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Why the Federal Government Fails

By Chris Edwards

EXECUTIVE SUMMARY

Most Americans think that the federal government is incompetent and wasteful. Their negative view is not surprising given the steady stream of scandals emanating from Washington. Scholarly studies support the idea that many federal activities are misguided and harmful. A recent book on federal performance by Yale University law professor Peter Schuck concluded that failure is "endemic."

What causes all the failures?

First, federal policies rely on top-down planning and coercion. That tends to create winners and losers, which is unlike the mutually beneficial relationships of markets. It also means that federal policies are based on guesswork because there is no price system to guide decisionmaking. A further problem is that failed policies are not weeded out because they are funded by taxes, which are compulsory and not contingent on performance.

Second, the government lacks knowledge about our complex society. That ignorance is behind many unintended and harmful side effects of federal policies. While markets gather knowledge from the bottom up and are rooted in individual preferences, the government's actions destroy knowledge and squelch diversity.

Third, legislators often act counter to the general public interest. They use debt, an opaque tax system, and other techniques to hide the full costs of programs. Furthermore, they use logrolling to pass harmful policies that do not have broad public support.

Fourth, civil servants act within a bureaucratic system that rewards inertia, not the creation of value. Various reforms over the decades have tried to fix the bureaucracy, but the incentives that generate poor performance are deeply entrenched in the executive branch.

Fifth, the federal government has grown enormous in size and scope. Each increment of spending has produced less value but rising taxpayer costs. Failure has increased as legislators have become overloaded by the vast array of programs they have created. Today's federal budget is 100 times larger than the average state budget, and it is far too large to adequately oversee.

Management reforms and changes to budget rules might reduce some types of failure. But the only way to create a major improvement in performance is to cut the overall size of the federal government.

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"Failure is a critical issue because the government controls many aspects of our lives."

INTRODUCTION

According to public opinion polls, Americans think that the federal government is too large and powerful.[1] Most people do not trust the federal government to handle problems.[2] Only one-third of people think that the government gives competent service, and, on average, people think that more than half of the tax dollars sent to Washington are wasted.[3] The public's "customer satisfaction" with federal services is lower than their satisfaction with virtually all private services.[4]

When Gallup recently asked Americans what the most important problem facing the nation was, more people identified "government" than any other problem, including the economy, immigration, health care, or terrorism.[5] After his examination of such polling data, Yale University law professor Peter Schuck concluded, "the public views the federal government as a chronically clumsy, ineffectual, bloated giant that cannot be counted upon to do the right thing, much less do it well."[6]

Americans' poor view of the federal government is not surprising given its many high-profile failures. In recent years, major scandals have erupted at the Department of Veterans Affairs, Internal Revenue Service, Secret Service, and other agencies. Federal auditors regularly uncover waste, fraud, and abuse in agencies, and revelations about special-interest giveaways in Congress are commonplace. But failure is about more than just scandals. Rigorous analyses find that many federal programs generate little value and produce harmful side effects.[7]

Failure is a critical issue because the government controls many aspects of our lives. Federal spending represents more than one-fifth of the nation's economic output, and federal regulations infiltrate many state, local, and private activities. When the government fails, it can create widespread harm by damaging the economy and reducing our freedom.

The first section of this study discusses views on government failure. People have different beliefs about the proper role of government, and that informs their judgment about its failures. This study takes a broad view of federal failure. The government fails when its operations are ineffective, ridden with fraud, or subject to bloated costs and other inefficiencies. It also fails when it intervenes in activities where it is unlikely to add value and that would be better left to the states or the private sector.

The bulk of the study describes five sources of federal failure. These include (a) reliance on top-down coercion, (b) lack of knowledge, (c) misaligned political incentives, (d) misaligned bureaucratic incentives, and (e) the government's huge size. The study concludes that the only way to substantially reduce failure is to downsize the federal government.

VIEWS ON GOVERNMENT FAILURE

Scholars have been examining the causes of federal failure for a long time. In a 1919 study, "A Little History of Pork," Chester Collins Maxey described how "log-rolling" in Congress led to the passage of low-value projects.[8] Stand-alone votes on local projects often did not pass, he said, so lawmakers began bundling hundreds of them in omnibus bills to pass. With an omnibus, "the good items in such a bill would stand as apologists for the bad," Maxey said. He argued that many projects in such bills were "pure waste" and a "terrible blight" on the budget.

In 1932 James Beck, who was a member of Congress and had been U.S. solicitor general, explored wasteful spending in *Our Wonderland of Bureaucracy*.[9] He wanted to inform people about the reality of federal programs, rather than the "bedtime stories" told by politicians. The Federal Farm Board, he said, was a "stupendous failure" and an "inexcusable legislative folly," as it spent $500 million and caused widespread distortions.[10] Subsidies for farmers, shipping companies, sugar companies, and other businesses made no sense, Beck argued. Federal efforts to run businesses during and after World War I were "costly failures" of "extraordinary ineptitude."[11] And the Interstate

Commerce Commission, which was supposed to improve the rail system, instead "increased the cost of railroad operations" and "paralyzed the initiative" of railroad companies.[12] The problem with the government, Beck concluded, was that the "remedy may often be worse than the disease."[13]

During the 20th century, many scholars examined why government intervention in the economy often failed. In 1944's *The Road to Serfdom*, economist F. A. Hayek argued that government planning could not successfully coordinate an advanced economy. Rather, he said, "it is the very complexity of the division of labor under modern conditions which makes competition the only method by which such co-ordination can be adequately brought about."[14] Hayek described how markets harness dispersed knowledge about individual preferences and local conditions. Government plans cannot access such knowledge, and thus cannot achieve the "differentiation, complexity, and flexibility" of markets.[15]

In his 1962 book, *Capitalism and Freedom*, Milton Friedman argued that a key problem was that government policies destroy individual choice. Policies fail because they "seek through government to force people to act against their own immediate interests in order to promote a supposedly general interest."[16] While "the great advantage of the market . . . is that it permits wide diversity," he said, "the characteristic feature of action through political channels is that it tends to require or enforce substantial conformity."[17]

In recent decades, economists in the "public choice" tradition have focused on the political and bureaucratic causes of government failure.[18] They argue that people in government—like people in markets—generally follow their own self-interest. The problem is that people in government face incentives to undermine the general welfare. Government failures are not caused by unfortunate mistakes, but by structural features of our democracy. Economist James Buchanan, a founder of public choice, called it the study of "politics without romance."[19]

Hayek, Friedman, and Buchanan were libertarians. But many scholars with centrist political views have also examined government failure. In a 2006 study, "Government Failure vs. Market Failure," Clifford Winston of the Brookings Institution examined the performance of federal microeconomic policies. He found that regulations that were supposed to correct market failures have, instead, "cost the U.S. economy hundreds of billions of dollars a year."[20] He also found that "public financing and management of transportation infrastructure, public lands, and various services have been extremely inefficient," while "redistribution policies have often made little progress in achieving their goals while wasting considerable resources in the process."[21]

In a 2014 study, Paul Light of Brookings studied dozens of federal failures, such as the response to Hurricane Katrina in 2005 and the ongoing mismanagement of veterans' health care. Light found that the number of such failures has increased and "have become so common that they are less of a shock to the public than an expectation."[22] The government has failed at operations, as with the HealthCare.gov launch in 2013, and it has failed at oversight, as with the BP oil spill in the Gulf of Mexico in 2010. The causes of failure, Light found, have included poorly drafted laws and ever-thickening bureaucracies.

Yale's Peter Schuck critiqued federal performance in his 2014 book, *Why Government Fails So Often*.[23] He examined dozens of programs and found widespread failure. Many programs are not delivering promised results, and they have costs that are higher than the benefits. Many programs generate fraud and abuse, and they intrude on activities that the private sector could do better.

Schuck concluded that federal performance has been "dismal," and that failure is "endemic."[24] He found that "many, perhaps most, governmental failures are structural. That is, they grow out of a deeply entrenched policy process, a political culture, a perverse official incentive system, individual and collective irrationality, inadequate information, rigidity and

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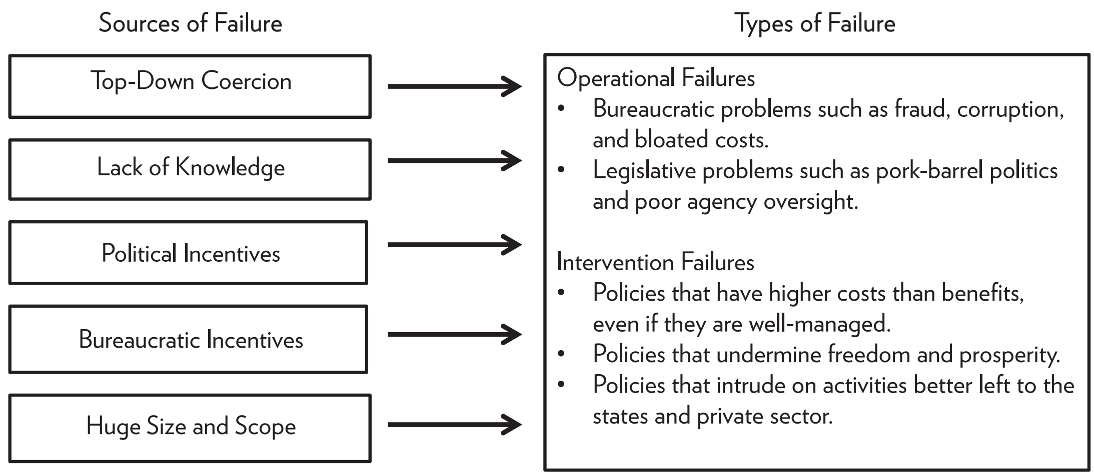
Figure 1
Federal Government Failure



Source: Author.

inertia, lack of credibility, mismanagement, market dynamics, the inherent limits of law, implementation problems, and a weak bureaucratic system."[25]

Despite all the research, scholars have not nailed down any hard definitions about what constitutes government failure.[26] Partly this is because people disagree about the proper role of government, particularly the federal government. As an example, libertarians argue that Congress fails when it intervenes in areas constitutionally reserved to the states, such as education. But other people have a more expansive view of proper federal powers and would not see federal involvement in education as a failure.

Nonetheless, people with different political views should be able to agree on many sorts of failure. If a federal program is not achieving what policymakers promised, it is a failure.[27] If a program is generating high levels of fraud or corruption, it is a failure. If the costs of a program are clearly higher than the benefits, it is a failure.

Most people would also count as failures policies that provide few benefits but undermine widely shared goals, such as economic prosperity and personal freedom. Milton Friedman was right when he said that in evaluating policies, we should count the cost of "threatening freedom, and give this effect considerable weight."[28]

This study examines government failure with a wide lens. It considers the sources of both operational failures and intervention failures, as shown in Figure 1. The following five sections of the study describe the main sources of these federal failures.

TOP-DOWN COERCION

The driving force behind market economies is that voluntary exchanges are mutually beneficial. Millions of buyers and sellers pursuing their own interests engage in billions of exchanges, each creating value on both sides. These transactions generate market prices, which help guide people and businesses toward the best use of their efforts and resources. The price system allows for the synchronization of vast amounts of production and consumption across the nation and around the globe.

Markets generate cooperation between people with different values and goals, and create an environment open to innovation. Markets thrive on diversity and allow for people to pursue different lifestyles, careers, and consumption choices. F. A. Hayek said that the market "reconciles different knowledge and different purposes which, whether the individuals be selfish or not, will greatly differ from one person to another."[29] Economist Thomas Sowell noted that "the diversity of tastes satisfied by a market may be its greatest economic achievement."[30]

Decisions Are Guesswork

The government does not work like this. Rather than voluntary exchange, it generally relies on coercion to pursue its ends. One consequence is that we cannot be sure that government actions generate net value. Because the government's activities are not based on mutually beneficial coordination, there is no sure source of information indicating whether or not they are useful. This is a fundamental weakness of government.

Federal agencies impose more than 3,000 new regulations each year.[31] Total federal regulations now span 168,000 pages.[32] The government will spend about $4 trillion this year and distribute benefits to people through more than 2,300 programs.[33] Needless to say, the federal government is making a vast number of decisions affecting every aspect of our lives.

In making its spending and regulatory decisions, the government is flying blind. Regulations are top-down requirements for action or restraint, not efforts at finding voluntary agreement. Federal spending relies on compulsory taxation, not customer revenue. Without voluntary agreement behind its actions, the government faces a large information void. There is no system of supply and demand, prices, and profits to inform policymakers if their activities are generating net benefits to society. Policymakers may believe that their interventions make sense, but that is usually wishful thinking based on guesswork.

Consider the purchase of aircraft. In the private sector, an airline chooses the number of planes to buy on the basis of demand for air travel, which is aggregated from individual preferences expressed in the marketplace. By contrast, when the Pentagon buys aircraft, the number chosen is decided by political factors and guesswork regarding threats. No market generates information about the benefits of a threat reduction.

More broadly, no reliable mechanism exists to help the government make efficient choices across alternative uses of funds. Would fighter jets, farm subsidies, or food stamps be the best use of added funds? In markets, tradeoffs are made with the help of prices. If the price of air travel goes up, consumers reduce their air travel and increase their automobile travel. But in the government, decisions on allocating its vast budget are not based on solid metrics.

In theory, government decisionmaking could be aided by cost-benefit analysis.[34] Experts could try to tally up all the monetary and nonmonetary costs and benefits of proposed actions, and the government could choose those options with the highest net returns. Since 1981 federal agencies have been required to perform such analyses for major regulatory actions.[35] However, these analyses have often been of low quality because of a lack of accurate data and the use of dubious assumptions.[36] Furthermore, experience shows that regulatory cost-benefit analyses are often biased in favor of the predetermined answers that government leaders favor.[37] As a result, these analyses have often been paperwork exercises that have not improved decisionmaking.

With spending programs, some agencies perform cost-benefit analyses for some programs, but there is no broad requirement to do so.[38] To the extent that such analyses are performed, the process shows similar shortcomings as regulatory analyses. The Army Corps of Engineers, for example, has long performed cost-benefit analyses on projects. But outside experts have complained that the agency's analyses are biased in favor of project approval—the Corps tends to overestimate the benefits of projects and underestimate the costs.[39] Investigations "have repeatedly caught the Corps skewing its analyses to justify wasteful and destructive projects that keep its employees busy and its congressional patrons happy."[40] A Government Accountability Office report in 2006 found that the

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analyses supporting some Corps' projects were "fraught with errors, mistakes and miscalculations, and used invalid assumptions and outdated data."[41]

Perhaps federal cost-benefit analyses could be insulated from politics and made more rigorous. If so, the technique could be used for more spending decisions within agencies.[42] The Department of Homeland Security, for example, needs more rigor in its decisionmaking process for capital investments.[43] However, it seems unlikely that such analyses would ever be used for broad allocation decisions by Congress, such as divvying up the budget between defense, housing, transportation, and other categories.[44]

In sum, decisionmaking in the market is a reality-based system rooted in individual preferences and trade-offs. By contrast, government decisions are based on guesswork. That is one reason why there is so much failure in Washington—and also why there is so much bickering. Everybody has a strong opinion about how to carve up spending and impose regulations, but nobody has hard data.

Funding Guaranteed

In markets, individuals and businesses often make bad decisions. But if they continue down the wrong path, their resources get depleted. A business making misguided investments will be punished by financial losses and may face bankruptcy or a takeover. About 10 percent of all U.S. companies go out of business each year, which is a remarkably high exit rate.[45] But losses and business failures prompt the beneficial reallocation of resources to more promising activities.

If government leaders are no more skilled than business leaders, their efforts will also have a high failure rate. But government activities that create no value can live on forever because the funding comes from a mandatory source: taxes. In theory, policymakers could rigorously analyze programs and then reallocate spending based on informed judgments about the successes and failures. But that usually does not happen in the federal government for reasons discussed in subsequent sections.

How about successful activities? Businesses that do a good job serving customers will earn high profits, at least until the profits are eaten away by competition. The quest for profits guides businesses toward generating net value. In government, there is no such guide. Federal subsidy programs may attract many recipients, or "customers," but that is not an indicator of success—or net value creation—because it does not take into account program costs.

People might assume that government has an advantage in tackling society's problems because it is a powerful institution that can use coercion. Actually, the fact that government has a compulsory revenue stream is a huge weakness that leads it astray. In markets, strong feedback mechanisms prompt rapid adjustments when failures arise, but in government there is usually too much inertia to make needed changes. To a large extent, government failure is baked into the cake because its misguided actions are not self-limiting the way that private actions are.

Winners and Losers

People in markets generally act in their own self-interest in pursuing their goals and trading with others. At first blush, that seems like an anti-social bias—an environment that creates winners and losers. But the opposite is true. In his 1776 classic, *The Wealth of Nations*, Adam Smith described how people in markets acting in their self-interest end up promoting the broader public good. An individual "intends only his own gain, and he is . . . led by an invisible hand to promote an end which was no part of his intention. . . . By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it."[46] People who work hard and allocate their resources to benefit themselves end up supporting overall prosperity. Their personal actions are socially beneficial.

F. A. Hayek expanded on Smith's observations. He noted that in markets people "are induced to contribute to the needs of others without caring or even knowing about them."[47] And in markets, Hayek said, people "following their own interests, whether wholly egotistical or highly altruistic, will further the aims of many others."[48] Markets are a win-win proposition for participants, a positive-sum game.

It is a similar situation with all sorts of private activity, such as pursuing friendships, supporting charities, and promoting social projects. In such voluntary activities, people engage with others in mutually beneficial ways. Individuals, of course, make mistakes and sometimes pursue harmful activities, but in those situations the damage will be limited because others are not compelled to go along.

Governments do not work that way. Their activities tend to create winners and losers. Consider that in markets individuals choose their own levels of each good and service to consume. Markets allow for diversity. But government tends to have one-size-fits-all activities. That creates winners and losers because the chosen level of a government activity will differ from many people's individual preferences. Economist James Buchanan called this loss caused by forced uniformity a "political externality" of government interventions.[49]

This suppression of individual choices in favor of top-down choices destroys value, and it is a key reason why every citizen should want to keep the sphere of government activities limited. Supporters of government control of activities seem to think that "people can be made better off by reducing their options."[50] But rather than making people better off, government interventions often lead to unhappiness and social conflict.

In the 1840s economist Frédéric Bastiat argued against France's subsidies for religion, education, arts, and other activities because of the discord they created. He said, "All these vital forces of society should develop harmoniously under the influence of liberty and that none of them should become, as we see has happened today, a source of trouble, abuses, tyranny, and disorder."[51] Milton Friedman similarly argued that the use of government to try and solve problems "tends to strain the social cohesion essential for a stable society."[52] In contrast, he said, "the widespread use of the market reduces the strain on the social fabric by rendering conformity unnecessary with respect to any activities it encompasses."[53]

When the government grows, divisions within society grow because more resources are distributed by coercive means than by voluntary means. But in America's increasingly pluralistic society, the last thing we need is more division being sown by one-size-fits-all federal policies. As "our society is becoming more diverse, the range of activities by the national government should be logically narrowed."[54]

All that said, federal activities can generate net value in some situations. The government can provide "public goods," which are items we all benefit from but that are underprovided by markets.[55] National defense is a good example. And the government can generate value by fixing "externalities," such as pollution.[56] When it addresses these and other market failures, federal policies can be a win-win proposition that improves economic efficiency and increases welfare.[57] The challenge is to keep the government narrowly focused on these roles and to tackle them effectively with a minimum of failure.

Taxes Create Deadweight Losses

When evaluating spending programs, policymakers should take into account the full costs of funding them. The direct cost of any program is the tax revenues the government will need to extract from the private sector. But another cost is created by the extraction process itself. Since taxes are compulsory, they induce people to try and avoid them by changing their working, investing, and consumption activities. Such responses harm the economy, a harm called a "deadweight loss."

Suppose the government imposes a new tax on wine. Wine drinkers would be harmed because part of their money would be confiscated. But an additional cost, the deadweight loss, would be created as people cut back their wine consumption. Because of the tax, people would enjoy less wine and lose some amount of welfare or happiness.

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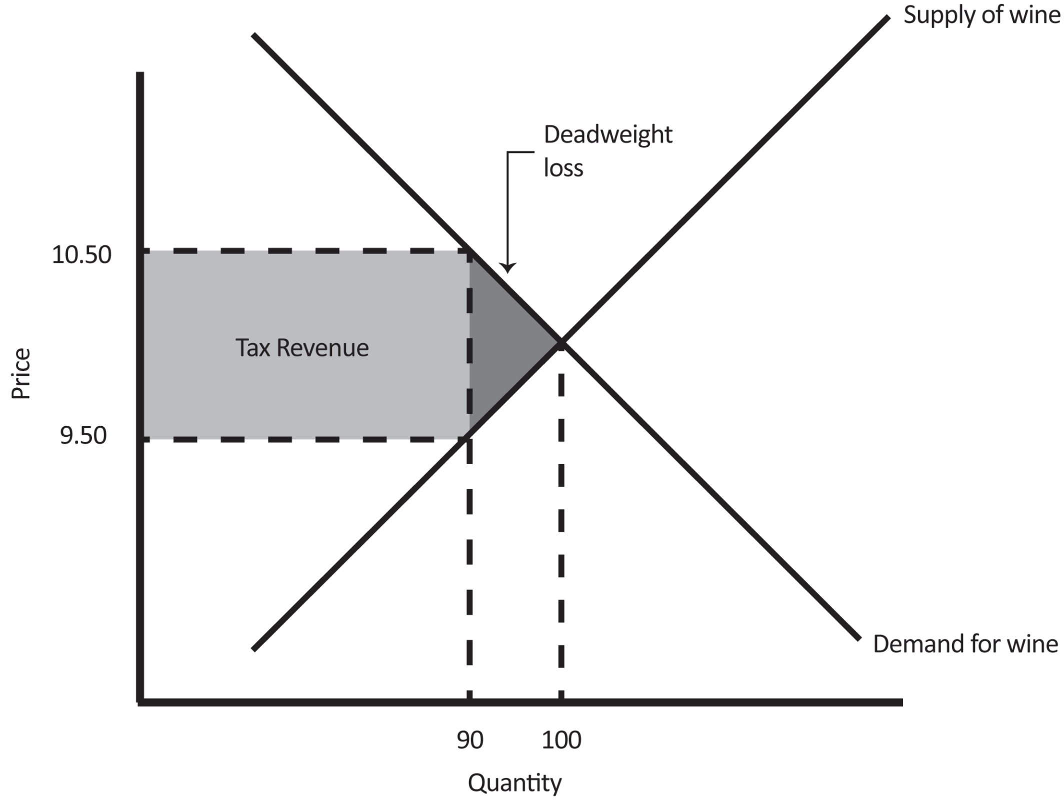
Figure 2
Deadweight Loss from a Wine Tax



Source: Author.

Figure 2 illustrates the damage caused by a wine tax of $1 per bottle. Before the tax is imposed, people consumed 100 million bottles at $10 per bottle. With the tax, the price rises and people reduce their consumption to 90 million bottles. The rectangular area shows the amount of revenue raised by the government. The triangular area is the deadweight loss, which is caused by people reducing their consumption by 10 million bottles.[58]

While the tax revenue amount represents a loss for the private sector and a gain for the government, the deadweight loss is a loss to society as a whole. The government has blocked 10 million bottles worth of mutually beneficial exchanges from taking place. Every federal tax causes this sort of damage by hindering market exchanges. Income taxes, for example, reduce the working and investing efforts of millions of families and businesses.

How large are the deadweight losses of federal taxes? They vary depending on the tax rate, the type of tax, and other factors. But for the federal income tax, studies have found that, on average, the deadweight loss of raising taxes by a dollar is roughly 50 cents.[59] Based on his pioneering work, Harvard University’s Martin Feldstein thinks that the loss may be higher, perhaps exceeding “one dollar per dollar of revenue raised, making the cost of incremental governmental spending more than two dollars for each dollar of government spending.”[60] Other estimates are, however, lower than Feldstein’s.

Suppose that Congress is considering spending $10 billion on an energy subsidy program. Putting aside whether the program is ethical or constitutional, does the program make any economic sense? The program’s benefits would have to be higher than the total cost of about $15 billion, which includes the $10 billion direct cost to taxpayers plus another $5 billion in deadweight losses.[61]

Currently, federal lawmakers do not consider deadweight losses when they make spending decisions, but they should. The scorekeeper of Congress, the Congressional Budget Office (CBO), generally does not include deadweight losses in its analyses. Federal agencies generally do not consider deadweight losses either, even though the Office of Management and Budget has recommended that they be included in program evaluations.[62]

The absence of deadweight loss information biases policymakers in favor of approving programs.[63] Consider the debate over the Affordable Care Act (ACA) in 2010. Health scholar Chris Conover estimated that ACA-imposed taxes would create up to about $500 billion of deadweight losses during the law's first decade, which was in addition to the bill's official cost of about $1 trillion.[64] If such an estimate had been provided to Congress by the CBO in 2010, it might have changed the debate over the legislation.

To see why deadweight losses can result in government failure, let's compare a private charitable project to a government program. Suppose that a philanthropist creates a $10 million project to help disadvantaged individuals, and the program generates $12 million in benefits. It would be a success. Now suppose a similar program is run by the government. It would be a failure because it would use tax funding and thus generate deadweight losses. The government program would cost $10 million directly plus another $5 million or so in deadweight losses, for a total cost that was higher than the benefits. Since government projects are funded by compulsory taxes, they are more costly than private projects. Coercion is not free.

LACK OF KNOWLEDGE

Markets allow millions of individuals and businesses to coordinate their activities. Prices are the key to markets, and they perform two functions. First, prices aggregate and communicate constantly changing information about resources, tastes, and technology. Second, prices create incentives for people to produce and consume efficiently. If a resource is expected to be in short supply, for example, the price rises and people start reducing their use of it while shifting to other products.

Vast amounts of such adjustments are made continuously, steering the economy toward higher levels of output and income. Investors and entrepreneurs direct their resources to the most promising industries. Workers figure out where to best use their skills and add value. Businesses strive to keep their production flowing and their customers happy. There are lots of mistakes, but prices are continually adjusting to keep everything on track and moving forward.

Unintended Consequences

When the federal government intervenes in the economy with subsidies and regulations, it throws a wrench into the price mechanism. Agriculture price supports, for example, are intended to help farmers, but they also prompt farmers to overproduce subsidized crops and underproduce other, more valuable, crops. Minimum wage laws are intended to help workers, but they raise the cost of hiring low-skill workers and so businesses hire fewer of them.

As with taxes, subsidies and regulations cause people to change their productive efforts, which imposes deadweight losses on the economy. Consider a welfare program. The higher taxes needed to fund the program will induce taxpayers to work less, while the spending itself will induce welfare recipients to work less. The late Sen. Daniel Patrick Moynihan of New York said, "It cannot too often be stated that the issue of welfare is not what it costs those who provide it, but what it costs those who receive it."[65] Actually, it is both.

Figure 3 illustrates the deadweight losses created by a farm subsidy program. It hypothesizes an unsubsidized market where people buy 100 million ears of corn for 50 cents each. Since markets are voluntary, we know that customers value those ears at 50 cents a piece or more, and we know that the cost of growing the ears is 50 cents a piece or less. Now suppose the government subsidizes farmers 10 cents per ear. Farmers would grow more corn

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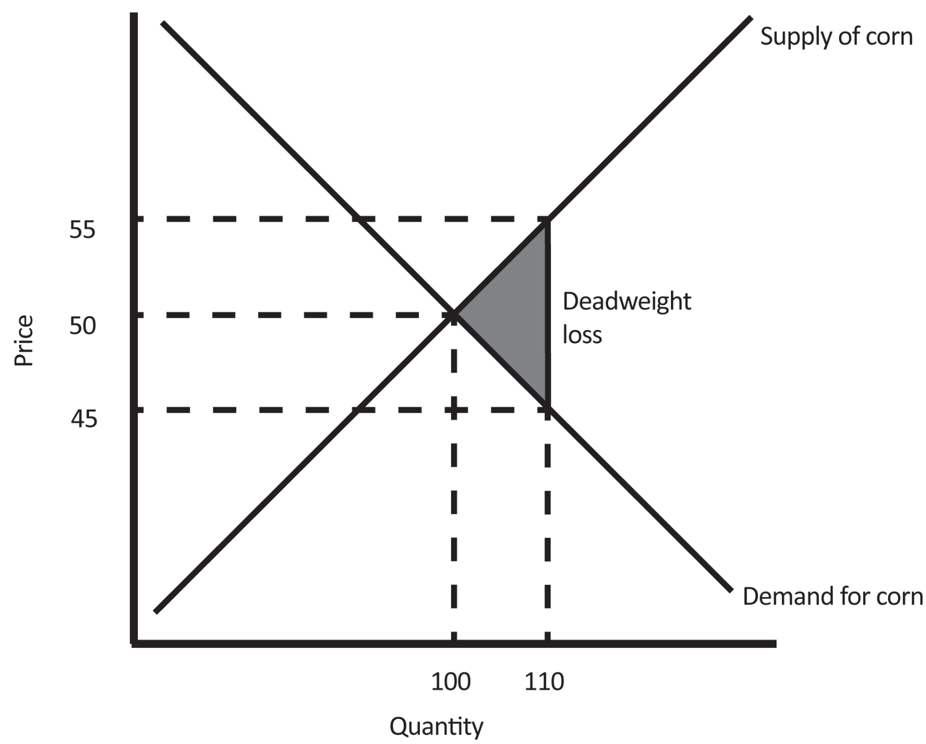
"Federal policymakers intend to help people, but their interventions induce people to change their behavior in ways that undermine the economy."

Figure 3
Deadweight Loss from a Corn Subsidy



Source: Author.

and reduce their investments in other activities. In the figure, the additional ears would cost more to produce than 50 cents, but they would be valued by consumers at less than 50 cents. The subsidy has thus destroyed value by generating production that costs more than it is worth. The amount of value destroyed is the deadweight loss, which is shown on the figure as the gray triangle.

We could make similar diagrams for hundreds of federal subsidy programs and regulations. Federal policymakers intend to help people, but their interventions induce people to change their behavior in ways that undermine the economy. Sometimes those negative effects ripple across the economy with numerous unintended consequences.[66] In his book, *Economics in One Lesson*, Henry Hazlitt said that economics "is the science of tracing the effects of some proposed or existing policy not only on some special interest in the short run, but on the general interest in the long run."[67]

Consider farm subsidies again. The direct effect of farm subsidies is to increase the output of subsidized crops. A secondary effect is to push up the demand for cropland, which causes less fertile lands to be brought into production. Those lands may require more intensive fertilizer and irrigation use, which in turn may generate environmental problems. Another secondary effect may be that as the price of farmland is pushed up, it becomes harder for young farmers to break into the business.

Here is a sampling of some of the unintended harmful effects of federal subsidies and regulations:

- The minimum wage reduces employment of low-skill workers.
- Unemployment insurance reduces labor supply.
- Subsidized flood insurance induces people to live in riskier flood-prone areas.
- Irrigation subsidies cause overconsump-

tion of water and exacerbates droughts.

- Subsidized loans for housing and college induce people to borrow too much.
- Traditional welfare encourages people to work less and form single-parent families.
- Ethanol subsidies reduce the cropland available for food and increase food prices.
- Trade restrictions designed to aid some industries harm others.
- Business subsidies undermine incentives for companies to innovate.
- Endangered species laws prompt landowners to rid their land of endangered species.
- Foreign aid empowers foreign dictators and stalls reforms.
- Food aid reduces the incentives for poor countries to feed themselves.
- Disability benefits encourage people who could work to drop out of the labor force.
- Social Security and Medicare discourage saving for retirement.
- Health mandates raise insurance costs and induce firms to drop coverage.
- Drug prohibition spawns organized crime and violence.
- Public housing creates negative social effects.
- Programs for the needy reduce private charity.
- Fuel efficiency standards result in more people buying smaller cars and more road deaths.
- Workers' compensation induces workers to be less careful on the job.

Federal programs generate an endless amount of such negative effects. Consider Medicare. Under Parts A and B, the government pays doctors and hospitals a set fee for each service provided. That encourages them to deliver unnecessary services because they make more money the more services they bill. As an example, investigations have found that doctors are ordering many unneeded drug tests for seniors.[68] Another problem is that doctors and hospitals are paid by the government regardless of the quality of service, so they have less incentive to reduce errors. Indeed, the system can pay more when there are errors if the errors lead to complications that require more services to be billed.

Medicare's fee-for-service system is essentially a price-control system for thousands of services purchased from more than 400,000 doctors and about 7,000 hospitals and clinics.[69] When the government sets prices too low, it creates shortages, which is the case with primary care doctors. When prices are set too high, doctors and hospitals have incentives to provide too much, which is the case for advanced imaging services.[70] The vastness of the system combined with its top-down nature have also made fraud rampant.[71]

In sum, federal subsidies and regulations induce individuals and businesses to change their behaviors. Those changes undermine overall prosperity because resources are diverted from their best uses. It is true, however, that just because a federal policy creates unintended collateral damage does not automatically mean that the overall policy is a failure. Some federal interventions do generate higher benefits than costs. The important thing is that policymakers look beyond the intended effects of their programs and consider how people and businesses may respond in negative ways over the longer term.

What Is Seen and Not Seen

In defense of federal policymakers, they have a difficult task. There are no clear cut metrics they can use to judge the success or failure of programs. The benefits are usually visible, but the costs are often unseen. In the marketplace, when consumers dislike products, sales and profits fall, which gives companies a strong signal to change course. There is no such built-in feedback for government programs.

Policymakers feel pressure to "do something" to solve society's problems. It seems reasonable to them and many of their constituents that spending and regulations should be

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> "To the government, top-down mandates on paper look neat and tidy compared to the decentralized operations of markets."

able to fix things. The benefits of government action are often immediate, while the costs are more distant and hard to understand. To make matters worse, politicians are usually not experts in the areas that they legislate in, so it is hard for them to understand the negative effects of their policies.

In "What Is Seen and What Is Not Seen," Bastiat, the French economist, described how policymakers focused on benefits and ignored costs. He said that a common argument against cutting the military was the harm from the loss of military jobs, but what was ignored was the jobs that would be created as taxpayers kept more of their money and used it for other purposes.[72] As another example, he described how iron manufacturers lobbied the "great law factory in Paris" to save mining jobs by imposing iron trade barriers. What was unseen were all the jobs that import barriers would destroy for metalworkers, nailmakers, blacksmiths, and cartwrights, who relied on imported iron.[73]

Government intervention is not just an invisible job killer, it is an invisible knowledge killer. Market processes generate information about consumer needs, costs, production methods, and technologies, but intervention undermines those processes. When regulations block entrepreneurs from entering markets, we never learn what innovations they might have created. When taxes prevent companies from buying new machines, technological advance is slowed because new machines often incorporate new designs. When farmers receive subsidies, we lose improvements they might have discovered if they had faced the full rigor of the market. Hayek noted, "Freedom is important in order that all the different individuals can make full use of the particular circumstances of which only they know. We therefore never know what beneficial actions we prevent if we restrict their freedom to serve their fellows in whatever manner they wish."[74]

What is often "not seen" by the government is how the market can solve problems by itself. A government analysis of an automobile fuel efficiency mandate in 2010 illustrated this blindness.[75] The government estimated that the consumer savings on gasoline from the mandate would be far higher than the added costs of the more expensive cars that met the standard. The government assumed that this estimate justified its mandate. But if the estimate were correct, we would not need the mandate because consumers would buy more fuel-efficient cars by themselves to save money. The government simply assumed that markets would not work, which has been called a "planner's paradox."[76] To the government, top-down mandates on paper look neat and tidy compared to the decentralized operations of markets.

When government intervenes, it preempts the development of market solutions, which is called "crowding out." The federal government began providing flood insurance in 1968 because it thought that private companies would not provide it.[77] Over the years, the federal program has built up a large debt and created distortions. Meanwhile, insurance companies have made advances over the decades, including improved computer modeling, such that private flood insurance would probably work today. But the existence of the subsidized federal program has blocked it from developing.

What is not seen by policymakers are all the state, local, business, and charitable efforts that would exist today if the federal government had not grown so huge. The classic example is welfare. Milton Friedman said, "One of the major costs of the extension of government welfare activities has been the corresponding decline in private charitable activities."[78] This point can be summarized simply as "state help kills self help."[79]

In sum, policymakers usually do not grasp the full effects of their programs. They seem to view the economy as a simple machine that can be easily manipulated. Adam Smith had a name for such policymakers:

> The man of system . . . seems to imagine that he can arrange the different members of a great society with as much ease as the hand arranges the different

> pieces upon a chess-board. He does not consider that the pieces upon the chess-board have no other principle of motion besides that which the hand impresses upon them; but that, in the great chess-board of human society, every single piece has a principle of motion of its own, altogether different from that which the legislature might chuse to impress upon it.[80]

More than two centuries after Smith, governments are still full of "men of system." They assume that regulations and subsidies can be used to organize society in a pattern of their choosing, like on a chessboard. Program after program coming out of Washington reflects an overconfidence in the ability of the government to solve problems. One of actor Clint Eastwood's most famous lines is, "A man's got to know his limitations." The government does as well.

Beyond Central Control

If legislators were more diligent and more humble, couldn't they carefully design regulations and subsidies to improve on markets? After all, there are areas—such as fixing externalities—where government can, in theory, intervene to generate net value.

The reality is that improving on markets is difficult to achieve. Government usually does not have enough knowledge. It only has access to a fraction of the information that is distributed across our society. Unlike governments, markets are able to tap into a vast amount of localized knowledge.[81] It is "knowledge of the particular circumstances of time and place," Hayek observed, which "never exists in concentrated or integrated form but solely as the dispersed bits of incomplete and frequently contradictory knowledge which all the separate individuals possess."[82]

This sort of knowledge is tacit and subjective, so it "cannot be conveyed to any central authority in statistical form," said Hayek.[83] A recent article by Cato scholar and practicing surgeon Jeff Singer on electronic health records (EHRs) illustrates Hayek's point. The federal government mandated EHRs without adequately studying them in the real world. Singer has found that the one-size-fits-all mandate harms his practice: "This rigidity inhibits my ability to tailor my questions and treatment to my patient's actual medical needs. It promotes tunnel vision in which physicians become so focused on complying with the EHR work sheet that they surrender a degree of critical thinking and medical investigation."[84]

Rather than being a chessboard—as Smith's man of system assumed—the market economy is more like a natural ecosystem that has subtle and hidden relationships that keep things in balance. Hayek coined the phrase "spontaneous order" to describe ecosystems in human society. A spontaneous order is a set of complex, evolutionary patterns or rules that come from bottom-up relationships. Other than the market economy, language is perhaps the best example of a spontaneous order. The idea that dispersed actions of individuals could create overall order was developed by Adam Smith and other thinkers of the Scottish Enlightenment.[85]

One of the features of both spontaneous orders in society and natural ecosystems is that they are not easy to successfully manipulate from the top down. Australian officials brought cane toads to their continent in the 1930s to control agricultural pests. As it turned out, the toads were not effective at controlling pests. But worse, the toads multiplied beyond control, and have become major pests themselves damaging the nation's biodiversity.

A recent *Washington Post* story described similar episodes. One regards parrotfish in the Pacific Ocean: "A decades-long conservation program there has led to a boom in parrotfish numbers, so much so that they are now harming local populations of corals and other species."[86] The *Post* story goes on, "This is not an isolated case: Ecologists are facing similar dilemmas with elephants in a South Africa reserve that are killing trees in the savanna and with protected sea turtles in the Bahamas that are harming meadows of invaluable sea grass.

"One of the features of both spontaneous orders in society and natural ecosystems is that they are not easy to successfully manipulate from the top down."

> **"By contrast, government does not have enough knowledge to make good decisions, and it lacks the flexibility to change direction when it makes mistakes."**

These instances show how even the best-thought-out conservation efforts can have unintended effects on the environment . . . "[87] That sounds a lot like government intervention in the economy.

Economist Dan Klein compared the spontaneous order of the market to the complex coordination that occurs on a skating rink.[88] Each skater is looking out for her own interests, and she meshes in with other skaters and tries to avoid collisions. She makes rapid and ongoing adjustments. She traces her own unique path, yet an overall order of skaters is achieved. The rink manager may set a few rules, but the coordination is almost all bottom-up. Mistakes are made, and people fall down. But others respond, some by making a wide berth around the fallen skaters and some by helping skaters get up.

Suppose that the manager wanted to centrally plan the skating. He could shout orders to individual skaters, telling them each movement to make and what speed to go. But it would not work; it is too complex and fast changing. Only individuals know their own skills, know when they are getting tired, and know when they are losing balance. In his central planning efforts, the rink manager might try to slow everyone down and impose tight regimentation, but that would ruin the fun. The result would be that skaters "would not find the joy and dignity that come from making one's own course."[89]

Perhaps the rink manager could control a very small number of skaters, but as the numbers increased, his task would become impossible. The lesson, says Klein, is that the more complex an economy or society, the stronger is the case against government intervention.[90] Hayek made a similar point: "The more complicated the whole, the more dependent we become on that division of knowledge between individuals whose separate efforts are co-ordinated by the impersonal mechanism for transmitting the relevant information known by us as the price system."[91]

In our economy today, markets guide billions of decisions based on fast-changing information across the globe. Prices, profits, and other market signals inform people about the adjustments they should make. Entrepreneurs try new strategies in millions of trial-and-error processes. Individuals and businesses sometimes fail, but they have strong incentives to get back on track. Markets are a process of ongoing change and discovery.

By contrast, government does not have enough knowledge to make good decisions, and it lacks the flexibility to change direction when it makes mistakes. If government enacted an alternative energy program in order to combat high oil prices, but then oil prices plunged, the program might become worthless, but it would probably live on for years. Bastiat said that a "public service" provided by government often becomes a "public nuisance" because it gets entrenched even as conditions change.[92]

Conditions are always changing, and always catching governments by surprise. Consider how inaccurate macroeconomic projections are. Economist Edward Lazear calculated that over a 15-year period, CBO projections of real growth in the U.S. economy for the following year were 1.7 percentage points off, on average.[93] That is a giant error given that the average growth rate during the period was 2.1 percent. If the government cannot predict the future, it will be hard pressed to successfully manipulate the future, especially because it is such an inflexible institution.

Consider the lead-up to the last economic recession. The housing bubble peaked in 2006 and then began deflating. Government experts did not recognize that falling housing prices were beginning to cause a broad-based economic implosion. Even with its sophisticated computer models, CBO completely missed it. In January 2008 CBO projected that growth would strengthen from 2.0 percent in 2008, to 2.3 percent in 2009, to 3.4 percent in 2010.[94] Actually, the economy fell through the floor in 2009, shrinking 2.8 percent.

What then should governments do? Adam Smith advised them to adopt the "simple system of natural liberty."[95] By removing interventions,

> the sovereign is completely discharged from a duty, in the attempting to perform which he must always be exposed to innumerable delusions, and for the proper performance of which no human wisdom or knowledge could ever be sufficient; the duty of superintending the industry of private people, and of directing it towards the employments most suitable to the interest of the society.[96]

Policymakers have just as many delusions today, and given the complexity of the modern economy, their knowledge is even less sufficient. In his book examining federal performance in recent years, Yale's Schuck concluded that the government's "endemic failure is rooted in an inescapable, structural condition: officials' meager tools and limited understanding of the opaque, complex social world that they aim to manipulate."[97]

POLITICAL INCENTIVES

In a romantic view of democracy, legislators always act with the interests of the general public in mind. They grapple with policy issues, work toward a broad consensus, and pass legislation that has strong support. They reevaluate existing programs and regulations, and prune the low-value and harmful ones. They put citizens first and carefully limit their actions to those allowable under the U.S. Constitution.

The problem with this "public interest theory of government" is that it has little real-world explanatory power. Congress often enacts ill-conceived laws that do not have broad public support. Many programs perform poorly year after year, but rather than being canceled they receive growing budgets. Programs are almost never terminated because legislators will not admit that their favored programs do not work. Legislators try to evade blame for program failures, and they only attempt to fix problems after high-profile scandals occur.

To explain the record of federal failure, we need a more realistic view of legislators. First, we should assume that legislators generally pursue self-interested goals, just as the rest of us do. Second, we should look at the features of our democratic process that shape political incentives. The argument here is that those incentives often run counter to the general public interest.

Incentives of Voters

Politicians want to get elected, and so they pay attention to the beliefs of voters in their districts and states. Most voters are not experts in economics or national affairs, and they are too busy with their lives to pay much attention to federal policy. At the same time, the activities of the federal government have become so complex that even informed citizens know only a fraction of what it does.

In the marketplace, consumers have a strong incentive to examine products and make sure that they get a good deal. By contrast, people know that their individual votes in elections will have almost no effect on outcomes, and so they have little reason to research candidates and policies in detail. As a result, people tend to know more about, say, their favorite television shows than about the workings of the federal government.[98] It is logical for most people to be "rationally ignorant" about public policy, meaning that it does not pay for them to investigate the issues.[99] Opinion polls of Americans over the decades have found "appalling levels of ignorance" about federal policy, notes Schuck.[100]

Unfortunately, "politicians know this, and hence they attempt to design policies that will attract ill-informed voters," concluded economist Gordon Tullock.[101] That assessment seems harsh, but politicians clearly have an incentive to favor policies that have short-run appeal and offer a "free lunch," but that have less visible long-run costs.

In a 2007 book about voters and politicians, economist Bryan Caplan argues that "voter ignorance opens the door to severe government failure."[102] Voters do not have strong incentives to find out about the costs and benefits of programs. And because the federal govern-

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ment is a monopolist in much of what it does, people cannot easily compare alternatives.

Caplan argues that many voters are not just ignorant, but also "irrational," meaning that they support policies that make themselves worse off.[103] People do not make hard-headed decisions about public policy by looking at the actual costs and benefits. Rather, they indulge their emotional and ideological feelings, often in an environment of biased information generated by special interest groups. Some of the irrational notions of voters are systematic, and that encourages politicians to persist in failed policies.

This study began with polling data showing that Americans have a dim view of federal government performance. Most people think that the government is incompetent and wasteful, and they are correct in that assessment. So how can scholars such as Caplan say that people are "ignorant" and "irrational?" The answer seems to be that people know enough to recognize the big-picture problems in Washington, such as the giant federal debt and all the lobbying and corruption. But few people have knowledge about what the best solutions to such problems are. And that is where politicians gain leeway—they tell their constituents that Washington is indeed messed up, but that they can be trusted to tackle the problems.

Incentives of Politicians

In 1787 James Madison wrote that legislators sought office "from 3 motives. 1. ambition 2. personal interest. 3. public good. Unhappily the two first are proved by experience to be most prevalent."[104] Politicians have not changed much since Madison's time. But these motivations are not the key to understanding whether government policies succeed or fail. For one thing, motivations are hidden. All politicians claim to be public-spirited—Madison himself said that selfish motives are "masked by pretexts of public good and apparent expediency."

Rather than looking at inner motivations, we can better understand congressional actions by looking at incentives. The fundamental incentive steering political behavior is reelection. If members do not satisfy voters in their districts, they will not survive in Congress. Furthermore, the most powerful positions in the House and Senate go to the members who have been there the longest, so the quest for reelection drives much of what Congress does.

Responding to the needs of voters in a democracy can be a good thing, but in Congress it has also become a key source of policy failure. Members put their states first, and that often comes at the expense of the general interests of all Americans. When summing up his two decades of congressional experience in a 2014 farewell address, Sen. Tom Coburn of Oklahoma focused on how his colleagues often sought narrow benefits for their states at the expense of American liberties and the U.S. Constitution.[105]

Congress has geographical representation and a decentralized power structure. Members have families and business ties in their states, as well as emotional attachments. So it is logical for them to seek federal benefits for their states because most of the costs will fall on other states. This is a major factor causing federal failure. The structure of Congress leads members to support programs that benefit their states but that are losers for the nation as a whole.

Even in the crucial role of providing national defense, the pursuit of parochial advantage "has become a full-time preoccupation that permeates Congress's activities and members' decisionmaking processes."[106] That is the view of Winslow Wheeler in his book, *The Wastrels of Defense*. As a long-time congressional aide, Wheeler found that members responsible for national defense put most of their efforts into grabbing benefits for their states, rather than overseeing the Pentagon and ensuring the effectiveness of our armed forces. He argued that Congress has "degenerated into a gaggle of wastrels competing for selfish advantage."[107]

That view is not entirely accurate. Some legislators do rise above parochial politics and pursue broader goals. Many members hold safe seats, and so they have some flexibility. Also, because many voters remain ignorant about the details of policy, legislators have leeway to pursue their own private and ideological goals. The problem is that these other goals often produce failed policies as well. There is no built-in check—no invisible hand—to guide members to make value-added decisions, so their personal beliefs about policy may be untethered from reality.

Such untethered beliefs are usually activist in orientation. People who enter politics tend to think that government programs are a powerful way to solve problems. That is an understandable belief. The benefits of government action are immediate and visible, while the costs are often more distant and abstract. Politicians are encouraged to fix problems in society, and it seems reasonable to them that spending and regulation should work. Many politicians see themselves as philanthropists trying to help people.[108]

This activist disposition is reinforced by the environment in Washington. Special-interest groups dominate policy discussions. Most witnesses to congressional hearings favor the programs being examined, and they focus on program benefits, not the costs. Most visitors to member offices on Capitol Hill are there to plead for special benefits. And members know that if they vote to confer benefits on interest groups, they will receive awards that they can hang on the walls of their offices and brag about on their websites.

All of this encourages Congress to create new and expanded programs.[109] The federal government has 47 job-training programs in 9 different agencies.[110] It has 15 programs for financial literacy.[111] It has 15 agencies overseeing food safety, 20 programs for the homeless, 80 programs for economic development, 82 programs for teacher quality, and 80 programs for helping poor people with transportation.[112] It has 10 offices that address AIDS in minority communities, 11 agencies that do autism research, and 8 offices in the Pentagon to handle prisoner-of-war and missing-in-action issues.[113]

There are bureaucratic reasons for some of this duplication, but the main cause is that Congress has dozens of committees and subcommittees, and each one wants a crack at "solving" problems in society. Legislators are entrepreneurs, and they gain prestige by creating new programs. Trimming low-value and obsolete programs is not much fun and it creates enemies, so few members focus their attention on that.

Programs accumulate over time because members have little incentive to repeal the failures. Members do not want to admit that their favored programs have failed, because their careers, reputations, and pride are on the line. The goals of their programs seem pure to them, so they overlook the flaws. And, unlike in the private sector, there is no profit and loss accounting in government activities to clearly signal failure.

Even when federal failures are obvious, members of Congress are not accountable for them. When something goes wrong, they blame the bureaucracy. One consequence is that Congress has little incentive to draft workable laws. Light, the Brookings scholar, examined dozens of major federal failures of recent years and found that the most common problem was poorly drafted laws: "Poorly designed policies come from Congress and the president, for example, and may be impossible to implement regardless of bureaucratic commitment."[114]

Politicians always tout what their programs are *supposed* to do, but whether programs actually work is less important to them. Democracy has many advantages, but it does not prevent policymakers from supporting a large number of failed programs.

"There is no built-in check—no invisible hand—to guide members to make value-added decisions, so their personal beliefs about policy may be untethered from reality."

Cost-Benefit Tradeoff

Congress proceeds with many failed policies because it does not confront direct cost-benefit tradeoffs. In the marketplace, people compare a product's cost to the expected benefits before they spend their money. Politicians do not face such a tradeoff. They are spending other people's money, which nobody spends as carefully as his own.

> "So when Congress focuses on the benefits of programs, but does not consider the full costs, lawmakers are biased in favor of supporting low-value or negative-value programs."

Furthermore, congressional spending decisions are often separated from taxing decisions. Agriculture committees, for example, vote on farm bills that cost hundreds of billions of dollars, but those committees do not deal with the unpleasant task of raising the taxes to pay for them. To the spending committees in Congress, the source of financing for their programs is usually someone else's problem.[115]

The pro-spending bias is exacerbated by the fact that the full costs of programs are rarely considered. The costs of spending include not just the added taxes, but the deadweight losses caused by extracting the taxes (or future taxes if the money is borrowed). Another cost is the compliance burdens of programs. Taxes, regulations, and spending programs all consume individual and business time on paperwork, which is time taken away from more productive activities. So when Congress focuses on the benefits of programs, but does not consider the full costs, lawmakers are biased in favor of supporting low-value or negative-value programs.

There is another hurdle to Congress making sound cost-benefit tradeoffs: *costs are benefits* to legislators. In markets costs are something to be minimized. But for legislators, costs represent spending on constituents, which is a political benefit. Consider a proposal to close down a low-value federal facility in a state. For the nation, the facility's modest benefits are outweighed by its larger taxpayer cost. But for the legislators with the facility in their state, the cost represents beneficial local spending. So to them, there is no tradeoff because both benefits and costs are benefits.

In Congress we often see members fighting to spend money in their districts on weapons systems that the Pentagon does not want. And we see members opposing the closure of post offices and other federal facilities in their districts that are not needed. A century ago Chester Collins Maxey described the same parochial pressures.[116] Back then Congress kept open unneeded Army posts that had been created to fight Indians decades earlier, and it kept open old assay offices that the U.S. Treasury said were no longer needed. It also constructed too many post offices in places where the postmaster general did not want them.

Perhaps in their hearts, many members of Congress try to put the national interest ahead of their narrow parochial interests. The problem is that they face a prisoner's dilemma: if they do not try to secure funding for their favored programs, they know that the money will be carved up and spent by other members, not saved. This problem is also called a "common pool" problem. The budget is like a fish stock in the ocean that gets depleted as each fisherman tries to maximize his catch. In sum, most members of Congress—even those who favor overall restraint—will pursue all the spending they can for their own states and preferred programs.

Concentrated Benefits, Diffuse Costs

Many federal programs deliver benefits to narrow groups but spread the costs widely across the population. Small groups of individuals and businesses are easier to organize than larger groups, and they have more focused goals, so they can be very effective in lobbying Congress for benefits.[117] The costs of narrow benefits—such as subsidies and regulatory advantages—are often diffused across tens of millions of taxpayers or consumers, often without the victims knowing that their pockets are being picked.

The federal sugar program is a good example. The benefits go to several thousand sugar producers, while the costs are spread across millions of consumers in the form of higher prices. Most Americans probably do not know that federal laws raise the price of sugar. And if they did know and complained to Congress, their voices would be drowned out by the professional lobbyists defending the program.

Bastiat described why arguments for such special-interest policies were often successful. With regard to trade barriers, he said, "Protection concentrates at a single point the good that it does, while the harm that it inflicts is diffused over a wide area. The good is apparent

Table 1
Majority Voting Does Not Ensure That Benefits Outweigh Costs

Legislator	Vote	Benefits Received by Constituents ($)	Taxes Paid by Constituents ($)
McConnell	Yea	12	10
McCain	Yea	12	10
Murkowski	Yea	12	10
Manchin	Nay	2	10
McCaskill	Nay	2	10
Total	**Pass**	**40**	**50**

Source: Author.

to the outer eye; the harm reveals itself only to the inner eye of the mind. In the case of free trade, it is just the reverse."[118]

Washington is teaming with lobbyists seeking special benefits—subsidies, regulations, trade protections—that come at the expense of the general public. Economists call this activity "rent-seeking," where "rent" means an abnormal profit. People often blame lobbyists for the problem, but rent-seeking is a two-way street. Jonathan Rauch of Brookings noted, "In the public's mind, the standard model of lobbying in Washington involves special interests buying influence, in a sort of legalized bribery. In fact, the process more often involves politicians shaking down special interests."[119]

It is easy to see why individual politicians support bills that include narrow breaks that they favor. But how do such bills gain a majority vote in Congress if they are bad for the nation? Table 1 provides an answer. A five-person legislature votes on a hypothetical program that provides nationwide benefits of $40 but costs taxpayers $50. Assuming that legislators vote in the narrow interests of their states, the program garners a majority vote. The key to the program's political success is that its benefits are more geographically concentrated than its costs. The legislation is a political success, but it is a failure for the nation because it costs more than it is worth.

Logrolling

Congress operates as a complex web of vote trading or logrolling. This key mechanism allows low-value and harmful programs to be passed. Logrolling usually works by bundling in a bill narrow provisions that benefit different states and interest groups. Committees support the logrolling process, as they help "members of Congress secure deals with one another, making sure that logrolls are durable over time."[120] Within the agriculture committees, for example, Congress bundles subsidies for different crops, each of which is important to different states. Also, farm bills typically include benefits for urban interests. These bills pass even though many specific provisions would not have majority support in Congress or among the public.

Table 2 shows how two subsidy programs, A and B, that both have higher costs than benefits can pass a legislature. Neither program has majority support, and each would fail if voted on separately. So McConnell, McCain, and Murkowski agree to bundle the two programs in one bill. They logroll. The two programs get approved, even though both of them impose a net cost on society.

Numerous factors strengthen the logrolling system in Congress. Committee chairs gather votes on bills by including special-interest provisions requested by each member. Members with safe seats can raise extra cam-

"Congress operates as a complex web of vote trading or logrolling. This key mechanism allows low-value and harmful programs to be passed."

"In 1886 Wisconsin Rep. Robert La Follette complained about the 'pernicious system' of logrolling, saying that members spent their time bickering about getting their share of funding rather than judging the 'real merits of any of these improvements.'"

Table 2
Logrolling Allows Passage of Narrow Subsidies

	Program A		Program B		
Legislator	Benefits Received by Constituents ($)	Taxes Paid by Constituents ($)	Benefits Received by Constituents ($)	Taxes Paid by Constituents ($)	Vote on Bill That Includes A and B
McConnell	15	10	8	10	Yea
McCain	15	10	8	10	Yea
Murkowski	4	10	20	10	Yea
Manchin	3	10	2	10	Nay
McCaskill	3	10	2	10	Nay
Total	**40**	**50**	**40**	**50**	**Pass**

Source: Author.

paign cash, which they offer to other members in return for their support on special-interest bills. Conscientious members who raise objections to special-interest bills get punished by party leaders.

Logrolling has been around since the 19th century. An early example was the Rivers and Harbors Act of 1826, which sprinkled Army Corps of Engineer projects across a dozen states to ensure its passage.[121] From the beginning, people have complained about the harmful effects of these bills. In an 1835 speech, Tennessee Rep. Davy Crockett said that he refused to go along with the "log-roll" system in the House.[122] And in 1836, Virginia Rep. John Patton criticized a rivers and harbors bill in the House as a "species of log-rolling most disreputable and corrupting."[123]

Studies in 1914 and 1919 by Chester Collins Maxey described the early history of "pork-barrel" legislation and "log-rolling."[124] He said that before the use of omnibus bills, legislation of "purely local interest" usually failed to pass, which made sense because such bills only had narrow support.[125] But after Congress started passing omnibus river and harbor bills, Maxey observed that about half of the projects included were "pure waste."[126] Numerous members of Congress during the 19th century had similar opinions about the low value of projects in these bills.[127]

The inclusion of projects in omnibus bills was typically not based on merit, but by the need to gain votes. Regarding river and harbor bills, Maxey said, "Committees have seldom been free to frame bills according to their own views of what was best for the country, simply because of the merciless pressure brought to bear upon them by their associates in Congress" to approve particular projects.[128] In 1886 Wisconsin Rep. Robert La Follette complained about the "pernicious system" of logrolling, saying that members spent their time bickering about getting their share of funding rather than judging the "real merits of any of these improvements."[129]

Pork barrel spending has usually been accompanied by hypocrisy. In 1866 Missouri Sen. George Vest—who was on the committee overseeing river and harbor bills—complained about members who came to him privately begging for projects, but then went to the Senate floor to "denounce the whole scheme of the bill as a piece of unconstitutional corruption."[130] President Ronald Reagan's budget chief, James Miller, recalls similar spending hypocrisy. Members privately pushed him for projects in their districts, but then would publicly bash the administration for not being tightfisted enough.[131]

When Maxey was writing, logrolling was expanding its grip on the federal budget. Members had long sought new post offices and other federal buildings in their districts, but these efforts often failed on stand-alone votes. Maxey said that in 1902 Congress began using omnibus bills for public buildings, and that led to an "avalanche" of new spending.[132] He described a similar spending increase after Congress switched to omnibus bills for veterans' pension claims in 1908.

Maxey concludes that "our government has suffered inestimable financial losses through log-rolling measures. The amount of money that has been directly or indirectly wasted upon unnecessary public buildings, obsolete and poorly located military posts, undeserved pensions, and the like can only be estimated; but it is safe to guess that it is enormous."[133] As a mechanism of waste, logrolling works the same way today, but the magnitude of spending is much greater.

These days, large omnibus bills that pass are usually portrayed by legislators as a victory for "bipartisan cooperation." And it is true that, in theory, logrolling can create an efficient outcome in some situations.[134] But, much of the time, logrolling leads to negative results, and it runs counter to the democratic ideal understood by most citizens of true majorities approving policies. Hayek said that legislatures should seek majority agreement on measures of general policy, but "the so-called approval by the majority of a conglomerate of measures serving particular interests is a farce. Buying majority support by deals with special interests . . . has nothing to do with the original ideal of democracy, and is certainly contrary to the more fundamental moral conception that all use of force ought to be guided and limited by the opinion of the majority."[135]

Fiscal Illusion

Ideally, federal legislators would carefully evaluate programs by comparing the costs to the benefits, and they would do so in a manner transparent to the public. However, legislators have developed numerous techniques to hide the costs of federal spending. As a result, people perceive the "price" of government to be lower than it really is, and they demand too much of it. Economists call this bias "fiscal illusion."[136]

Here are some of the ways that legislators hide the costs:

- *Debt.* The federal government currently finances about half a trillion dollars a year of its spending with borrowing. People see the benefits of the spending, but the costs are pushed to the future in the form of accumulated debt. The federal government ran deficits 85 percent of the years between 1930 and 2015.[137] Deficit spending is a chronic failing of modern governments. A survey of 20 high-income industrial countries covering 1960 to 2011 found that 14 of them ran deficits in more than three-quarters of those years.[138]
- *Withholding.* The federal government requires employers to withhold income and payroll taxes from worker paychecks, which makes earnings disappear before workers can see the cash. Withholding was introduced during World War II to make paying taxes feel less painful and thus to reduce taxpayer resistance to it.[139]
- *Business Taxes.* The federal government collects hundreds of billions of dollars a year from taxes on businesses, including the corporate income tax and the employer half of the federal payroll tax. The burden of these taxes ultimately falls on individual investors, workers, and consumers, but the collection is invisible to them.
- *Real Bracket Creep.* The federal income tax is indexed for inflation, but not for real economic growth. Because the income tax is graduated—rates rise as one earns more—the system results in the government automatically and invisibly gaining a larger share of American incomes over time.

"Legislators have developed numerous techniques to hide the costs of federal spending. As a result, people perceive the 'price' of government to be lower than it really is, and they demand too much of it."

> **"Without the profit goal, agencies have little reason to restrain costs and stem wasteful spending. Nor do agencies have a strong incentive to improve the quality of their services."**

- *Penalize a Minority.* Higher-income households pay a much larger share of their income to federal income taxes than do lower-income households. As a result, a small minority of earners—those who have the highest incomes—pay the great majority of all income taxes. The political effect of this tax structure is to bias people with lower and middle incomes to favor government expansion because most of the tax bill is paid by others.
- *Complexity.* Congress has spread out the federal tax burden across multiple different tax bases. It has also made the largest tax—the income tax—hugely complex. These techniques of tax design reduce the ability of voters to appreciate the overall cost of government.
- *Regulations.* When Congress wants to confer benefits on a group of voters, an alternative to a tax-funded spending program is a regulation. For example, current federal mandates require businesses to provide employees with health insurance, family and medical leave, facilities for the disabled, and other benefits. The costs of such mandates ultimately fall—in a hidden manner—on individuals in the form of lower wages or higher prices.
- *Smoke and Mirrors.* The government uses various accounting tricks to sidetrack budget rules so that spending programs get approved. For example, Congress partly funded the 2014 highway bill with a gimmick called "pension smoothing," which changed the timing of business taxes.[140] Another common trick is the "salami strategy," which is used by executive branch agencies, such as the Pentagon, on large projects. With this technique, the full costs of projects are only revealed a slice at a time, so that by the time the full costs are evident, the project is too far along to be canceled. This is one reason why federal projects often have large reported cost overruns.[141]

The use of fiscal illusion is a contributing factor to government failure. By partly hiding the burden of government, policymakers are emboldened to pursue ill-advised programs that have higher costs than benefits. Citizens and voters are left in the dark, not recognizing that the costs of all the benefits pouring forth from Washington are higher than they seem.

BUREAUCRATIC INCENTIVES

There are two common narratives about executive branch employees of the federal government. They are hard-working "public servants" who are skilled and politically neutral experts. Or they are slothful and inept "bureaucrats" whose mismanagement is behind the failures in government.

Which portrayal is more accurate? Actually, the personal attributes of federal workers are not the key to understanding bureaucratic failure. Instead, it is the incentives created by the structure of government that matters. We can assume that federal workers pursue many of the same sorts of self-interested goals that the rest of us do, such as higher pay and career advancement. But in the government, self-interested goals interact with bureaucratic incentives to explain many failures.[142]

The following are some of the failure-causing features of the federal bureaucracy:

- *Absence of Profits.* Unlike businesses, federal agencies do not have the straightforward and powerful goal of earning profits. That has a profound effect on efficiency and innovation. Without the profit goal, agencies have little reason to restrain costs and stem wasteful spending. Nor do agencies have a strong incentive to improve the quality of their services or the effectiveness of their management. It is easier for agencies to live the quiet life than to take risks and try to enhance performance.
- *Absence of Losses.* Poorly performing agencies do not go bankrupt, so there is no built-in mechanism to end low-

value activities. There is no automatic corrective to programs that have rising costs and falling quality. In the private sector, businesses abandon activities that no longer make sense, but "the moment government undertakes anything, it becomes entrenched and permanent," noted management expert Peter Drucker.[143] In government, resources remain stuck in obsolete activities, rather than being reallocated to better uses. Drucker said that "the strongest argument for private enterprise" over government is not the role of profits, but the role of losses.[144] Losses send a powerful signal to businesses that they need to make changes. Failing government programs do not send such a signal.

- *Monopoly.* Adding to the problem caused by the absence of profits and losses, many federal activities are monopolies. That further reduces incentives to restrain costs and improve quality. It also means there are no alternative sources of information for people to gauge the efficiency of a government activity. In competitive markets, people can compare the performance of different companies and products, but with monopolies, poor performance is harder to identify.
- *Output Measurement.* Business output can be measured by profits, revenues, market share, and other metrics. But government output—the quantity and the quality—is more difficult to measure. That makes it hard for Congress and the public to judge performance, or to set goals for agencies, managers, and employees. The missions of federal agencies are often multifaceted and vague. And agencies tend to describe their activities in opaque language with lots of buzz words, which makes it difficult to hold officials accountable for results.
- *Monitoring and Transparency.* Businesses produce audited financial statements, and their products are usually in the public realm for everyone to see. Shareholders, creditors, and other players in capital markets monitor companies, as do consumers and competitors in the marketplace. Ironically, private organizations are often more transparent and easier to monitor than public ones. With Britain's privatization program in the 1980s, for example, hidden financial troubles of government companies were exposed when companies were floated on the stock exchange. A current example of opaqueness is our National Park Service (NPS). The agency provides to the public few details about the budgets of its individual parks. A report by Sen. Tom Coburn in 2013 noted that the NPS produced a 2,400-page study on dog-walking options in the Golden Gate National Recreation Area, yet the same park provides the public virtually no information about its budget.[145] For a contrast to the NPS, look at the private Mount Vernon in Virginia, home of George Washington. The Mount Vernon Ladies Association publishes detailed and audited financial statements for the estate showing how money is raised and spent on each of its activities.[146] Why is this important? Without transparency and outside monitoring, organizations will receive less feedback, and that will make them more likely to fail.
- *Rigid Compensation.* Federal employee compensation is based on standardized scales generally tied to longevity, not performance. The rigid salary and benefits structure makes it hard to encourage improved employee efforts or to reward outstanding achievements. Rigid pay scales reduce morale among the best workers because they see the poor workers being rewarded equally. With rigid pay scales, the best workers have the most incentive to leave, while the poor workers will stay, decade after decade. But attempts to introduce greater pay-for-performance in the federal government have not worked very well either.

> **"Ironically, private organizations are often more transparent and easier to monitor than public ones."**

> “Recent data show that just 0.5 percent of federal civilian workers a year get fired for any reason, including poor performance or misconduct. That rate is just one-sixth the private-sector firing rate.”

A recent effort to give bonuses to outstanding employees in the senior executive service has led to the great majority of them being judged “outstanding.”[147] That dubious result was presumably facilitated by the lack of good output measurement in federal agencies.

- *Lack of Firing.* Disciplining federal workers is difficult. They have strong civil service protections, and about one-third of them are represented by unions.[148] When surveyed, federal employees themselves say that their agencies do a poor job of disciplining poor performers.[149] An investigation by *Government Executive* noted, “There is near-universal recognition that agencies have a problem getting rid of subpar employees.”[150] Federal workers are virtually never fired for poor performance. Recent data show that just 0.5 percent of federal civilian workers a year get fired for any reason, including poor performance or misconduct. That rate is just one-sixth the private-sector firing rate.[151] The firing rate is just 0.1 percent in the senior executive service, which includes the top career people in the government.[152] By contrast about 2 percent of corporate CEOs are fired each year, which is a rate 20 times higher than the senior executive service.[153]
- *Red Tape.* Federal agencies and programs are loaded with rules and regulations, which generally reduce operational efficiency. For example, people have complained for years about the heavy paperwork involved in federal recruiting, but this problem never seems to get fixed.[154] Large private organizations also have “red tape” problems, but the problems are worse in government. One reason for all the federal rules is to prevent corruption and fraud, which are big concerns because the government hands out so many contracts and subsidies. Government has enormous power, and so layers of rules are needed to safeguard against abuse.[155] Another reason for all the rules in government is that there is no profit goal, and so detailed rules provide an alternate way for superiors to monitor workers.[156] In the private sector, headquarters will monitor a regional office by seeing whether it earned a profit. In the government, headquarters will monitor a regional office by seeing whether it handed in all its paperwork. Finally, government workers themselves have reasons to favor red tape: if they follow detailed written rules, they can “cover their behinds” and shield themselves from criticism.[157] In sum, red tape is an unavoidable feature of the government and one reason why it will never be as efficient as the private sector.
- *Bureaucratic Layering.* American businesses have become leaner in recent decades, with flatter management structures. Research has found that the average number of executives reporting directly to corporate CEOs has increased substantially in recent decades, while the number of management layers in major corporations has fallen.[158] By contrast, in the federal government, “layering has become very extreme,” says Peter Schuck.[159] Paul Light found that the number of layers, or ranks by title, in the typical federal agency has jumped from 7 to 18 since the 1960s.[160] The federal workforce has become top-heavy with a growing number of executive designations (such as “principal associate deputy undersecretary”).[161] Light concluded that today’s “over-layed chain of command” in the government is a major cause of failure.[162] Overlaying stifles information flow, and it makes it hard to hold anyone accountable for failures.
- *Political Priorities.* The federal executive branch is headed by an elected president who appoints about 3,000 people to top positions across the bureaucracy.[163] Political leadership of federal agencies has some benefits, but it also causes fail-

ures.[164] New administrations come into office eager to launch new initiatives, but they are less interested in managing what is already there. Political appointees think that they know all the answers, so they do not bother learning the lessons from past efforts, and they repeat mistakes. As each administration yanks agencies in new directions, past investments are thrown down the drain.[165] The average tenure of federal political appointees is short—just two and half years—and so appointees tend to push superficially appealing initiatives that look good on their resumes, but they shy away from tackling longer-term, structural reforms.[166] Another problem with appointees is that many of them are political partisans who lack management or technical experience. One of the reasons for the failed response to Hurricane Katrina in 2005 was that many executives in the Department of Homeland Security were inexperienced party loyalists.[167] This lesson from Katrina has not been learned. Today, for example, many U.S. ambassadors are political donors with no experience in the countries they are posted.[168] Another specific example is the current acting head of the 900-employee Federal Railroad Administration, Sarah Feinberg, who seems to have no background in railroads or transportation, or apparently any technical qualifications. The ticket to the top for this official appears to have been a decade of media relations jobs for members of Congress and the White House.[169]

- *Agency Capture.* Federal agencies get influenced or "captured" by special interests, such as businesses. Interest groups may gain influence by providing gifts or benefits to federal employees, or by using their relationships with legislators who oversee the agencies. Lobbyist influence also stems from the power of the revolving door, meaning the possibility of officials gaining lucrative private-sector jobs after leaving government. Another power that interest groups often have is control over information and expertise that a federal agency needs. Economist George Stigler developed the idea that interest groups would "capture" regulatory agencies, meaning that agencies would work on behalf of regulated industries, rather than the general public.[170] By being regulated, businesses can use government to give them monopoly power, keep prices high, and gain other benefits. A classic example of capture was the Interstate Commerce Commission, which regulated railroads between 1887 and 1995. Milton Friedman said that it "started out as an agency to protect the public from exploitation by the railroads," but eventually became "an agency to protect railroads from competition by trucks and other means of transport."[171] Similarly, the Civil Aeronautics Board "managed and enforced a cartel among air carriers" to the detriment of the general public between 1940 and 1978.[172] In a more recent example of capture, the federal agency supposed to be overseeing Fannie Mae and Freddie Mac leading up to the recent financial crisis overlooked problems at the government-tethered companies.[173] Another captured agency was the federal Minerals Management Service (MMS). MMS employees had very close relationships with, and often received gifts from, employees of the energy companies that they were supposed to oversee.[174] That closeness appears to have been a factor in MMS's failures leading up to the BP Deepwater Horizon oil spill in 2010.
- *Principal-Agent Problem.* Numerous relationships in the economy involve a person (the principal) paying someone else (the agent) to do a job for the principal, but the agent instead pursues his or her own goals. In the government, employees are paid to faithfully execute the laws, but they often pursue goals counter

"One of the reasons for the failed response to Hurricane Katrina in 2005 was that many executives in the Department of Homeland Security were inexperienced party loyalists. This lesson from Katrina has not been learned."

“The government will always fall far short of competitive private markets in efficiency and innovation.”

to those of legislators and the public.[175] Unionized federal workers, for example, actively oppose legislators who support trimming worker pay or program budgets.[176] Meanwhile, agency leaders try to maximize their budgets in underhanded ways. They exaggerate problems in society to gain support for their missions. They leak biased information to the media to ward off budget cuts.[177] They put forward the most sensitive spending cuts in response to proposed budget reductions, which is called the “Washington Monument” strategy. They signal to the public that they are solving problems without actually solving them—for example, security agencies use “security theater” techniques that are visible to the public but do not make people safer. Agency leaders trumpet the supposedly great job they are doing, but hide agency failures from the public. And officials stonewall congressional requests for information that may shed a bad light on them. What is missing in the federal bureaucracy is critical self-examination, and that is one reason why agencies often find themselves in major failures and scandals that could have been avoided.

These sorts of bureaucratic drivers of federal failure have been observed for many decades. In a 1952 book, Illinois Sen. Paul Douglas, who was a famed PhD economist, discussed reasons for the “elephantiasis” of federal agencies.[178] He described, for example, how agencies have little incentive to control costs and why it was almost impossible to fire “deadwood” employees.

Many presidents have tried to improve executive branch efficiency.[179] President Theodore Roosevelt appointed the Keep Commission in 1905 to improve federal management. In a message to Congress, Roosevelt said, “There is every reason why our executive government machinery should be at least as well-planned, economical, and efficient as the best machinery of the great business organizations, which at present is not the case.”[180] The president was expressing Progressive-era optimism in government, but, as we have seen, such optimism is misguided.

President William Howard Taft appointed a Committee on Economy and Efficiency in 1910.[181] Then there was President Franklin Roosevelt’s Brownlow Commission in the 1930s, President Harry Truman’s and President Dwight Eisenhower’s Hoover Commissions in the 1940s and 1950s, President Ronald Reagan’s Grace Commission in the 1980s, and Vice President Albert Gore’s “Reinventing Government” project in the 1990s. President George W. Bush had a “management agenda” that examined the effectiveness of programs. And President Barack Obama promised in his 2011 State of the Union address to create “a government that’s more competent and more efficient. . . . My administration will develop a proposal to merge, consolidate, and reorganize the federal government in a way that best serves the goal of a more competitive America.”[182]

Despite all those efforts, the performance of the executive branch may be getting worse today, not better.[183] Federal employee morale, for example, is low and declining, and experts agree that the process of filling senior positions in agencies is broken.[184] Furthermore, federal personnel systems do not work very well. *Government Executive* recently concluded, “The processes for hiring and firing employees are riddled with complex regulations and confusion over how to apply rules designed to preserve fairness and diversity. The system frustrates employees and citizens alike, and makes it hard for agencies to effectively deliver services.”[185]

So the reform efforts over the decades may have been useful exercises, but they were just tinkering around the edges. Such efforts cannot solve fundamental structural problems, such as the absence of measured profits and losses in government activities. The government will always fall far short of competitive private markets in efficiency and innovation.

In 1969 Peter Drucker wrote the influential article “The Sickness of Government.” In it he stated that the love affair with government was coming to an end because it was increasingly clear that government "costs a great deal but does not achieve much."[186] He noted that governments have simply not performed very well, and that their record was "dismal."[187] He argued that the problems of government bureaucracy were deeply structural, and so fiddling to improve management was not enough. Drucker called for "reprivatization" of government activities, a word that would morph into "privatization."

A decade later in 1979, Great Britain's Margaret Thatcher launched a privatization revolution that swept the world. Britain privatized housing, energy firms, seaports, airports, airlines, air traffic control, utilities, passenger rail, and many other activities. Dozens of nations followed Britain's lead, and more than $2.5 trillion worth of government businesses and infrastructure has been sold off over the past two decades.[188]

Unfortunately, the privatization revolution has largely bypassed the U.S. federal government. Yet many federal activities could succeed in the private sector, such as air traffic control, passenger rail, postal services, and various infrastructure. Congress is failing by holding onto activities that would generate more value for the public in the private sector. Academic studies across many countries have revealed that privatized activities generally perform better than similar government activities.[189]

In sum, the federal bureaucracy has many features that contribute to poor performance and failure. Members of Congress may wish that programs they dream up are delivered to their constituents in an efficient manner by expert civil servants, but that is not how the government often works. Congress should try to improve federal management, but it is more important for Congress to focus on ending or privatizing activities.

HUGE SIZE AND SCOPE

Failure has plagued the federal government since the beginning. A federal effort to run Indian trading posts starting in the 1790s was beset with waste and inefficiency.[190] Corruption afflicted numerous federal agencies during the 19th century.[191] And federal infrastructure spending has always suffered from cost overruns and pork barrel politics. An 1836 Ways and Means Committee study, for example, criticized the waste in river and harbor spending, having found that many projects were substantially over budget.[192]

So federal failure has always been a problem. But it is much worse today because the government is so much larger. Federal spending grew from 4 percent of gross domestic product (GDP) in 1930 to more than 20 percent today. Some people argue that the growth has stemmed from citizen demand for bigger government.[193] But this study has described structural features of government that have promoted excess expansion.[194]

Whatever the causes of the federal government's large size, that large size itself is generating failure. Some of the causes of failure already discussed get worse as the government expands. For example, there are so many programs today that they must be bundled into massive reauthorization and appropriation bills, rather than each being voted on individually. As a consequence, logrolling has become a more important institution because Congress does not have the time to evaluate each program separately.

This section looks at three additional reasons why we should expect the government to fail more as it grows larger. First, policymakers have become overloaded by all the activities that they are supposed to oversee. Second, new spending is likely to be worth less than existing spending. Third, deadweight losses increase rapidly as tax rates rise.

Policymaker Overload

The huge size and scope of federal activities is overwhelming the ability of lawmakers to allocate resources efficiently and make needed reforms. Consider that the federal budget of about $4 trillion is 100 times larger than the average state government budget of about $40 billion.[195] The federal government

"The huge size and scope of federal activities is overwhelming the ability of lawmakers to allocate resources efficiently and make needed reforms."

> **"The more programs the government has, the more likely they will work at cross purposes."**

has many more employees, programs, contractors, and subsidy recipients to keep track of than any state government. So even if federal legislators spent their time diligently scrutinizing programs, the job is simply too large for them to do effectively.

The federal government is not just large in size, it is sprawling in scope. In addition to handling core functions such as national defense, the government runs more than 2,300 subsidy and benefit programs, which is double the number as recently as the 1980s.[196] The government has spread its tentacles into many formerly state, local, and private activities, such as education, energy, welfare, housing, and urban transit.

Congress does not have the time or expertise to allocate resources efficiently in all these areas. Members are spread too thin, which is evident from the fact that they routinely miss all or parts of congressional hearings.[197] Congress grabs for itself vast powers over nonfederal activities, but then members do not have the time to properly monitor how their interventions are actually working.

Legislators and presidents are being distracted from performing their basic constitutional duties. As one example, many shortcomings in security and intelligence agencies went unfixed before the 9/11 terrorist attacks, as policymakers were too busy with other issues.[198] And on that terrible day, President George W. Bush was in Florida promoting local school programs, which epitomizes the federal entanglement in nonfederal activities. Even in the years after 9/11, members of the House and Senate intelligence committees apparently did not make intelligence matters their highest priority.[199]

In recent years, numerous failures have erupted into major scandals, and each time the White House has claimed to be unaware of the developing problem.[200] Numerous foreign policy developments have also caught the White House by surprise. The government is involved in so many activities that warnings about brewing failures are not filtering up to the president's desk until it is too late. Paul Light noted that President Obama seems to be "either too distracted to concentrate" or "too bored by the nitty-gritty of management" to ward off developing crises.[201]

Meanwhile, members of Congress spend their time fundraising, securing benefits for their districts, and giving speeches, but little time actually learning about policy. Members usually blame government failures on the executive branch, but they fail in their own oversight role. When the Secret Service and the Department of Veterans Affairs scandals erupted in 2014, the public found out that the problems had been developing for years, but went unaddressed by those two branches of government.

The government is doing too much and doing little well. It is like a conglomerate corporation that is involved in so many activities that executives are distracted from their core business. Markets force bloated corporations to refocus and shed their low-value activities, but no mechanism forces the federal government to do so. Milton Friedman noted, "The tragedy is that because government is doing so many things it ought not to be doing, it performs the functions it ought to be performing badly."[202]

While legislators are overwhelmed by the size and scope of the government, the bureaucracy has also become unmanageable. Paul Light thinks that one reason for the increase in failures is the "ever-thickening hierarchy" of departments.[203] He says that "communication continues to be a major source of failure, in part because information has to flow up through multiple layers to reach the top of an agency."[204] President Obama's frequent appointment of "czars" partly reflects the recognition that the traditional bureaucracy is not working.

The more programs the government has, the more likely they will work at cross purposes. Some programs keep food prices high, while others subsidize food for people with low incomes. Some programs encourage people to live in risky flood areas, while others try to reduce flood risks. The government promotes breastfeeding, but it also subsidizes baby formula. Many programs subsidize health care and infrastructure, but regulations raise the costs of those activities. The government is too large for it to coordinate its activities. Many failures during Hurricane Katrina in 2005 stemmed from the excessively complex array of emergency response agencies, laws, regulations, and procedures.[205]

In his book *Government's End,* Brookings scholar Jonathan Rauch used the word "demosclerosis" to describe how government becomes less effective as it grows larger.[206] Because government rarely eliminates failed programs, it becomes more wasteful over time. Rauch argued that "the rise of government activism has immobilized activist government," such that "the more different things it tries to do at once, the less effective it tends to become."[207]

Ironically, even as Congress has created many new programs to supposedly help the public, the public has not grown fonder of the government. Instead, people have become more alienated. Milton Friedman observed, "As the scope and role of government expands . . . the connection between the people governed and the people governing becomes attenuated."[208] One reason is that the larger the government gets, the more resources it forcibly transfers between people, which in turn generates "diametrically opposed interests" in the public.[209]

Public polling supports these points. Even though Americans have become more dependent on the federal government, Pew Research Center finds that the share of people who trust government has plunged.[210] Trust in the federal government fell from more than 70 percent in the early 1960s to about 30 percent by 1980, even though that period was one of government expansion. Trust edged upward slightly during the 1980s and 1990s when domestic spending was being trimmed, but it has fallen since 2000 as the government has grown again.

In sum, as the government has grown larger, leaders have become overloaded. They do not have enough time to understand programs, to oversee them, or to fix them. The more programs there are, the harder it is to efficiently allocate resources, and the more likely it is that programs will work at cross purposes. Within departments, red tape has multiplied, information is getting bottled up under layers of management, and decisionmaking is becoming more difficult because more people are involved. The government is failing more, and the public is getting ever more disgusted.

Declining Value of Spending and Regulating

As the government grows larger, each increment in its size is likely to have less value. If the Air Force adds a fighter jet, the marginal benefit to national security will be less than the benefits of jets it already has. If education spending grows, each added dollar produces less benefit than the last. If food stamps are expanded to 47 million people, the 47 millionth recipient is likely to be less needy than the first. The same is true for regulations. Each new regulation for, say, clean air is likely to have less value than the initial rules passed decades ago.

Legislators do not seem to appreciate this idea of declining marginal value. They often say things like "education funding helps students" or "defense spending protects the nation." They confuse the *average* value of all the current spending with the *marginal* value of the last dollar spent. The marginal value is lower because we already spend a lot on these activities.

Declining marginal value also occurs as the *scope* of the government expands. Each new activity is further removed from the government's core functions and likely generates fewer benefits. Historically, the government focused on constitutional functions such as national defense and ensuring open interstate commerce. The federal government is uniquely qualified to carry out those high-value functions. But as the decades have passed, newer federal activities are less unique and more likely to be duplicative of existing state, local, and private activities.

> **"Ironically, even as Congress has created many new programs to supposedly help the public, the public has not grown fonder of the government. Instead, people have become more alienated."**

"Programs that might have made sense when the federal government was smaller may no longer make sense when the government is larger."

Furthermore, as the government expands, more of its activities are focused on narrow benefits, not the general welfare. With a larger government, the power of special interests is increased.[211] Milton Friedman noted why state and local governments are more likely to generate value than the federal government: "The smaller the unit of government and the more restricted the functions assigned government, the less likely it is that its actions will reflect special interests rather than the general interest."[212]

Why do policymakers support continued federal expansion, despite the declining marginal value of its activities? For the reasons discussed above in the politics and bureaucracy sections. But also because of the "halo effect" of government. People regard the government's core functions, such as national defense, as so crucial that it creates a positive halo over government in general. The government is powerful, so people assume that it can solve many problems in society. If the government can fight foreign wars, for example, it should be able to fight a war on poverty and a war on drugs.

The reality is that America is a great country because the government has fulfilled its core function of guaranteeing our basic freedoms. The mistake that people make is to assume that the nation's greatness can be extended by government into an endless array of other tasks.

Rising Marginal Cost of Funding

This study discussed how taxes create damage called deadweight losses. Taxes not only shift resources to the government, but the process of extracting taxes from people causes harm in itself. Each added dollar of federal income taxes creates roughly 50 cents in deadweight losses.[213] So a $10 billion federal project would cost the private sector $10 billion directly plus another $5 billion in deadweight losses.

The magnitude of deadweight losses depends on the tax rate. As the tax rate rises, deadweight losses increase rapidly. Harvard University economist Greg Mankiw explains: "It is a standard proposition in economics that the deadweight loss of a tax rises approximately with the square of the tax rate. . . . If we double the size of a tax, the deadweight loss increases four-fold; if we triple the size of the tax, the deadweight loss increases nine-fold."[214]

Federal spending is funded by taxes, either current taxes or deferred taxes in the form of deficits. Higher spending eventually requires higher tax rates, and that causes rising economic damage.[215] A study for the European Central Bank stressed the importance of this fact: "Each additional dollar of spending, requiring an additional dollar of revenue, will impose additional and rising marginal costs on the economy unless that dollar comes from reducing some other spending. The concept of efficiency in public spending must take this into account."[216] In other words, policymakers should consider the escalating tax damage when they are thinking about raising spending.

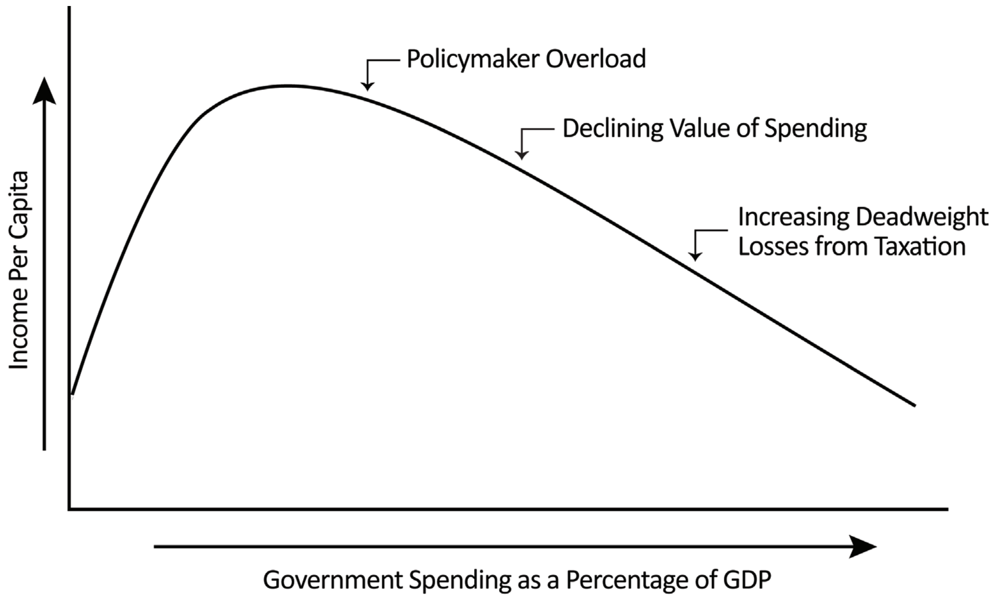
Because federal taxes are already high, any new spending faces a high hurdle for it to make sense because of the elevated damage caused by funding it. Programs that might have made sense when the federal government was smaller may no longer make sense when the government is larger. As the government grows, it is more likely that new spending will fail, meaning that the benefits fall short of the costs.

More Government, Less Prosperity and Freedom

Let's put these ideas about taxes and spending together. The harm from taxes and the inefficiency of much spending creates a "leaky bucket" problem.[217] When the government transfers money from taxpayers to welfare recipients, for example, it induces both groups of people to work less. That reduces economic output and overall incomes, which is like losing water when you pass a leaky bucket from one person to another.

Economist Michael Boskin estimated the size of the leak:

Figure 4
The Size of Government and Average Incomes



Source: Author.

> The cost to the economy of each additional tax dollar is about \$1.40 to \$1.50. Now that tax dollar . . . is put into a bucket. Some of it leaks out in overhead, waste, and so on. In a well-managed program, the government may spend 80 or 90 cents of that dollar on achieving its goals. Inefficient programs would be much lower, \$.30 or \$.40 on the dollar.[218]

So a new program might cost the private economy \$1.50, but produce benefits of, say, \$0.50, for a 3-to-1 ratio.

Economist Edgar Browning came to similar conclusions. Browning is an expert on the effects of taxes and government spending, and he summarized his research in the 2008 book, *Stealing from Each Other*.[219] Looking at the federal government overall, he roughly estimated that "it costs taxpayers \$3 to provide a benefit worth \$1 to recipients."[220]

The government's bucket gets leakier the larger the government becomes. As the government grows, the marginal value of spending declines, the marginal cost of taxation rises, and policymakers get overloaded, which causes more failures. As the government grows, the net value of new activities declines and turns negative, which drags down the overall economy.

Figure 4 illustrates this idea. It shows the relationship between government size and average incomes.[221] On the left, tax rates are low and cause little damage, and the government delivers useful public goods such as securing property rights and combating crime. Those activities create high returns, so incomes initially rise as government expands.

As government grows further, tax rates rise, people reduce their productive activities, and deadweight losses increase. Meanwhile, government expands into noncore activities that create fewer benefits. New regulations are piled on top of existing regulations, and it becomes increasingly difficult for individuals and businesses to deal with all the paperwork and restrictions. Policymakers get overwhelmed by all the programs, and they have less time to reform or prune the ineffective ones. Government accumulates a growing pile of losers.

In Figure 4, average incomes peak and then begin falling as spending and taxing increases.

"As the government grows, the marginal value of spending declines, the marginal cost of taxation rises, and policymakers get overloaded, which causes more failures."

> "The federal government and the private sector both fail. The difference is that the government fails more and fixes less."

Government enters negative-value territory. New programs add little value but impose rising tax damage. Economic output and average incomes fall. Of course, different taxes and spending programs have different effects, and the chart represents an aggregation. But the point is that the larger the government, the less likely that new spending will generate net value.[222]

Government spending at all levels in the United States was 38 percent of GDP in 2014.[223] The federal government is responsible for two-thirds of that, and if it were located on the line in Figure 4, it would be on the right-hand side. In his book, Browning reviews federal taxing and spending activities and concludes that the government's excessive size reduces average U.S. incomes by roughly 25 percent.[224] Such a large loss represents government failure on a grand scale.

Economist Richard Rahn presented a chart like Figure 4 in the 1980s, and numerous scholars have since made statistical estimates of the curve.[225] Some scholars have described the peak of the curve as the "optimal" size of the government because incomes are maximized at that point.[226] But incomes are only one dimension along which the government affects our well-being. In a 1957 speech, Ronald Reagan said, "Remember that every government service, every offer of government financed security, is paid for in the loss of personal freedom."[227] He is right. So we could draw a similar figure but with personal freedom on the vertical axis. Sadly, America today would be on the right-hand side of that figure as well—that is, in the region of declining freedom.

Some people might argue that today's big government, nonetheless, improves our well-being in other ways, such as by increasing our life expectancies or improving education. Economist Vito Tanzi examined that question for a sample of high-income countries using the United Nation's human development index (HDI). He found "no identifiable relationship between levels of public spending and HDI."[228] So today's large governments in the United States and elsewhere reduce incomes and freedom, and they might generate few, if any, compensating benefits.

CONCLUSIONS

The federal government and the private sector both fail. The difference is that the government fails more and fixes less. This study described many of the reasons why. The top-down nature of federal policies creates winners and losers and turns decisionmaking into guesswork. The government's funding mechanism is compulsory, so there is no built-in mechanism to end harmful activities. And policymakers have strong incentives to favor new programs, but few incentives to prune the waste.

In the private sector, businesses learn from failure and continually redirect their efforts and resources to higher-valued uses. That is why in his book, *Why Most Things Fail,* British economist Paul Ormerod said,

> America is the most successful society the world has ever seen. . . . Yet, paradoxically, American success is built on failure. It is precisely the willingness to experiment, to try new ways of doing things, and to embrace change that distinguishes America from the less dynamic societies of Continental Europe.[229]

America's historical success was built on the freedom of entrepreneurs to take risks, challenge existing businesses, and build new industries. There have been many business failures, but that has led to ongoing regeneration—creative destruction—in American industry.

Governments are different. Rather than *creative destruction*, its failures lead to *stifling obstruction*. Failed programs do not disappear, they just keep piling up. "Governments of all persuasions," says Ormerod, "appear chronically unable to admit that any single aspect of their policy has failed."[230] A half century ago, Ronald Reagan made basically the same point:

"A government bureau is the nearest thing to eternal life we'll ever see on this earth."[231]

For decades, federal bureaus, programs, laws, and regulations have proliferated. Policymakers do not have the time, inclination, or incentives to fix the constant stream of failures that develop in Washington. So the larger the government becomes, the more failed and obsolete policies it imposes on society.

What is the solution? The public should press Congress to make fiscal and procedural reforms. Those reforms might include tighter spending restraints, more rigorous evaluations of programs, and an overhaul of the tax code to reduce the economic damage. Constitutional amendments to limit congressional terms and impose greater budget discipline are also promising ideas.

However, the most important way to improve federal performance would be to greatly cut the government's size. In recent decades, the federal government has expanded into hundreds of areas better left to state and local governments, businesses, charities, and individuals. That ongoing centralizing of government power is a terrible mistake, and it is delivering steadily worse governance to Americans over time.

Reforms should shift federal activities back to the states and the people. State and local governments certainly suffer failures, but their failures are not thrust onto the whole nation. Indeed, when policies fail in some states, other states can learn the lessons and pursue different strategies. Furthermore, the states compete with each other for people and investment, which creates discipline and ongoing pressure to reform. The states also have governance advantages over the federal government that help to reduce failure, such as legal requirements to balance their budgets.

Polls show that Americans support moving power out of Washington. Large majorities of people prefer state rather than federal control over education, housing, transportation, welfare, health insurance, and other activities.[232] In recent decades, there has been a steady shift in public opinion in favor of federalism or the decentralizing of power.[233]

Why do Americans support federalism? Polls show that people have a much more favorable view of state and local governments than of the federal government.[234] More people think that state and local governments provide competent service than the federal government.[235] And when asked which level of government gives them the best value for their tax dollars, two-thirds of people say state and local governments and just one-third say the federal government.

In sum, political and bureaucratic incentives and the huge size of the federal government are causing endemic failure. The causes of federal failure are deeply structural, and they will not be solved by appointing more competent officials or putting a different party in charge. Americans are deeply unhappy with the way that Washington works, and everyone agrees that we need better governance. The only way to achieve it is to greatly cut the federal government's size and scope.

"The causes of federal failure are deeply structural, and they will not be solved by appointing more competent officials or putting a different party in charge."

NOTES

1. Joy Wilke, "Americans' Belief that Gov't Is Too Powerful at Record Level," Gallup.com, September 23, 2013. And see RasmussenReports.com, "Most Think Feds Too Big a Presence in Their Lives," August 12, 2014.

2. Pew Research Center, "Public Trust in Government: 1958–2014," November 13, 2014.

3. John Samples and Emily Ekins, "Public Attitudes toward Federalism," Cato Institute Policy Analysis no. 759, September 23, 2014, figs. 24 and 27.

4. American Customer Satisfaction Index, "ASCI Federal Government Report 2014," www.theacsi.org, January 27, 2015.

5. Justin McCarthy, "Americans Name Government as No. 1 U.S. Problem," Gallup.com, March 12, 2015.

6. Peter H. Schuck, *Why Government Fails So*

Often: And How It Can Do Better (Princeton, NJ: Princeton University Press, 2014), p. 4.

7. Schuck reviews many scholarly studies in ibid.

8. Chester Collins Maxey, "A Little History of Pork," *National Municipal Review* 8, no. 10 (December 1919): 691–705. Maxey was a supervisor at the New York Bureau of Municipal Research.

9. James M. Beck, *Our Wonderland of Bureaucracy* (New York: The MacMillan Company, 1932).

10. Ibid., pp. 139, 142.

11. Ibid., pp. 152, 154.

12. Ibid., p. 160.

13. Ibid., p. 155.

14. F. A. Hayek, *The Road to Serfdom* (London: Ark Paperbacks, 1986), p. 36.

15. Ibid., p. 37.

16. Milton Friedman, *Capitalism and Freedom* (Chicago: University of Chicago Press, 1962), p. 200.

17. Ibid., p. 15.

18. For a brief overview of public choice, see Pierre Lemieux, "Public Choice Revolution," *Regulation* 27, no. 3 (Fall 2004): 22–29. For a detailed examination, see William C. Mitchell and Randy T. Simmons, *Beyond Politics: Markets, Welfare, and the Failure of Bureaucracy* (Boulder, CO: Westview Press, 1994); and see Dennis C. Mueller, *Public Choice III* (Cambridge, UK: Cambridge University Press, 2003).

19. Buchanan also refers to public choice as "the economic theory of politics" and a "theory of government failure." See James M. Buchanan, "Politics without Romance," in *The Collected Works of James M. Buchanan, Volume 1: The Logical Foundations of Constitutional Liberty*, ed. Leland B. Yeager (Indianapolis: Liberty Fund, 1999), p. 45.

20. Clifford Winston, "Government Failure vs. Market Failure: Microeconomics Policy Research and Government Performance," AEI-Brookings Joint Center for Regulatory Studies, 2006, p. 73.

21. Ibid., pp. 63, 88.

22. Paul C. Light, "A Cascade of Failures," Brookings Institution, July 2014, p. 1.

23. Schuck, *Why Government Fails So Often*.

24. Ibid., pp. 371, 372.

25. Ibid., p. 372.

26. In contrast to government failure, theories of market failure have long been presented in basic textbooks. It is also true, however, that market failure concepts are subject to much debate. For a look at market failure and government failure, see Charles Wolf Jr., "A Theory of 'Non-Market Failure': Framework for Implementation Analysis," Rand Corporation, 1978.

27. This is the standard of government failure chosen in a review of Canadian government performance in Charles Lammam et al., "Federal Government Failure in Canada" Fraser Institute, October 2013.

28. Milton Friedman, *Capitalism and Freedom* (Chicago: University of Chicago Press, 1962), p. 32.

29. F. A. Hayek, *Law, Legislation and Liberty, Volume 2: The Mirage of Social Justice* (Chicago: University of Chicago Press, 1976), p. 110.

30. Sowell goes on to say that diversity "is also its greatest political vulnerability" because many people and political leaders have a desire to impose their values on others. Sowell, *Knowledge and Decisions*, p. 42.

31. These are "final rules" published in the *Federal Register*. See Clyde Wayne Crews Jr., "Ten Thousand Commandments 2014," Competitive Enterprise Institute, 2014, p. 2.

32. This number is the total page count in the Code of Federal Regulations. See Crews Jr., "Ten Thousand Commandments 2014," p. 63.

33. Chris Edwards, "Independence in 1776; Dependence in 2014," *Cato at Liberty* (blog), Cato Institute, July 3, 2014. By 2015, the number of programs had topped 2,300. See www.cfda.gov.

34. Most public finance textbooks provide background on cost-benefit analysis. See David N. Hyman, *Public Finance: A Contemporary Application of Theory to Policy* (Mason, Ohio: Thomson South-Western, 2005), chap. 6. Or see Harvey S. Rosen, *Public Finance: Sixth Edition* (New York: McGraw-Hill, 2002), chap. 11.

35. President Reagan issued Exec. Order No. 12291 in 1981 mandating the use of cost-benefit analysis for significant regulatory actions, which are those that have an impact of more than $100 million a year. This order was superseded by President Clinton's Exec. Order No. 12866 in 1993. "Independent" federal agencies are exempt from the requirements, including most of the agencies that impose financial regulations.

36. Susan E. Dudley, "OMB's Reported Benefits of Regulation: Too Good to Be True?" *Regulation* 36, no. 2 (Summer 2013): 26–30.

37. Jerry Ellig, "Improving Regulatory Impact Analysis through Process Reform," testimony before the Joint Economic Committee Hearing "Reducing Unnecessary and Costly Red Tape through Smarter Regulations," June 26, 2013.

38. The Office of Management and Budget's "Guidelines and Discount Rates for Benefit-Cost Analysis of Federal Programs" (Circular A-94, October 29, 1992), establishes guidelines for cost-benefit analyses within agencies.

39. Chris Edwards, "Cutting the Army Corps of Engineers," DownsizingGovernment.org, Cato Institute, March 2012. And see Marc Reisner, *Cadillac Desert: The American West and Its Disappearing Water* (New York: Penguin, 1993).

40. Michael Grunwald, "Reining in the Corps of Engineers," *Time*, September 20, 2007.

41. Government Accountability Office, "Corps of Engineers: Observations on Planning and Project Management Processes for the Civil Works Program," GAO-06-529T, March 15, 2006, p. 5.

42. For suggestions on improving regulatory cost-benefit analyses, see Susan E. Dudley, testimony June 26, 2013, before the Joint Economic Committee Hearing, "Reducing Unnecessary and Costly Red Tape through Smarter Regulations." And see Robert W. Hahn and Erin M. Layburn, "Tracking the Value of Regulation," *Regulation* 26, no. 3 (Fall 2003): 16–21.

43. Chris Edwards, "Terminating the Department of Homeland Security," DownsizingGovernment.org, Cato Institute, November 2014.

44. In cost-benefit analyses, costs and benefits imposed on different people are tallied in dollars, and if the latter are larger than the former the project is deemed beneficial. The procedure assumes that it is appropriate for the government to impose losses on some people as long as others gain more. But, of course, that does not take into account more fundamental values such as individual rights.

45. Brian Headd, Alfred Nucci, and Richard Boden, "What Matters More: Business Exit Rates or Business Survival Rates?" U.S. Census Bureau, Business Dynamics Statistics Brief 4, 2010. European statistics also show a roughly 10 percent exit rate. See "Business Demography Statistics" in *Eurostat Statistics Explained*, December 2014, http://ec.europa.eu/eurostat/statistics-explained/index.php/Business_demography_statistics.

46. Adam Smith, *The Wealth of Nations* (Chicago: University of Chicago Press, 1976), vol. 1, bk. 4, chap. 2.

47. Hayek, "The Market Order or Catallaxy," in *Law, Legislation and Liberty, Volume 2*, p. 109.

48. Ibid., p. 110.

49. Buchanan, "Politics, Policy, and the Pigovian Margins," in *The Collected Works of James M. Buchanan, Volume 1*, p. 66. See also James M. Buchanan and Gordon Tullock, *The Calculus of Consent: The Selected Works of Gordon Tullock, Volume 2* (Indianapolis: Liberty Fund, 2004). Political externalities (or "external costs") would be eliminated in a political system based on unanimous agreement. But a requirement for unanimity would impose high decisionmaking costs. *The Calculus of Consent* examines the tradeoffs an individual might consider between the external costs and decisionmaking costs of government.

50. Sowell, *Knowledge and Decisions*, p. 173.

51. Frédéric Bastiat, "What Is Seen and What Is Not Seen," in *Selected Essays on Political Economy* (Irvington-on-Hudson, NY: Foundation for Economic Education, 1995), p. 13.

52. Friedman, *Capitalism and Freedom*, p. 23.

53. Ibid., p. 24. Murray Rothbard made similar observations. On markets, he said, "there is a harmony of interests, for everyone demonstrably gains in utility from market exchange. Where government intervenes, on the other hand, caste conflict is thereby created, for one man benefits at the expense of another." See Murray N. Rothbard, *Power and Market: Government and the Economy* (Menlo Park, CA: Institute for Humane Studies, 1970), p. 126.

54. William S. Peirce, "Government: An Expensive Provider," in *Limiting Leviathan*, ed. Donald P. Racheter and Richard E. Wagner (Northhampton, MA: Edward Elgar, 1999), p. 57.

55. Public goods are usually defined as those that are "nonrivalrous" and "nonexcludable." Nonrivalrous means that one person's use of the good is not reduced as others use more of it. Nonexcludable means that once a good is provided, it is difficult to exclude anyone from consuming it. National defense is a classic public good. See Tyler Cowen, "Public Goods," in *The Concise Encyclopedia of Economics*, accessed June 4, 2015, www.econlib.org/library/Enc/PublicGoods.html.

56. Externalities occur when production or consumption activities of one person have an effect on another person outside of the price system. There is a large literature examining whether market failures have occurred in particular situations and whether the government should try to fix them given the government's own tendency to fail. Economist Ronald Coase famously described how private parties could agree to efficient solutions with respect to externalities without government intervention if transaction costs are low.

57. The main idea of efficiency used by economists is "Pareto efficiency." An efficient outcome is one where nobody can be made better off without somebody being made worse off. Put another way, resources are allocated to their most productive uses. Perfectly functioning competitive markets achieve Pareto efficiency.

58. The measure of deadweight loss is often called a "Harberger triangle" after the economist who popularized the measurement of these losses, Arnold Harberger. Deadweight loss is also called "excess burden," For an excellent review of the development of deadweight loss theory, see James R. Hines, "Three Sides of Harberger Triangles," National Bureau of Economic Research Working Paper no. 6852, December 1998.

59. Chris Conover surveyed the literature and reported an average of 44 cents for the marginal cost of all federal taxes, and 50 cents for federal income taxes. Christopher J. Conover, "Congress Should Account for the Excess Burden of Taxation" Cato Institute Policy Analysis no. 669, October 13, 2010. See also Edgar K. Browning, *Stealing from Each Other: How the Welfare State Robs Americans of Money and Spirit* (Westport, CT: Praeger Publishers, 2008), pp. 156, 166, 178. The Congressional Budget Office has stated, "Typical estimates of the economic cost of a dollar of tax revenue range from 20 cents to 60 cents over and above the revenue raised." See Congressional Budget Office,

"Budget Options," February 2001, p. 381.

60. Martin Feldstein, "How Big Should Government Be?" *National Tax Journal* 50, no. 2 (June 1997): 197–213.

61. If the subsidy program were funded by borrowing, it would delay tax payments to the future, but the deadweight losses could be even higher. Browning, *Stealing from Each Other*, p. 166.

62. The White House issued guidelines for cost-benefit analyses in 1992 that recommended that agencies multiply project costs by 1.25 to take into account the deadweight losses from taxation. But these procedures are not a hard mandate and, I am told, are not widely used. The guidelines are Office of Management and Budget, Circular No. A-94 Revised (October 29, 1992). As an example of a detailed federal cost-benefit analysis, Mathematica prepared a 98-page analysis of Job Corps on contract to the Department of Labor in 2006. The study did not include the deadweight loss of tax financing. It found that the benefits of the program were $3,544 per participant, while the costs were $16,205 per participant. That creates a net loss of $10,300 per participant. The inclusion of deadweight losses would have made the net losses even higher. See Peter Z. Schochet, John Burghardt, and Sheena McConnell, "National Job Corps Study and Longer-Term Follow-Up Study," Mathematica Policy Research, Inc., August 2006.

63. In addition to deadweight losses, policymakers leave out other costs when comparing government activities to private activities. For one thing, they leave out the opportunity costs of their assets, such as the rental value of government-owned properties. See Antonio Afonso, Ludger Schuknecht, and Vito Tanzi, "Public Sector Efficiency," European Central Bank Working Paper 581, January 2006.

64. Christopher J. Conover, "Congress Should Account for the Excess Burden of Taxation," Cato Institute Policy Analysis no. 669, October 13, 2010.

65. Quoted in Nicholas Eberstadt, "American Exceptionalism and the Entitlement State," *National Affairs* 22 (Winter 2015).

66. The secondary effects rippling outwards from subsidies and regulations may or may not cause further deadweight losses beyond the immediate market. It depends on whether other markets have distortionary aspects that prevent them from adjusting. See Hines, "Three Sides of Harberger Triangles."

67. Henry Hazlitt, *Economics in One Lesson* (Norwalk, CT: Arlington House Inc., 1979), p. 191. Originally published 1946.

68. Christopher Weaver and Anna Wilde Mathews, "Doctors Cash In on Drug Tests for Seniors, and Medicare Pays the Bill," *Wall Street Journal*, November 10, 2014.

69. Number of doctors and hospitals from Fred Schulte, Joe Eaton, and David Donald, "Code Creep Costs Medicare $11 Billion," *Washington Post*, September 16, 2012.

70. Government Accountability Office, "Higher Use of Advanced Imaging Services by Providers Who Self-Refer Costing Medicare Millions," GAO-12-966, September 2012.

71. Chris Edwards and Michael Cannon, "Medicare Reforms," DownsizingGovernment.org, Cato Institute, September 2010.

72. Bastiat, "What Is Seen and What Is Not Seen," p. 5.

73. Ibid., p. 26.

74. F. A. Hayek in the introduction to Bastiat, "What Is Seen and What Is Not Seen."

75. Dudley, "OMB's Reported Benefits of Regulation."

76. Brian Mannix, "The Planner's Paradox," *Regulation* 26, no. 2 (Summer 2003). And see Dudley, "Reducing Unnecessary and Costly Red Tape."

77. Chris Edwards, "The Federal Emergency Management Agency: Floods, Failures, and Federalism," DownsizingGovernment.org, Cato Institute, December 2014.

78. Friedman, *Capitalism and Freedom*, p. 191.

79. Albert Venn Dicey quoted by Friedman, *Capitalism and Freedom*, p. 201.

80. Adam Smith, *The Theory of Moral Sentiments* (London: A. Millar, 1759), chap. 6, sec. 2, para. 42, www.econlib.org/library/Smith/smMS.html.

81. F. A. Hayek, "The Use of Knowledge in Society," *American Economic Review* 35, no. 4 (September 1945): 519–30. See also Gerald P. O'Driscoll Jr. and Mario J. Rizzo, *The Economics of Time and Ignorance* (New York: Basil Blackwell, 1985).

82. Hayek, "The Use of Knowledge in Society," p. 519.

83. Ibid., p. 524.

84. Jeffrey A. Singer, "ObamaCare's Electronic-Records Debacle," *Wall Street Journal*, February 17, 2015.

85. Ronald Hamowy, *The Scottish Enlightenment and the Theory of Spontaneous Order* (Carbondale, Ill: Southern Illinois University Press, 1987). Bernard Mandeville, writing in the early eighteenth century, is also credited with developing these ideas.

86. Gayathri Vaidyanathan, "Sometimes, Protecting One Species Harms Another," *Washington Post*, February 2, 2015.

87. Ibid.

88. Daniel B. Klein, *Knowledge and Coordination*: *A Liberal Interpretation* (Oxford, UK: Oxford University Press, 2012), chap. 1. I have expanded on Klein's story.

89. Ibid.

90. Ibid., p. 5.

91. Hayek, *The Road to Serfdom*, p. 36.

92. Bastiat, "What Is Seen and What Is Not Seen," p. 19.

93. Edward Lazear, "Government Forecasters Might as Well Use a Ouija Board," *Wall Street Journal*, October 16, 2014.

94. Congressional Budget Office, "The Budget and Economic Outlook: Fiscal Years 2008 to 2018," January 23, 2008. See also Chris Edwards, "CBO Forecast Accuracy," *Cato at Liberty* (blog), Cato Institute, February 6, 2012.

95. Smith, *The Wealth of Nations*, p. 208.

96. Ibid., p. 208.

97. Schuck, *Why Government Fails So Often*, p. 412.

98. Murray Rothbard quotes Joseph Schumpeter: "The picture of the prettiest girl that ever lived will in the long run prove powerless to maintain sales of a bad cigarette. There is no equally effective safeguard in the case of political decisions." See Rothbard, *Power and Market*, p. 16.

99. Indeed, public choice economists argue that it is rational for citizens to abstain from voting since their votes count for so little. So why do so many people vote anyway? The answer seems to be that they feel that it is their responsibility and that it makes them feel like good citizens.

100. Schuck, *Why Government Fails So Often*, p. 156.

101. Gordon Tullock, "The Theory of Public Choice," in Gordon Tullock, Arthur Seldon, and Gordon L. Brady, *Government Failure: A Primer in Public Choice* (Washington: Cato Institute, 2002), p. 7.

102. Bryan Caplan, *The Myth of the Rational Voter: Why Democracies Choose Bad Policies* (Princeton,

NJ: Princeton University Press, 2007), p. 100.

103. Decades ago, economist Joseph Schumpeter made similar observations. He said, "the typical citizen drops down to a lower level of mental performance as soon as he enters the political field." And citizens tend to have "irrational prejudice and impulse" when it comes to politics. Quoted in Dennis C. Mueller, *Public Choice II* (Cambridge, UK: Cambridge University Press, 1989), p. 348.

104. James Madison, "Vices of the Political System of the United States," in Philip B. Kurland and Ralph Lerner, eds., *The Founders' Constitution* (Chicago, IL: University of Chicago Press, 1987), chapter 5, http://press-pubs.uchicago.edu/founders/documents/v1ch5s16.html. Jay Cost's book alerted me to this essay.

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107. Ibid., p. 16.

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112. Damian Paletta, "Billions in Bloat Uncovered in Beltway," *Wall Street Journal*, March 1, 2011.

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115. There are exceptions. For example, highway spending is (supposed to be) tied to a dedicated revenue stream through the highway trust fund. Also, in some situations, budget rules require legislators to provide a funding source for proposed spending.

116. Maxey, "A Little History of Pork."

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118. Frédéric Bastiat, *Economic Sophisms* (Irvington-on-Hudson, NY: Foundation for Economic Education, 1964), p. 4.

119. Jonathan Rauch, *Government's End: Why Washington Stopped Working* (New York: Public Affairs, 1994), p. 91.

120. Jay Cost, *A Republic No More: Big Government and the Rise of American Political Corruption* (New York: Encounter Books, 2015), p. 215.

121. The 1826 law is available from the Army Corps of Engineer's website at http://planning.usace.army.mil/toolbox/library/WRDA/rha1826.pdf.

122. Davy Crockett, *An Account of Col. Crockett's Tour to the North and Down East, in the Year of Our Lord One Thousand Eight Hundred and Thirty-Four* (Philadelphia: E. L. Carey and A. Hart, 1835), p. 120, https://books.google.com.

123. Chester Collins Maxey, "Log-Rolling," MA Thesis, University of Wisconsin, 1914, p. 3.

124. Maxey, "A Little History of Pork," and Maxey, "Log-Rolling."

125. Maxey, "A Little History of Pork."

126. Ibid.

127. Maxey quotes many members of Congress during the 19th century. Maxey, "A Little History of Pork."

128. Maxey, "Log-Rolling." p. 16.

129. Ibid., p. 30.

130. Ibid., p. 18.

131. James C. Miller III, *Monopoly Politics* (Stanford, CA: Hoover Institution Press, 1999), p. 70.

132. Maxey, "A Little History of Pork."

133. Maxey, "Log-Rolling," p. 39.

134. Mueller, *Public Choice II*, p. 83.

135. F. A. Hayek, *Law, Legislation and Liberty, Volume 3: The Political Order of a Free People* (Chicago: University of Chicago Press, 1979), p. 134.

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138. Charles Wyplosz, "Fiscal Rules: Theoretical Issues and Historical Experiences," National Bureau of Economic Research Working Paper no. 17884, March 2012, Table 1.

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143. Peter F. Drucker, "The Sickness of Government," *The Public Interest* 14 (Winter 1969): 12.

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154. Kellie Lunney, "Held Back: Why Government Struggles So Much with Job One: Hiring," *Government Executive*, January–February 2015, www.govexec.com/feature/held-back/.

155. Sowell, *Knowledge and Decisions*, p. 137.

156. Economist Ludwig von Mises noted, "In the absence of profit goals, bureaus must be centrally managed by the pervasive regulation and monitoring of the activities of subordinates." Ludwig von Mises, *Bureaucracy* (New Haven, CT: Yale University Press, 1944), p. 47.

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161. Christopher Lee, "Agencies Getting Heavier on Top," *Washington Post*, July 23, 2004.

162. Light, "A Cascade of Failures," p. 11.

163. James P. Pfiffner, "Presidential Appointments and Managing the Executive Branch," Political Appointee Project, undated, www.politicalappointeeproject.org. This is the number of full-time positions.

164. One benefit is that political leadership limits the power of career professionals to block beneficial reforms. That may be more of a problem in the British and Canadian parliamentary systems, where there are fewer political appointees.

165. A good example is how recent administrations have changed the direction of the National Aeronautics and Space Administration (NASA) and thrown expensive investments down the drain. See David A. Fahrenthold, "NASA's $349 Million Monument to Its Drift," *Washington Post*, December 15, 2014. Another example is the way that recent administrations have repeatedly changed directions on alternative energy subsidies.

166. For the 2.5 years statistic, see Pfiffner, "Presidential Appointments and Managing the Executive Branch."

167. Chris Edwards, "The Federal Emergency Management Agency: Floods, Failures, and Federalism," Cato Institute Policy Analysis no. 764, November 18, 2014.

168. Philip Giraldi, "Diplomacy by Donorism," *The American Conservative*, February 27, 2014, www.theamericanconservative.com/articles/diplomacy-by-donorism/.

169. Feinberg's biography is at www.fra.dot.gov/Page/P0167.

170. George J. Stigler, "The Theory of Economic Regulation," in *Chicago Studies in Political Economy*, ed. George J. Stigler (Chicago: University of Chicago Press, 1988).

171. Friedman, *Capitalism and Freedom*, p. 29.

172. Miller, *Monopoly Politics*, p. 28. The agency was dismantled in the Airline Deregulation Act of 1978 and went out of existence in 1985.

173. The Office of Federal Housing Enterprise Oversight was in charge of overseeing Fannie and Freddie.

174. Juliet Eilperin and Madonna Lebling, "MMS's Troubled Past," *Washington Post*, May 29, 2010.

175. Former Cato chairman William Niskanen examined the self-interested behaviors of government bureaucracies in Niskanen, *Bureaucracy and Representative Government*.

176. The head of a major federal union recently proclaimed that those lawmakers who stood in his way were "fools," and he would "whoop" their "ass" unless they acceded to union demands. See Eric Katz, "Federal Employee Union Vows to 'Open a Can of Whoop Ass' on Unfriendly Lawmakers," *Government Executive*, February 9, 2015.

177. One example in the news recently regarded a Transportation Security Administration air marshal who leaked information to the press about supposed budget cuts in the air marshal service. See Robert Barnes, "Justices: No Law Was Broken in Leak," *Washington Post*, January 22, 2015.

178. Paul H. Douglas, *Economy in the National Government* (Chicago: University of Chicago Press, 1952), p. 74.

179. For a brief summary of the efforts, see Jack Shafer, "Another President Is Reorganizing Government. Again." www.reuters.com, January 17, 2012.

180. Ronald C. Moe, *Administrative Renewal: Reorganization Commissions in the 20th Century* (Lanham, MD: University Press of America, 2003), p. 28. The Keep Commission was officially the Commission on Department Methods. The informal title reflected the name of the commission's chairman, Charles Hallem Keep.

181. James M. Beck, *Our Wonderland of Bureaucracy* (New York: The MacMillan Company, 1932), p. 228.

182. President Barack Obama, State of the Union Address, January 25, 2011.

183. Schuck, *Why Government Fails So Often*, chap. 10.

184. Regarding morale, see Billy Mitchell, "'Disturbing': Federal Employee Morale, Confidence in Leadership Drops," FedScoop, October 24, 2014, http://fedscoop.com/federal-employee-morale-getting-worse-highlighted-negative-feelings-leadership.

185. Kellie Lunney and Eric Katz, "Hiring and Firing: Why Agencies Need to Do Better," *Government Executive*, January 21, 2015. See also Joe Davidson, "Is Federal Hiring Fair and Open or Do 'Special Hiring Authorities' Get in the Way?" *Washington Post*, January 9, 2015.

186. Drucker, "The Sickness of Government," p. 3.

187. Ibid., p. 7.

188. These are worldwide privatization proceeds. See figure 1 in William L. Megginson, "Privatization Trends and Major Deals in 2013 and 2014," *The PB Report 2013–14*, December 2014, www.feem.it/userfiles/attach/20151716304PB_Annual_Report_R2013-2014.pdf. And see John Nellis, "The International Experience with Privatization: Its Rapid Rise, Partial Fall and Uncertain Future," University of Calgary, January 2012.

189. William L. Megginson and Jeffry M. Netter, "From State to Market: A Survey of Empirical Studies on Privatization," *Journal of Economic Literature* 39, no. 2 (2001): 321–89. The authors concluded that privatization "appears to improve performance measured in many different ways, in many different countries." See also Mueller, *Public Choice III*, p. 373. Mueller summarizes 71 academic studies comparing the public and private provi-

sion of particular goods and services. He reports that in only five of these studies were public firms found to be more efficient than comparable private firms.

190. Burton W. Folsom Jr. and Anita Folsom, *Uncle Sam Can't Count: A History of Failed Government Investments, from Beaver Pelts to Green Energy* (New York: Broadside Books, 2014), chap. 1.

191. The Bureau of Indian Affairs, for example, was plagued by scandal. See Chris Edwards, "Indian Lands, Indian Subsidies, and the Bureau of Indian Affairs," DownsizingGovernment.org, Cato Institute, February 2012.

192. Maxey excerpts some of the 1836 Ways and Means report. See Maxey, "Log-Rolling," p. 37.

193. The growth of government in the 20th century can be thought of as a demand or supply phenomenon. The growth might result from citizens and interest groups demanding higher spending, or it might result from pro-spending biases in legislative and executive branches. For a summary of this framework, see Thomas A. Garrett and Russell M. Rhine, "On the Size and Growth of Government," *Federal Reserve Bank of St. Louis Review* 88, no.1 (2006): 13–33.

194. Before 1930, outside of the Civil War, federal spending was relatively stable at between 3 and 4 percent of GDP. An interesting question is why the factors discussed in this study led to the enormous growth in government after 1930, but not so much before. Some of the reasons might be (a) the creation of the income tax in 1913, (b) the emergence of Keynesian economic theory in the 1930s, and (c) the enactment of large entitlement programs beginning in the 1930s.

195. Total state government expenditures in 2014 were $1.8 trillion, or a bit less than $40 billion per state. States with roughly $40 billion in spending include Georgia, Virginia, Wisconsin, and North Carolina. See National Association of State Budget Officers, "State Expenditure Report, 2012–2014," 2014, Table 1.

196. Edwards, "Independence in 1776; Dependence in 2014." By 2015 the federal program count topped 2,300. See www.cfda.gov.

197. A recent analysis found that at least 20 members missed more than two-thirds of hearings in their committees. See Luke Rosiak, "Many House Members Miss More Than Two-Thirds of Their Committee Meetings," *Washington Examiner*, September 29, 2014.

198. There were many bureaucratic failures leading up to 9/11. The CIA was mismanaged, and it underinvested in human intelligence. The Department of State had lax procedures for issuing foreign visas. U.S. border control was not up to the task of screening for terrorists. The Federal Aviation Administration bungled its security responsibilities: it received 52 intelligence reports regarding Bin Laden and al Qaeda in the six months leading up to 9/11, some of which discussed hijackings and air suicide missions. Finally, the FBI mismanaged its internal information flow and was hampered by antiquated computer systems.

199. There is a variety of evidence for this. The *Washington Post* reported in 2004 that most members of the House and Senate intelligence committees had not read crucial terrorism reports or held oversight hearings to rectify intelligence problems. See Dana Priest, "Congressional Oversight of Intelligence Criticized," *Washington Post*, April 27, 2004. Also, a former chief counsel of the Senate intelligence committee confirmed that very few senators bothered to view secure intelligence documents. See Victoria Toensing, "Oversee? More Like Overlook," *Washington Post*, June 13, 2004.

200. Foxnews.com, "'We Did Not Know': 9 Times the Obama Administration Was Blindsided," June 19, 2014.

201. Light, "A Cascade of Failures."

202. Milton Friedman, "Why Government Is the Problem," Hoover Institution Essays in Public Policy no. 39, 1993.

203. Light "A Cascade of Failures," p. 10.

204. Ibid., p. 23.

205. Edwards, "The Federal Emergency Management Agency."

206. Rauch, *Government's End*.

207. Ibid., pp. 153, 198.

208. Milton Friedman and Rose Friedman, *Free to Choose: A Personal Statement* (New York: Avon Books, 1981), p. 283.

209. Browning, *Stealing from Each Other*, p. 182.

210. Pew Research Center, "Public Trust in Government."

211. Philip J. Grossman, "The Optimal Size of Government," *Public Choice* 53 (1987): 139. Other public choice scholars have also made this point.

212. Friedman and Friedman, *Free to Choose*, p. 283.

213. The average estimate from a sample of academic studies is about 50 cents on the dollar. See Conover, "Congress Should Account for the Excess."

214. Greg Mankiw, "An Expositional Challenge," *Greg Mankiw's Blog*, November 22, 2006, http://gregmankiw.blogspot.com/2006/11/expositional-challenge.html.

215. To raise more revenue, the government could broaden the tax base. But for whatever tax base is chosen, rates need to increase as spending increases.

216. Afonso, Schuknecht, and Tanzi, "Public Sector Efficiency."

217. Economist Arthur Okun proposed the metaphor of a leaky bucket. For a description, see Browning, *Stealing from Each Other*.

218. Michael Boskin, "A Framework for the Tax Reform Debate," in *Frontiers of Tax Reform*, ed. Michael Boskin (Stanford, CA: Hoover Institution Press, 1996), p. 14.

219. Browning, *Stealing from Each Other*.

220. Ibid., p. 179.

221. An early version of this chart was published in the 1980s by economist Richard Rahn. *Forbes* illustrated "The Rahn Curve" in a 1993 article. Peter Brimelow, "Why the Deficit Is the Wrong Number," *Forbes*, March 15, 1993. See also Robert J. Barro, "A Cross-Country Study of Growth, Saving, and Government," National Bureau of Economic Research Working Paper no. 2855, February 1989. And see Gerald W. Scully, "What Is the Optimal Size of Government in the United States?" National Center for Policy Analysis Policy Report no. 188, November 1994. Some versions of the curve plot government size against the growth rate. My curve plots government size against the level of income.

222. A 2011 paper surveys empirical studies on government size and economic growth describes the theory behind the inverted U curve and provides estimates for France. See Francois Facchini and Mickael Melki, "Optimal Government Size and Economic Growth in France (1871–2008)," Centre d'Economie de la Sorbonne, December 2011.

223. Organisation for Economic Co-operation Development, Economic Outlook, Annex Tables, Table 25, www.oecd.org/eco/outlook/economicoutlookannextables.htm. Note that the OECD uses a somewhat broader measure of government size than does the U.S. Bureau of Economic Analysis.

224. See Browning, *Stealing from Each Other*, pp. x, 188. This is the reduction in gross incomes before taxes are paid.

225. Rahn Curve is discussed in Brimelow, "Why the Deficit Is the Wrong Number." Rahn proposed his curve in Richard Rahn, U.S. Chamber

of Commerce, testimony to the Republican Platform Subcommittee on Economy, Jobs, and the Budget, August 1988. Robert Barro presented a similar curve in Robert J. Barro, "A Cross-Country Study of Growth, Saving, and Government," National Bureau of Economic Research Working Paper no. 2855, February 1989.

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227. Ronald Reagan, Commencement Address at Eureka College, Eureka, IL, June 7, 1957.

228. Vito Tanzi, "The Economic Role of the State in the 21st Century," *Cato Journal* 25, no. 3 (Fall 2005): 617–38.

229. Paul Ormerod, *Why Most Things Fail: Evolution, Extinction, and Economics* (New York: Wiley, 2007). Preface to the paperback edition.

230. Ibid.

231. Ronald Reagan, "A Time for Choosing," speech presented during the 1964 U.S. presidential campaign on behalf of Republican candidate Barry Goldwater, October 27, 1964. Reagan's comment was nearly the same as one by Sen. James Byrnes on the floor of the Senate in 1933. See Chris Edwards, "Government Program Immortality," *Cato at Liberty* (blog), Cato Institute, December 21, 2010.

232. Samples and Ekins, "Public Attitudes toward Federalism," pp. 3, 4.

233. Ibid.

234. Ibid., p. 21. And also see Schuck, *Why Government Fails So Often*, pp. 95–98.

235. Samples and Ekins, "Public Attitudes toward Federalism," p. 23.

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