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When Technology + The Market = Freedom

by Stephen Lazarus

Is the era of "big government" over, as President Clinton suggested in his State of the Union Address in 1996? Dr. Richard McKenzie answers a confident "Yes" in his contribution to *Limiting Leviathan*, a new book from Public Interest Institute to be published in 1998.

McKenzie points out that many governments around the world have actually stopped growing relative to their gross national product. They are even ardently pursuing pro-market policies — lowering their marginal tax rates, cutting spending, deregulating industries, and privatizing services previously provided by government. How did this happen? While statutory and constitutional limits on government power have played an essential role, he explains, often important economic and technological changes have undermined the taxing and regulating powers of governments. These developments help explain why "big government" has lost much of the appeal it enjoyed earlier this century.

How have economic and technological changes reined in the power of government and limited its control over the economy and wealth of its citizens? First, McKenzie argues, new technologies have transformed capital from "captive capital" to "quicksilver capital." Capital — understood as goods and wealth used to produce other goods (factories and equipment are industrial examples) — has become smaller, lighter, and more mobile. With the development of new information-based technologies, such as computers, production becomes not only more efficient, but also more difficult to tax and regulate.

In the Industrial Age and into the 20th century, much industrial expansion required the building of larger and larger plants often located near major markets and important resources. When production is centralized in this way, government can easily tax and regulate the large concentrations of plants and equipment entrepreneurs develop. The risk of owning "captive" or immobile capital, McKenzie explains, is that, like a static oil well, it is subject to being "tapped" or "drained dry" through excessive taxation.

The promise of "quicksilver capital" is its ability to make the production process more mobile and efficient, without requiring ever more space for production. Computers were once huge mainframe systems used only by big businesses and governments. However, thanks to microchips, desktop and laptop computers have revolutionized business, freeing information, money, and other assets from national boundaries.

The shift to an information-based economy has made the ingredients of the production process more intangible. In the 19th century, land was a much more important factor, and could easily be taxed. Today, brain power, ingenuity, and information technology, like the latest software, have become the critical factors which give entrepreneurs a competitive edge. These assets are more difficult to control, tax, and regulate than physical property. "They can be sent across national borders at the speed of light and at the cost of a phone call," writes McKenzie. The wealth and productivity of Hong Kong and Japan (with their limited land mass) suggests that times have indeed changed.

Second, modern communication technology such as video conferencing, the Internet, and e-mail allows production to occur most anywhere in the world. Businesses have begun to take advantage of this opportunity and will often locate in the most tax-friendly location possible. If governments consistently adopt policies hostile to the flourishing of enterprise, businesses will move. Thus, governments have become aware that they must compete to attract business. This provides an incentive to government to pursue pro-market policies such as tax reform, deregulation, and privatization.

New technological advances also strengthen the growth of international trade and further the integration of the global economy. Trade and investment flow freely across traditional borders all around the world, increasing the pressure to lower protectionist barriers. McKenzie explains, “Economic integration has dulled the influence of governments’ fiscal and monetary policies and increased the responsiveness of capital and resources to changes in tax rates and regulatory costs.”

When a regional or national economy becomes a global one, both businesses and governments must become more competitive. “In non-technical terms,” writes McKenzie, “governments (as well as unions and multinational firms) have had to compete by lowering their tax prices and by finding ways of giving more value for the dollar or pound or mark.” Businesses with mobile capital take advantage of opportunities to lower their tax and regulatory burdens. Thus, the base of capital which governments can tax is no longer as stable as it once was. Governments — like businesses — must then do their own downsizing to “attract and retain capital that can easily fly off on the wings of electrons.”

The Soviet Union, according to this perspective, did not keep up with the pace of technological change, and was forced to divest its “national welfare clients” of socialist republics. The massive amount of land they covered had lost much of its value, because central planners stifled new ideas, technologies, and creative brainpower through government control. The economies of Eastern Europe became ever more uncompetitive and unworkable, and eventually the whole system of political and economic repression collapsed.

“In the past,” concludes McKenzie, “free market economists lamented how governments have undermined the power of markets. They never dreamed this day would come, a time when markets are undermining the powers of governments!” The challenge today is to determine how to restructure governments so they can become more competitive in the globalized economy.

This Institute Brief is one in a series on the chapters of an upcoming book, Limiting Leviathan*, edited by Dr. Don Racheter, Executive Director of Public Interest Institute, and Dr. Richard Wagner, Economics Professor at George Mason University and Chairman of the Institute's National Academic Advisory Board.* Limiting Leviathan *makes a case for limited government and discusses the types of limitations on government that are appropriate and necessary.*

The author of this chapter in Limiting Leviathan *is Dr. Richard McKenzie. He is Walter B. Gerken Professor of Enterprise and Society in the Graduate School of Management at the University of California, Irvine. He also serves on the Institute's National Academic Advisory Board.*

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