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Competition Is Healthy for Governments, Too

By N. GREGORY MANKIW

Should governments — of nations, states and towns — compete like business rivals?

The question is simpler to ask than to answer. But it reflects why conservatives and liberals disagree on many big issues facing the nation.

Most everyone agrees that competition is vital to a well-functioning market economy. Since the days of Adam Smith, economists have understood that the invisible hand of the marketplace works only if producers of goods and services vie with one another. Competition keeps prices low and provides an incentive to improve and innovate.

Granted, competition is not always good for producers. I produce economics textbooks. I curse the fact that my competitors are constantly putting out new, improved editions that threaten my market share. But knowing that I have to keep up with the Paul Krugmans and the Glenn Hubbards of the world keeps me on my toes. It makes me work harder, benefiting the customers — in this case, students. The upshot is that competition among economics textbooks makes learning the dismal science a bit less dismal.

For much the same reason, competition among governments leads to better governance. In choosing where to live, people can compare public services and taxes. They are attracted to towns that use tax dollars wisely. Competition keeps town managers alert. It prevents governments from exerting substantial monopoly power over residents. If people feel that their taxes exceed the value of their public services, they can go elsewhere. They can, as economists put it, vote with their feet.

The argument applies not only to people but also to capital. Because capital is more mobile than labor, competition among governments significantly constrains how capital is taxed. Corporations benefit from various government services, including infrastructure, the protection of property rights and the enforcement of contracts. But if taxes vastly exceed these benefits, businesses can — and often do — move to places offering a better mix of taxes and services.

This lesson is on the minds of policy makers today. Over the last few decades, corporate tax rates have fallen around the world. As of April 1, when Japan cut its tax rate, the United States was left with the world's highest statutory corporate tax rate. This is one reason corporate tax reform is now high on the policy agenda. President Obama has proposed cutting the rate to 28 percent from its current 35 percent, while Mitt Romney — for whom I am an adviser — has proposed cutting it to 25 percent. While their proposals differ in some key details, it is noteworthy that they agree on the direction this rate should head.

Conservatives applaud such competition among governments. They are skeptical of government power, and they see competition as a check on its potential abuse. Because people and capital will flee from places where their tax dollars do not deliver commensurate value, government officials have little latitude to pursue personal agendas that are substantially adverse to any group of citizens.

This logic leads naturally to the principle of federalism. Because exiting a state or locality is easier than leaving the nation, some policy options should be available to state and local governments but not to the federal government. The founding fathers were no fools.

Health care reform is a case in point. Anyone who finds the Massachusetts health insurance mandate objectionable can easily move to live-free-or-die New Hampshire. A national mandate leaves people with fewer options. This is one way the health reform advanced by Mr. Romney as governor differs from that pursued by President Obama, and why the Massachusetts law raises fewer constitutional objections than does the national one.

While conservatives embrace governmental competition, liberals have good reason to worry about it. The left has a more expansive view of the role of public policy. Liberals want the government not only to provide public services but also to redistribute economic resources. In the words of President Obama, they want to “spread the wealth around.”

Yet redistribution is harder when people and capital are free to move to other jurisdictions that offer better deals. If you are going to take from Peter to pay Paul, Peter may well decide to leave. It is perhaps no surprise that state and local tax systems are less progressive than the federal one.

Whether competition among governments is good or bad comes down to the philosophical questions of what you want government to do and how much you fear government power. If the government’s job is merely to provide services, like roads, schools and courts, competition among governmental producers may be as good a discipline as competition among private producers. But if government’s job is also to remedy many of life’s inequities, you may want a stronger centralized government, unchecked by competition.

These are two fundamentally different visions. The next election, and to some degree every election, is about which one voters find more compelling.