

# Mackintosh School

## Built Environment Level 1

ECONOMIC CONCEPTS 4:  
Workers of all nations Unite!  
... but is revolution really the answer to market failure? The failure of planned systems and the mixed economy of welfare  
Gwilym Pryce

2/7/2007

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Notices:

- Feedback forms

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# Aims and Learning Objectives:

## Aim:

- To introduce students to the arguments against intervention and planned allocation

## Learning Objectives:

By the end of this lecture students should be able to:

- understand what is meant by state intervention & failure;
- know the main areas of state failure
- consider the problem of choosing the appropriate mix of market and state provision.

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## Plan:

- 1. Market Failures
- 2. Efficient Intervention
- 3. State Failures
- 4. Mixed economy



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# 1. Market Failures

- i) Failure of Competition
- ii) Public Goods and Externalities
- iii) Incomplete Markets
- iv) Information Failures
- v) Macro Instability

# 2. Efficient Intervention

- Efficient intervention assumes the following:
  - Policy maker has perfect knowledge
    - of every individual's response to policy & its incentives
  - Societies preferences are accurately & unambiguously reflected thru the democratic process
  - No adverse effects on priv. sector or work incentives
  - Beaucroatic process is a neutral element to intervention:
    - i.e. it does not distort policy outcomes or itself produce adverse effects for society
  - Policy maker seeks only the good of society
- We know that markets fail, but on the other hand...

### 3. Intervention Failures:



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### 3.1 Information Problems

- In reality, the state suffers from imperfect information, just like the market
  - => policies can have unforeseen perverse incentives or unintended outcomes
- e.g. **Social Housing Schemes:**
  - Many failed social housing schemes in the Glasgow area alone:
  - Perhaps the most infamous is Moorepark:
    - see Sean Damer's book: "From Moorepark to "Wine Alley"

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### ○ Inter-war tenements (3-storey walk-up flats)

- Moor Park, Govan ('Wine Alley')
- Built: 1930s
- Many of this type of flats have been modernised or demolished across the city.

### ○ 2-storey semi-detached houses for owner-occupation

- Kinfauns Drive, Drumchapel
- Built: 1990s
- A social experiment in 'class integration', surveys show that this does not happen.



### ○ 4-storey flats and maisonettes

- Newfield Square, Priesthill/Pollok
- Built: 1950s
- To be demolished as soon as funds are available.

### ○ High rise flats

- Sighthill (and many others)
- Built: 1960s
- A long-standing problem; currently it is too expensive to replace them.



### ○ Deck-access flats

- Darnley (now largely demolished)
- And Hutchesontown 'E' (demolished)
- Built: 1960s
- The worst housing ever devised!

### ○ 2-storey terraced houses (system-built, originally with flat roofs)

- Petersburn, Airdrie
- Built: 1970s
- Now in a 5-year programme of clearance.

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### ● e.g. **Planning System**

- overall structure plan (regional or county levels)
  - sets out the broad lines of development by zoning land & relating to strategic objectives
    - (e.g. how many private houses have to be built)

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### ○ Problems:

- Info Probs: accuracy of 'predict & provide' methodology of zoning land for house-building:
  - effect of demographic factors not straightforward (endogenous new Household formation);
  - how ascertain location preferences (land released in areas where no demand).
- Failure of democracy: How reflect preferences of population?



### ○ rent-seeking:

- planning permissions become a commodity which HHs/B/Os spend money to obtain by campaigning etc.
- But lobbying is an unproductive activity, & diverts resources away from productive activities
- NB rent seeking arises because policy makers have imperf. Info re best option, society's views etc.



- Invites Corruption:
  - outcome may be optimal for the planner but not for society!
- Perverse Incentives caused by Plan<sup>9</sup> Perms System:
  - incentive to 'land-bank': developers become landowners:
  - buy land eligible for Planning permission & hold on to it until it is most profitable to sell/develop
  - ⇒ speculative & volatile land markets

## Further problems with Land Planning:

- Less resp to individ prefs than taxes & subsidies
  - e.g. may underestimate value of existing land use -- redevelopment damage communities etc.
- Case by case planning
  - ⇒ delays & stilted supply
- Tends to reactive than proactive:
  - less successful in initiating developments
- Unintended economic conseqs:
  - higher house prices
    - restricted supply pushes up house prices ⇒ limits access to home ownership for lower income groups



# Other examples of “unintended consequences”

- e.g. **1 Council Tax (Muellbauer)**

- Regressive:

- ‘Imagine a tax where the owner of a Ford Fiesta pays proportionately four times more per pound than the owner of a Rolls-Royce, where second and third cars pay half the rate of first cars and where there is a huge discount if the owner lives in Kensington compared with Liverpool’ (Muellbauer & Cameron, Financial Times, 8/3/2000)

- Adverse Environmental Effects:

- “houses greediest for space, in the most expensive locations and belonging to those with more than one home attract the lowest tax rates. But it is the small homes that are most highly taxed, despite the trend toward smaller families’

- Work Dis-incentives of council tax rebate

- Exacerbates regional differences in house prices



- E.g. 2 **MIRAS**
  - caused outward shift of dem, but steep supply curve
- E.g. 3 **Rent Controls**
  - caused excess demand and a fall in supply
- E.g. 4 **Housing Benefit**
  - up-marketing & work incentives
- E.g. 5 **Council House 'Affordable' Rents**
  - => flat rent structure => sub-optimal allocation of housing (e.g. single divorcee stay in large house)

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- E.g. 6 **GP Fundholders & Purch/Provider**
  - Incentive for GPs to ditch unhealthy patients!
- E.g. 7 **University RAE**
  - Incentive to avoid students & teaching!
  - Disloyalty Incentives: one day census.
- E.g. 8 **Police**
  - Incentive not report crime
- E.g. 9 **Schools**
  - Incentive not to admit less capable pupils

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## 3.2 Decision Problems

- Prob of Designing Simple but Effective system

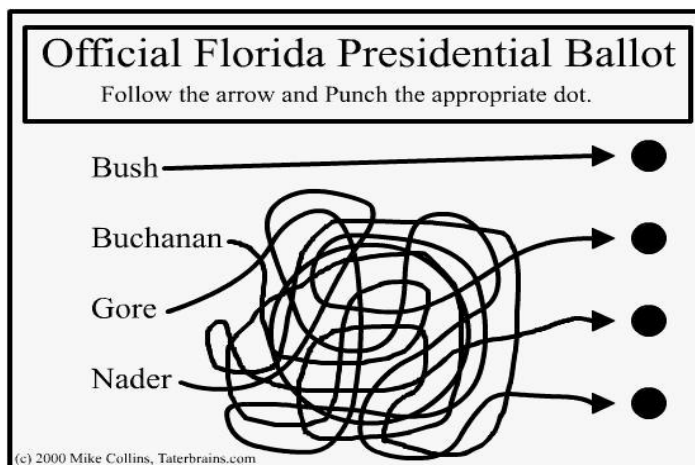
- e.g. Florida:

- Fragility of Voting systems\*: Voters easily confused
- 1st past the post system brks down if votes 50:50

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## \*Fragility of voting systems...



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- Problem of preference revelation: how aggregate preferences without causing ambiguity & contradiction
  - A majority voting 'equilibrium' may not exist:
    - Policy A preferred by majority over policy B
    - Policy B preferred by majority over policy C
    - Policy C preferred by majority over policy A
  - Arrow's Impossibility Theorem:
    - impossible to find an alternative, non-dictatorial political mechanism that resolves the problem of majority voting
- Tendency towards political homogeneity:
  - Incentive to appeal to median voter even though not the preferred ideology of the majority

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### 3.3 Crowding-Out

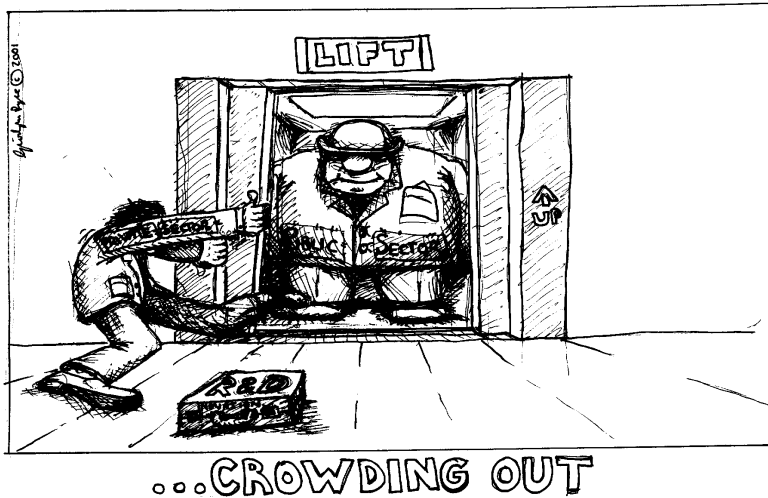


- Zero Sum Game:\*
- State activity may simply displace private activity, particularly if state goes beyond providing public goods:
  - 'The important thing for Government is **not to do things which individuals are doing already, and to do them a little better or a little worse**; but to do those things which at present are not done at all' (Keynes)
  - Growth in public sector coincided with collapse of manufacturing & argued that this bec. the state used resources that private sector could have used

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## \* Zero Sum Game



## Crowding Out Examples:

- E.g. Best land given to social housing
- E.g. Council house construction employed scarce skilled labour
- E.g. Effect of tax: debt laffer curve (see Economist Article)
- E.g. Effect of borrowing:
  - issue of bonds soaks up demand for debt in stock market -- private sector can't compete bec higher risk
  - causes inflation (borrowing to spend, rather than spending on the basis of increased output)

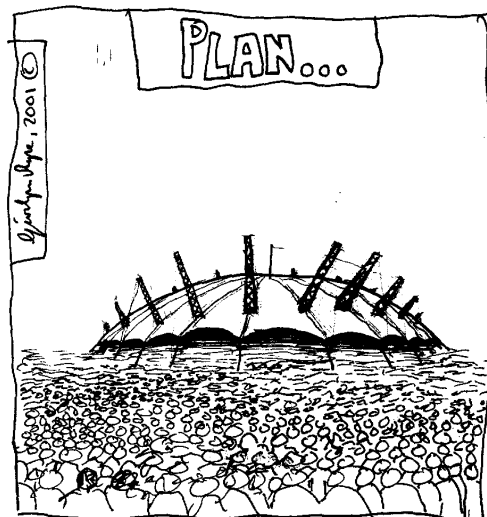
## 3.4 Failures of Bureaucracy

### ● Implementation Failures:\*

- G. set up agencies to carry out policies => complex control mechanisms, long chains of decision-making & complex management systems.
  - E.g. Dome Vs Millennium Wheel

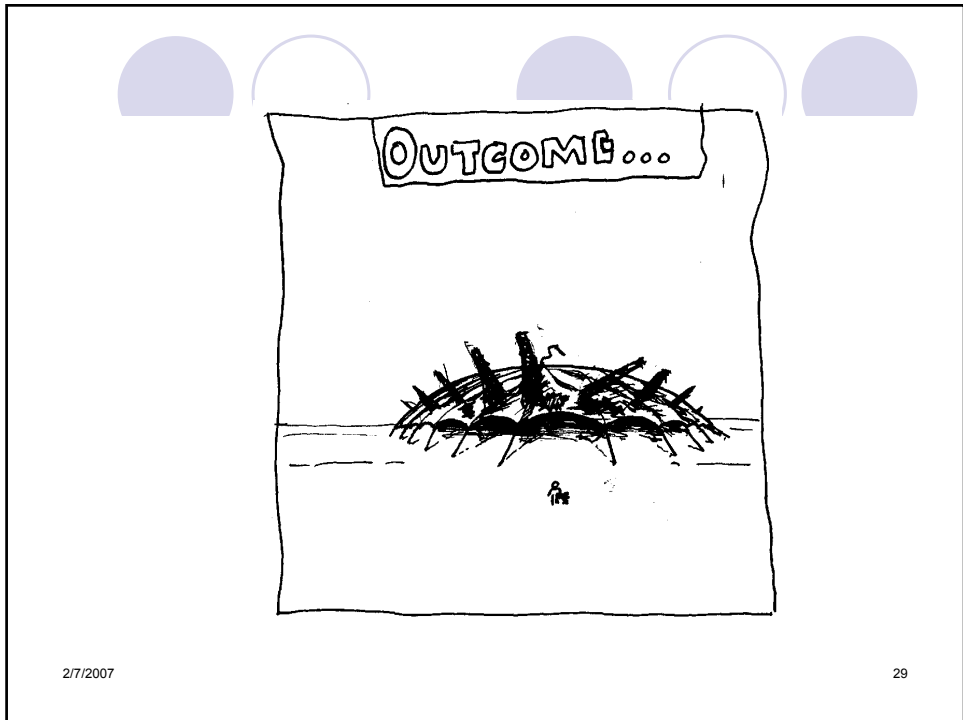
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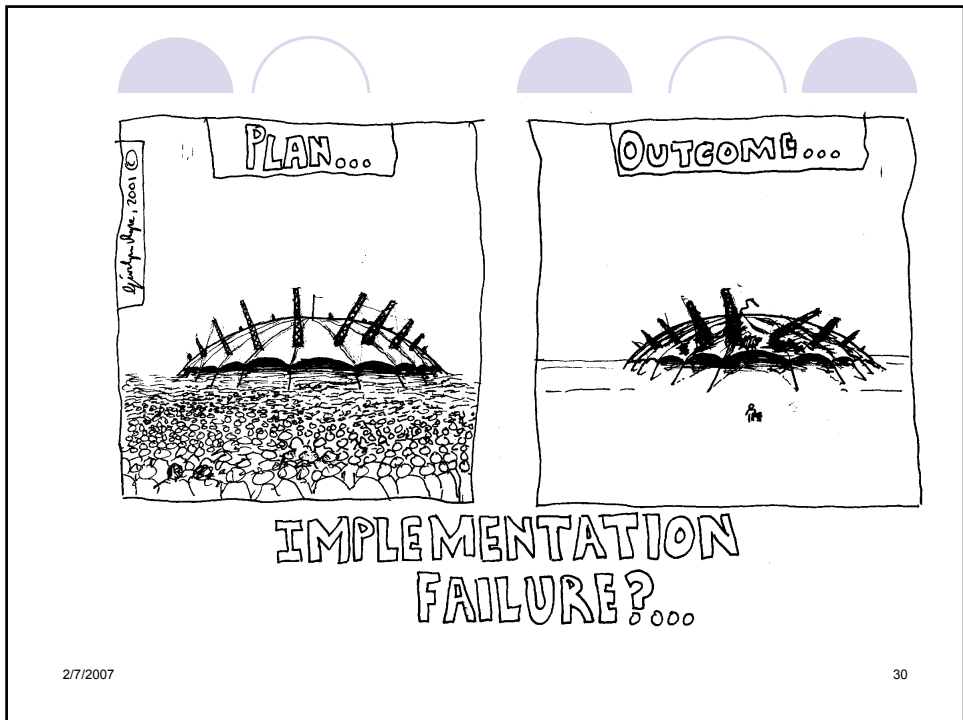
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## E.g. Collapse of £900m NHS campus (BBC Online, 30 Jan 07)

- The public accounts committee said the government had left the Paddington Health Campus project to local managers who were "out of their depth".
  - The project, designed to merge three north-west London hospitals, was abandoned after costs rose by £300m.
  - would have merged St Mary's, the Royal Brompton and Harefield hospitals, was approved in October 2001.
  - Health bosses thought it would be finished by 2006 but the projected costs more than doubled and the completion date slipped to 2013.
  - The North West London Strategic Health Authority withdrew the plans in June 2005 but only after £15m costs had been run up.

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- The MPs found that the Campus partners, overseen by the SHA which has now been scrapped, were imprudent in submitting a business case in 2000 which was "manifestly inadequate". They said at that stage, health chiefs had not even consulted their own doctors and nurses and were thus unable to determine with any degree of accuracy the land requirements and likely costs.
- The eventual collapse of the scheme can be traced directly to the ill-informed decisions taken at the outset by the NHS in north west London, the MPs said.

### **Moral of the Story:**

- People who are good at getting elected or at passing civil service exams, aren't necessarily good at managing large, important projects.

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- E.g. Scottish Parliament
- E.g. 2012 London Olympic Village
- + Myriads of examples of incompetent decisions at all levels of government and public sector provision...
  - State failure can be just as bad as market failure.

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- Rent-seeking
  - developers lobby for planning permission
  - environmentalists lobby for containment
  - but lobbying itself is a non-productive activity & distorts democracy: richest lobbyist most powerful

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- Inflexible:

- cw market, centralised decision making bodies have difficulty adapting rapidly to changing conditions.
  - E.g. delays associated with changing tax rules (MIRAS), or possessions policy (Scotland), or changing demand for housing (LA housing & low demand)
- Red Tape tangles up private sector decisions also
  - e.g. Urban partnerships & regeneration

- X-inefficiency - not min[ave. costs]

- lack of competition in public sector => no incentive to minimise costs of production.
- Evidence: Growing real cost of public sector output



- But Baumol:

- two fundamentally different classes of output:
  - technologically productive activities: econs of scale, capital accumulation & innovation => cumulative increases in output per worker
  - technologically unproductive activities: none of the above possible; but real living standards cont to rise & so wage bill rises without equiv. increases in output
- much of public sector fall into latter category
  - teaching, health, social work, social housing managt



## 3.5 Absence of Altruism:

main goal of policy maker may be to maximise own welfare

- Budget Maximisation:

- Niskanen argued that senior bureaucrats want to max[salary, promotion, bur<sup>c</sup> power, public reput<sup>n</sup>]
- => achieved by max[departmental budget]
- effectively in bargaining game with politician who want to minimise budgets:
  - outcome depends on bargaining strength of the 2 parties
- but:
  - public sector outputs v. difficult to measure;
  - only bureaucrat knows true costs of production
  - polit<sup>cons</sup> temp, thus easily duped by long standing bureau<sup>ct</sup>.

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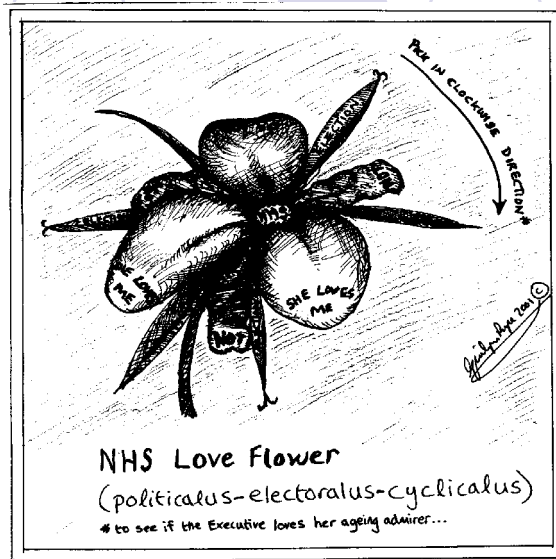


## ● Political Business Cycles:

- Nordhaus (1975) & Alesina (1989)
- Incumbent governments manipulate economy to maximise their chances of re-election
- In the lead up to elections they boost the economy by cutting taxes and increasing public spending
- Try to undo the damage in the first year or so following election by cutting back exp., ↑ taxes
- pursuit of self-interest by politicians destabilises the economy, not optimal for soc<sup>y</sup>

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## ● Partisan Theories:

- 'A government which robs Peter to pay Paul can always depend on the support of Paul' (G.B. Shaw, 1944)
- Hibbs assumed a trade off between inflation and unemp.
  - Political parties distinguished by their views on income redistrib<sup>n</sup>
  - Left: redistrib income to lower middle class; Right: to upper
  - Inflation erodes real value of money assets which are held in greater proportion by upper middle classes
  - Unemployment affects lower middle classes most severely
  - => Left choose policies that => high infl & low unemp
  - => Right choose policies that => low infl & high unemp
- But Blair says Class War is over & so Partisan Theory no longer relevant...

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## 4. How Should Market & State Work Together?

- Marx saw the state as legitimising and buttressing the hegemonic coercion of the ruling class, artificially prolonging the doomed capitalist system
- Free market libertarians see the state as inefficient, oppressive and interfering.
- We have looked at...

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the Invisible Hand (or Emperor's clothes?)  
of the Market...



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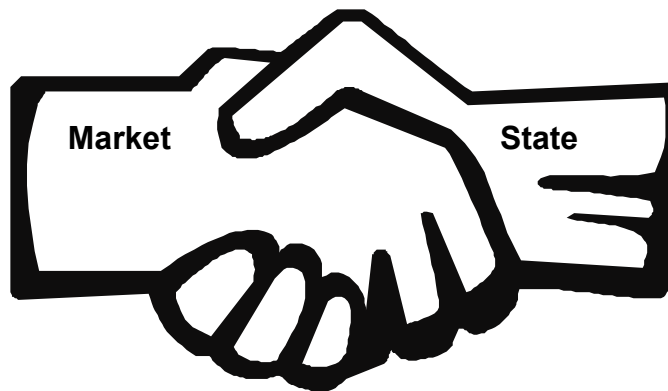
...and the Very Visible (helping?) Hand of the State...



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In most countries, allocation of resources is via a mixture of the two:



**Best of both worlds?**


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# Summary

- In this series of five lectures we have looked at:
  - the different perspectives of economists and planners/architects
  - the role and working of the market
  - the assumptions necessary for efficient mkts and the “amazing” outcome in terms of allocative efficiency if these conditions are met.
  - Market failures
  - State failures

- 
- The goal has been to:
    - introduce some key economic concepts and controversies,
    - To help you understand the world you live and work in:
      - Why some goods and services are provided by the private sector and some by the public sector
      - Why some have argued for a greater role for the market and others have argued for a greater role for the state.



○ I have tried to encourage you to think critically:

- About the economic causes & consequences of your actions as architects/planners.
- About whether architects should be more democratically accountable for what they build.
- About the way society allocates resources and the implications for housing and planning.
- About how the bigger forces of social and economic change shape your role.
- About whether your future role as an architect (and the wider architecture community) will pander to, and legitimise, a system of resource allocation that is fundamentally unjust, inefficient, and ultimately unsustainable.

## Reading:

- Chesire, P. and Sheppard, S. (2000) "Building on Brown Fields: The Long Term Price we Pay", *Planning in London*, 33, April/June, pp 34-6, available at: <http://econ.lse.ac.uk/staff/francois/realsepapers/bbf.pdf>
- Chapters 1 & 7 of Pennington, M. (2000) "*Planning and the Political Market*", The Athlone Press, London, ISBN 0 485 00606 5 PB
- Sean Damer (1989) *From Moorepark to "Wine Alley"*, Edinburgh University Press



# Role of Architecture in the Economy:

- <http://www.buildingfutures.org.uk/>
- Eric Loe (2000) *“Value of Architecture: Context and Current Thinking”*
  - *“Architecture is the only art that is wholly related to economics. The architect can virtually build nothing – and so cannot express his creative art – without incurring definite ‘costs’, which have an economic ‘value’”* (I.E.D. Jefferiss  
Matthews OBE: Address to the RIBA Conference, 1956)
- Ken Worpole (1999) *“Value of Architecture: Design, Economy and the Architectural Imagination”*