Volume 5, Number 20 July 1998

Government is Expensive

by Daniel Primbs

The recent talk about "reinventing" government reminds one of Milton Friedman's cautionary tale of the barking cat. In the case of the barking cat, a man would own a cat provided it barks like a dog. Some proponents of reinventing government want a similar thing. They desire government production, regulation, and bureaucracy with the flexibility, cost-effectiveness, and devotion to consumer preference of a private business. While most people recognize the fanciful nature of making a cat bark, making government bureaucracy much more efficient seems to many highly plausible. The salutary thing is to recognize the nature of the animal in question. Likewise, the plausibility of reinventing government should be based on understanding why government behaves as it does. William Peirce provides just this service in his chapter "Government: An Expensive Provider" in the forthcoming Limiting Leviathan.

Since almost any perceived problem can lead to an outcry for government intervention, Dr. Peirce stresses that good public policy will attempt an accurate accounting not only of the purported benefits of new policy but also the often ignored costs. The chapter gives a detailed analysis of why government is an expensive provider and what this implies for the desirability of expanding government's functions. While government can be a convenient provider of some desirable goods that are difficult for markets to provide (e.g., national defense), expansion of governmental duties should be carefully scrutinized because "[g]overnment is an expensive provider, however, so it is not enough to say that private markets have failed or that people 'want' or 'need' something."

The demand for government production differs from the demand for private production in that voting is not equivalent to private decisions to purchase goods. Politicians, as self-interested actors, are rationally concerned with re-election. With a diverse population, vested interest groups tend to win political favor because the majority of the population is not well-informed about government activity. The ability of organized interest groups to lobby government for special favors (such as tariffs, licensing, monopoly, etc.) is traditionally known as "rent seeking." To serve specific constituent interest groups politicians often are required to engage in vote-trading, or "logrolling." Rent-seeking combined with logrolling leads to an expansion of government into areas that fully informed voters wouldn't desire: "In this busy world, most people do not take the time to inform themselves of the myriad of small favors to other districts or occupations or firms that nibble away at their wallets."

Once the government commits to solving a problem or providing a service, the task is usually assigned to bureaucrats. While government agencies and bureaucrats make easy targets for criticism, bureaucratic production is intrinsically problematic. Dr. Peirce explains how the detailed rules guiding bureaucrats and ponderous constraints on bureau flexibility are often necessary to limit corruption, control costs, and ensure fairness.

Rational control of bureaucracy is a much more difficult task than managing private industry because bureaucracy lacks the profit motive. Private firms are managed on their ability to turn a profit on goods and services sold. Bureaucracies, on the other hand, often don't sell the goods or services they produce and, when they do, the price is usually set by law. The problem of rationally allocating resources in a bureaucracy is compounded when the output of the bureaucracy is difficult to measure or quantify.

Furthermore, the ability to earn profit acts as a powerful incentive for private business to control costs, innovate, and adjust output. This requires owners and managers to make hard decisions, ever mindful of the costs. Managers of bureaucracies can't act as residual claimants of profit and therefore lack this vital incentive. As Dr. Peirce notes, "[d]espite great amounts of goodwill and professionalism in the bureaucracy, the fact remains that no one has a strong incentive to cut costs." For these reasons bureaucracy must be subject to detailed control over the costs of production. This, of course, stifles innovation but provides some measure of protection for taxpayers.

Without having calculable profit or loss, "bankruptcy of a government bureau is not obvious and rarely has consequences." Where bankruptcy serves as the ultimate constraint on private business, the bureau equivalent to bankruptcy is often used to justify budget expansions.

The problems created by government production and regulation extend beyond the internal problems of the bureau. In fact, government "often inflicts costs on other organizations and individuals without having to accept any consequences or responsibility." Bureaus that inflict a cost on the private sector can appear to save money while actually expanding the cost to society.

The tendency for government to grow further inflates the cost of government provision. Compensation of bureau heads is often linked to the number of subordinates or size of the bureau's budget. This problem is compounded by budgetary rules that take away unspent amounts at the end of the fiscal year. While this provides a disincentive for bureaus to reduce costs, as Dr. Peirce observes, "remedies are hard to find." Larger bureaucracies run into increasing costs of control, communication, and informal cooperation with other agencies. Also, public oversight of government production can be stifled by the complexity of large bureaus.

While it was only possible to highlight a few of the usually unexamined costs of government provision, the chapter provides a myriad of reasons to suggest that boosting government efficiency is far from a trivial task. In fact, because of the great costs of government provision, many current functions should be given renewed scrutiny for possible elimination. As Dr. Peirce demonstrates, new constraints on government growth need to be instituted because, essentially, "[t]he fundamental reason for growth is that growth is pleasant for everyone except the taxpayer."

This Institute Brief is one in a series on the chapters of an upcoming book, Limiting Leviathan, *edited by Dr. Don Racheter, Executive Director of Public Interest Institute, and Dr. Richard Wagner, Economics Professor at George Mason University and Chairman of the Institute's Academic Advisory Board.* Limiting Leviathan *makes a case for limited government and discusses the types of limitations on government that are appropriate and necessary.*

The author of this chapter is Dr. William Peirce of Case Western Reserve University.

This summary of Dr. Peirce's chapter was written by Daniel Primbs, a Visiting Scholar at Public Interest Institute.