

Gratis is Not Great

Almost every psychologically normal human is delighted to here about products everyone can enjoy free of charge. “The schools are free!” “Health care is free!” “Lunch is free!”

According to basic welfare economics, however, gratis goods are almost automatically inefficient. Unless the marginal social cost of the product miraculously happens to be zero, setting a price of zero leads to socially wasteful behavior.

So what makes “free” so beloved? The simplest explanation is that people are reacting selfishly. When someone says, “Oh great, free stuff!” they aren’t assessing the social desirability of the outcome. They’re saying, “Oh goodie, *I* don’t have to pay for this.” But this explanation is quite implausible, because people are also pleased to hear about free stuff even when they’re *personally* ineligible to receive it. Think about how often Americans gush, “In Canada, X is free!” Furthermore, even from a totally selfish point of view, free is often a bad deal overall. Making products free ultimately requires higher taxes, and often leads to shortages and lower quality.

A better story is that people are taking transactions costs into account. Free is almost never first-best efficient, but it can easily be second-best efficient. Suppose, for example, that the marginal social cost of adding another car to the road is \$.75, but the cost of collecting a toll is \$1.00. On balance, it’s less inefficient to let people drive for free than impose marginal cost pricing.

On reflection, however, this story is also quite weak. If it were true, people would be pro-gratis for products that are *cheap* to produce. In reality, however, what most excites and delights mankind is gratis products that are *expensive* to produce. Free health care and free education are far more popular than free toothpicks.

The most charitable explanation is that people like making goods free because it’s a politically palatable way to redistribute with dignity. If only the poor receive free health care, the story goes, we’ll stigmatize the beneficiaries. They’ll receive substandard treatment at best. In the long-run, even this substandard care will be forever vulnerable to repeal. Once we make healthcare free for everyone, all these problems go away.

But this story, too, is shaky. Empirically, it’s far from clear that means-tested programs are markedly less popular or politically stable than universal programs. Whatever their subtle disadvantages, means-tested programs have an obvious advantage: Helping the needy is far cheaper than helping everyone. Finally, if it really were true that we have to help *everyone* to help *anyone*, that would be a potent argument against helping anyone! As I explained a while back:

Economists habitually mock protectionism for its high cost-benefit ratio. "\$265,000 per job saved! How ridiculous."...

Notice, however, that we can easily ridicule universal social programs in exactly the same way that we ridicule protectionism. Suppose two-thirds of the population is perfectly able to provide for its own retirement and health insurance. Then the budgetary cost of cloaking welfare for the bottom one-third in universal garb is triple the apparent cost. And that ignores all the disincentive effects of the extra taxes and giveaways. Add it all up, and you could easily get a number in the protectionist ballpark. Think: "\$100,000 per retiree lifted out of poverty! How ridiculous."

Even if I'm wrong here, the "Make goods free in order to redistribute with dignity in a politically palatable way" argument is *far* too sophisticated to explain popular affection for gratis goods. So what *does* explain this affection?

The most credible explanation, as usual, is simple-minded populism. We're sick of paying for stuff! We don't want to hear a bunch of bean-counting excuses about the budget! Stop being greedy cheapskates and just give it to us for free! Efficiency means we have to set every price equal to marginal social cost. But our knee-jerk impulses say, "Shut up and fork it over."