

Crony capitalism

Tip of the corporate
welfare iceberg

IN THIS ISSUE:

100 Plus—Book
recommendation

The crusade against
plastic bags

Elephants, CEO hiring,
and Adam Smith

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Welcome!

Dear Readers,

We are excited to announce that the 2013 spring issue of *Canadian Student Review* has a new format. There are many new features including a book recommendation by Fraser Institute researchers and quotes from famous influential free market thinkers. We have also delved into our *Fraser Forum* archives to find a past article on an economic concept (Adam Smith and specialization on page 30) that is still relevant today.



This issue also features articles on crony capitalism and the negative consequences of banning plastic bags.

We have announced our 2013 Essay Contest topic, *Is the "War on Drugs" working or is it time for drug policy reform?* on page 6. Enter to win part of \$2,250 in cash prizes.

I hope you enjoy all of the new features.

Best,

Lindsay Mitchell

Editor, *Canadian Student Review*

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The Harper government's **Crony capitalism**

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Mark Milke

You might think the federal Conservatives, who added \$125 billion to the federal debt since 2008 and will add another \$21 billion by the end of March, might be shy about unnecessary expenditures. Alas, that's not the case, as it appears Prime Minister Stephen Harper and his colleagues would rather hand out cash to corporate Canada instead.

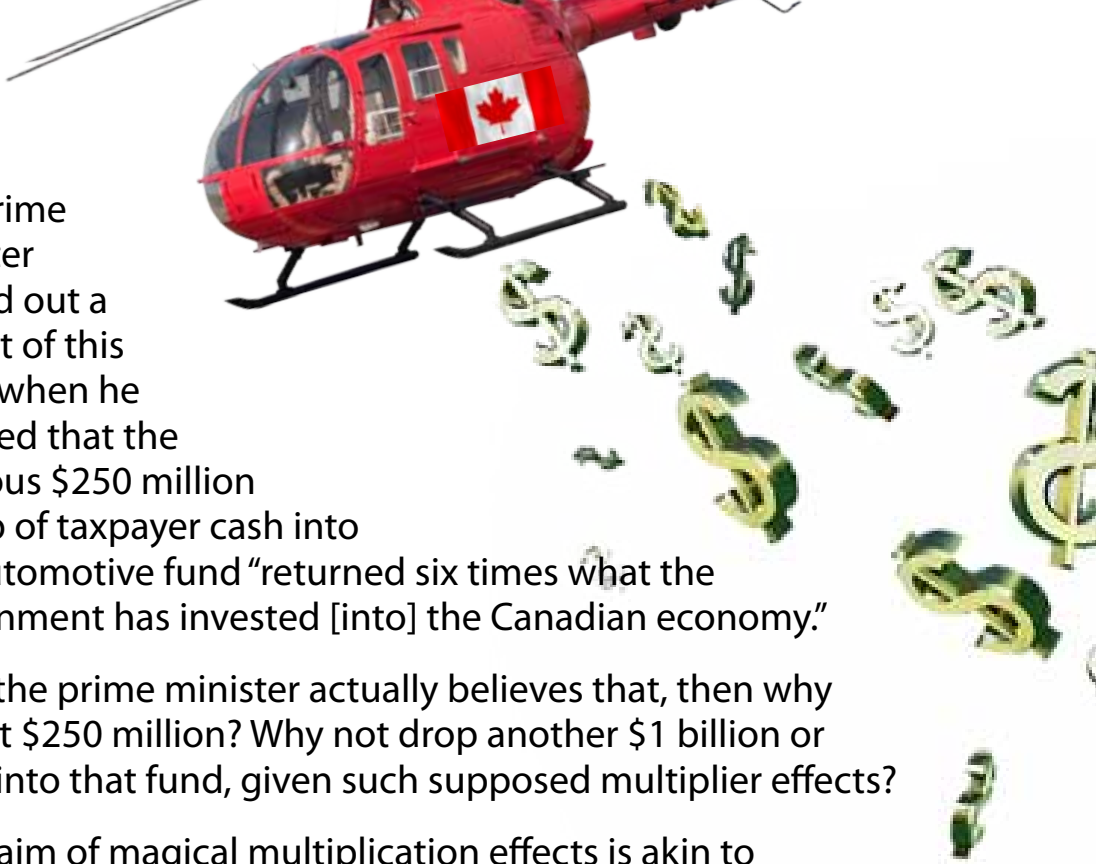
In the first two weeks of January, the Prime Minister announced another \$250 million for the Automotive Innovation Fund—a federal subsidy program that provides the auto sector with taxpayer cash for research and development.

Then the Prime Minister announced \$400 million for venture capital, mystifying those of us who thought it was fine to let private-sector angel investors risk their own cash, not that of taxpayers, on high-risk start-ups.

The recent taxpayer gifts are but the tip of the corporate welfare iceberg. Between 1994 and 2007, \$202 billion was disbursed by all governments across Canada through subsidies to business.

Whenever politicians wish to shower taxpayer money around, predictable excuses are offered up in defence of crony capitalism.

One is that corporate welfare creates new economic activity, and thus extra jobs and new tax revenues.



The prime minister trotted out a variant of this claim when he asserted that the previous \$250 million dollop of taxpayer cash into the automotive fund “returned six times what the government has invested [into] the Canadian economy.”

But if the prime minister actually believes that, then why stop at \$250 million? Why not drop another \$1 billion or more into that fund, given such supposed multiplier effects?

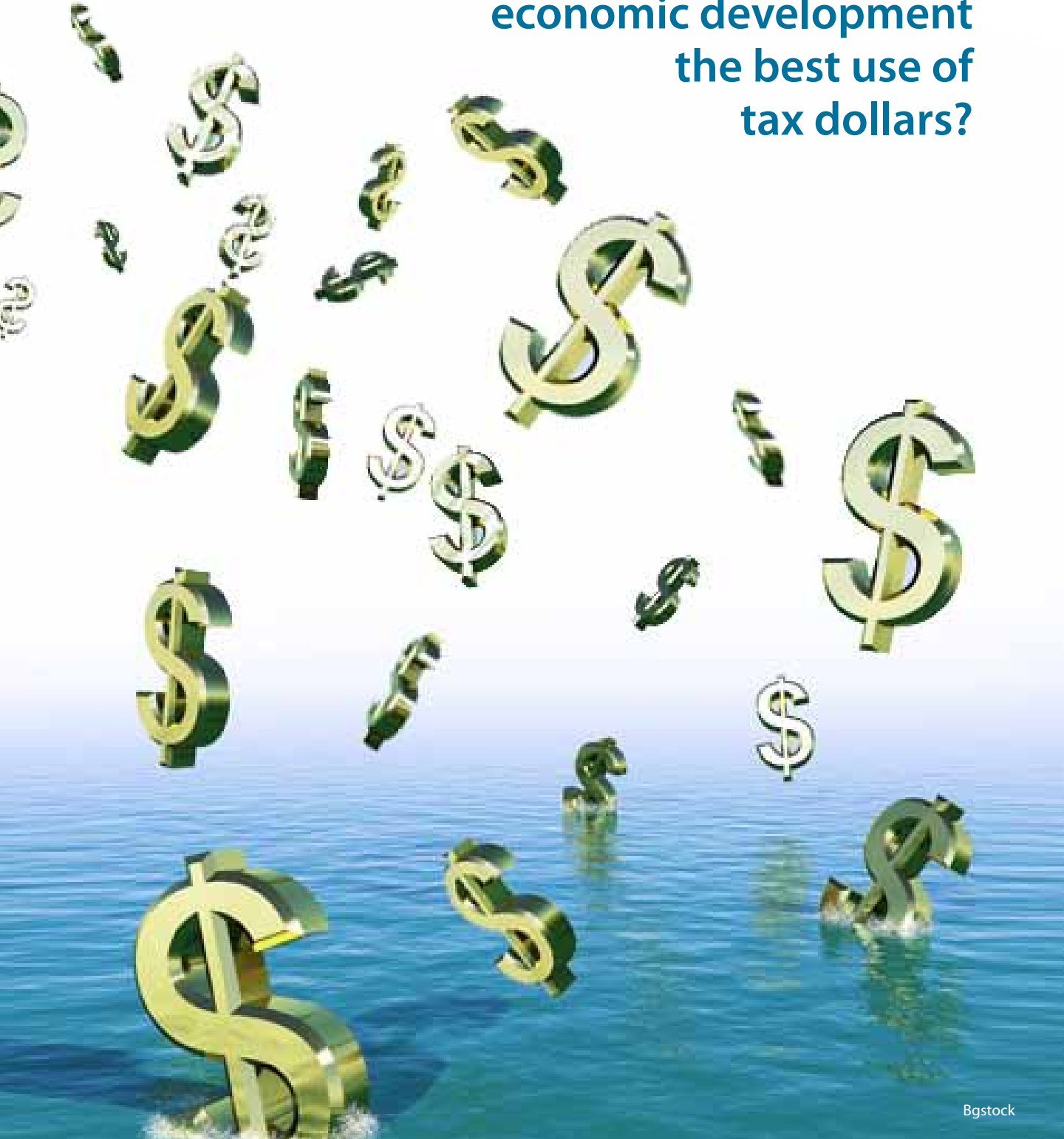
The claim of magical multiplication effects is akin to dropping \$250 million in taxpayer cash from the top of the CN Tower onto pedestrians below.

Of course such soon-collected money will be pocketed and later spent; that cash might create temporary one-time increases in economic activity and spinoff benefits. And no doubt, some politician would point to the ensuing spending as evidence that such economic development strategies work.

But the relevant question is where the money originated in the first place and whether such a “helicopter” approach to economic development is the best use of tax dollars.

Such scattering of tax dollars to the wind ignores the substitution effect. That is where tax dollars must be taken from others (i.e., through personal and business taxes) to finance the new round of crony capitalism.

Is a “helicopter” approach to economic development the best use of tax dollars?



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Sometimes politicians will admit that crony capitalism is an economic shell game



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The economic literature on subsidies and the substitution effect is clear: had such dollars been left with individuals and businesses, that money would have been spent elsewhere or saved and invested.

That too would have created economic activity, jobs, and eventually tax revenues for governments. It would have

occurred without the inefficient recycling of tax dollars through the political picking of corporate welfare winners—and losers.

As one American expert on corporate welfare, Terry Buss, described it, the hidden victims of crony capitalism are businesses not in on the take and taxpayers in general—“potential losers are always in other cities or states, and few people concern themselves with the national interest.”

Sometimes politicians will admit that crony capitalism is an economic shell game. Still, they and others will defend it on the grounds that other governments subsidize business, so Canadian politicians play the same subsidy game.

But not everyone does. Sometimes, politicians choose differently.

In 1996 under then Premier Ralph Klein, the Alberta government passed the Business Financial Assistance Limitation Act to stop most loans, loan guarantees, and outright subsidies to business (the exception being small

businesses). That came after \$2.2 billion in government loan guarantees to various businesses went sour.

In New Zealand, the government stopped subsidizing farmers long ago.

More recently, the Saskatchewan government ended the lucrative film tax credit (which cost the province \$100 million over the years). Saskatchewan did so over the wrongheaded objections of some business organizations, such as the Saskatchewan Chamber of Commerce. The Chamber should be opposed to having the government pick winners and losers through tax credits and direct subsidies and instead support more neutral business taxation.

Where pressure exists to subsidize companies or to engage in unproductive tax credit schemes, one antidote is to toughen up existing free-trade agreements to end such abuses of taxpayers and their money. The very point of free-trade agreements is the pursuit of a level playing field and more economic growth for all.

After all, why should taxpayers (and their money) from any city, province, or country be dragged into the competition between corporations? Let companies duke it out without taxpayers being forced into the ring. ■

This article appeared in the Calgary Herald on January 19, 2013.



Mark Milke is the director of Alberta Policy Studies at the Fraser Institute. He also manages the Fraser Institute's Centre for the Study of Property Rights.



The Book Corner

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Fraser Institute researcher-recommended books on free market policies and economics

100+ *How the Coming Age of Longevity Will Change Everything, From Careers and Relationships to Family and Faith*

Humanity is on the cusp of an exciting longevity revolution. The first person to live to 150 years has probably already been born. What will your life look like when you live to be over 100? Will you be healthy? Will your marriage need a sunset clause? How long will you have to work? Will you finish one career at sixty-five only to go back to school to learn a new one? And then, will you be happily working for another sixty years? Maybe you'll be a parent to a newborn and a grandparent at the same time. Will the world become

overpopulated? How will living longer affect your finances, your family life, and your views on religion and the afterlife?

In *100 Plus*, futurist Sonia Arrison takes us on an eye-opening journey to the future at our doorsteps, where science and technology are beginning to radically change life as we know it. She introduces us to the people transforming our lives: the brilliant scientists and genius inventors and the billionaires who fund their work. The astonishing advances to extend our lives—and good health—are almost here. In the very near future fresh organs for transplants will be grown in laboratories, cloned stem cells will bring previously unstoppable diseases to their knees, and living past 100 will be the rule, not the exception.

Sonia Arrison brings over a decade of experience researching and writing about cutting-edge advances in science and technology to *100 Plus*, painting a vivid picture of a future that only recently seemed like science fiction, but now is very real. *100 Plus* is the first book to give readers a comprehensive understanding of how life-extending discoveries will change our social and economic worlds. This illuminating and indispensable text will help us navigate the thrilling journey of life beyond 100 years. ■



Sonia Arrison



Sonia Arrison

Sonia Arrison was a former intern of the Fraser Institute. Her website is [HERE](#)



**The crusade
against plastic**

BAGS

net_efekt

Kenneth P. Green and Elizabeth DeMeo

Recently, anti-plastic rhetoric has swept North America, resulting in a variety of public policy efforts to limit the use of plastic grocery bags. In the US, for example, Washington DC, has enacted a 5 cent bag tax (Gowen, 2010) while Washington State's Bainbridge Island recently enacted an ordinance which outlaws plastic bags and imposes a fee on paper bags (Baurick, 2012). Here in Canada, seven provinces (Alberta, BC, Manitoba, Ontario, Quebec, Nova Scotia, and PEI) have taken a variety of steps to limit plastic bag use ranging from outright bans to negotiated agreements with bag distributors (Retail Council, 2012). Four municipalities (Leaf Rapids, MB; Fort McMurray, AB; Nain, NFLD; and Huntington, QB) have enacted plastic bag bans, and the city of Toronto recently considered, but rejected one (Environmental News Service, 2012).

The question is, "does this make good public policy?" At the risk of letting the reader off the hook by stating our conclusions up front, the answer is "No, plastic restrictions offer little benefit (either environmental or with regard to human health), they impose significant costs, and, perversely enough, they may well increase risks to the environment and human health."

The three central arguments used against plastic grocery bags are that plastic bags pollute the air and water, and pose a significant litter problem, clogging our lakes, rivers, and oceans.




Premier Packaging

Claim: Plastic bags pollute the air

According to most plastic bag critics, it takes roughly 12 million barrels of oil to produce the 100 billion plastic bags used in the US each year (Sierra Club, undated). Environmental activists note the production and decomposition of plastic bags emits greenhouse gases and other pollutants at every stage of a plastic bag's life (*New York Times*, 2007). This, however, tells less than half of the story, as most analyses of bag impacts don't consider the costs and benefits of plastic bags relative to alternatives.

A study released in 2011 by the Environmental Agency of England helps put environmental impact claims in perspective. In *Evidence: Life Cycle Assessment of Supermarket Carrier Bags*, researchers offer a "cradle-to-grave" review of seven different types of grocery store bags: conventional lightweight plastic bags; plastic bags treated with a chemical to speed its degradation; a lightweight bag made from a biodegradable starch-polyester blend; a regular paper bag; a heavy-duty "bag for life" made from low-density polyethylene (LDPE); a heavier duty polypropylene bag; and a cotton bag (Edwards and Meyhoff Fry, 2011).

The researchers compared the environmental damage done by the bags using a number of indicators of environmental impact, including global warming potential, acidification, eutrophication, human toxicity, and others. They found that the conventional plastic bag had the lowest environmental impact of the lightweight bags in eight out of nine impact categories and that biodegradable plastic bags had even larger environmental impacts than the regular kind. Paper bags performed poorly on the environmental impact tests, and the



**Paper bags
must be used
four or more
times to be more
environmentally
friendly than
plastic bags**

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study found that they must also be used four or more times to match the global warming potential of the plastic bags. In sum, cotton bags were found to have a greater environmental impact than the conventional bags in seven of nine categories, even when used 173 times—the number of times needed for its global warming potential to be on par with that of a plastic bag.



**Exaggeration about
plastic bag pollution
undermines scientific
credibility**

johnmca

Claim: Plastic bags pollute the water

Another frequently recited argument in favour of banning plastic is that we face a crisis of plastic-encrusted waterways. Environmental groups paint horrific pictures of plastic pollution like the Great Pacific Garbage Patch, which purportedly spans twice the size of Texas (Oceanic Defense, undated). Though it's certainly true that plastic bags can be harmful to all things aquatic, it's important, again, to put such claims in perspective. As assistant professor of Oceanography Angelicque White reports, the claims about the size of the Great Pacific Garbage Patch are simply wrong (2011). She explains, "The amount of plastic out there isn't trivial, but using the highest concentrations ever reported by scientists produces a patch that is a small fraction of the state of Texas, not twice the size." Moreover, "there is no doubt that the amount of plastics in the world's oceans is troubling, but this kind of exaggeration undermines the credibility of scientists. We have data that allow us to make reasonable estimates; we don't need the hyperbole." And the contribution of plastic grocery bags to ocean plastic-pollution is relatively small: environmental group Grow NYC estimates that only "7.5% of our waste stream consists of plastic film such as supermarket bags" (2012).

Dangers of alternatives

Alternatives, such as trendy cloth bags, pose a danger. A closer look proves cloth bags are not only less environmentally safe as described above, but they pose their own risks to human health. In June 2010, Charles Gerba and colleagues at the University of Arizona and Loma Linda University released a

study on contamination of reusable bags. As they explain in *Assessment of the Potential for Cross Contamination of Food Products by Reusable Shopping Bags*:

Large numbers of bacteria were found in almost all bags and coliform bacteria in half. *Escherichia coli* were identified in 12% of the bags and a wide range of enteric bacteria, including several opportunistic pathogens. When meat juices were added to bags and stored in the trunks of cars for two hours, the number of bacteria increased 10-fold indicating the potential for bacterial growth in the bags.

While some critics dismissed the study due to its partial funding by the American Chemistry Council, real world examples corroborate Gerbera's results (*Huffington Post*, 2012). In October 2010, for example, a teenaged soccer player in Oregon fell mysteriously ill, kicking off a nasty strain of norovirus that quickly spread to her teammates and left scientists puzzled. Epidemiologists ultimately uncovered the bizarre yet treacherous culprit: a contaminated cloth grocery bag from the soccer player's hotel room. An NBC report explains, "The girl had been very ill in the hotel bathroom, spreading an aerosol of norovirus that landed everywhere, including on the reusable grocery bag hanging in the room. When scientists checked the bag, it tested positive for the bug, even two weeks later" (Aleccia, 2012).

To avoid such dangers, epidemiologist Kimberly K. Repp (whose report on the mystery above appears in the *Journal of Infectious Diseases*) rightly advises that, "we wash our clothes when they're dirty; we should wash our bags too." Unfortunately, however Gerbera et al found that "reusable bags are seldom if ever washed and often used for multiple purposes" (2012).





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Economic Impacts

Finally, many proponents of the plastic bag ban spend the majority of their time on environmental benefits, and offer little substantive analysis as to the economic impacts of a plastic bag ban or tax. As it turns out, the economic case for plastic bag bans and /or taxes is less than airtight. A report released in January 2011 by the Suffolk University's Beacon Hill Institute conjectures that Washington, DC's bag tax, by making purchases more inconvenient, will lead consumers to reduce how much they buy in the District, which "will eliminate a net of 101 local jobs. The job losses will cause

annual wages to fall by \$18 per worker and aggregate real disposable income to fall by \$5.64 million. The wage and income losses will combine to lower income tax collections." A recent study from the National Center for Policy Analysis also found that plastic bags cost jobs:

The NCPA surveyed store managers in Los Angeles County where a ban of thin-film bags took effect in July 2011, to determine the ban's impact on revenues and employment. Over a one year period before and after the ban, stores that fell under the bag ban experienced a 10 percent reduction in employment, while employment in stores outside of the ban slightly increased (2012).

Conclusion

The panic surrounding plastic grocery bags is largely unfounded. Despite continued demonization of plastic bags, the evidence shows that they're less likely to be contaminated, typically save more energy than paper or cloth alternatives, and are less hazardous to marine life than is commonly conjectured.

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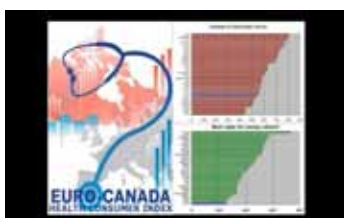


Elizabeth DeMeo is a research assistant at the American Enterprise Institute.

The

VIDEO

Gallery



Canada's Health Care Crisis

Watch Dr. Brian Day, former President of the Canadian Medical Association, present on health care reform. The presentation was given at the Fraser Institute's Vancouver office on November 28, 2012.

See the video [HERE](#)

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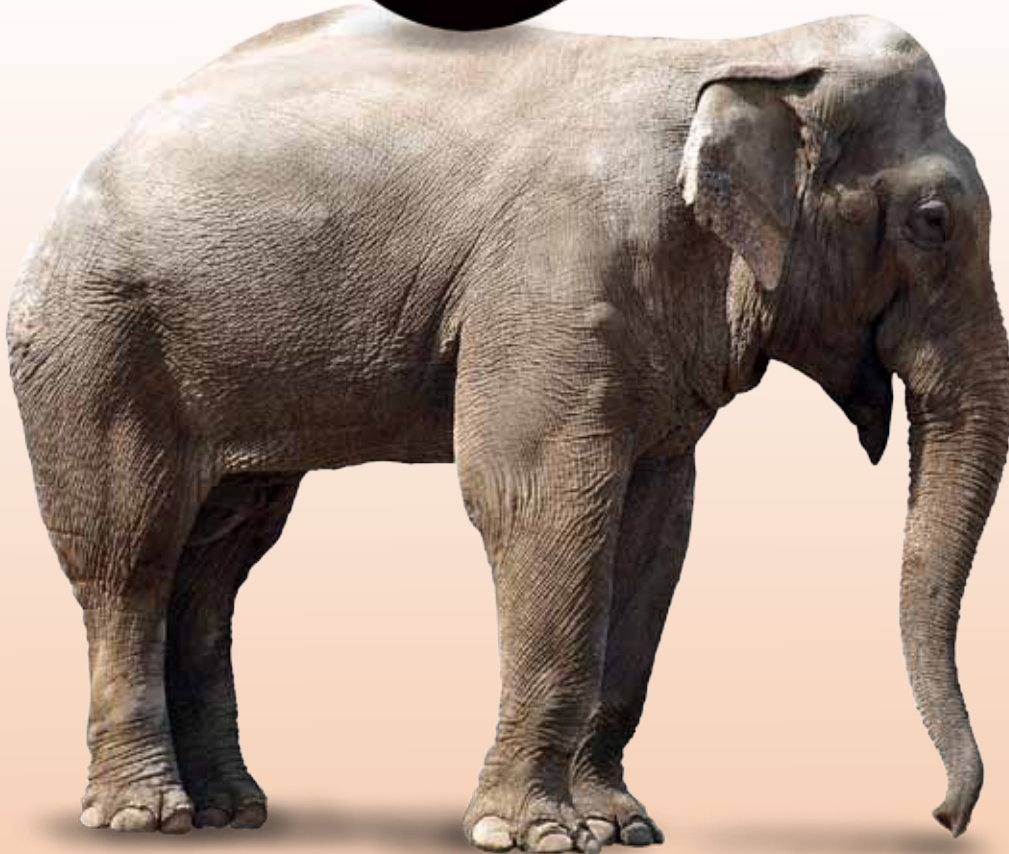
Elephants, CEO Hiring, and Adam Smith

Owen Lippert

During the siege of Stalingrad in the Second World War, the Nazis bombed the city every night. Despite pleas from his colleagues, a professor of mathematics always refused to go to the bomb shelter. He told his concerned friends that his odds of being hit were too small to inconvenience himself. One night, to their amazement, they found the professor in the deepest recess of the local bomb shelter. When asked why, he told them, "in this city, there are five million people and one elephant. Last night, a bomb hit the elephant." In Canada, there are approximately 5,000 fair-sized companies. What is the probability that one of them will hire an executive who will single-handedly destroy the company? The odds are a lot higher for an average Canadian company than for that poor elephant.

Companies risk their survival every day. Most risks they cannot do much about. A competitor starts a rumour about a

Companies risk their survival every day



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defective product line. A financial analyst issues a “sell” recommendation because of an interest rate hike. A major client thinks they can find a better deal with another company.



Adam Smith identified the reason for the scarcity of executives.....

Some risks a company can and should be able to manage. The hiring process should be one of them. Yet one often hears of decision makers going with their “gut instinct” in hiring an executive. Some times they’re right and some times they’re wrong—really wrong. Is there a systematic way to understand the hiring process as more than measuring the height of paper credentials, or divining “personal chemistry”?

The modern study of economics offers a way to understand the hiring process. A basic economic tool in understanding the executive hiring process is scarcity. That sounds strange since there are lots of people out there who describe themselves as executives. If you posted a notice on the Internet—or even on a

lamppost—saying, “Wanted: executive for high-paying position,” you would be inundated with resumes. Yet, the majority of respondents would be inappropriate, despite impressive educational and work histories. Why, then, is there this scarcity?

Adam Smith identified the reason over 200 years ago: the specialization of labour. As economies grow, individuals perform ever-more specific tasks over and over again until they become highly competent and productive at those tasks. Smith’s logic becomes clearer if you look at the software industry. In a 10 person company, would it be efficient for each person to write his or her own program, produce copies, market it, and then provide after-sales service? Of course not. It would be far more efficient if four programmers wrote programs, an engineer produced copies, three marketers marketed it, and two technicians provided after-sales service. The coming of the “knowledge economy” has further specialized labour vertically by creating new industries and careers. At the same time, “globalization” has specialized labour horizontally by providing Canadian companies with access to new markets, each with particular customer preferences.

The specialization of labour is why, when a company seeks to hire an executive, it usually faces difficulties and uncertainties. The company wants someone with experience at making certain kinds of decisions at a certain level of responsibility, whether the specific area of expertise is marketing, accounting, or human resources. They want

...over 200 years ago

someone with experience in their industry or one closely related. They want someone who can align themselves with their corporate values and culture. In a short time, those 500 resumes on file fail to yield the right person. Compromises may have to be made, thus increasing the risk of making a poor decision. In a competitive business environment, poor decisions usually end up as expensive decisions.

The second important economic tool for

**In business,
poor decisions
are expensive
decisions**



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understanding the hiring process is called transaction costs. Bear with me as I try to explain this fundamental but often misunderstood concept in modern economics. It might help to set the stage by saying who came up with this idea, and why.

Ronald Coase, alive today at 102, began his career in the 1930s by asking a very simple yet disarming question: Why do companies exist at all, and if the corporate structure is so efficient, how come there's not just one big company?

His analysis brought him to investigate a basic building block of economic life, the contract. He argued that every contract is shaped by what he called "transaction costs." Specifically, these are the costs incurred by defining what is to be exchanged, negotiating the terms, and monitoring and enforcing the performance of the exchange. Coase posited that if transaction costs were lower, companies would negotiate employment and supply contracts every morning, just as markets daily adjust the prices of the goods and services offered by companies. If transactions costs were nil, why would anyone bother to form a company?

In the real world, however, transaction costs are high. What drives up these costs in time and money are asymmetric information and opportunism. Each party to an exchange does not know what the other knows, and people don't always either tell the whole truth, or do what they say they will. In short, not many meals would be served if, every day, a restaurant chain had to re-negotiate its contracts with its managers and cooks. In order to avoid the market process in the supply of labour—to lower transaction costs—

companies will typically offer an employment contract on fixed terms for an indefinite period. That is why companies as institutions exist.

There are two basic reasons that there is not just one big company. At some level, the additional cost to a company of supervising and managing a new employee will exceed the employee's marginal contribution to corporate profits. As well, at some point, there will be a loss from hiring permanent employees as opposed to using contract workers. That is, companies will pay marginally more for having hired permanent employees than they pay for contract employees and the transaction cost of negotiating their services.

The relative level of transaction costs leads to arrangements other than permanent employment. In the labour market, just as with other markets, there is a "make or buy" decision. Do we hire this person permanently, or do we buy his or her services for a short time? At the heart of the much-discussed issue of "outsourcing" is simply the comparison of the relative transaction costs incurred by using either permanent or contract employment. For Canadian companies, the tremendous increase in self-employed individuals (from under 10 percent twenty years ago to 25 percent today) has made it easier to find and hire spot-contract employees, particularly those providing technical services.

Still, for the critical leadership positions, companies prefer the certainty and stability of a longer-term contract with their CEO or COO. Such a relationship understandably generates the loyalty which is a prime incentive for high

performance. At the same time, a long-term contract heightens the risk involved in hiring the right person in the first place. Here we meet again the problems of asymmetric information and opportunism.

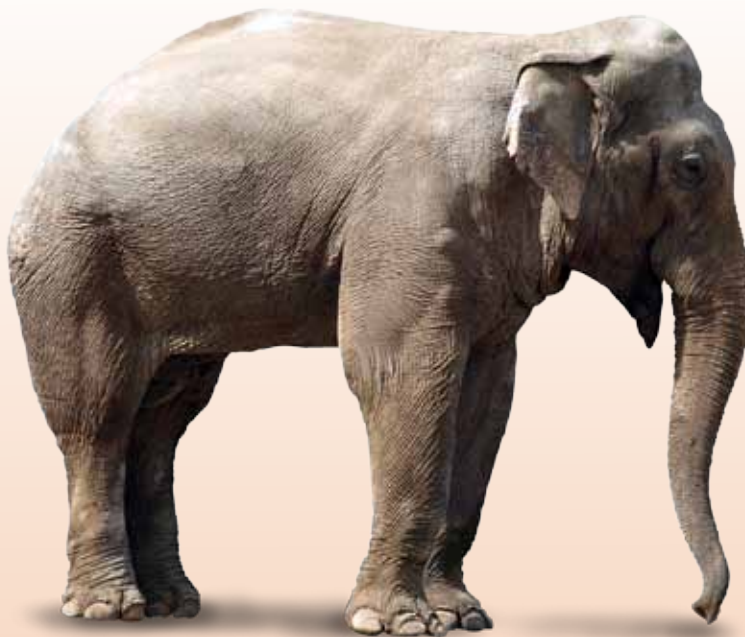
Every board of directors wonders when interviewing someone for the CEO position, "Is this candidate telling us everything we need to know to make the best decision?" Is he or she taking credit for increased sales at their last company which were the result either of another person's efforts, or just plain, dumb luck? Is his or her marriage on the rocks? Would he or she still accept a compensation package 10 percent lower than what they are being offered? The questions are endless, and they're asked on both sides of the table.

To acquire perfect information about a CEO candidate, if not impossible, is, at least, too expensive in time, money, or the distrust engendered by overly intrusive questions. Hiring decisions have to be made under conditions of imperfect information. The risk of a bad decision can only be reduced, not eliminated, whatever the decision maker's "gut instinct."

In assisting companies to make critical decisions under conditions of imperfect information, specialized human resources (HR) professionals are increasingly providing value. Their specialized labour goes beyond simply identifying candidates. That's easily enough done by any number of means, particularly in our age of telecommunications and the Internet. The comparative advantage of HR professionals lies in their experience. Through repeated assignments and assessments, they

have developed an expertise that a company, which may only hire a CEO once every 5 years, simply has not had the opportunity to develop. Nor, one imagines, would a company last very long, if in order to achieve such expertise, it hired a new CEO every year. HR professionals help companies to lower the odds of hiring the wrong person.

Seen another way, specialization helps to save elephants. ■

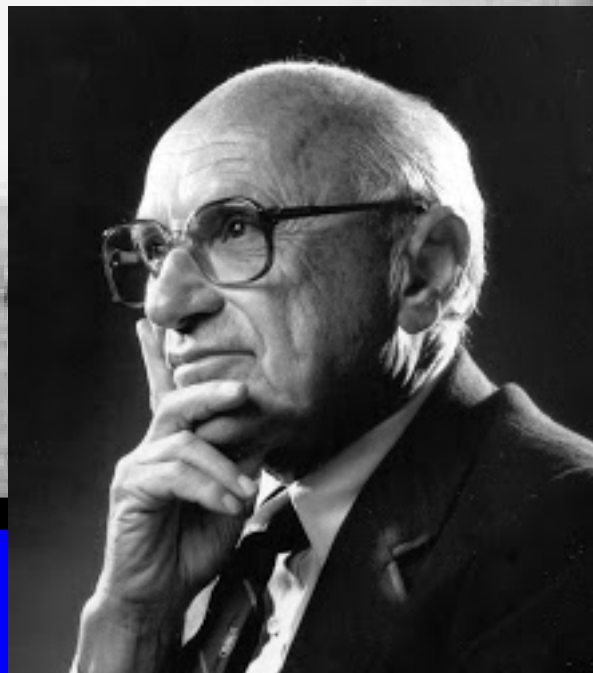


Owen Lippert was the Director of the Law and Markets at The Fraser Institute when this article was originally published in Fraser Forum in February 1999. Dr. Lippert is now an Associate at InterChange Public Affairs.

THE QUOTE WALL

The most important single central fact about a free market is that no exchange takes place unless both parties benefit.

—Milton Friedman



Friedman Foundation for Educational Choice

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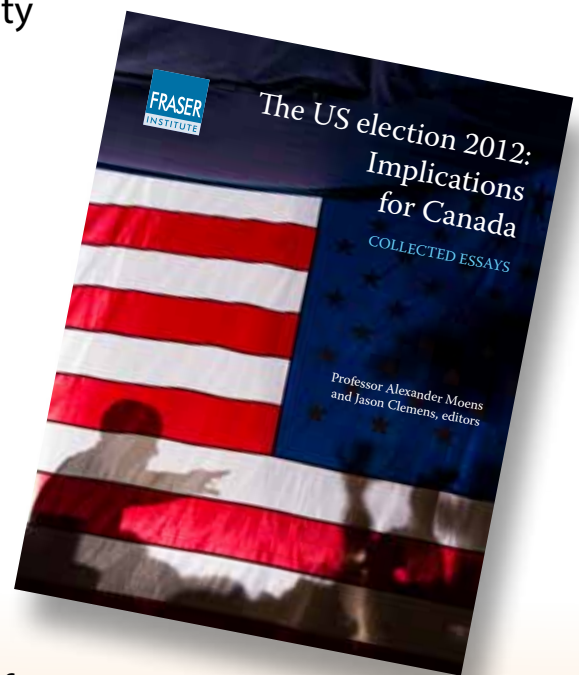


HOT TOPICS!

The US election 2012: Implications for Canada

Canada's fortunes and prosperity are intimately affected by the electoral decisions of our American neighbours. The Fraser Institute asked 10 noted Canadian and American scholars to write about the implications of the 2012 US presidential election on Canada in a number of key policy areas. Each essayist was asked to answer, to varying degrees, three questions relating to the results of the US election:

(1) What are your expectations for policy in the near future (two to four years)? (2) What are the problems or opportunities with such policies? (3) And what are the implications of such policies for Canada?

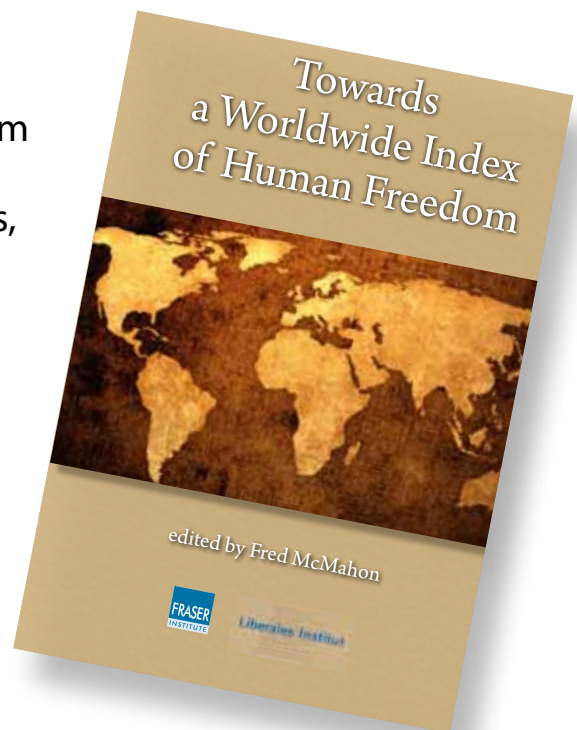


Read the full study [HERE](#)

Towards a Worldwide Index of Human Freedom

People have been seeking freedom for millennia but not freedom for all. Slaves, serfs, women, outsiders, and the defeated were not included. That changed in the last few centuries as the circle of those deserving freedom expanded. Two centuries ago, slavery was alive in many nations, not just the United States; a century ago, women lacked full citizenship and the freedoms that go with it; more recently, sexual orientation is being removed as a barrier to freedom. Yet, efforts to measure freedom have only emerged in the last quarter century or so. This project focuses on creating the first comprehensive and conceptually consistent index of freedom.

Read the book [HERE](#)



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Fraser Insight (bi-monthly): A Fraser Institute review of public policy in the United States.



Canadian Student Review: A collection of articles from both economists and students.

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