

FREEDOM AND AUTHORITY: “RIGHT-SIZING” GOVERNMENT

John Norton Moore

How do we “right-size” government? Even today, when discussing the proper size of government, we tend to use the vague terms “left” and “right,” terms inherited from the French Revolution of 1789, when supporters of the king sat on the right of the National Assembly and supporters of the Revolution sat on the left. The near vacuous nature of these terms can be quickly illustrated by looking at aggregations of groups said to be “on the left” and “on the right.” The left includes not just progressives, but also anarchists, socialists, and communists. And the right includes not just conservatives, but also monarchists and neoliberals. It is time to retire a vocabulary so lacking in real meaning. But how do we at least ask the right questions about right-sizing government?

As a starting point, we know today that democratic governments perform much better in the aggregate than totalitarian or authoritarian governments. The evidence is striking across many indicators. Freedom House, in its *World Survey of Economic Freedom, 1995–96*, calculated that 24 percent of the world population living in “free” and “partly free” nations produced 86 percent of total world output, and the

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66 percent of the world population living in “mostly not free” and “not free” nations produced only 13 percent of global output (Messick 1996: 9).¹ While the past rapid economic growth in China is an outlier, democratic nations as a whole continue to strongly outperform economically. Democracies rarely, if ever, engage in major wars with other democracies. When engaged in war, democracies win at a higher rate than nondemocracies. Democracies have far better records on human rights; in contrast, totalitarian regimes have slaughtered their own and neighboring populations in the millions, as we see with the Holocaust under the Nazis, Mao’s starvation of millions of Chinese, or Pol Pot’s slaughter of over 20 percent of the population of Cambodia. Democracies do not themselves experience famines, which we now know to be a product of nondemocratic governments, as in North Korea today, or colonialism, as under British rule in India and Ireland. Democracies even have better environmental records.²

Most important, full or “liberal” democracies not only elect their leaders through free and regular elections, but protect important human freedoms: religious liberty, freedom of speech and association, freedom of the press, freedom to petition the government for redress of grievances, due process of law, equal protection under the law, property rights, and the right to a fair and speedy trial. But while living in a liberal democracy (not just an electoral democracy that has elections but only curtailed freedoms) is one of the greatest blessings an individual can enjoy, democracies too have government failure—just an order of magnitude less failure than totalitarian and authoritarian regimes.³ Today, thanks to the work of James M. Buchanan on Public Choice Theory, which won the Nobel Prize in Economics for

¹The percentages of governments in the four categories, of course, have changed over those used in the 1995–96 survey. Freedom House each year also publishes *Freedom in the World*, a survey of freedom for every nation in the world, across many indicators. For the 2019 *Freedom in the World* survey see https://freedomhouse.org/sites/default/files/Feb2019_FH_FITW_2019_Report_ForWeb-compressed.pdf.

²For a fuller discussion of the superiority of “liberal” democracies to authoritarian and totalitarian regimes, see Moore (2004: 2–7).

³The spectrum from best form of government to worst runs from liberal democracy, through electoral democracy, through authoritarian regimes, to totalitarian regimes. The United States, the United Kingdom, and Switzerland are examples of liberal democracies; Nazi Germany, Stalin’s Soviet Union, Mao’s China, and Kim Il Sung and his successors’ North Korea are examples of totalitarian regimes. Russia today is an “electoral democracy,” but its curtailment of freedoms under Putin suggests that it may be better characterized as an authoritarian government.

him, and which I refer to as “Government Failure Theory,” we know a great deal about the causes of government failure.⁴

The starting point for “right-sizing government” must be to ask what is the alternative to government? While the family, the church, and many volunteer organizations carry out essential functions, for the most part the alternative to government we think of is individual exchange or markets.⁵ If that is our focus, then we have a readily available basis for answering many of the questions about right-sizing government. Economic theory, particularly Welfare Economics, tells us a great deal about the strengths and weaknesses of markets. And, government failure theory tells us a great deal about the strengths and weaknesses of government. Many of the answers then, about right-sizing government are simply to be found at the intersection of these important fields of knowledge.

This article will seek to clarify that intersection of important theories by first examining the strengths and weaknesses of markets. Second, it will provide a beginning analysis of government functions in relation to market needs and market failure. Third, it will review some of the mechanisms causing government failure. Fourth, it will develop a theoretical analysis of categories of government failure. Avoidance by government of those categories of government failure will then point the way to a right-sized government. Caution is in order, however, in not assuming that this analysis generates mechanical “cookie cutter” answers for the profoundly difficult issues in right-sizing government. There will always remain important differing value choices as to the appropriate size and composition of the safety net for individuals, and a myriad of other choices as to assessment of costs and benefits in particular governmental programs. Hopefully, however, a categorization of government failure will at least lead to asking the right questions. Finally, this article will canvas a few categories of mechanisms designed to reduce government failure and more effectively lead to a right-sized government.⁶

⁴For an overview of Buchanan’s work, see Shughart (2008).

⁵There is, I believe, a strong argument for strengthening the family as one of the antidotes to an overly large government. Yet many of our tax and welfare policies seem to create incentives, whether intentional or not, that diminish the family.

⁶For the United States, a federal structure, there is yet another important set of issues not dealt with in this article. That is, at what level, state or federal, should a particular governmental activity be carried out? Clear federal responsibility certainly includes foreign affairs, defense, and certain central bank functions. On the other side of the scale, one advantage of leaving an issue for the 50 states is the potential for real-world comparison and competition.

There is a popular conception that markets are about “greed” and government about “the greatest good for the greatest number.” But this popular conception is a myth for both markets and government. Both have strengths and weaknesses and an important role to play. And both need checks where they fail. The challenge is in understanding the strengths and weaknesses of each—and in implementing appropriate checks on both.

The Strengths and Weaknesses of Markets

Properly functioning markets, or informed free exchanges, have some remarkable qualities. First, a transaction would not take place unless those on both sides of the transaction believe that they will be better off from the transaction, based upon their own value choices. So, the transaction is a “win-win” for both parties, as well as a “win” for both as assessed by their own values, not the values of some other party. These remarkable starting qualities of markets are not accurately described as “greed.” Second, markets have low “transaction costs,” that is, low costs associated with a simple exchange or transaction. Finally, markets, in society as a whole, are remarkably contextual (taking place daily with millions and millions of transactions) and, as such, characteristically have reasonably good information available to the participants.

Markets, however, have their needs and problems. First, we need government to create stable property rights, contracts, and a host of laws to facilitate stable expectations, enable efficient exchange, prevent theft and crime, and maintain macroeconomic stability. Second, markets can generate “market failure” where a transaction imposes costs on nonparties to a transaction (or society as a whole). This is the classic “negative externality.” An example would be generating environmental costs when a factory making “widgets” pollutes the water or the atmosphere in its manufacturing process. There can also be a reverse market problem of “positive externalities” when markets will not produce enough because the stream of benefits cannot be fully captured in exchange. This is why we create intellectual property and why government has a role in funding basic research in health and science. There can also be settings in which information is lacking for one of the participants in ways that distort efficient functioning.

Finally, there are a host of functional areas where markets will not function optimally alone. These include “insurance failure” (where those presenting high risks will be unable to obtain insurance),

“monopoly” (where prices will be distorted by a single supplier), “public goods” (areas such as defense spending generating “free-rider” problems of those not opting in if they believe others will bear the cost), and a critical problem for any caring democracy—an appropriate “safety net” for those in society, who because of illness, injury, or otherwise, are not able to work.

Government Functions Related to Proper Functioning of Markets

In many respects, understanding the needs and problems of markets leads to an understanding of government functions needed for a proper functioning of markets, as well as government functions needed to meet societal requirements in certain areas where markets simply will not function efficiently. These include:

- A constitutional structure that provides a check on arbitrary power and is capable of maintaining its own structure as a “liberal democracy,” including maintaining free elections, a free press, equal protection, and the rule of law;
- A legal system providing stable expectations for exchange and human creativity;
- A legal system protecting “minimum order” that is preventing theft and fraud and protecting individual integrity;
- A legal system regulating “monopolies” and dealing efficiently with “insurance failure” and “public goods” (this includes providing public education, insurance regulation, and national defense and security);
- Providing macroeconomic stability;
- Controlling “negative externalities” (this includes protection of the environment and public safety);
- Serving unmet needs in settings of “positive externalities,” such as funding for basic research in science and health;
- Providing and protecting the truthfulness of information; and
- Meeting a wide range of “safety net” issues for the ill, the unemployed, and other disadvantaged members of society.

The bottom line is that the anarchists who believed government was unnecessary were, of course, badly wrong. A properly functioning market economy needs a properly functioning government, whether to meet market needs for stable expectations or to deal with areas of market failure.

Mechanisms Causing Government Failure

Most of the above concepts are likely well understood by the well-educated citizen. But what follows, much of which traces to public choice theory, is not nearly as well understood. Indeed, while there is general understanding of “market failure,” as well as a generalized angst about the performance of government, there is far less understanding as to why we have “government failure.”

Before we get to the principal mechanisms underlying government failure, it is important to note that when governments act, they do so with certain important disadvantages to properly functioning markets. First, government actions are not “win-win,” but instead (even when good) will simply generate greater aggregate costs than benefits. This means certain groups will likely be negatively affected and that the values advanced through the government action will be some governmental value choice, not necessarily that of the individuals affected.

Second, government action is not characterized by low transaction costs. When government acts, it must engage in collective law making, publicize the laws, and then enforce violations. Frequently, there are not just costs known to those enacting such laws but also a variety of unanticipated costs. Rent control is a good example. In seeking to assist low-income needs through holding rents down, unanticipated and unwelcome costs may appear in the form of reduction in maintenance of the facilities, and a reduction in supply of new rental housing. Price controls, with vast unanticipated consequences, as with President Nixon’s effort to hold down inflation by mandating price controls, provide well-known examples. Transaction costs in governmental actions more fully include creating and enacting rules and regulations, enforcement of the rules and regulations, inefficiencies in regulatory mode chosen, effect on incentives of taxes and transfer payments, and unwelcome unintended consequences.

Finally, government does not act with the same contextuality as markets. Rather, government may operate on a five-year plan or some overall decision process far removed from the myriad of instances affected in daily life. This may mean that compared to an aggregate of decentralized transactions, government may operate with an information deficit.

These inherent limitations on government action mean that where markets work, it is markets that should be the choice for action rather than government. Markets, however, require government action to

provide stable expectations in exchange, and to deal with areas of market failure as discussed above. To complicate matters, government action, like market action, is subject to failure for many reasons we understand generally today. It is not enough, then, to simply understand that an area requires government action. Rather, we need to engage in the needed government action while seeking to structure it to lessen the causes of government failure. The principal causes underlying government failure in a democracy⁷ include the following:

- *Rational Ignorance.* Government carries out thousands of decisions each day. It simply is not rational for each of us to pay attention to all of these, as doing so would leave no time to live our lives. As such, interest groups form that selectively pay attention to individual issues. Government then tends to respond to the demands of these interest groups as though they represented the entire electorate. Moreover, these special interest groups, benefiting from government actions and expenditures, have more incentive to organize than the marginally affected general taxpayer. This inevitably leads to government support of special interests.
- *Electoral Preferences.* Elected officials will understandably tend to support the preferences of those who they believe might vote for them. This means that costs may be more likely to be imposed on minority groups (ethnic, economic, or other), unborn generations, and those not of voting age (through deficit spending), and other groups not actively involved in the electoral process.
- *Concealing Costs while Trumpeting Benefits.* Hiding the costs of government programs while promoting the benefits discourages real cost/benefit discipline in the minds of the electorate. For example, federal unfunded mandates imposing costs on the states, imposing costs off-budget through regulation of the private sector, and use of rhetoric such as “single-payer,” concealing who pays in health care debates. Closely related,

⁷Totalitarian, authoritarian, and other nondemocratic governments have more profound modalities generating their massive government failure, particularly the ability of the absolute rulers or “vanguard party” to do whatever they like, and externalize costs on the rest of the population.

government taxes work in innumerable ways to conceal their true costs: impose an estate tax to take assets after the owner is dead and can no longer object; deduct taxes from each paycheck so a large tax bill will not be due at tax time (and government may even generously provide a “refund”); impose federal taxes on your phone bill that you believe you are paying to the phone company, and so on.

- *The Time Horizon Problem.* Since benefits generate support and costs reduce support, government officials may seek to reap the benefits of public actions prior to the next election but postpone the costs as long as possible, and certainly until after the election. This may, for example, lead to the United States renting all of its embassies abroad rather than purchasing them, even if the long-run savings from purchase would make purchase the better choice.
- *Supply by Government Agency.* Each agency, and its bureaucracy, believes that its program is the most important and thus each will likely fight for a larger slice of the pie. This thinking is no stranger to congressional entities either. But whether executive or congressional, the resulting bureaucratic fight for turf and budget may distort a more efficient overall allocation.
- *Overly Risk-Averse Behavior.* Government officials understand that taking an action may be personally riskier than not taking action. This is a classic problem in drug approval. An official responsible for approving a disastrous drug like Thalidomide is gone. Fewer notice nonapproval for a new drug that might have been an effective cure.
- *The Tax at a Federal Level and Spend at a State Level Distortion.* Federal taxes are imposed on the citizens of all the states. But the senators and representatives of each state, whether from New York, California, West Virginia, or Alaska, want to get back in federal expenditures for their state at least what the citizens of the state paid to the federal government in taxes. This leads to support for wasteful expenditures, simply to get the expenditures in their home state. It also leads to massive national distortions when powerful politicians such as Senator Bobby Byrd of West Virginia (the “paving of West Virginia with government facilities”), or Senator Ted Stevens of Alaska (the “bridge to nowhere”) become entrenched as the chair of the Senate Appropriations Committee.

- *Atherosclerosis of Government or “Regulatory Inflation.”* This is simply a growing world of special-interest rules and regulations on top of special-interest rules and regulations, and an inability to break free of the growing inefficiencies. In turn, “rule upon rule” leads to regulations unknown to the average citizen and undermines the rule of law itself.
- *Limited Legal Accountability.* Typically, a breach of obligation in markets is subject to legal recourse. But there is only limited ability to bring legal recourse against government failings.⁸
- *Corpulent Government.* This is when government gets so large that its actions, taxes, and/or debts inhibit economic growth. There is considerable evidence, for example, that when the national debt of a country exceeds 90 percent of its gross domestic product, as is currently the case in America, growth will be significantly affected. Japan and Greece provide all too concerning examples. Similarly, it is even clearer that an excessive regulatory or tax burden will also reduce growth. And in a federal system, at some level of federal tax burden, the remaining tax base for the states will be too curtailed for a healthy federalism. The points at which government gets too large through its tax, regulatory, and debt burdens are crucial issues, which we know matter, but about which we know too little. The current high debt, tax, and regulatory burdens in America, however, may well be a major cause of our current anemic “new normal” growth rate.

Categories of Government Failure

Taken together, the above observations lead to the following categorizations of government failure within democratic governments.⁹ Again, this is not some mechanical slot machine for right-sizing government, but rather a useful check list for asking questions about a

⁸There is a limited ability to sue the U.S. government for certain torts, for takings in contravention of the Constitution, and for certain administrative and civil rights violations. Suits against foreign governments are even more limited—with “sovereign immunity,” a doctrine stemming from old thinking that “the king can do no wrong,” still largely dominant over a genuine rule of law.

⁹Totalitarian, authoritarian, and other nondemocratic forms of government may have additional categories of government failure.

particular government program or action. The principal categories of government failure are the following:

- Government loses its checks on arbitrary power and becomes simply an “electoral democracy,” an authoritarian regime, or worse. The breakdown of Russian democracy under Putin, or Venezuelan democracy under Chávez and Maduro, are examples.¹⁰
- Government fails to act in a setting of market failure. The pre-1970s failure to address environmental problems caused by market externalities provides an example. A continuing example is the likely failure of government to more robustly fund basic biological and health care research, a classic “positive externality” in market failure—research that could potentially lead to a cure or dramatic reduction in disease burdens, saving much more than the costs of the research, and end or reduce the pain and disabilities of millions of Americans.
- Government acts where markets work better. If there is no reason why an activity cannot be carried out privately without “market failure,” it is likely that government running of the activity will be more costly. An example might be municipalities running their own trash collection.
- Government acts, but in doing so generates greater costs than benefits. For example, some of the regulations are discussed by Judge Stephen Breyer, now Supreme Court Justice Breyer, in his classic book *Breaking the Vicious Circle: Toward Effective Risk Regulation* (1992).¹¹ Foreign affairs are not exempt from government failure. I believe that the decision to invade Iraq for the purpose of replacing Saddam Hussein has generated far greater costs than benefits for America, in each of the human, economic, security, and foreign policy realms (see Moore 2004: 73–82; Phillips 2005; and Ricks 2006).
- Government acts, likely generating greater benefits than costs, but better options are available with better cost/benefit ratios.

¹⁰While this category of government failure is not what this article is about, one can hardly categorize “government failure” without including this ultimate failure, which in turn creates other mechanisms for government failure, including direct and massive externalization of costs by regime elites.

¹¹Some of the real-world examples used by Judge Breyer, from cases that had come before him as a Court of Appeals Judge on the Fifth Circuit Court of Appeals, were outrageous in generating massive costs for only minimal risk reduction.

The existing Social Security system in the United States is an example. The system provides an important retirement safety net for senior citizens. It fails as a retirement system in not providing a reasonable return on investment and in not realizing its potential in reducing the wealth gap for American workers.

- Government acts appropriately, and optimally, but performs poorly in doing so. For example, the failure some years ago of District of Columbia school system officials to provide textbooks to the students in a timely manner.¹² That the poor performance by government remains endemic can be seen in comparing this two-decade-old example with the 2011 shortage of school supplies for students in Madison, Wisconsin (Woodard 2011), and the 2015 shortage of basic supplies, including copy paper, soap, and toilet paper in Philadelphia public schools.¹³
- Abuse of law. Government acts ostensibly for one purpose, but actually is motivated by another. Examples include municipal speed traps ostensibly designed to prevent accidents, but which are actually being used to raise revenue and externalize costs on those who do not vote in that municipality, and inappropriate civil forfeitures, ostensibly used to reduce crime but which are actually being used to fund police departments.
- Abuse of power/crime by government. This is where government, or government officials, act in contravention of law. The beating of Rodney King in Los Angeles, or corrupt officials taking bribes, are examples.
- Government grows too large for sustained growth, or, in a federal system, for healthy federalism. This is perhaps the most important of all categories of government failure, whether the triggering mechanism is that the debt is too large, the taxes are too high, or the regulatory burden too great. The consequences are severe, possibly eventually even disastrous, and go on and on like the Energizer Bunny.

¹²“What goes on these days in the District of Columbia school system borders on child neglect. Here it is, three months into the school year, and as *Post* staff writer DeNeen Brown reported yesterday, hundreds of students are trying to learn without books. That is an outrage. It is rivaled in absurdity only by the alibis being served up by school officials. A \$500 million school system that fails to supply students with textbooks is misnamed. An educational disgrace is more like it” (*Washington Post*, December 2, 1995).

¹³See <http://watchdog.org/203938/philadelphia-schools-flush-shortages>.

Mechanisms for Reducing Government Failure

We need government. But we don't just need government; we need *good* government. So what might be done to reduce government failure and encourage good governance? Some possibilities include:

- Enhanced citizenship education in our public schools, particularly education about the strengths and weaknesses of markets, the causes of government failure, and the reasons supporting a culture of lawfulness. If our citizens believe reflexively in markets, or in government, the nation will lose its ability to achieve an efficient balance and promote good governance. The magic of good governance lies in checks and balances.
- Enhanced transparency in government programs. For example, we should consider establishing a small agency charged with publicizing to the American people the most costly and inefficient government regulations.
- Constitutional, politically imposed (adopted by one or both principal parties), or legislatively imposed structural limits. These might take the form of balanced budget amendments, limits on taxation, limits on regulatory overreach, measures to reduce the national debt, or measures to return certain federal programs to the states.
- Fully applying equal protection of the laws. This is a classic solution offered by economists. It would mean, for example, reducing and controlling progressivity in income taxes, perhaps through a flat tax. Out-of-control progressivity serves to concentrate the pain of taxes on an ever-smaller group of the electorate and thus largely removes electoral incentives to control tax and spending.
- Expanding legal recourse. We might want to review the potential for expanding legal recourse against additional categories of government failure, including excessive “regulatory takings.” Expanding legal recourse is particularly needed against intentional actions of foreign governments, and their responsible officials, in supporting terrorism against Americans.
- Altering incentives for elected and government officials, such as through imposition of term limits.
- Altering incentives for voters to impose costs on others by providing them a greater stake in the economy. A side-benefit of

Social Security optionality, building up substantial stakes in individually owned retirement accounts for American workers, provides an example.

Conclusion

Government is a necessary part of our lives. But when government gets too profligate, as we are witnessing in the unfolding tragedy of Greece, it literally destroys the lives and hopes of its people. Short of the Greek level of collapse, government failure imposes unnecessary costs on all of us. Today we know something of the causes of such government failure. As such, it is the responsibility of our national leaders to work to reduce that failure. There is no magic here. Differences over appropriate safety nets and how we assess costs and benefits will remain large. But hopefully a framework that better identifies government failure may prove useful in thinking about the problems and ultimately in right-sizing our government.

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