decision-making.
 - f. Public firms often don't get to use full prices, for example, hospitals don't charge patients, and therefore do not get patients 'voting with their feet' when the price of service is too expensive for what is received. However, here, the price perceived by the patient is much less than the real price of providing the service. So, the information gotten from patients about the value of the service is much weakened.
7. Individuals in organizations have their own (non profit maximising) goals.
 - a. Time horizons: politicians are elected on a 4-5 year (at most) election cycle. Thus, they may have a tendency to pursue goals that have benefits within this cycle, and costs way off in the future.
 - i. One implication is that elected politicians may be tempted to acquire lots of debt for governments so that we can have fun now and pay later (when they are not in charge).

- b. short-vision: bureaucrats may be inclined to think that their bit of government is important. In this case, they may attempt to enlarge their bit at the expense of other bits. If all bureaucrats are trying to do this, then there may be a tendency for the government sector to grow, even if underlying economic conditions are unchanging.
8. Sometimes programmes have unintended effects that the creating agency *is not responsible for*. Wolf calls these *internalities* because they are like externalities (eg, pollution), but act within government.
- a. This is a coordination problem across agencies. For example, both federal employment insurance and provincial welfare programs provide income support for the unemployed. Thus, when the federal government shrank the employment insurance program in the mid 1990s, this implied increased loads on provincial welfare programs. However, the feds did not really work this into their calculations of the 'total cost' of the program changes.
9. **These problems exist in large organizations, whether public or private.**