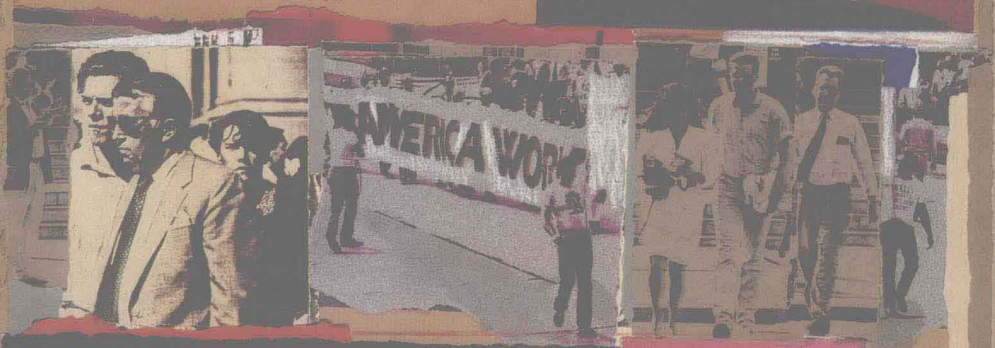
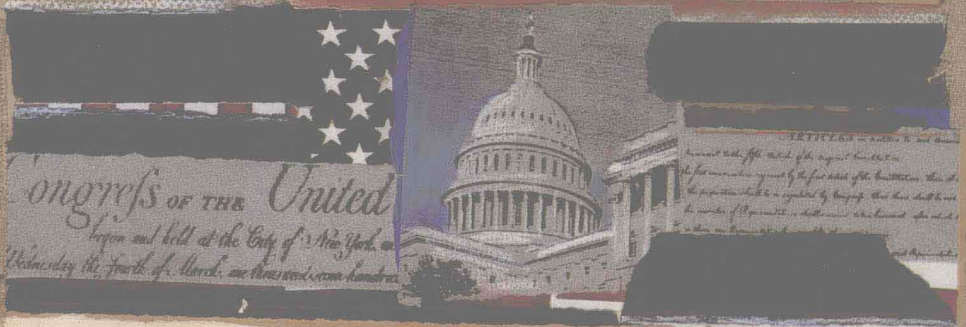
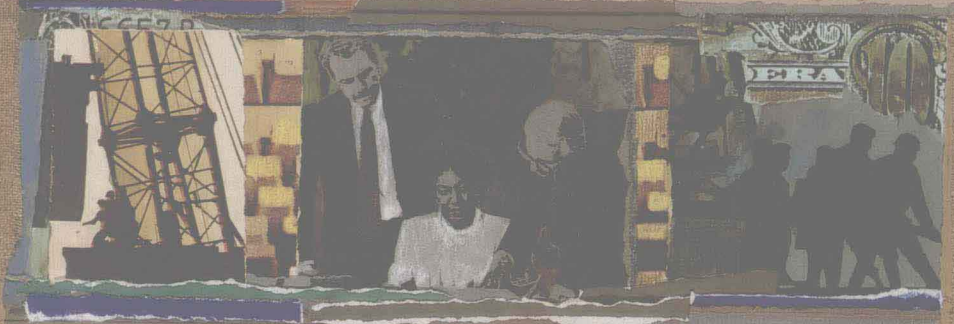


ENTERPRISE, GOVERNMENT, AND THE PUBLIC

STEPHEN J. K. WALTERS



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ABOUT THE AUTHOR

STEPHEN J. K. WALTERS received his B.A. in economics from the University of Pennsylvania in 1975, worked in the research department of the Federal Reserve Bank of Philadelphia, and then began graduate study in economics at the University of California at Los Angeles. He received his Ph.D. in 1982. He is currently associate professor of economics at Loyola College in Maryland, where he has been responsible for undergraduate and MBA-level courses on government regulation of business since 1981. His published research covers such topics as antitrust economics, economic and social regulation, privatization, and academic research productivity. He also has written over a hundred general-interest articles appearing in major newspapers, and he often serves as a consultant on matters involving antitrust, contracts, and corporate valuation.

PREFACE

In the last two decades, economists have learned a great deal about the complex interaction of government and enterprise. The new branch of economics called public choice analysis has shed much light on the motives and effects of government intervention in markets. A heightened appreciation of the importance of the costs of transacting has led to the development of many new hypotheses concerning firm behavior. The field of mathematics known as game theory has revolutionized the way in which economists view the interaction of rivals and the strategic behavior of firms. And enough time has elapsed for scholars to study the effects of the regulatory boom of the early 1970s and the experiments in deregulation of the 1980s.

Sadly, however, many texts in the field of business and government simply have not kept up with the pace of change. While most update their descriptions of policy and law periodically, they generally have failed to incorporate new analytical tools and perspectives in their treatment of standard issues. Many texts lack any mention of such crucial topics as public choice theory, transaction cost economics, incentive-compatible regulation, privatization, nonprice predation, and behavior aimed at raising rivals' costs. In addition, many fail to explore fully the policy implications of rent seeking, the economic theory of property rights, the market for corporate control, and the Coase theorem.

I've tried to make this text up to date both descriptively and analytically. Readers will encounter the latest insights and findings of leading researchers on the topics listed above and many more. However, I have avoided higher mathematics in favor of verbal, numerical, or geometric exposition, and I have tried to make the writing crisp and readable. Readers who have had no more than an introductory microeconomics course should find the material accessible, while readers with more extensive backgrounds in economics should nevertheless find it interesting and challenging. And all readers should find that they develop a mature appreciation for both the power and the limitations of markets and of government regulation of them.

To emphasize that the analytical tools which readers will master are relevant to practical affairs, I have included abundant illustrative material throughout the book. The longer, more detailed illustrations are specially labeled as

vignettes. The dictionary tells us that a vignette is a “short, descriptive literary sketch.” I don’t know how “literary” the vignettes I have included are, but they are usually written in a less ponderous style than is typical of textbooks. They appear whenever I thought it desirable to step back and address what I think are some basic but important questions readers might have (e.g., Is this analysis valid? How does it apply to the real world? How does it relate to other material I’ve read earlier?). I think the vignettes are long enough to provide sufficient detail to be useful, but not so long that they will cause readers to lose the thread of the main discussion.

Other Features

The text has many additional distinctive features:

- The introductory section (Part One) includes not just a discussion of the history and nature of government intervention in economic affairs and the various public-interest rationales for it, but also an entire chapter on peculiarities of the “political marketplace.” What is more, important elements of public choice analysis are woven throughout succeeding chapters.
- The treatment of antitrust issues (in Part Two) balances an institutional and theoretical perspective. Readers should get enough factual or descriptive knowledge of business behavior and government policy that they know what is and is not accepted practice. But they should also master those economic models that can help us understand why consumers, business firms, or enforcement authorities do what they do and can help us predict the consequences of these actions.
- Two special chapters in Part Three (on economic regulation) provide useful case studies of key regulated industries, including provocative discussions of the impact of regulation in agricultural markets and the savings and loan industry.
- Sophisticated yet accessible chapters on social regulation (in Part Four) will enable readers to make sense of the issues that are the stuff of today’s headlines, e.g., pollution control, “drug lag,” hazards facing workers and consumers, and the “tort crisis.”
- A final chapter summarizes and unifies the text and discusses some systematic forces that will guide the progress of regulation in the future.
- End-of-chapter summaries genuinely facilitate reader review, and end-of-chapter questions provoke thought and force readers to apply what they have learned. (Answers to the questions are provided in a separate *Instructor’s Manual*.)

A Special Note to Students

Studying the interaction of enterprise and government should have a very tangible payoff: It will almost certainly make you a better manager or policymaker. In the United States, the various levels of government directly spend about

40 percent of annual national output and affect how the remainder is produced or consumed in countless ways. Clearly, then, modern managers must know a great deal about the nature and effects of government regulation, and policymakers will want to learn about the patterns of business behavior that carry the potential for social harm.

I hope, in addition, that this book will prove interesting to those who plan never to manage a firm or formulate public policy. Most often, government intervention in economic affairs signals either that market organization of productive endeavor entails some important deficiency or that there is some equally important deficiency in the political process that gave rise to the intervention. Thus, when we study the interface of enterprise and government, we confront circumstances where our most powerful institutions are, in some sense, failing us. Such study can be alternately exhilarating or deflating, but it will usually be challenging. Those who rise to the challenge will learn a great deal about ordinary human conduct and so eliminate some of the mystery about the way the world works. At the very least, this should make them happier, better-adjusted people, for in a complex, ever-changing world, ignorance definitely is *not* bliss.

I have tried to make the writing in this book as “reader-friendly” as possible. This does not mean, however, that it can or should be read at the pace of a drugstore novel. One error students commonly make in reading textbooks—especially economics texts—is that they move along too rapidly, and without appropriate stops along the way to think about what they have read. So go slowly; try to interact with the text. Ask yourself lots of questions as you read, apply the tools discussed to new situations, and evaluate whether the assertions made are consistent with your own experience. The investment of time will pay off in vastly improved comprehension.

ACKNOWLEDGMENTS

I have imposed on many friends and colleagues in the process of developing this book. I owe them all a great debt, for they have significantly improved the product and saved me from many errors of commission and omission. If some errors remain, it is entirely my own fault. Those who have reviewed or class-tested some of or all the book include: Kathleen A. Carroll, University of Maryland, Baltimore County; Christopher B. Colburn, Old Dominion University; Joseph P. Fuhr, Jr., Widener University; Rick Geddes, Fordham University; Steve H. Hanke, The Johns Hopkins University; Thomas W. Hazlett, University of California, Davis; Herbert Kessel, St. Michael’s College; Benjamin Klein, University of California, Los Angeles; Mark E. McBride, Miami University of Ohio; William S. Reece, West Virginia University; Bruce Seaman, Georgia State University; William Sjostrom, Northern Illinois University; Robert J. Stonebreaker, Indiana University of Pennsylvania; Nancy Williams, Loyola College; and Peter Zaleski, Villanova University. I thank them all.

I also must acknowledge the contributions of many others who were instrumental in getting this project started and seeing it through. Becky Ryan and Bill Webber both helped convince me it was worth doing, and Nick Miggins convinced me McGraw-Hill was the best publisher for the job. Scott Stratford, Iness Snider, and Caroline Izzo have been models of efficiency and patience in guiding a rookie author through the production process. Bonnie Nauman, Mary Kontorosis, and the staff at the Milton S. Eisenhower Library provided able assistance throughout this book's lengthy gestation period. Most of all, I would like to thank all my friends and family members, who put up with more than my usual volume of absentmindedness while I was preoccupied with this project.

Stephen J. K. Walters

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**OVERVIEW: HOW AND
WHY GOVERNMENT
INTERVENES IN MARKETS**

- CHAPTER 1** WHAT GOVERNMENT DOES: REGULATORY ACTIVITIES
- CHAPTER 2** WHAT MARKETS DO: COMPETITION AND EFFICIENCY
- CHAPTER 3** GOVERNMENT INTERVENTION AND THE PUBLIC INTEREST
- CHAPTER 4** CAPTURE THEORY AND BEYOND: THE POLITICAL MARKETPLACE