

Government Intervention in the Marketplace

Background

Theoretically, if a perfectly free economy is left alone by government, it will settle into a state where all sellers and buyers will get what they want at a reasonable price. Often, though, the government interferes with the market in an attempt to control and influence economic outcomes.

Even in protracted recessions, economic markets generally correct themselves. But when governments intervene, with the intent to protect or restore market conditions to where they were prior to a downturn, this slows the natural corrective actions of the marketplace and delays recovery.

Next to taxes, the most common form of government interference is subsidies, which reduce the price of a product or service. However, subsidies are horribly inefficient since they usually cost more to implement than the benefits they deliver:ⁱ

- Because subsidies mask the true cost of a product or service, consumption almost always increases.
- Because the providers of subsidized goods are able to bypass open-market competition to sell their product, there is no incentive for them to improve it. This has the ironic effect of delaying the introduction of innovations that would make their product more competitive in a free-market economy.
- Subsidies allow the government to pick economic “winners and losers.”

The following are some examples of how different types of government subsidies have distorted the marketplace:

- Federal corporate average fuel economy (CAFÉ) standards are a good example of how government has distorted the market through its intervention. According to the standards, an automobile

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manufacturer’s fleet of cars and light trucks must, on average, meet or exceed a federally established minimum miles per gallon. Subsidies are also given to manufacturers who incorporate alternative energy sources, such as electric and natural gas, to improve miles per gallon.ⁱⁱ

While CAFÉ standards have increased the average miles per gallon since the oil shocks of the 1970s, gasoline use has not declined. On the contrary, dependence on foreign oil has increased from 37 percent in 1980 to 60 percent in 2010. Moreover, CAFÉ distorts the market by forcing automobile manufacturers to sell large numbers of small, high-mpg cars at a loss, with the balance made up through the sale of larger, more profitable vehicles.ⁱⁱⁱ

- In 2002, the Milk Income Loss Contract (MILC) was created as a part of that year’s farm bill to subsidize the dairy industry by effectively creating a price floor for domestic milk. The program was estimated to cost taxpayers \$1.3 billion, but ended up costing more than \$2 billion. Moreover, the dairy industry was already subsidized with the Dairy Price Support Program, which cost \$500 million per

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year from 1999 to 2004 for the purchase of surplus dairy products.^{iv}

- In fiscal year (FY) 2007, the federal government subsidized or otherwise supported approximately 16,581 energy programs, at a cost of \$16.6 billion. By comparison, there were only 8,194 such programs in FY 1999, at a cost of \$8.2 billion. The plurality of these programs (4,875) went to renewable energy.^v
- The federal government is set to provide \$6 billion worth of tax credits for 2011 to encourage ethanol production. These subsidies have caused the price of corn to increase from an inflation-adjusted \$2.43 per bushel in 2000 to \$6.50 at the end of June 2011.^{vi} Ten years ago, only about 6 percent of the nation's corn crop was converted into ethanol. By 2009, 32 percent of all the corn grown in the U.S.—4.3 billion bushels—was earmarked for ethanol production.^{vii}

Using much of the nation's corn crop to make fuel is having serious global effects. Although record crops of corn have been produced over the past five years, the USDA predicts global production of 866.2 million tons will still not meet demand of 871.7 million tons for next year.^{viii} And, because corn is used as a component of many foods, its scarcity will likely make grocery prices jump, not just in America, but worldwide.

Policy Consideration

According to The Heritage Foundation's most recent *Index of Economic Freedom*, the nations of the world that are most likely to recover the quickest from the current recession are those which have embraced the concepts of private property and freedom in business, finances, labor, and trade. Moreover, higher levels of economic freedom are also associated with higher per-capita incomes and higher levels of well-being.^{ix}

Recommendation

The federal government should begin removing tax subsidies and direct support programs for specific

industries in exchange for lower marginal tax rates for all marketplace participants. Rather than picking winners and losers in the marketplace, the government should create equal opportunities for success and leave the economic outcomes to consumers.

Further Reading

- Ambassador Terry Miller, "Government Intervention: A Threat to Economic Recovery. Testimony before The House Committee on Foreign Affairs' Subcommittee on Terrorism, Nonproliferation and Trade, June 10, 2009. Available at <http://tinyurl.com/4pmze2j>. Access verified August 4, 2011.

ⁱ Peter J. Wilcoxon, "Effect of a Subsidy." Maxwell Microeconomics (web). October 1, 2005. Available at <http://tinyurl.com/6hpprev>. Access verified July 1, 2011.

ⁱⁱ Dirk Chase Eldredge, "CAFÉ Standards Have Nothing to Do with Lunch." Following Fossil Fuels (blog), August 1, 2011. Available at <http://tinyurl.com/4xvjc7e>. Access verified October 10, 2011.

ⁱⁱⁱ *Ibid.*

^{iv} "CAGW Slams Milk Income Loss Contract Program." Citizens Against Government Waste, press release, December 5, 2005. Available at <http://tinyurl.com/3ss5vg6>. Access verified August 5, 2011.

^v "Federal Financial Interventions and Subsidies in Energy Markets: 2007." Energy Information Administration, Office of Coal, Nuclear, Electric, and Alternate Fuels, April 2008. Available at <http://www.eia.gov/oiaf/servicert/subsidy2/pdf/subsidy08.pdf>. Access verified June 30, 2011.

^{vi} "Price of Corn." June 30, 2011. Available at www.quotecorn.com. Access verified June 30, 2011.

^{vii} "Table 852. Principal Crops—Supply and Use: 2000 to 2009." In U.S. Census Bureau, *Statistical Abstract of the United States: 2011*. (130th Edition) Washington, DC: 2010. Available at <http://tinyurl.com/4npsv3e>. Access verified June 30, 2011.

^{viii} Whitney McFerron and Jeff Wilson, "Corn Stocks Plunging to 1974 Low as China Adds Brazil-Sized Crop to Demand." *Bloomberg* (website), June 20, 2011. Available at <http://tinyurl.com/4yyap5g>. Access verified June 30, 2011.

^{ix} Ambassador Terry Miller and Kim R. Holmes, *2011 Index of Economic Freedom*. The Heritage Foundation, January 2011. Available at <http://tinyurl.com/6dewqfu>. Access verified August 4, 2011.