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Learning from Failure: A Review of Peter Schuck's *Why Government Fails So Often: And How It Can Do Better*[†]

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Peter Schuck catalogs an overwhelming list of US government failures. He points to both structural problems (culture and institutions) and incentives. Despairing of cultural change, Schuck focuses on incentives. He relies on Charles Wolf's theory of nonmarket failures in which "internalities" replace the heavily-studied market failure from externalities (Wolf 1979). Internalities are evidence of a discord between the public goals by which a program is defended and the private goals of its administrators. What might economists contribute? We suggest that economists have neglected internalities because they take group goals as exogenously determined and we defend an alternative tradition in which group goals are endogenously determined. (*JEL* A11, D72, D82)

1. *Introduction*

As we remember the hopes that accompanied some of the programs that enter into Peter Schuck's catalog of US domestic policy failures, reading his *Why Government Fails So Often* is enormously depressing. So voluminous is the list of failures that his assessment of the success of the Social Security System (pp. 337–39) brought a measure of cheer. We say this in spite of whatever reservations we share with him about the long-term solvency of the system. On Schuck's terms, Social Security works for now. Most of the other policies he discusses do not pass this bar.

Perhaps surprisingly, given the title of his book, Schuck's research will not delight the believer in limited government who also believes in reform. Nor, however, will it please those who count themselves as progressives. His is a brave book that closely examines what policy measures try to do and what they actually accomplish. It is rooted in "the real world outside Washington DC" (p. 229), unvarnished and difficult to change as that is. Schuck's criteria for policy success are

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modest: “whether a policy’s benefits exceed its costs and whether it is cost-effective” (p. 41). He is a self-described “melioristic realist” (p. 26), a pragmatist whose conclusions emerge from wide and careful observation of policy outcomes. A major theme of Schuck’s study is that whatever reform one might propose will be hostage to the same problems that plague the original policy. Hence, he favors reform at the margin, as opposed to reconstruction and overhaul.

Schuck’s examination is both wide, encompassing a long historical swath of policy, and detailed. To make even his short list of successes, he reaches far back in history to the Homestead and the Morrill Acts of 1862 (pp. 331–37) before considering the Social Security Act of 1935. Yet he does not presume to be exhaustive in his examination of government policy. Schuck limits the treatment to domestic national policies; state and local government thus are removed from the examination. So, too, is foreign policy.

Why Government Fails consequently omits significant examples of government failure. Eugenic policy—especially “negative” eugenic measures—must count as a policy disaster; yet since sterilization laws were implemented by states, they fall outside Schuck’s compendium.[1] It is perhaps worth noting that forced sterilization represents a failure at a deeper level than that of the cost–benefit calculus to which Schuck adheres. His cost–benefit analysis, citing the tradition of Kaldor–Hicks, depends upon the possibility of compensation for harms (p. 44), but what possible compensation could there be for children who would never be born? In addition, Kaldor–Hicks compensation is imagined to take place in monetary units so that all goals collapse to one. We shall return to the specification of unitary goals below.

The subtitle of the book, *And How It Can Do Better*, frames Schuck’s reformist agenda. His discussion of what can be done to improve matters is, if anything, more depressing than the compendium of failures itself. He divides the reasons for failure into “structural” causes—such as culture and institutions—and incentives. Most policy failures, he argues, are structural: “they grow out of a deeply entrenched policy process, a political culture, a perverse official incentive system, individual or collective irrationality, inadequate information, rigidity and inertia, lack of credibility, mismanagement, market dynamics, the inherent limits of law, implementation problems, and a weak bureaucratic system” (p. 372).

The inescapable conclusion is that the probability of large-scale reform is nil. *Nothing* in the American system escapes blame. The Constitution was designed to encourage divided government. Republican government, as has been known for millennia, is plagued by faction. Democracy seems to depend on informed participants, but its students have known for centuries that information gaps and irregularities (pp. 161–72) and collective action problems persist (pp. 136–37). In separate chapters, Schuck discusses America’s long historical engagement with “localism” and individual choice (chapter 4), its “rights obsession” that “impoverishes political discourse” (p. 104), and markets that frequently confound and compete with policy choices (chapter 7). Such “cultural values,” he writes, “are constitutionally inscribed and all are so deeply embedded in our national psyche that they are alterable, if at all, only slowly and at the

[1] Schuck’s study does, however, encompass immigration policy and here might have noted the historical connections with eugenic theorizing. In their study of Jewish immigration, the statisticians Karl Pearson and Margaret Moul asked “What purpose would there be in endeavouring to legislate for a superior breed of men, if at any moment it could be swamped by the influx of immigrants of an inferior race, hastening to profit by the higher civilisation of an improved humanity?” (Pearson and Moul 1925, p. 7)

margins" (p. 374). Thus, the structural context is not the most promising context for successful political action. Inertia persists in part because those who are in the system have no incentive to improve: "Congress is well aware of its poor reputation with the public," for instance, yet it "shows no interest in reforming itself" (p. 380).

2. *The Role of Economists*

Schuck therefore enters the economist's bailiwick with a laser-like focus on incentives, an approach consistent with "cautious incremental" reform to the systems he predicts will, for the most part, persist (p. 372). Moral hazard comes in for special attention, especially in Schuck's discussion of the roles of Fannie Mae and Freddie Mac in the subprime mortgage meltdown (pp. 141–42) and present and worsening problems associated with student financial aid policies (pp. 261–66). In the case of Dodd–Frank, he finds that policymakers seem "to have learned the wrong lesson from this fiasco," increasing "moral hazard by broadening Wall Street's safety net" (p. 142). Perhaps unsurprisingly, Schuck maintains that they would do well instead to attenuate or perhaps not create moral hazard in the first place. For those programs that *are* inevitably subject to moral hazard, he advocates cost sharing "adequate to assure that beneficiaries have enough skin in the game to act responsibly, with the amounts scaled to what they can afford" (p. 383). Here, he also focuses on improved information flows as a means by which the public, and especially the poor public, might be better served by policy. Schuck cites research by Caroline Hoxby and Sarah Turner in support of cost-effective measures that provide information to low-income college-ready students (pp. 397–98).

Another glimmer of hope is evident in Schuck's lengthy discussion of Charles Wolf's theory of "non-market failures" (Wolf 1979). We quote part of the passage:

> The most important category of nonmarket failure is what he [Wolf] calls "internalities" (corresponding to the "externality" problem in private markets.) Internalities are the private goals that apply within non-market organizations to guide, regulate, and evaluate the performance of agencies and their personnel. These goals are "private" . . . because they—rather than, or at least in addition to the agency's "public" purposes—provide the motivation behind individual and collective behavior (p. 150).

This insight, along with the focus on incentives and information, opens the way for an additional positive contribution by economists. Perhaps a policy fails because it fails to align the private goals of acting individuals who administer the policy and those in the collective polity who establish the administrating agencies on the basis of an articulation of public goals. Economists typically take Wolf's "public" goals as motivational forces, whereas they may neglect important private goals that counteract or confound the so-called "public" goals. To put this somewhat differently, if a policy is designed to address a "public" goal at the expense of the private hopes and desires of those who make up the collective, its failure may be altogether predictable, as those whose hopes and desires conflict with the policy are motivated to undermine the "public" policy goal. Private actors may actively work to prevent the implementation of the policy or to avoid its consequences and the policy then "fails" because it is never implemented as originally planned. Alternatively, as in the case of eugenics, the policy is forced into place and coercion is used to override the desires of a segment of the population in the name of a so-called "public" goal—"racial betterment." In either case, the specification of the "public" goal is mismatched with private goals.

This is not a new insight. In 1961, James Buchanan explained to Kermit Gordon[2] that the difference between the economics tradition in which he participated, that of Frank Knight and his students, and the orthodox economics tradition to which he thought Gordon adhered, was that Knight, Buchanan, and their followers did not take group goals as exogenously determined. As is well known, Buchanan opposed the Kaldor–Hicks approach to compensation by which all individual goals are collapsed into one exogenously determined goal (Buchanan 1959). George Stigler, who began his career steeped in the economics of Knight, remarked that to conclude that a decision is a mistake meant only that one failed to understand it, that is, the goal to which it was directed (Stigler 1975, p. x). If economists misspecify group goals or posit group goals that are supposed to override individual ones, then policy "failure" might be a result of their misunderstanding of the process they presumed to model. Such a modeling failure might well be independent of the US Constitution, democracy, or any of the deep American cultural facts Schuck cites as explanations of failure.

Indeed, if government failure were uniquely related to American institutions and culture, then there should be little or no policy failure when we move away from the US structural situation. This empirical question lies beyond the confines of Schuck's already extensive treatment. He does, however, provide comparisons with Canada and Australia that are significant: there, adaptation to change was more rapid and, he argues, more conducive to obtaining highly skilled immigrants (p. 181). If inflexibility is a peculiar result of the American system, perhaps there are ways to emulate some of the flexibility associated with a parliamentary system.

To this fixation with the inflexibility of system one might add some evidence from nondemocratic regimes with centrally directed economies. When the Soviet Union was extant, many economists predicted that the Soviet economy would shortly surpass the American. Students at the time were advised to learn Russian, as that was surely the language of future economists. American economics textbooks published between 1960 and 1980 compared the supposed growth rates of the US and Soviet economies, relying on what we now know to be significant overstatements of Soviet growth. Textbooks that employed the production possibility frontier as a device to compare American and Soviet growth rates claimed that Soviet growth outpaced that of the American economy year after year, and yet the size of the Soviet economy never caught up to the American. The textbooks did not call attention to this contradiction; it was pointed out decades after the fact. (We return to this failure to acknowledge disconfirming evidence when we discuss Schuck's concern with types of reasoners.) By contrast, textbooks without the production possibility model refrained from making predictions about the growth or size of the Soviet economy, so they did not contain this contradiction (Levy and Peart 2011).

How does this example relate to the public/private goal distinction noted above? The production possibility set in the textbooks described what was feasible for an economy in terms of public goals of plenty and power. When the economy is on the frontier of the

[2] Shortly after, Gordon would become a member of President John F. Kennedy's Council of Economic Advisors. He was, at the time of the correspondence, Director of the Program for Economic Development and Administration at the Ford Foundation. Buchanan and his colleagues at the Thomas Jefferson Center applied in May 1960 to the Ford Foundation for $1.14 million to support the Center. Buchanan, Warren Nutter, and University of Virginia president, Edgar Shannon, met with Ford Foundation officials on August 31, 1960. They were unsuccessful in their attempt to obtain support. The application and related documents are reproduced in Levy and Peart 2014.

production possibility set, all of its resources are expended in pursuit of these public goals and there is nothing left for expenditure on the private goals referred to by Wolf and Schuck. The textbook modeling exercise assumed away all the (private) rent-seeking activity that enriched some of the population while it pushed the Soviet society into the interior of the production possibility set (Levy and Peart 2008). The failure of eugenics provides a second example of how policy failed by neglecting private goals.

The first thing for economists to do is to get the private goals right. Accordingly, Schuck pushes hard on incentives in his analysis and his suggestions for improvement focus on the incentives of the people directly affected by the policies in question. He rightly argues that those who design and implement policy would be well advised to take incentives into account. But those who implement policy *also* have private goals, and here perhaps another opportunity exists to reduce the instances and severity of policy failure. Like the Soviet rent seekers who lined their pockets while consumers were unable to purchase ordinary goods and services, those who design, recommend, or implement policy are also subject to incentives. If policy modelers fail to take these incentives into account, any policy may well be hijacked.

Schuck rightly focuses on the "structural and endemic features" of the federal bureaucracy (p. 307), noting that there are sometimes sixty layers of decisionmakers and a vacuum of leadership in federal agencies (pp. 318, 315). To these, we would add a nod to incentives of the bureaucrats and policy advisors themselves. When an agency is established, modelers need to inquire about the private goals of those who will fill the bureaus. Schuck and Wolf cite agency budgetary growth as a concern (p. 151), but using budgetary growth as an indicator of incentives run amok will produce mixed results. Agency growth may be the result of successful rent-seeking behavior, but it may instead be the result of public approval of the mission and successful delivery of the service. Concern about budgets speaks to the usual considerations of income and status; however, if there is an ideological "mission creep" that, too, might push the agency beyond what elected policymakers imagined at the outset. The attempt to use public health procedures to regulate ammunition sales provides a case in point. The goals of those who staff the public health agencies may differ markedly from those who cast votes in congressional elections. Hawkins (2012) puzzles over the EPA's reluctance to push ahead in this direction, although the propensity of voters to remove congressional gun control advocates seems obvious enough.

3. *The Role of Experts and Private Goals*

Schuck discusses the role of the securities-rating firms in the financial meltdown (p. 61). This episode is a critical one for economists. It was, after all, economists who studied the performance of ratings in detail consequent to their use in New Deal banking policy (National Bureau of Economic Research 1941; Hickman 1958). The context was how to ensure against another banking collapse after the Great Depression. President Franklin D. Roosevelt himself questioned whether it was good policy to insure all banks, sound and unsound.[3] At the time, bond ratings were regarded as the means by which to distinguish sound from unsound investments. The first academic study of bond ratings (Harold 1938) documented the private incentives of the four

[3] At his first Presidential news conference, Roosevelt stated the problem with Federal insurance: "The general underlying thought behind the use of the word 'guarantee' with respect to bank deposits is that you guarantee bad banks as well as good banks." (Phillips 1995, p. 38).

extant ratings agencies to bias their ratings upward. The principle is simple: no one complains about a rating that is too high. College teachers, who grade student work and occasionally referee journal articles, are familiar with the incentives.

To deal with the incentive to bias, Harold's study offered the plausible heuristic of using the minimum of the four ratings. Subsequently, the NBER study of the performance of the ratings, commissioned by the FDIC, tabulated the universe of large US corporate bonds of the period and 10 percent of the smaller bonds (Hickman 1958.) The NBER analysts also worried about the tendency to upward bias and they consequently devised a "composite" rating, the downward-rounded median of multiple ratings.[4]

What seems to have happened is that, because the rating agencies were initially not trusted to serve only the public goal of providing accurate ratings, precautions were put into place against the predicted upward bias. For decades thereafter, this worked well enough. But as the ratings became trusted over time, precautions against private goals fell away. By the onset of the financial crisis, it was common practice to shop for ratings and it became acceptable to rely on only one, the highest obtained. Analysts who had once used a worst-case estimate of the soundness of a security moved to the most optimistic estimate possible. The change seems to have happened without much public awareness or discussion of the incentives involved, and hence the growing fragility of the system went largely unremarked.

As noted above, lack of information looms large in Schuck's discussion of policy failures. He expresses deep skepticism about the role of the courts in any reform program because, as he sees it, judges are not experts; indeed, they are often ill-informed about technical matters (p. 171). Such skepticism stands in contrast with Judge Richard Posner's optimism (Posner 1999a, 1999b) about the efficacy of a naïve jury advised by contending expert witnesses in determining monetary damages for civil matters. Of course, in Posner's example, the contending experts are biased witnesses for their clients, but everyone involved is aware of the bias. The rule of discovery coupled with motivated examination creates a considerable amount of transparency and, he argues, a more intense scrutiny than sometimes occurs in academic economics.[5] As a consequence, the opinions of contending experts are sufficiently reliable and the jury might simply split the difference in their estimates of damages (Froeb and Kobayashi 1996; Posner 1999a, p. 1539).

In the expert witness case, the conjunction of competition, awareness of expert bias, and a procedure that offers the evidence to all parties suffices to yield trustworthy (unbiased) results. Does such a conjunction exist outside the court system, in the world of policy recommendation and implementation? Schuck's account suggests that it does not, presently. Perhaps one additional idea for reform is to make disputes about policy proposals subject to such a process: advocates for and against a policy and required disclosure

[4] "When only one rating could be obtained for an issue, the coded value of that rating was used as the composite rating. If two ratings were available, the composite is the arithmetic mean of the coded values of the two, rounded downward in the event of a fractional value, to the next lower rating (i.e. grade II is the composite rating assigned an issue rated Aaa by Moody's and A1 by Standard). For three ratings, the composite is the middle value of the array of coded ratings; for four values, it is the arithmetic mean of the middle two (rounded downward in the event of a split rating)." Hickman (1958, p. 143).

[5] Posner (1999b, p. 94): "expert evidence is subject to intense critical scrutiny. . . . In the case of economics, where the tradition of replicating previous studies is weaker than in the natural sciences, a study conducted for purposes of litigation is more likely to receive more intense scrutiny than an academic study, even one published in a refereed journal."

rules would allow the voting public to assess the contending cases contingent on richer information sets and with full knowledge of the incentive to bias.

4. *Conclusion*

Early in his book, Schuck (pp. 57–58) cites Philip Tetlock's *Expert Political Judgment* research on alternative styles of reasoning that, following Isaiah Berlin's use of the fragment of the Greek poet Archilochos, he labels "hedgehogs" and "foxes" (Tetlock 2005). Hedgehogs know one big thing, the trick that always works, and foxes know many things that rarely work.[6] As Tetlock explains it, the problem with hedgehogs is that they are not equally open to disconfirming evidence.

> Hedgehogs bear a strong family resemblance to high scorers on personality scales designed to measure needs for closure and structure—the types of people who have been shown in experimental research to be more likely trivialize evidence that undercuts their preconceptions and to embrace evidence that reinforces their preconceptions (2005, p. 81).

Such "trivialized evidence" was apparent in the treatment, discussed above, of Soviet growth by some economists. When predictions of Soviet growth failed to materialize, a wealth of confounding factors was provided to "explain" the failure of the prediction.

Without knowledge of personality type or the ability to look back at events of earlier decades, how might economists use Tetlock's insight? The issue of whether group goals can be taken as exogenous or not may provide the means by which to move from hidden psychological traits to observable models. If group goals are exogenous, the implementation of policy is fundamentally an engineering calculus. But once the goals are taken as endogenous in an ill-understood process, as Wolf and those in the tradition of Knight suggest, then implementation is contingent upon the shifting goals and ambiguity pours into the analysis.

For whom does the hedgehog's trick always work? For the hedgehog, of course, but not always for the public who depends upon the hedgehog's analysis. Short of economists becoming foxes, perhaps the best we can hope for is a world in which motivated hedgehogs compete with each other in some more transparent manner akin to expert witnesses in civil litigation.

Adam Smith was much struck by the difficulties inherent in formulating, much less implementing, public goals. He worried about how policy advocates—his famous phrase is the "man of system"—become so attached to their system that they ignore private goals in service to the system. In his view, and even more prominently in the recommendations of his two followers, James Mill and John Stuart Mill, public discourse may attenuate this problem by better aligning the incentives of the system makers to the private goals of those in the system (Peart and Levy 2015). *Why Government Fails so Often* demonstrates why the issue is even more critical now than it was in Smith's time. Peter Schuck's important book reminds us about the allure of expert judgments and the need for public discourse at each step along the traverse of policy formulation and implementation.

[6] Guy Davenport provides an interpretative translation of the fragment of Archilochos: "Fox knows eleventythree tricks and still gets caught; Hedgehog knows one but it always works." Davenport (1980, p. 57).

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