

**Arizona Blue Chip**  
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**Where Do We Go From Here?**  
By Elliott D. Pollack

There seems to be a serious debate as to whether Arizona's budget deficit was caused by tax cuts in the 1990's, or very rapid rates of expenditure growth that took place in the first half of this decade. While I believe that the answer is the expenditure increases in the first half of this decade, I also believe that this is the *wrong* debate. The real debate should be over *how much* government Arizonans really want and how much they are willing to pay for it.

*Basic Market Principles*

Market economies are about efficiency. People, in essence, vote with their dollars. Companies that earn a profit are winning votes. They are providing a good or service that consumers want and are willing to pay for voluntarily. Companies that don't make a profit are simply not providing a good or service that enough people want or are willing to pay for voluntarily. Those companies that don't make money are not benefiting people enough to stay in business. In our country, people have a right to spend their money on things that they believe will make them happy. Remember life, liberty and the pursuit of happiness? The assets of the failed businesses will be reallocated to ventures that do provide what consumers demand. Joseph Schumpeter described it as "creative destruction." Thus, the market itself dictates that resources will be used efficiently, according to what people want, and not necessarily what a central planner wants.

This creative destruction goes on all the time. Thirty years ago, there was PanAm and TWA. Today there is Southwest Airlines. Thirty years ago there was Montgomery Ward. Today there is Target. Thirty years ago there was IT&T. Today there is Microsoft. Companies go out of business all the time because they are not providing a demanded good or service at a competitive price. Someone always comes up with a better idea. Those that don't adapt go out of business.

*Government Efficiency*

This basic premise related to the marketplace can also be applied to how the government functions. When monies are taxed and spent based on some bureaucrat's vision rather than by personal choice, the less efficient an economy will be and, therefore, the less consumers will benefit. This is why government should be kept small and focus placed primarily on those services that the private sector can not efficiently deliver.

So what is the basic purpose of government? According to Adam Smith, the basic role of government is to provide a court system and police protection. In other words, to protect private property rights. And government should do collectively what individuals can not do individually (i.e. build infrastructure such as roads, bridges, schools, libraries, and some social safety net).

The function of government has been greatly expanded over the last fifty years at all levels. The people of Arizona need to decide what they want government to do and what they want government not to do. But, they have to understand, the bigger the government, the less efficient and the less growth oriented your economy becomes. If you have a monopoly, you risk monopoly results (inefficiency, poor service, etc.). This article doesn't represent a complete review of what many State programs should be eliminated. However, defining the role of government is the political debate that needs to take place, especially in a world where, in essence, the party is over.

#### *What About the Deficit?*

The type of growth in government revenues that occurred in the 1990's and the early part of this decade is not likely to occur again for quite some time. The rapid revenue growth that took place in the first half of this decade was driven not just by incomes but also by growth in consumer net worth. Over the next few years, and perhaps even longer, that type of growth will not occur.

What caused the deficit? The basic underlying assumption of those who say the deficit was caused by tax cuts made years ago is that without the tax cuts the money would not have been spent. The expenditure of those funds would somehow not have occurred, so that today the deficit would not exist. Given the nature of politics, this is hard to believe. No, this is impossible to believe. In my opinion, politicians would have spent the funds. On what? Who knows? Politicians at all levels of government spend what they can. Generally, they will spend any excess revenues available. Look at what happened to the "rainy day" fund. If money is available for expenditure, especially without constraint, the funds will eventually be used for something, be it Alt Fuels, or all-day kindergarten, or some other idea. So, if taxes were not previously cut, State expenditures undoubtedly would have been higher. And, perhaps because of that, the deficit might have even been larger than it is now.

#### *The Transitory Nature of Revenues*

Another reason for the current deficit is that politicians in Arizona utilized *temporary* revenues derived from the housing boom on *permanent* government programs or, to a lesser extent, on permanent tax cuts. Since the growth in revenues used to finance the rapid growth in expenditures was, in part, temporary and the government did not build up the necessary reserves in the rainy day fund, the deficit was fait accompli.

#### *Conclusions*

What is the proper role of government in a free society? What should it spend, and what should it do? Obviously, this is an interesting debate. Indeed, the Achilles heel of any republic is that benefits are specific and costs are diffused. Any benefits program has people who are willing to spend money to defend the program because they alone benefit. The expenditure might cost each individual in the state \$5 and, therefore, there will be no power base on that side arguing against that specific program. These types of incentives create what is known as the "tragedy of the commons." It gives signals that certain

resources can be used as if they are free or near free. But, their use imposes costs on all others who have been deprived of their use or who must pay for their use.

The following points represent my primary beliefs related to the role of government and how it relates to the State of Arizona.

1. It doesn't matter whether the deficit was caused by tax cuts or expenditures at this point. The problem is that we have a deficit.
2. The issue now is to decide where we, as a more frugal society with less revenue, should be spending our money.
3. Government spending is not the same as individual consumer spending. Individuals have a direct incentive to be efficient with their spending. Government is not bound by this constraint to the same degree.
4. No government can be all things to all people. However, given the State's infrastructure needs, the main question should probably be, how do you fund infrastructure, such as schools and roads, and have some safety net program, without destroying the efficiency of the economy and create disincentives for growth to occur?
5. It is difficult to raise taxes on people when they are being squeezed by too much debt, not enough savings, and declining asset values.
6. In case you missed it, it is especially important to deal with core infrastructure issues such as roads and schools, as well as the protection of private property rights. This will require solutions that are "outside of the box."

Let the real debate begin.