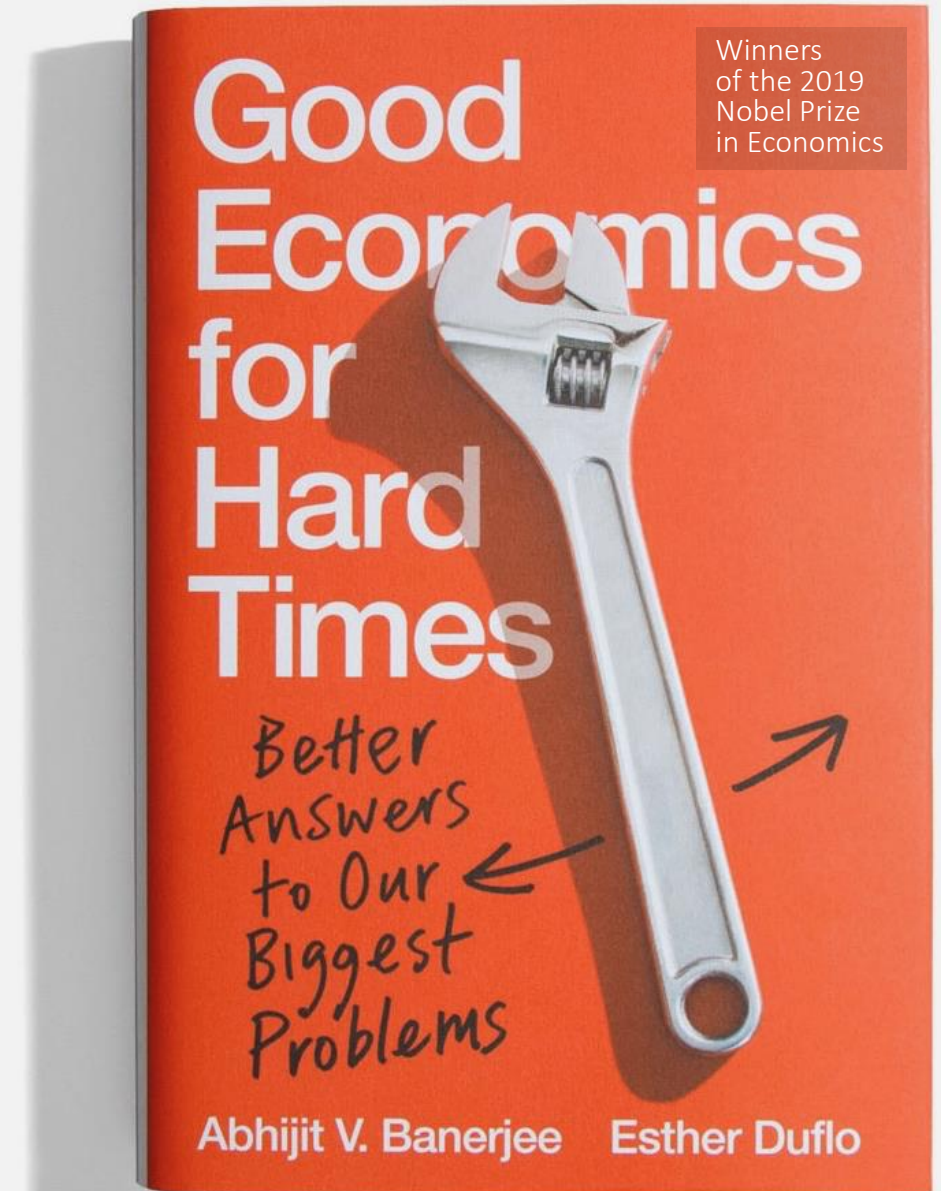


Good Economics For ~~Hard Times~~ ~~Harder Times~~ More Hopeful(?) Times

A course by Abhijit Banerjee
and Esther Duflo



Lecture 16 and 17: Legit.gov

The problem of trust in government

The COVID-19 crisis reminds us why we need governments...

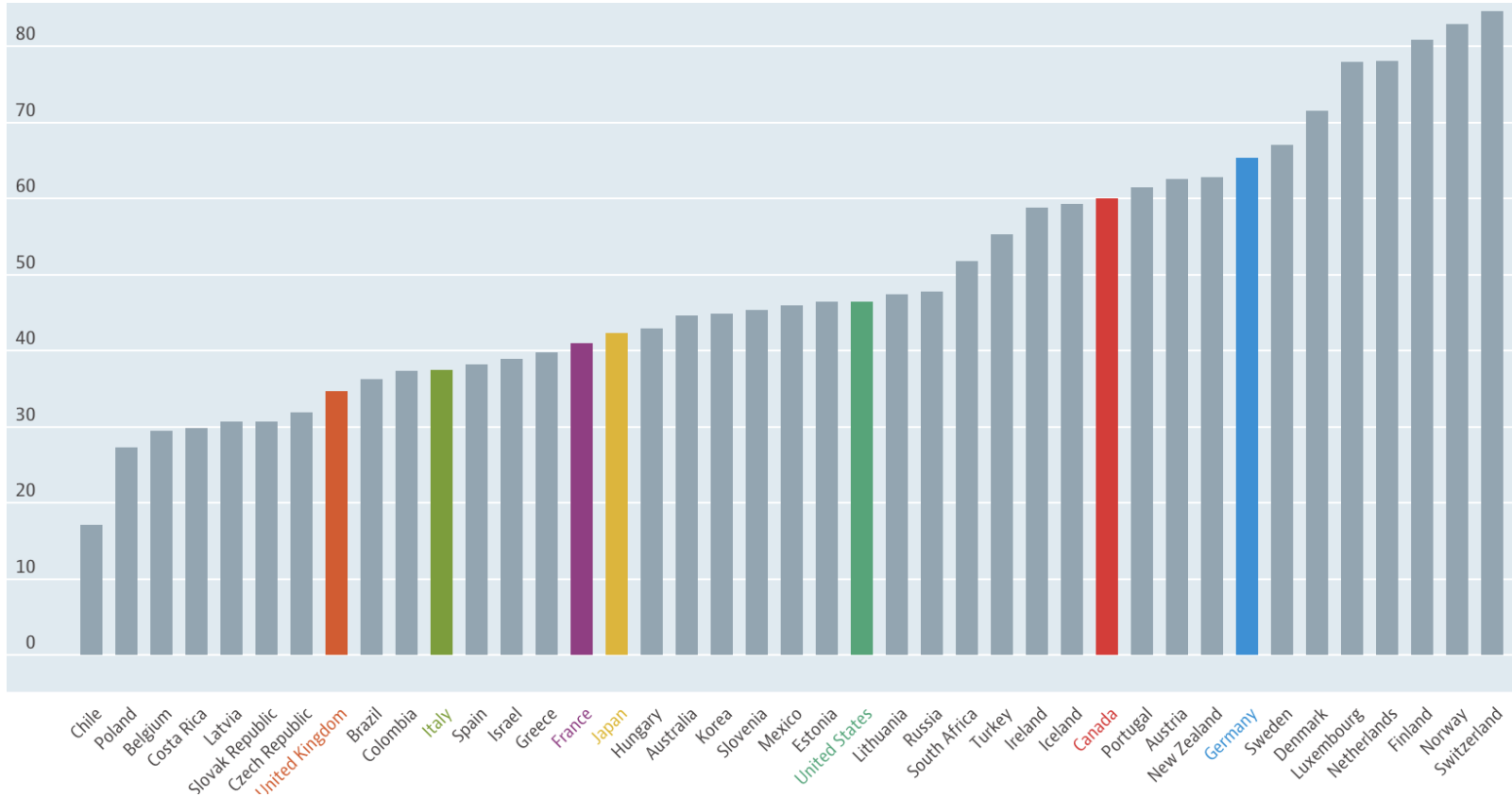
Shutting down your business,
wearing a mask, are externalities...

Vaccine development

Economic rescue package

Making sure that the
right people get the vaccine

Trust in government is low in a majority of countries

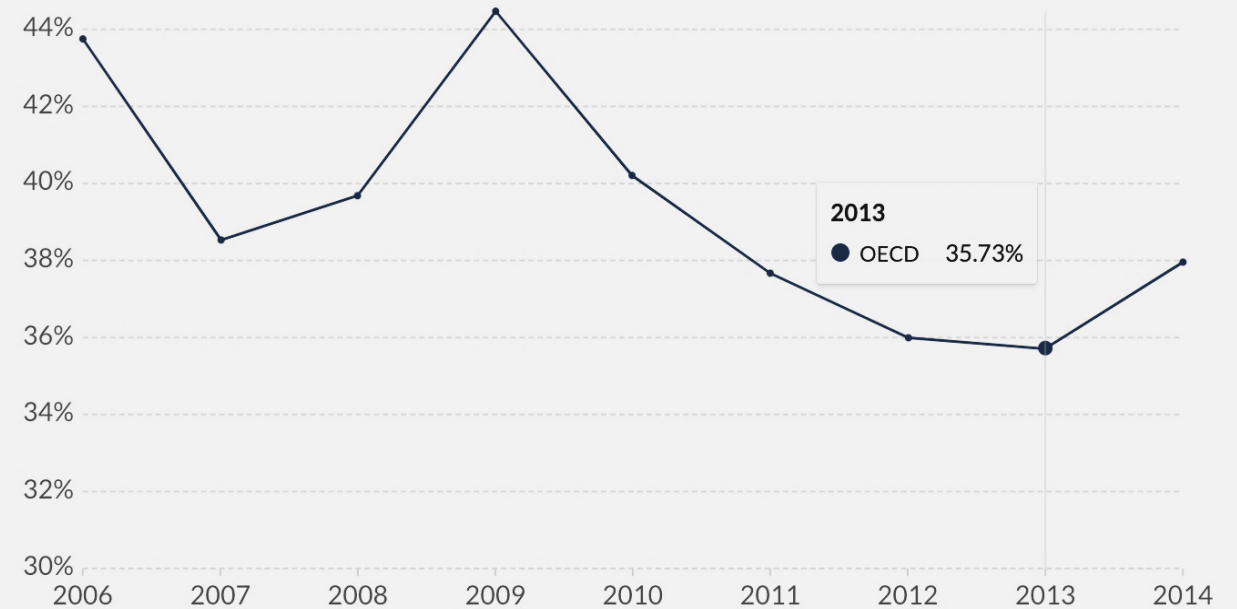


Question: In this country, do you have confidence in... national government? The sample is ex ante designed to be nationally representative of the population aged 15 and over.

And it's declining

OECD average trust in governments, 2006-2014

Percentage of the population reporting confidence in the national government

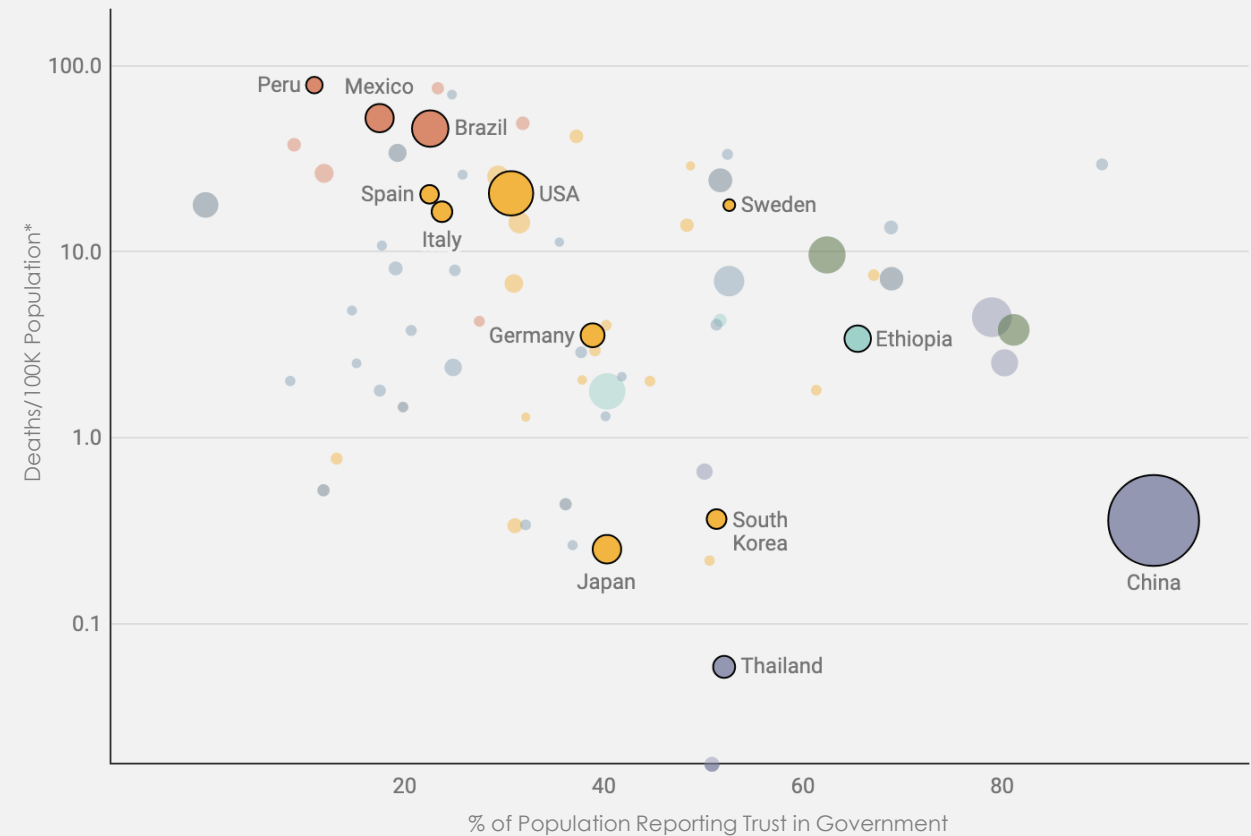


A worrying correlation with COVID-19

Countries Without Government Trust Have Performed Poorly

A comparison of government trust and cumulative COVID-19 death rates

North Africa & Middle East Sub-Saharan Africa Central/Eastern Europe & Central Asia High-income Countries
Latin America & Caribbean South Asia Southeast/East Asia & Oceania



Why is trust in government so important?

- Most successful policy changes are not "win-win" to start with
- They can often be made win-win by suitable redistribution or other interventions
- But these interventions require commitment
 - Financial compensations can always be denied or expropriated later
 - Typically governments tend to be constrained by lack of funds and cannot pay lump sum compensation when the policy is announced
 - Moreover lump sum compensations create commitment problems on the other side
 - Regulatory changes can be unenforced
- Commitment typically requires trust

A case-study of a reform effort

A short history of the battle over Farm Laws in India

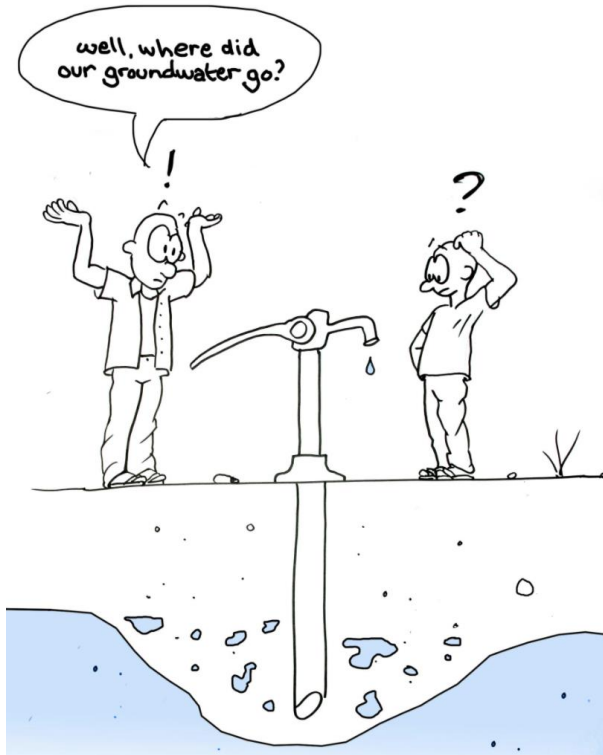


Illustration: StressedAfrican

In the late 1960s India was facing famine. Farm productivity was too low

The “green revolution” came to the rescue

- New seeds for wheat and then rice—more productive, short growing cycles
- Expansion of irrigation, using pump-sets to access the water table
- Subsidized by un-metered electricity
- And encouraged by Minimum Support Prices (MSP)—govt guaranteed prices

The response to these policies



Photo: Shutterstock.com

Basmati is one of the world's favorite types of rice

Punjab and Haryana states of Northern India are some of the biggest growers

This is relatively recent: the amount of land under rice paddies (in rice season) went from 10% to over 70% between 1970 and 2015

- The combination of free electricity to pump out water and government guaranteed prices made it profitable

India's food supply now exceeds demand. The government purchases large amounts and gives it away almost free through the Public Distribution system

Despite that it has accumulated huge stocks of grains—the rats are happy

The current situation is unsustainable

- Punjab is extremely hot and dry in April and May, when farmers sow rice.
- As a result Punjab uses roughly three times the water to produce a kilo of rice, compared to Eastern India (5K liters/Kilo)
- On the other hand Punjab gets only 20" of rain a year (60+" in Eastern India)
- This is only possible by drawing on reserves of ground water
- The water table is falling: average depth of the tube-well to get at the water has gone from less than 50 feet in the 1960s to over 125 feet in 2010s.
- The government of Punjab estimates that the state will run out of water by 2039.
- Moreover to clear the land of rice stubble to enable the fall planting of wheat/corn, farmers burn stubble, which in winter makes Delhi the most polluted national capital in the world

An attempted reform

In 2020 the Indian Federal government proposed three main reforms

1. A set of changes in laws that permit corporates to purchase all farm products directly from the farmers, rather than go through the official markets where middlemen buy from farmers
2. Penalties for stubble burning
3. Changes in electricity pricing

Was met with loud and organized opposition by the farmers in Punjab and Haryana (but also increasingly elsewhere).

- Roads to Delhi were blockaded and there was an extended sit-in

Though interrupted by the pandemic, the movement continues

Why are farmers so upset? Why the opposition to the option to sell to corporates?

Nobody is forcing them to sell to the corporates

There is no mention of the MSP anywhere. The government is promising that it will continue.

- If they don't want to sell to the corporates they can sell at MSP



Illustration: Irfran | cartoonsbyirfran.in

What the farmers fear

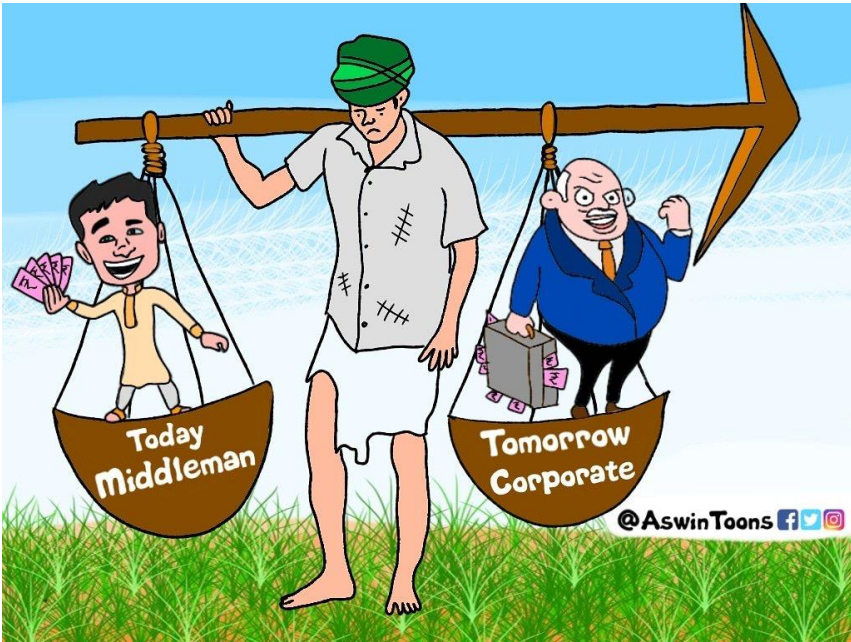


Illustration: Aswin Toons

The farmers know that some reform is inevitable—the situation is unsustainable

With protests the government quickly gave up on power pricing and the stubble burning

- The two most critical social issues

Suggests that the farm purchase liberalization was the main goal of the govt.

The farmers wondered why that was so important, if the MSP, which is typically a lot above the market price, continues

- Why would the corporates want to enter?

They suspect that the corporates with their deep pockets will kill the markets. And then make full use of their monopolies/oligopolies

- To make this possible the MSP will be removed or purchase amounts will fall

At the heart of the problem



Illustration: Irfran | cartoonsbyirfran.in

Government's story is not entirely coherent

- Especially combined with the general fiscal tightening (MSP costs a lot)
- and the fact that MSP has been lower in real terms in recent years

The policies were announced without any mention of potential losses to the farmers or the possibility of compensation

But ultimately it is related to mistrust in the government—otherwise the fact that the government says that farmers will benefit would suffice

**Why are governments
not trusted?**

Sources of lack of trust

Ideology

Lack of transparency

Commitment problems

Corruption and red-tape

Capture



Illustration: Nicholas



“

If you put the federal government in charge of the Sahara Desert, in 5 years there'd be a shortage of sand.”

Milton Friedman

The libertarian credo

We don't need the government—just the army, the courts and the police.

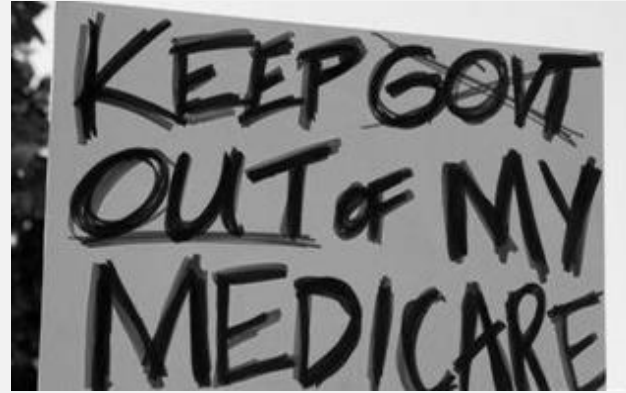
If there is anything else that people need that needs some collective action—it will happen on their own

- People will negotiate with each other when there is mutual benefit
- Sometimes called Coasian bargaining after Chicago Professor Ronald Coase, who asked why such bargaining should not be our default

Seems totally farfetched

- All of India will negotiate on whether masks should be compulsory?
- Within days? Before everyone understands the need for masks?
- Or who should get vaccinated first? And suppose there is an impasse?
- Or how should those who lose their jobs because of the lock-down be compensated? Who pays? And how much?

It's easy to treat the
government as a
punching bag



Photos: Dawn Teo | Huffington Post; tcf.org; stocksandjocks.net

Lack of transparency: why certain decisions got made

(Mostly) Bad Reasons:

- The govt. had something to hide
- They felt the public would not be able to understand the reasoning
- They believed that the “public will thank us later”

(Mostly) Good Reasons:

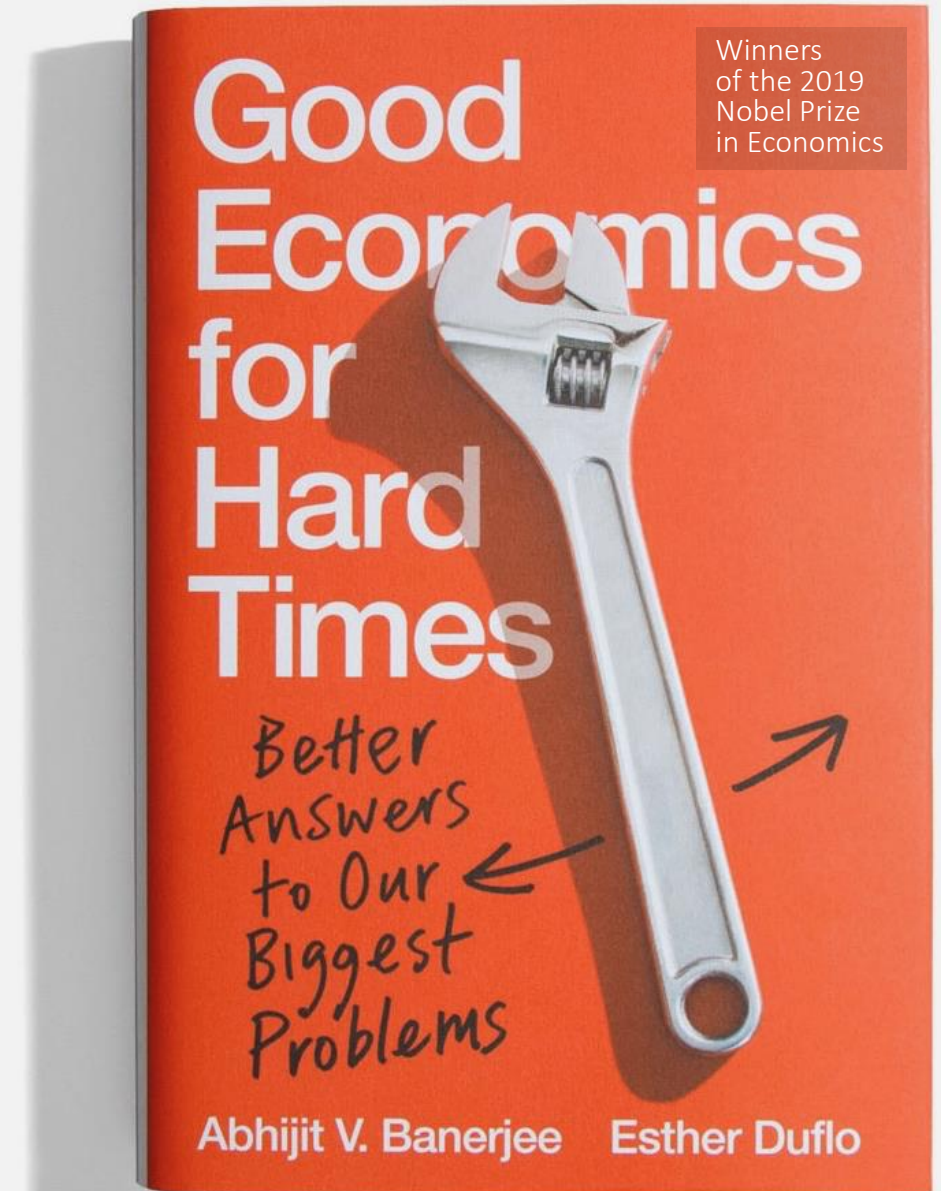
- The govt. felt that speed was of essence
- It takes too much effort to make the basis of every decision public—transparency needs to be selective
- There is so much data: if everything is made public, it actually makes it easier to hide wrong-doing

The commitment problem

- Governments in democracies need to make long-term commitments
- But they also lose elections and the new government does not want to be bound by the decisions of the last administration (they lost didn't they?)
- This is built into the very structure of democracy
- Democratic governments try to tie their hands by creating independent institutions (central banks, judiciary, etc.) and by creating political constituencies that benefit from particular policies who can be expected to resist changes in the policy
 - Obamacare survived Trump because there were enough voting beneficiaries and potential beneficiaries who had a stake in its survival
- Dictatorships may have more continuity over time, but they are less able to submit to the writ of institutions

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Why are governments not trusted:

Corruption and red-tape

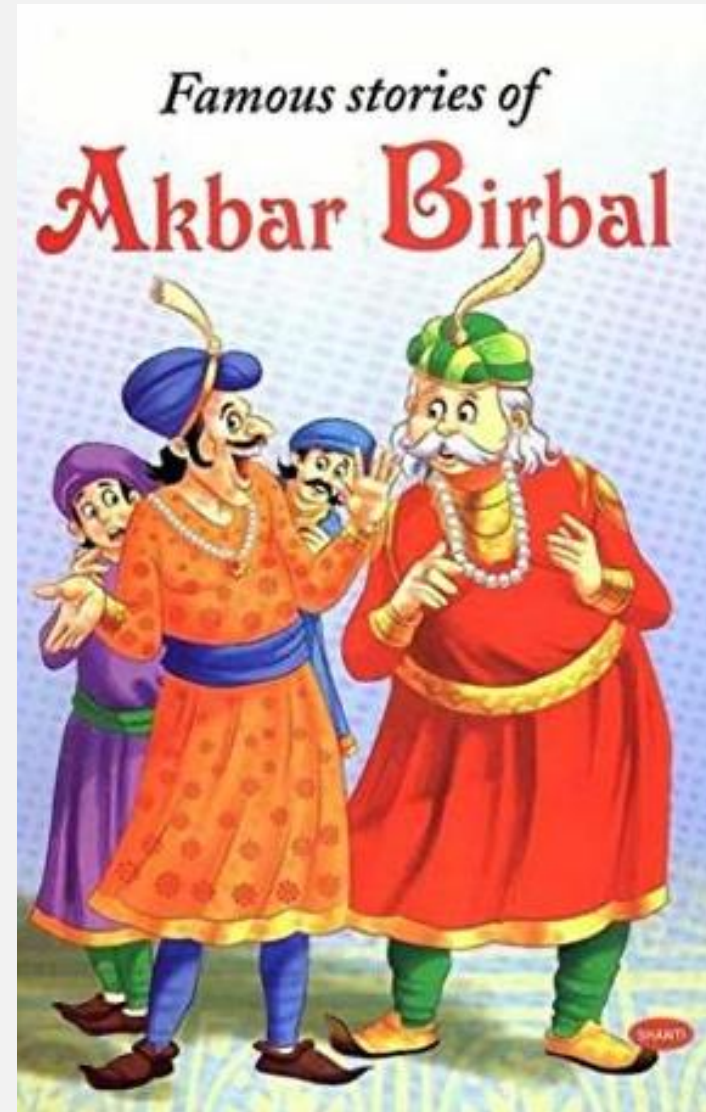
Akbar Birbal

One of the many stories of Akbar, the 16th century emperor of India and his advisor, Birbal, is about a corrupt government official

When he was caught, Akbar wanted to give him a second chance by posting him to a job where there was no scope for corruption.

Birbal challenged the emperor to find such a job

Akbar sent the official to count waves in the river



Book Cover: Good Reads

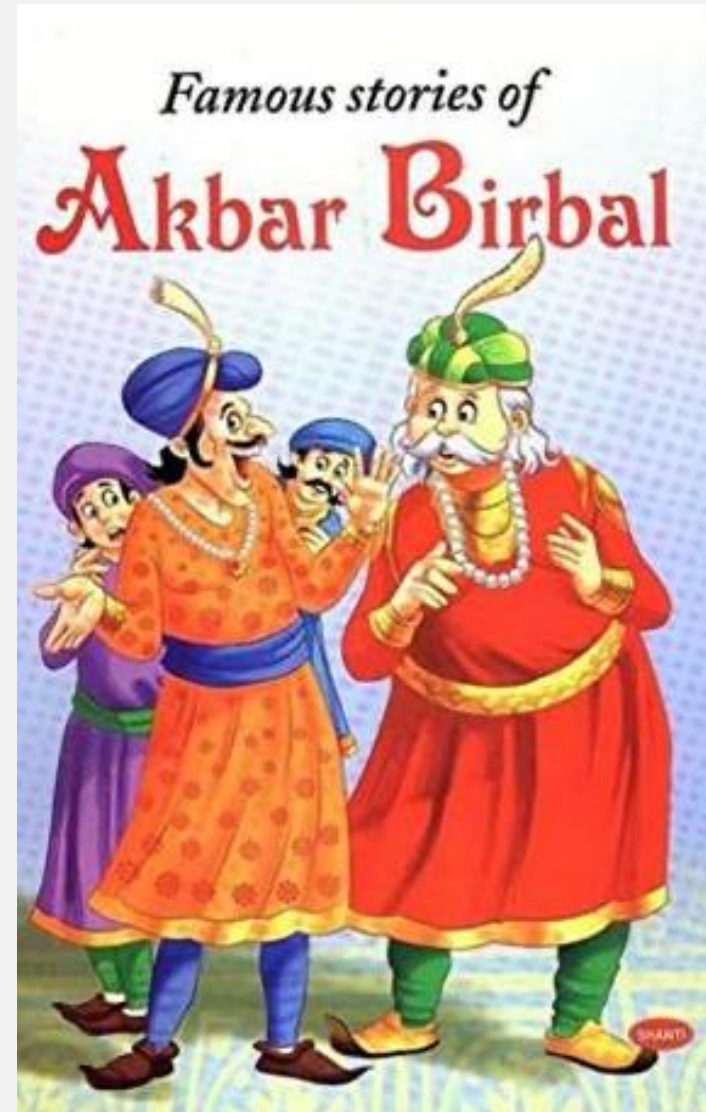
Akbar Birbal

When they went to check on him disguised as fishermen, he appeared to be writing

But as soon as he saw them he yelled:

"Who are you? What are you doing here?" "Do you know you have interfered with some work I was doing under royal orders? I have been appointed to count waves in the river. Now you have come and disturbed me. You will be punished for this."

And asked for a bribe of a hundred gold pieces



Book Cover: Good Reads

Corruption

Corruption is when an official does something he/she is not supposed to do in his/her official role for personal financial benefit

- There is no law against disturbing government officials on the river bank
- The official made up the charge in order to ask for money

Red-Tape

Red-tape is a government procedure that is not necessary for the conduct of a transaction between officials and citizens but makes the transaction more costly in terms of delays/stress/time spent

The procedure could be real or invented by the official

- The official had no business harassing the fishermen

Simple economics of corruption and red-tape: 1

The primary role of the government is to step in where markets cannot work

- Tax collection
- Enforcing laws (driving a motorcycle without a helmet)
- Providing merit goods like healthcare and education to those who cannot afford them (who should get a vaccine?)
- Regulating pollution (preventing the release of chemicals into drinking water)
- Protecting citizens from the market (Ponzi Schemes, adulterated foods)

We recently saw the scandals in admissions to elite universities, which is another case of an institution which wants to resist the market's allocation

Simple economics of corruption and red-tape: 2

In each of these cases certain citizens would want a different transaction than the one the government is offering them

- Pay less in taxes
- Avoid the fine for driving without a helmet
- Get the vaccine even if you are not in a priority category
- Pollute
- Sell adulterated foods

And the government official does not benefit directly from following the rule. She/he may be happy to break the rule (for a suitable fee).

By contrast there are very few rules that a shop-keeper is required to follow:

- She/he makes her/his own rules (sets the prices, plans the inventory)
- And has no reason not to follow them

Simple economics continued

The tax payer who does not want to pay, can offer the tax collector a part of what she/he would have to pay, which is more than what the tax collector would get to keep normally

How do you stop a voluntary transaction that two parties want?

- Which makes them both better off
- In a sense it is the market creeping back in



What's Darth Vader's corrupt brother's name?

Taxi Vader

Simple economics continued

The government makes a rule that such transactions are illegal, and those who get caught pay a fine, go to jail and/or lose their job

This is the rule that some tax payers and collectors will violate: what we call corruption

The government also sets up other procedures to catch defaulters and corrupt officials

- Audits, reporting on what you own, etc
- Only purpose is prevention: red-tape



What's Darth Vader's corrupt brother's name?

Taxi Vader

Photo: Arindam Banerjee, Shutterstock.com | Joke: Joko Jokes

A Moroccan story

There was a policeman and he was corrupt. He always stopped people to ask them for bribes.

One day he worked all day and didn't stop anyone. He realized as the sun was going down that he didn't have anything. So he said to himself, "I'm going to stop the next person I see."

Shortly thereafter, there came a man riding a new moped. The moped appeared to be working fine, the man was wearing his helmet, but the policeman stopped him anyway.



Photo: Shutterstock.com

A Moroccan story

The man's papers were all in order and the corrupt policeman couldn't find a reason to ask for a bribe. He said to the man, "Aren't you scared to be riding out here all by yourself?"

The man answered, "I'm not by myself, I have God and the Prophet with me." The corrupt policeman responded, "Three of you on that little moped? You'll have to pay a fine."



Photo: Shutterstock.com

Simple economics continued

The presence of seemingly unnecessary procedures in government makes it possible to invent more unnecessary procedures to extract money

The policeman is allowed to stop anyone and ask them questions to probe for violations

- So he can continue to probe till he finds something to “work with”

We can get rid of corruption by privatizing the collection of taxes and fines

Sell the right to collect to private entrepreneurs

- Who will now get to keep all of the money
- And therefore would not settle for a bribe

In the case of taxes this is called tax farming

The problem with tax farming

The tax farmers tended to have too strong incentives

- They tried to collect more than they were owed
- Abusing the powers that they had to be given to collect the due amount

It was so hated that most states moved away from it.



Photo: Anonymous [Queen Mary Master], Public domain, via Wikimedia Commons

In sum

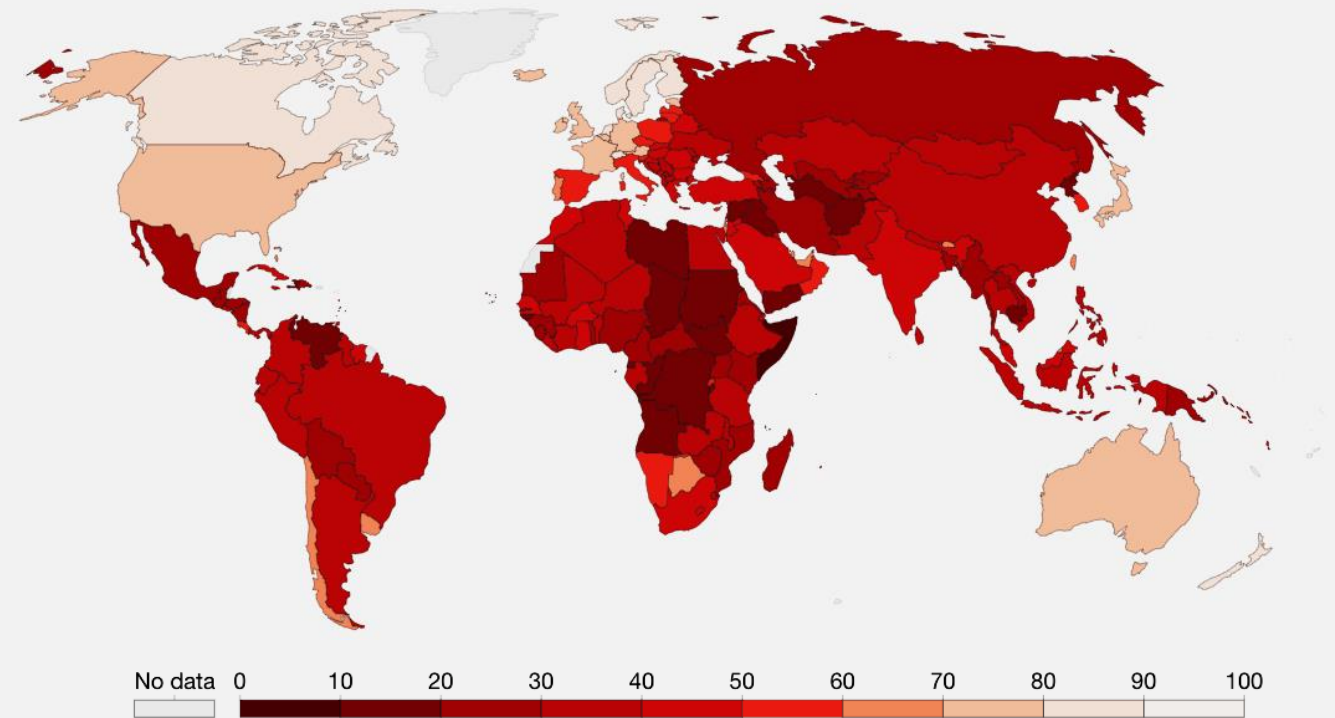
Corruption and red-tape are embedded in the very nature of what the government does, which is to act where the market fails

- For that reason getting rid of corruption is probably unrealistic

Nevertheless perceived corruption varies enormously across countries with rich liberal democracies doing the best

Transparency International's Corruption Perception Index

Scores are on a scale of 0-100, where 0 means that a country is perceived as highly corrupt.



There is a lot we can do to fight corruption

Transparency: In Indonesia making sure that subsidy beneficiaries had a card showing what they were entitled to and that the list of beneficiaries is public reduced leakage by half or more

Direct payments: In India reducing the layers of government which subsidy payments go through led to substantial savings for the government with no losses to the beneficiaries

Incentives: In Pakistan, a small incentive to property tax collectors based on taxes collected, increased collection by 13% (but bribes went up)



But we can also focus too much on corruption

In Italy, government departments (like universities) can procure from the market or from a government recognized vendor, Consip

Since the list of goods that Consip carries varies over time, it is possible to see what happens when a particular good becomes Consip-eligible

The answer is that buyers switch to buying from Consip, and this raises overall cost to the government

The authors argue that buying from the market is efficient (even though there may be some hanky panky) but buying from Consip limits the possibility of being accused of corruption

The bureaucrats prefer to avoid the accusations at the cost of spending more

Capture

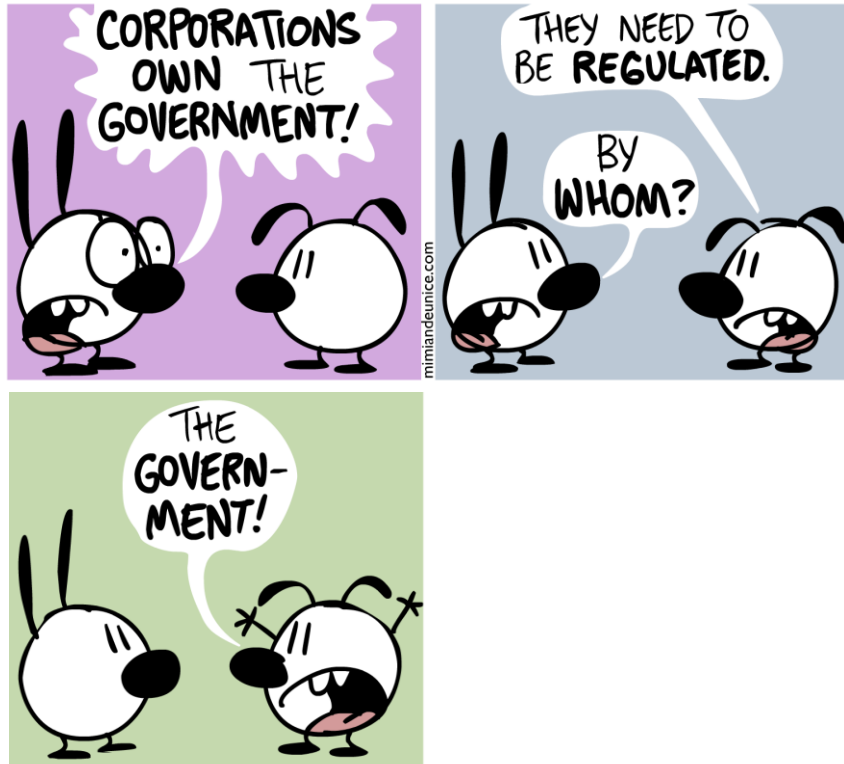


Illustration: Mimi and Eunice | mimiand Eunice.com

The perception that the government favors certain specific interest groups

- Corporates
- Certain countries
- Certain ethnicities
- Certain religions, etc

The perception does not have to be correct

- For example, certain ethnic groups may be beneficiaries of particular government programs, not because of bias, but because they fit the program better
- Blacks in the US are poorer and therefore are more likely to participate in Medicaid
- It may still be perceived as a bias
- And therefore it is widely held that government spending is a waste

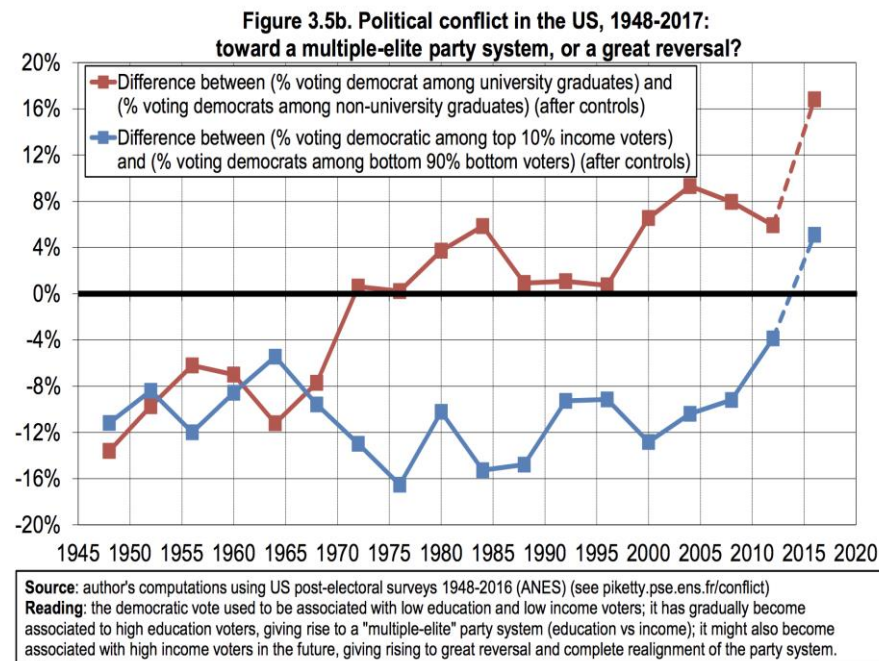
Costs of delegitimizing governments: limits on tax collection

In 2015, 23% of Americans said that they could trust the government most of the time

- 59% had a negative opinion of the government

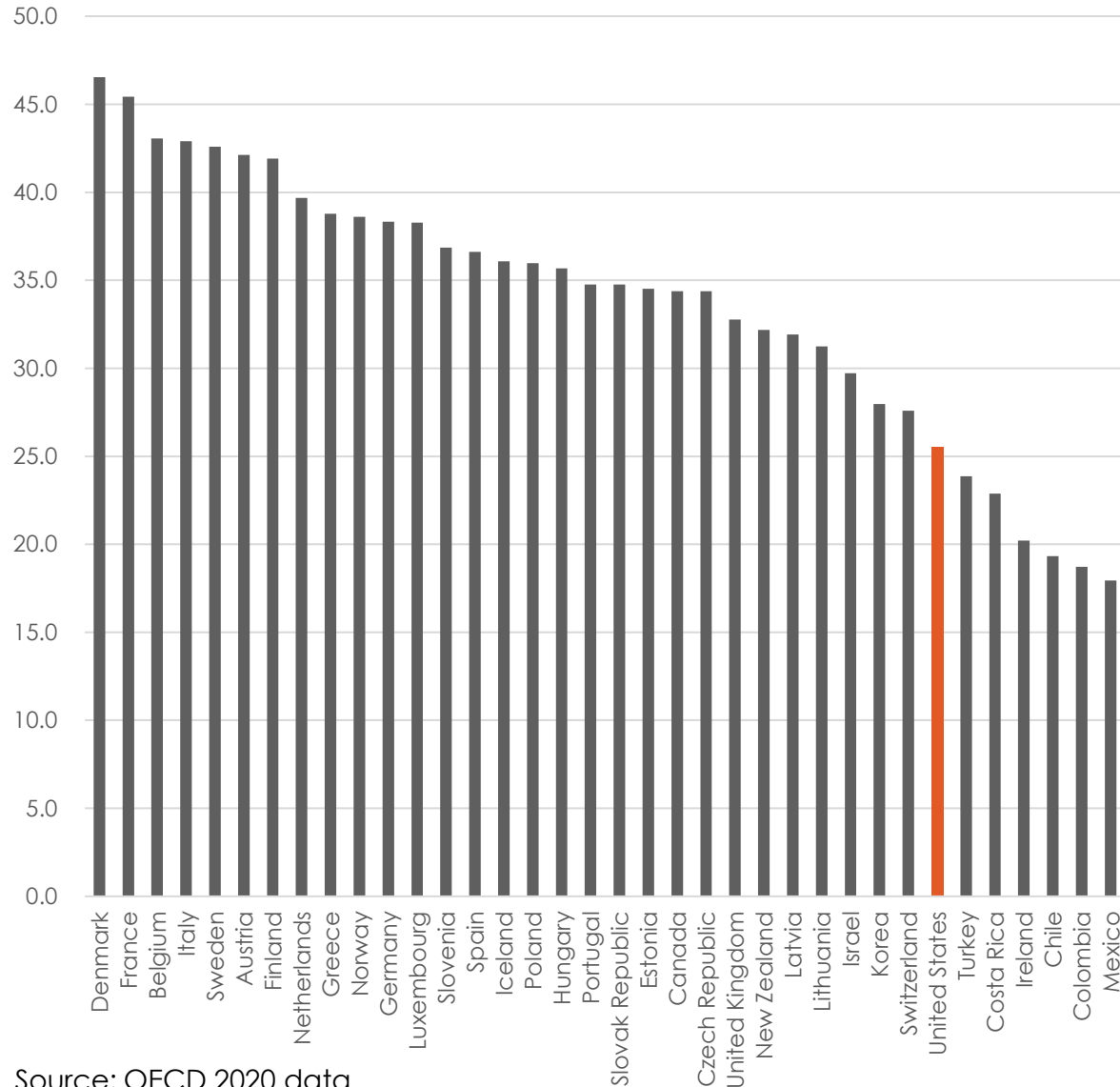
20% thought the government could do nothing to shrink the rich-poor gap and 32% thought cutting taxes would help the poor most

This includes a large fraction of the poorer people who increasingly vote for the right-wing anti-redistribution Republicans



Tax/GDP ratio

Tax Revenue/GDP



Source: OECD 2020 data

The result is that

The US has a very low tax/GDP ratio

It redistributes relatively little

Despite ballooning inequality

And the fact that average real wages are roughly the same in 2018 as they were in 1972

And the fact that social mobility in the US is now lower than that in Europe

Costs of delegitimizing governments: discouraging enterprise among officials

We already saw the example of how Italian officials play safe to avoid being accused of corruption.

The government also fears corruption scandals and therefore ties the hands of its officials to avoid any suspicion of wrong-doing

When purchasing officers in schools and hospitals in Pakistan were given the freedom to determine how they buy basic supplies the government ended up saving a lot of money, because the officials went out and negotiated better prices.

Costs of delegitimizing governments: recruiting the wrong people

In the US just 26% of the population say they trust civil servants who are widely perceived as being stodgy, lazy and corrupt

- Talented young people do not look for government jobs

The bureaucracy has a reputation for being corrupt in India

- An experiment compared aspiring bureaucrats and other job aspirants in how honestly they report the number of heads they found when tossing a coin a certain number of times without being observed
- Would-be-bureaucrats were more likely to cheat, even though they only made 1 rupee for every 2 extra heads

In Denmark, where bureaucrats are well-respected we see the reverse

- The would-be bureaucrats are more honest

Costs of delegitimizing governments: populism

Since voters believe that the government is out of control, they tend to put their faith in (often self-proclaimed)

- Outsiders
- Successful businessmen
- Strong men

With disastrous consequences



Photo: Brandon Stivers | Shutterstock.com

Governments are very far from perfect

But the problems
they wrestle with
offer no easy solution

And abolishing
(or drastically limiting)
governments is not
one them

We need the government
more than ever and
finding a way to restore
faith in its possibilities is
one of the great
challenges of our time