UNLV | UNIVERSITY LIBRARIES

Brookings Scholar Lecture Series | Brookings Mountain West

10-7-2009

Should the Economic Crisis Change Our Assessment of Markets and Government?

Clifford Winston
Brookings Institution

Follow this and additional works at: https://digitalscholarship.unlv.edu/brookings_lectures_events

Part of the Economic Policy Commons, Economic Theory Commons, and the Public Policy Commons

Repository Citation

Winston, C. (2009). Should the Economic Crisis Change Our Assessment of Markets and Government?.
Available at: https://digitalscholarship.unlv.edu/brookings_lectures_events/13

This Lecture is protected by copyright and/or related rights. It has been brought to you by Digital Scholarship@UNLV with permission from the rights-holder(s). You are free to use this Lecture in any way that is permitted by the copyright and related rights legislation that applies to your use. For other uses you need to obtain permission from the rights-holder(s) directly, unless additional rights are indicated by a Creative Commons license in the record and/or on the work itself.

This Lecture has been accepted for inclusion in Brookings Scholar Lecture Series by an authorized administrator of Digital Scholarship@UNLV. For more information, please contact digitalscholarship@unlv.edu.

BROOKINGS | UNLV
UNIVERSITY OF NEVADA LAS VEGAS

The Brookings Mountain West Initiative

http://brookingsmtnwest.unlv.edu

Should the Economic Crisis Change our Assessment of Markets and Government?

Clifford Winston
Brookings Institution

Broad Objectives of the Study

- Base policy debates on empirical counterfactual evidence.

- Begin accumulating evidence and identifying common themes so we don’t have to start from “square one.”

- Provide guidance for policymakers.

Sources of Market Failure

- **Market power in input/output**
- **Natural monopoly**
- **Imperfect information**
- **Externalities**
- **Public goods**

Assessment

- **Is there evidence of market failure?**
- **Is government policy improving performance?**
- **Is government policy optimal?**

Conclusions Before the Crisis

- **Intervention is often unnecessary.**
- **There are missed opportunities to improve efficiency.**
- **A greater role for market-oriented policies should be considered**.

Conclusions in Light of the Economic Crisis

- **A serious market failure—imperfect information—did occur and it led to the economic crisis.**
- **But the current backlash against markets and broad claims of market failure are misleading and may lead to counterproductive policies.**
- **There is still little evidence that government micro policies are effective and that government can prevent the market failure that contributed to the crisis.**

Approaches to the Issue

- **Applied welfare economics**
- **Counterfactual analysis**
- **Academic studies**
- **Not major divisions among studies**
- **More work clearly needed**

Market Power: Antitrust Policy

- **Monopolization**
- **Collusion**
- **Mergers**
- **Deterrence**

Antitrust Update

- Christine Varney, head of DOJ antitrust division, announced that the Department planned to restore an aggressive enforcement policy against corporations that abuse market dominance.

- Evidence that this will be an effective strategy?

Natural Monopoly: Economic Regulation

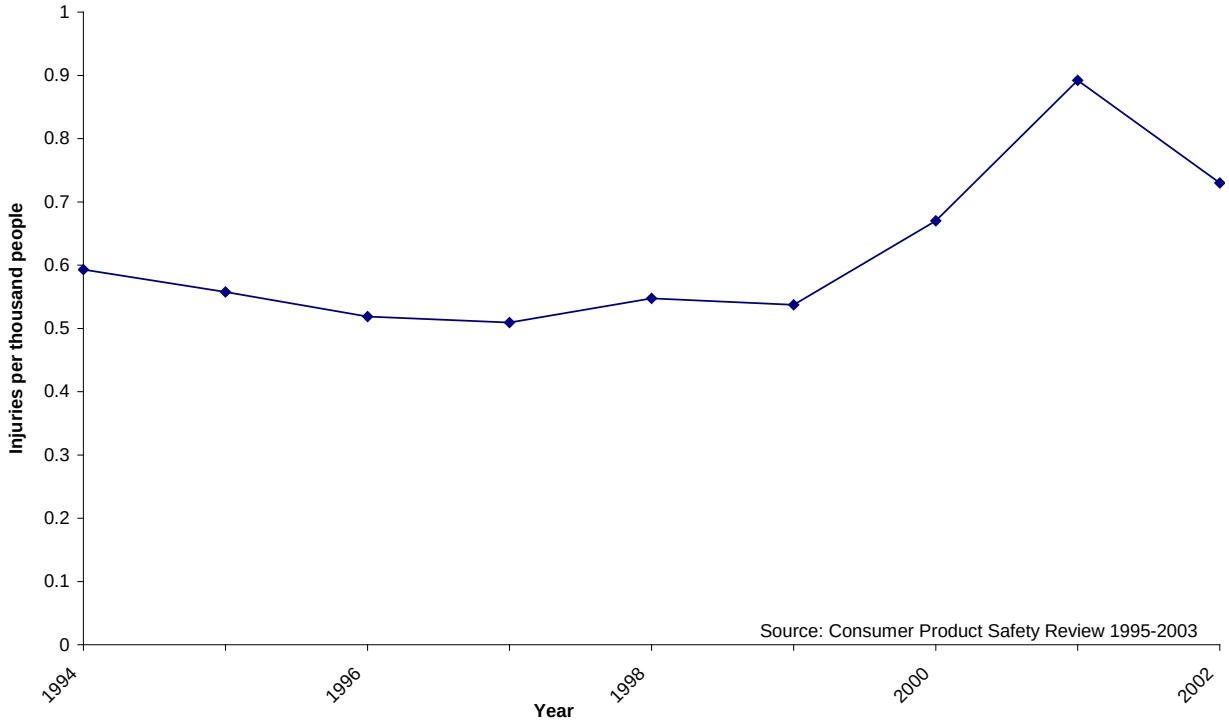
- **Substantial partial deregulation**
- **Agricultural subsidies**
- **Quotas and tariffs**

Imperfect Information

- **False advertising**
- **Product disclosure**
- **Product safety standards (offsets)**
- **Workplace safety**
- **Deterrence**

Information Policy

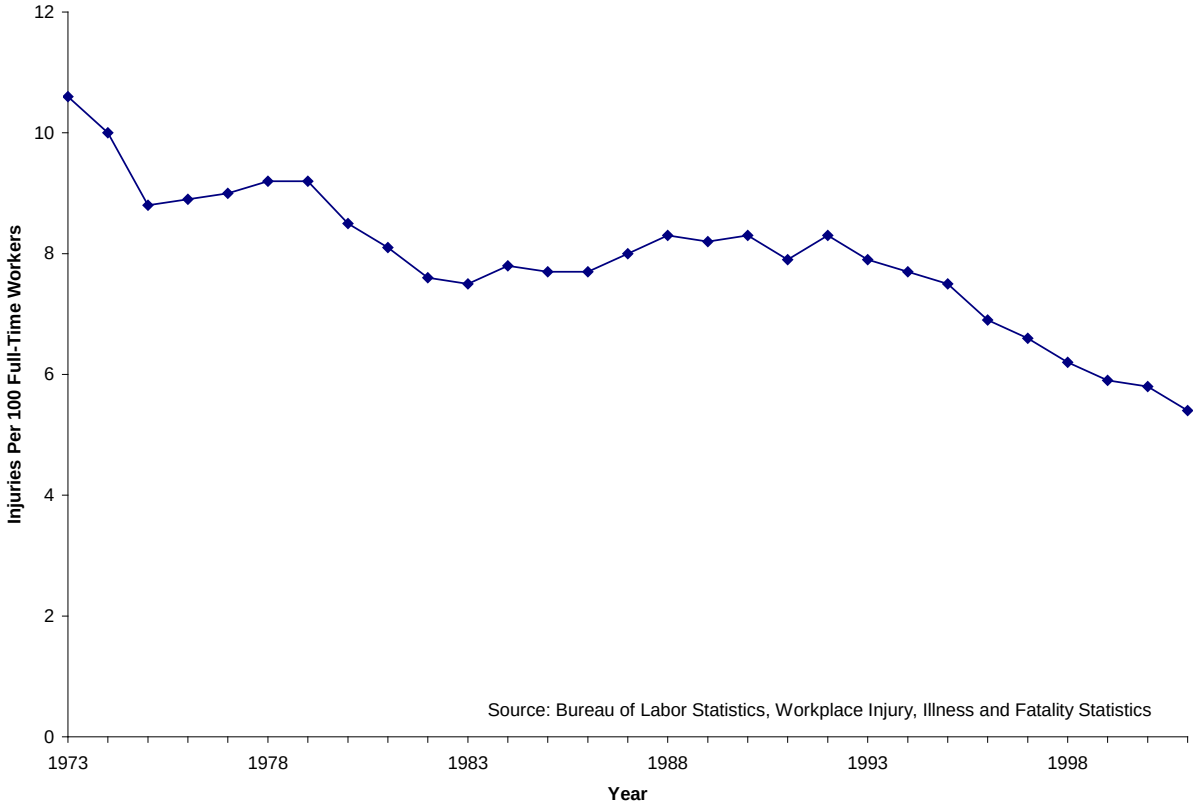
Figure 1a. US Toy Related Injuries, 1994-2002



*Injuries include any toy related injury which requires hospital care and all deaths

Information Policy

Figure 1b. Occupational Injuries for Private Industry, 1973-2001*



*Occupational injuries include all injuries sustained on the job, including those that require time off from work and those that do not.

Imperfect Information Update

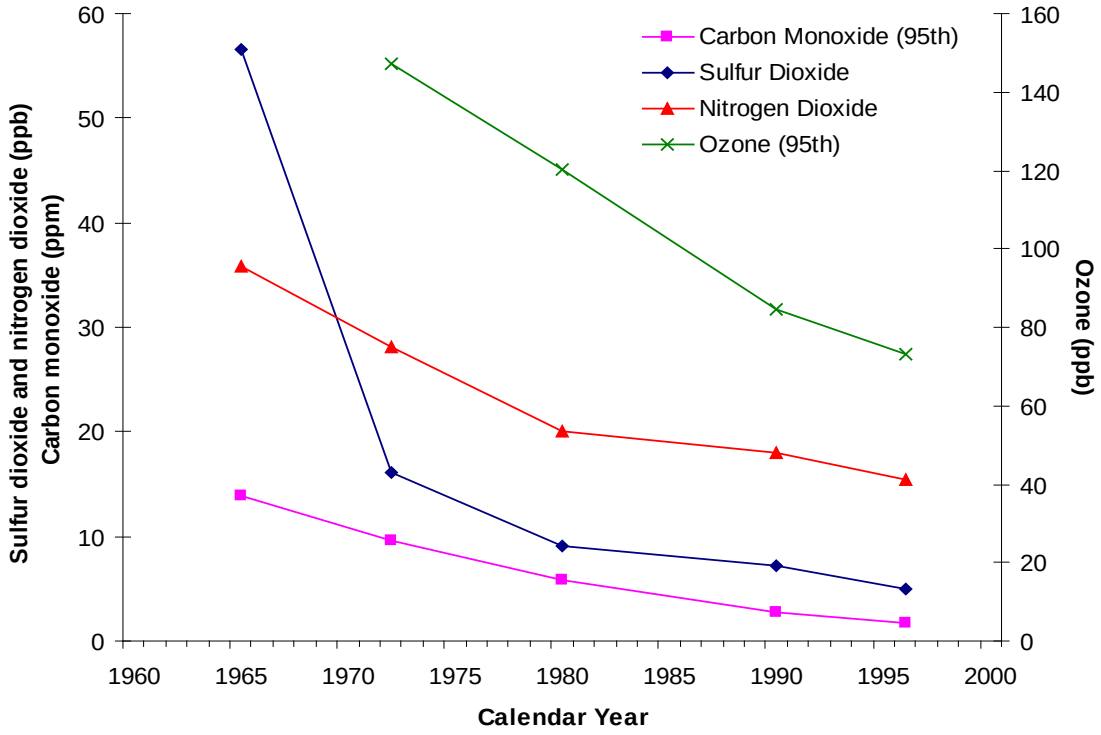
- Children's Toys: One CPCS toy tester.
- HOUSING MARKET: home buyers and investors did not properly weight the credit risks they were assuming.
- Banks and rating agencies underestimated the probability of a major decline in housing prices.
- NOTE: most defaults were centered in regulated financial institutions that purchased and invested in sub-primes. Even Bernie Madoff's operations were subject to federal regulation.

Consumption Externalities

- **Automobile emissions**
- **Aircraft noise**
- **Smoking and drinking**

Externalities

Figure 2. Average Ambient Levels of Air Pollutants, 1965-1995

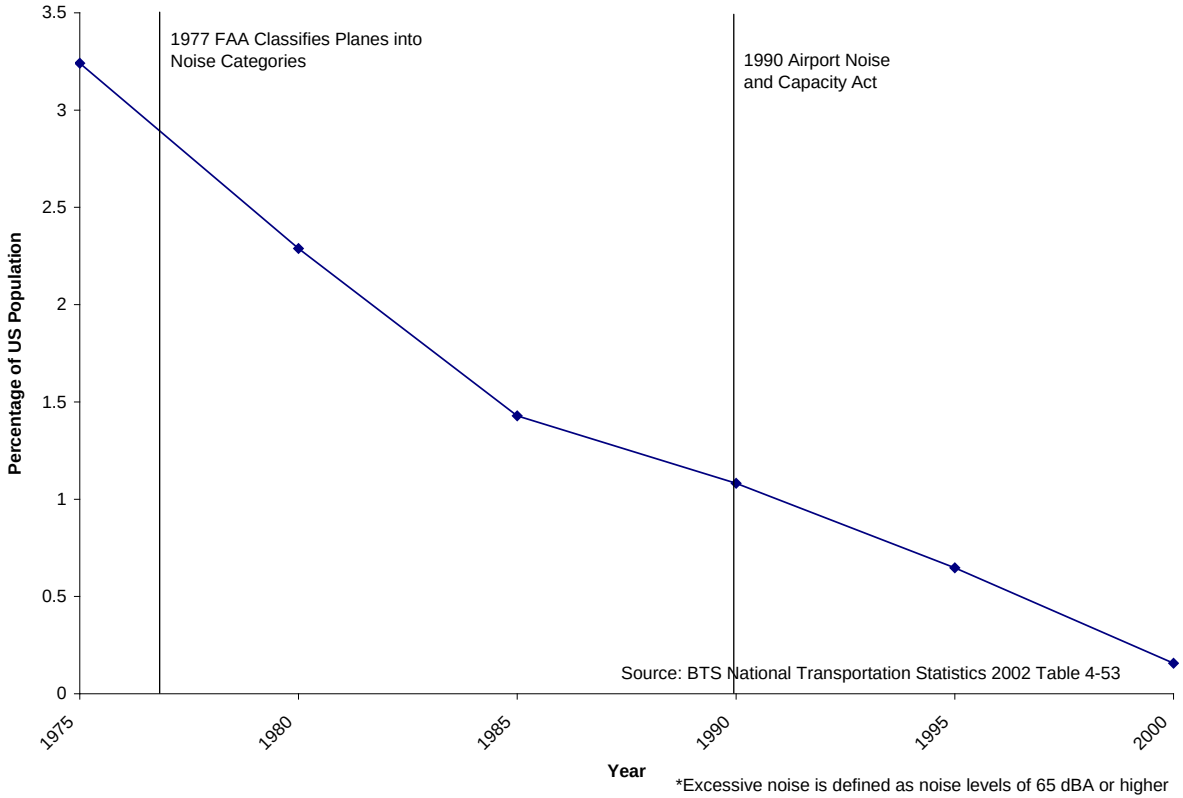


Based on data reported in F.W. Lipfert and S.C. Morris, "Temporal and Spatial Relations between Age Specific Mortality and Ambient Air Quality in the United States: Regression Results for Counties, 1960-97," *Occupational and Environmental Medicine* 59, no. 3 (2002), 156-74.

Carbon monoxide and ozone levels are averages of the 95th percentile of daily one hour readings at each monitoring location. Sulfur dioxide and nitrogen dioxide levels are averages of annual means from each monitoring location.

Externalities

Figure 3. Percentage of Population Exposed to Excessive Aircraft Noise*



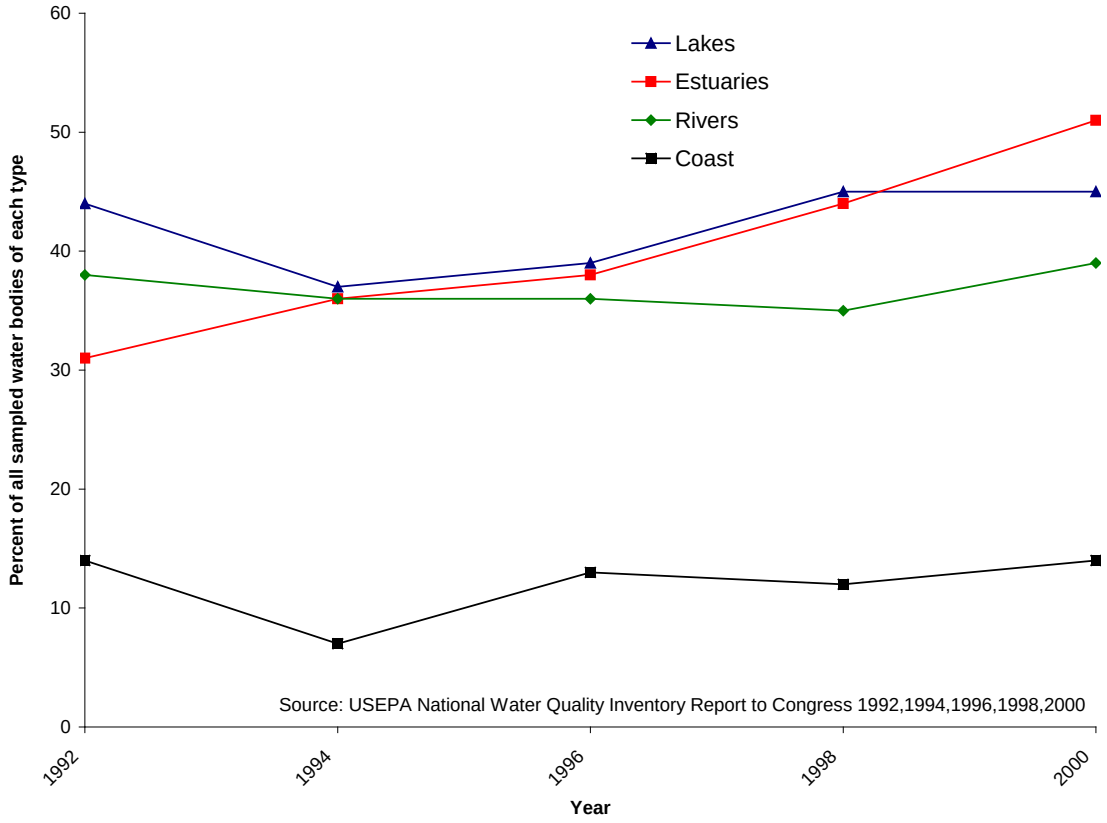
*Excessive noise is defined as noise levels of 65 dBA or higher

Production Externalities

- **Air pollution**
- **Emissions trading**
- **Water pollution**
- **Superfund**

Externalities

Figure 4. Water Bodies Considered "Impaired" or Worse by the US Environmental Protection Agency, 1992-2000



Externalities Update

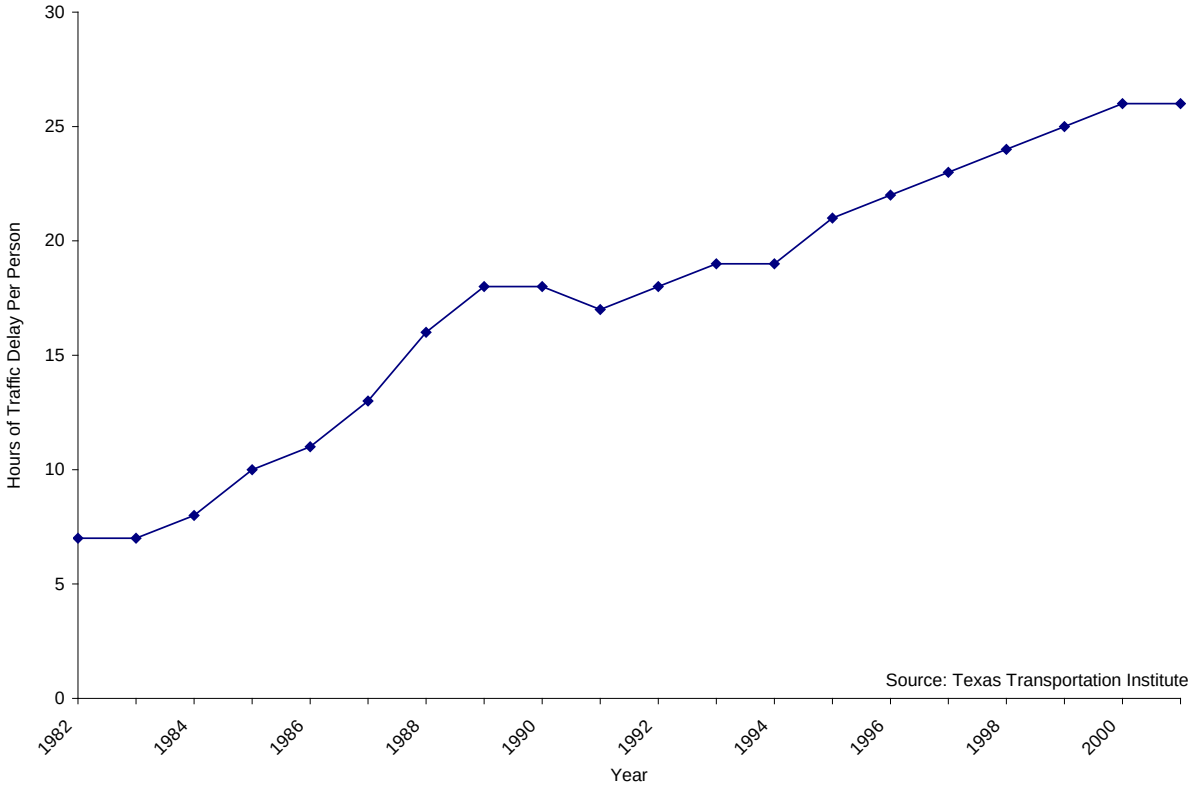
- **Raising Corporate Average Fuel Economy standards: consider tradeoffs.**
- **Cash for Clunkers: new cars are driven more than old cars.**
- **Cap and trade: rights to emit carbon should be auctioned off.**

Public Production

- **Highways**
- **Airports**
- **Urban transit**

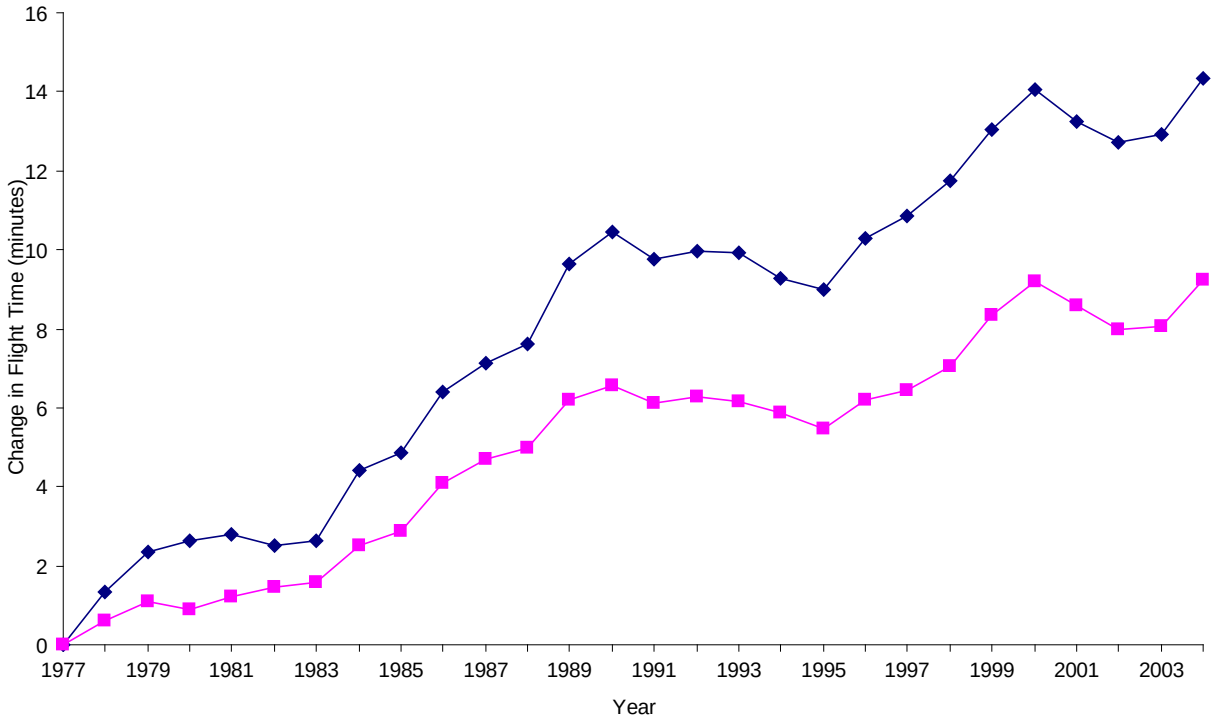
Public Production

Figure 6. Average Annual Traffic Delay in Major Metropolitan Areas, 1982-2001



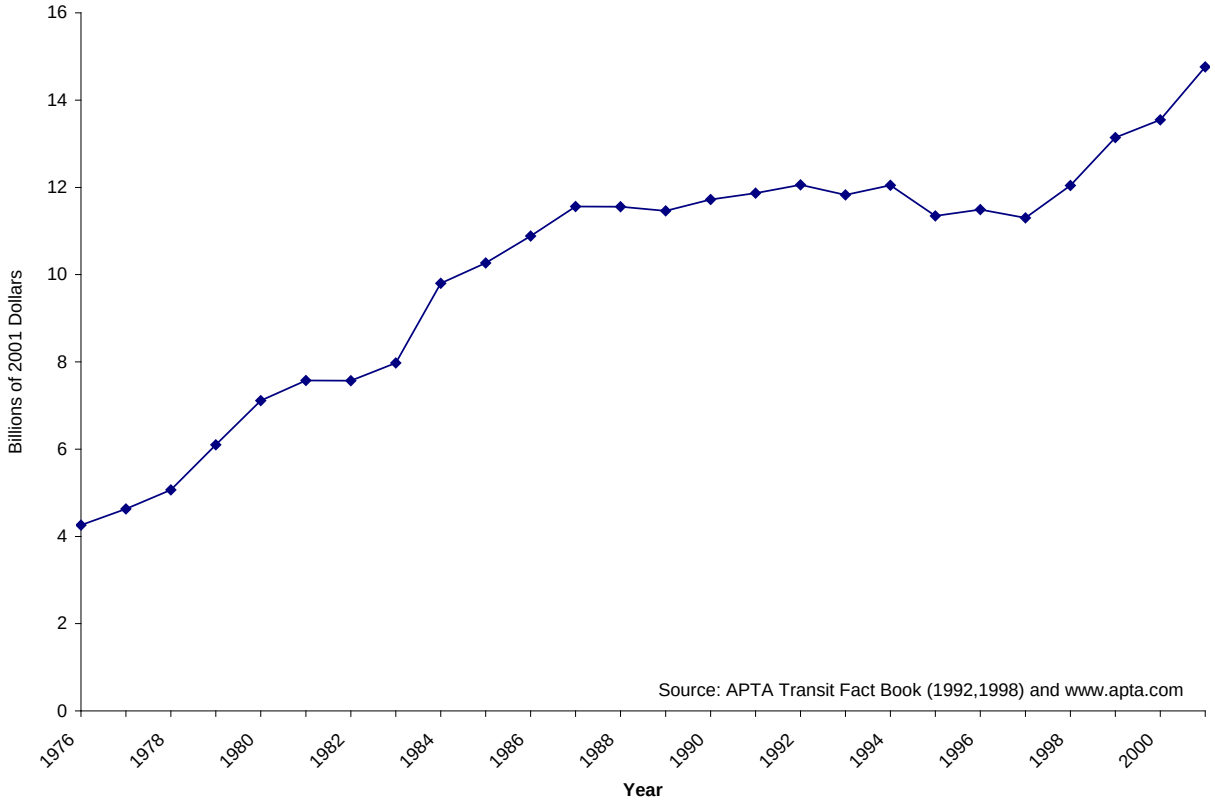
Public Production

Figure 7. Changes in Air Travel Time, 1977-2004



Public Production

Figure 8. Government Transit Operating Assistance, 1976-2001



Public Production Update

- **Public infrastructure spending: a source of economic stimulus?**
- **Two tiny villages in Alaska are getting $28 million for airport funds.**
- **Washington state isn't using stimulus funds to relieve congestion in Seattle but is spreading the funds to other regions of the state.**
- **Money for high speed rail!!!**

Synthesis Before the Crisis

Less intervention warranted:

- **Antitrust**
- **Monopsony**
- **Regulation**
- **Information**

Synthesis Before the Crisis

Missed opportunities to improve economic efficiency:

- **Consumption externalities**
- **Production externalities**
- **Public production**

Explaining Performance

- **Robustness of markets**
- **Agency inflexibility**
- **Policy conflicts**
- **Political forces**
- **Do policymakers learn?**

Updating the Synthesis

- **Market failure related to imperfect information clearly contributed to the economic crisis.**
- **Government failure is still a major concern as government intervention expands in several areas.**
- **It is far from clear that government has learned from its past failures. It is clear that markets are learning—but they will never be able to eliminate the costs associated with risk and future crises.**

What Should the Interested Lay-Person Take Away?

- **Markets make mistakes—sometimes big ones. Does that mean government intervention will improve matters?**
- **Government Failure imposes large costs; market performance is often better than recognized.**
- **Retrospective empirical assessments and the accumulation of evidence contribute to "truth."**

What Should the Interested Lay-Person Take Away?

- **Policy outcomes and the sources of inefficiencies are similar across an array of policies.**
- **Challenge advocates to provide scholarly evidence.**

BROOKINGS | UNLV
UNIVERSITY OF NEVADA LAS VEGAS

The Brookings Mountain West Initiative

http://brookingsmtnwest.unlv.edu