Review Essay

The Law Does Not Make Us Righteous

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Why Government Fails So Often And How It Can Do Better
Peter H. Schuck. 2014. Princeton, NJ: Princeton University Press. ISBN 978-0-691-16162-4. $27.95.

Simpler: The Future of Government
Cass R. Sunstein. 2013. New York: Simon and Schuster. ISBN 978-1-4767-2659-5. $26.00.

We have here two books that are devoted to the effectiveness and efficiency of government, how government goes wrong, and how it can be improved. Both books are written by Ivy League law school professors. They both advocate the use of cost-benefit analysis to assess government programs, and to assist in their design. Both point to economic incentives and the quality of information as keys to understanding how government programs can go wrong, and how to redesign them to be more effective. This is very familiar territory to most economists. But the limitations of this approach are familiar too. Where there are external effects and public goods, it is hard to get private incentives to work well. Where distributional considerations are important, cost-benefit analysis is of little help. The biggest problems the government faces today are the very ones that these tools are ill adapted to solve.

Peter Schuck of Yale describes himself as a "militant moderate," though he tends to accept the conservative side of disputed issues in the literature on government effectiveness, and he holds an unrelieved hostility to public-sector unions. Indeed, an annoying aspect of his book is his tendency to treat some controversial conclusions as beyond doubt (for example, the bias of the official poverty index [p. 171] or the failure of fiscal policy [p. 209]). The pessimistic tone of the book is apparent even in the sour expression on the author's face in his jacket portrait. However, he did smile a lot and seemed to have a good time at his interview with Jon Stewart on *The Daily Show*.

In the long middle section of the book, Schuck draws heavily on concepts from standard economics to explain the failures of government. He believes that officials often face perverse incentives that frustrate their programs' goals, that they do not have the information they need, that their statutes and rules are too inflexible to adapt to changing circumstances, and that the management structures of federal agencies are bloated and top-heavy. Market forces often at least partially frustrate the government's objectives. He clearly states he is not making a general claim that markets should replace government programs, but he does use "well-functioning markets to highlight the systemic conditions that doom so many government policies to failure" (p. 128). However, the more of this you read, the more you understand that many of these failures are not the result of misplaced incentives, but rather stem from the compromises, or failures to compromise, that cause the political process to deliver a flawed product.

In an early chapter on "The Political Culture of Policy Making," Schuck posits reasons this is so. Some of it has to do with the roles of religion and of the Constitution in American politics. Because we tend to see so many social issues in moral and religious terms, and because the Constitution guarantees religious freedom, many policy disputes end up going through litigation in the courts, rather than being settled by the political branches of government. This not only takes a great deal of time and effort, but it produces decisions that are ruled by legal rather than practical criteria, and are pretty inflexible, making effective policy that much harder.

Schuck's book is encyclopedic and rather abstract. It rarely introduces examples of particular programs to illustrate its points, and one of its big problems is that it doesn't have a sense of the connections between means and ends. It requires some understanding of economics from the reader, but a professional economist would have encountered much of this material before in applied "field courses" in economics. It reads like a textbook for a master's degree program in public policy or public administration.

The book by Cass Sunstein of Harvard, on the other hand, is personal, chatty, comparatively brief, and, well, simpler. (The chattiness is the annoying feature.) In his jacket portrait he is tieless and grinning at someone off camera. (He wears a tie in his Jon Stewart interview. It's about a different book.) The book draws heavily on behavioral economics and marketing research. It is chock full of examples from Sunstein's service as head of the White House Office of Information and Regulatory Affairs (OIRA) in the first Obama administration. It would make a good resource for a high-school student doing a civics term paper.

Sunstein's thesis is that by making use of behavioral insights, regulation can become simpler and more cost-effective. His examples come mostly from informational programs like the Agriculture Department's nutrition information (the "plate" that replaced the "food pyramid"), and the disclosure rules for the fuel economy of new automobiles. Sunstein's goal is to shape the architecture of choice for consumers so that they will make more rational decisions, but without making the decisions for them in a paternalistic way. He calls this the "nudge" (the title of his previous book). The point is to preserve freedom of choice while at the same time improving the long-run outcomes of people's decisions. The car salesman tempts you with an impressive SUV, which would boost commissions and profits, but the window stickers show clearly and succinctly that you would spend a lot more on gas. I should mention that Sunstein goes out of his way *not* to be critical of business in this book. He never mentions car salesmen. He focuses almost exclusively on individual consumer behavior, which limits the applicability of his analysis.

Sunstein and Schuck are both big advocates of cost-benefit analysis (CBA). Indeed, Schuck expresses his admiration for Sunstein's innovation of retrospective cost-benefit studies of existing programs by OIRA. Schuck understands that CBA is controversial, and rehearses some of the familiar problems (such as choosing a discount rate and valuing a statistical life for safety purposes) and approaches to addressing them. In the end, his conclusion is that "A CBA should not necessarily be deemed dispositive of a program's effectiveness, but if it meets the objections reasonably well, it should at the very least shift the burden of proof to those who would challenge its conclusions" (p. 51).

Sunstein's approach to CBA is more subtle. While he puts great importance on economic efficiency, the criterion that CBA addresses, he understands that there are other social and economic objectives that CBA does not incorporate. He puts forward distributional issues and questions of human dignity as considerations not captured by CBA, and stresses the importance of including these considerations (pp. 163–169). He does not add environmental sustainability to this list, though it is also often cited as an economic objective distinct from efficiency and not captured by conventional CBA.

In a late chapter, Schuck offers a list of government programs he feels have been successful. The largest category is transfer programs: the Homestead Act, Food Stamps (now SNAP), Social Security, the Earned Income Tax Credit, and the Temporary Aid to Needy Families program. There are three education and research programs: the Morrill Act (which created the land-grant universities), the GI Bill, and the National Institutes of Health. Two are related to citizenship: the Voting Rights Act and the Immigration and Nationality Act, both passed in 1965. Only one has to do with business regulation, and that is the *deregulation* of the airlines in 1980.

What government seems to do best, then, is to write checks. Schuck's take on it is a little different: "To succeed, then, these programs largely needed to engage the actors' self-interest; they did not need to create new values or transform deeply rooted behaviors" (p. 365). A little later on, he elaborates: "It is easier to alter people's incentives than to change their values or character. Policy environments are more tractable than the people who inhabit them" (p. 367). He puts very little stock in regulations that call for people to act for some interest other than their own short-term, individual interest in making money. Of course, this puts him in company with most conventional economic analysis, but it rests uncomfortably with his own view that "the market underscores . . . the self-interested value of cooperating with others, and the benefits of attending to their interests as well as one's own" (p. 200). More about that later.

Though Schuck takes a generally dim view of business regulation, he can't seem to make up his mind about the "capture theory" of regulatory behavior. On the one hand, he downplays the influence of corporate campaign contributions (pp. 219–220), but on the other, he thinks lobbying compromises enforcement (p. 223). But it is hard to deny that campaign contributions buy access to the political process, and this process strongly influences policy formation, rule making, and enforcement.

The deregulation of the airlines certainly looked like a success at first. In the early 1980s new firms entered the industry and overall fares fell. Small cities were not abandoned, as some critics feared. Service quality did not change much, remaining the staple of many standup comedy acts. Price discrimination became common, and customer loyalty programs and secret deals with big customers were introduced. These market-power abuses were not addressed by the Reagan administration's antitrust enforcers. So the relatively straightforward connection between price and cost under regulation was broken.

Industries with high fixed costs and demand that is cyclical and price-elastic can be prone to price wars when the economy is depressed. That is one of the reasons airlines were regulated in the first place in the 1930s. Such price wars broke out frequently after the mid-1980s, resulting in repeated bankruptcies and mergers, and interrupting service to some markets. Today's airline industry is a tight oligopoly. Capacity is greatly reduced, prices are high, and price discrimination is rampant. While few mourn the end of airline food, crowding and discomfort are so abysmally bad it isn't even funny anymore. This does not seem to me to be a success.

The biggest, most visible failures of government during the Obama years have been the backlog of benefits claims at the Department of Veterans' Affairs (VA), and the "Fast and Furious" operation at the Department of Justice. In books about government effectiveness, these cases should merit special attention. Schuck points to plain old mismanagement as the root of the VA problem, though it is exacerbated by eligibility criteria that are easy to satisfy but complicated to administer. He points to budget increases and significant staff increases as evidence that the agency is not wanting for resources (p. 191). Sunstein's only mention of the VA is to give their "Blue Button" health records access program as an example of his concept of Smart Disclosure (p. 98). Fast and Furious gets no mention in either book. It is apparently the kind of one-off misadventure that doesn't prove any general point about government.

Schuck is pessimistic about the prospects for the Affordable Care Act, suggesting that the glitches and uncertainties surrounding its rollout mean that it will ultimately prove to be ineffective and highly costly. Since the ACA is part transfer program and part regulation of the medical insurance market, it bridges one category that Schuck usually finds effective with one that he does not. It is clearly too early to assess how it will turn out. As ACA becomes more a part of the landscape, and as its benefits become clearer and compliance rises, things may look different than they do now.

Sunstein's approach also relies on the incentives people face, but focuses on improving the choice architecture (often involving the provision of information in easily digestible forms) so that their decisions are more "rational." Reading his book makes it seem like this is the only task for government in today's U.S. economy. It is also relatively easy, since businesses have been producing and using research on choice for a long time, and most of the basics are well known by now. With his focus on information and incentives, he implicitly concedes that changing values or social norms is beyond what government programs can do.

Emphasizing efficiency and incentives, as both these authors do, works for a certain range of issues that government has historically faced. The bad news is that the most urgent issues we face as a society now are issues where economic incentives are more likely to be the problem than the solution.

The financial crisis of 2008 was the culmination of two and half decades of growing business corruption in our country. The deregulation of the thrifts with the Garn-St. Germain Act began a process that led to the collapse of the industry and its complete reorganization in 1989. This process was marked by fictional accounting, crony lending, consumer fraud, government corruption, misappropriation, and unconscionable risk taking. In the end came an enormous bailout of the industry, though the shareholders were not spared their losses, and some people did go to jail.

This was followed in the 1990s by a near-miss financial crisis over the Long-Term Capital Management hedge fund, in which the major money-center banks took on huge risks they did not understand or try to assess, but which almost drove them into insolvency. Then came the clump of scandals that goes by the collective name of Enron. The misstatements on business financial statements were large enough to require the revision of the national income accounts. The attempted reforms of Wall Street corruption by New York Attorney General and then Governor Eliot Spitzer were abruptly halted by his own personal scandal. And then came Countrywide, WaMu, Lehman, AIG, *et cetera*, and the largest financial collapse the world has yet seen. As I write, it still seems like each week sees new fines and penalties assessed against major financial institutions for market manipulation.

In response to these scandals, the federal government has put in place the Sarbanes-Oxley Act of 2002 (Sarbox) and the Dodd-Frank Act of 2010. I don't think either of these laws would make anyone's short list of successful government programs. Schuck thinks the main effect of Sarbox is to drive companies to incorporate or register abroad, and that the

Volcker Rule (part of Dodd-Frank) will ultimately prove unworkable. Sunstein only discusses the “nudge” aspects of Dodd-Frank, mostly involving better methods of disclosing the cost of borrowing to consumers.

Trying to assess initiatives like these by using cost-benefit analysis is a non-starter. Financial regulation has many purposes. Some of these are of the mundane variety that Sunstein’s approach fits well. How much money do households save by a more effective and rational choice of home financing, facilitated by disclosure requirements? What is the value to the average household of deposit insurance on a portion of their financial assets? But the main purpose of these regulations is to prevent a massive financial catastrophe of unimaginable magnitude and impact, which might occur once in a lifetime. What is the value of that benefit? There is no reasonable answer to that question.

Schuck makes the general point that government programs do not succeed without voluntary compliance from the vast majority (p. 226). He also believes that while social norms play an essential role in all social ordering, they are not realistic alternatives to markets (p. 228). His view of markets and the economic process is sophisticated enough to recognize that there are advantages to market participants in cooperation, and in attending to the interests of others (p. 200). It is these kinds of insights about the role of social norms in economic behavior, and the importance of other-regarding behavior in economic success, which I believe are central to a Christian approach to economics.

Schuck may be right that it is difficult at best to change social norms and values, or to launch a project to improve the character of the citizens or change the culture of industries. It is certainly not something that government can do by enacting laws, imposing regulations, levying taxes, or writing checks. But the insight that Christian social thought brings to economics is this: the success of an economy, in terms of justice, sustainability and efficiency, depends on the character, norms and values of the people in it. To maintain that culture at a high level requires the efforts of leaders in all three sectors of society: government, business, and moral-cultural, as has been well described by Michael Novak (1982) and Robert Benne (1981).

If we understand society this way, the fact that the leaders of the major private-sector financial institutions have not signed on to the need for reform is a huge problem. They seem to view the new laws as a nuisance that they must put up with to mollify the public. They fail to understand that it is their role, *and it is in their interest*, to take some responsibility, along with the government, for the overall stability of the financial system. Financial stability is a common interest, or if you will, a public good. All of us benefit from it, though we have no individual incentive to bring it about. It only is realized if people take a public-spirited approach to their own decisions. This includes, but goes beyond, voluntary compliance with government regulations.

Altering the short-term pecuniary incentives faced by the industry is not going to be the complete solution here. What is needed is a change in the culture, values, and character of America's business leadership, the very thing that is the most difficult to do. A new government agency, or program, or choice architecture is not the solution. New courses in business ethics in MBA programs are not the solution. Leadership is the solution. We need leaders who can point to the common interest we all have in a functional financial system, one not prone to a major failure every five years. We need leaders to challenge us to take the common interest into account, and act to realize it. So far, the leaders in business, government, journalism, academia, and the church have mostly failed to call for new standards and a new culture in the financial sector.

Some public figures have tried to raise these issues without much success. Warren Buffet and Elizabeth Warren are extensively covered by the media, but they are treated as isolated, eccentric voices in the wilderness. Joseph Stiglitz and Robert Reich get less coverage and are often dismissed as partisans. William C. Dudley, the President of the Federal Reserve Bank of New York, recently gave a very detailed speech at a Fed-sponsored workshop on how to change the culture of major financial institutions (Dudley, 2014). As an important figure in the regulatory apparatus, his words should carry a lot of weight. But surveys of the industry suggest little change so far (Sorkin, 2015). This is also reflected in the lack of visible statements by prominent financial industry leaders, or major, publicly-reported efforts at cultural change in the industry.

Another major crisis confronting us today is global climate change. It bears some resemblance to the corruption problem, being a kind of "public good." We have a common interest in seeing it addressed, but none of us has anything to gain personally from addressing it. The Obama administration offered (among other initiatives) increased fuel economy standards for cars (C.A.F.E. standards), supplemented by improved disclosures of gas mileage, structured by Sunstein's emphasis on money saved. But if consumers only respond to their own private pecuniary savings, and not to their common interest, then we are not doing nearly enough to reduce external effects of conventional pollution, let alone greenhouse emissions.

The Obama administration's proposed tradable carbon emission permit system for power plants could have begun to address the bigger problem, but it was defeated by conservatives who had long advertised their supposed belief in "free-market environmentalism." Emission trading has been a successful strategy in addressing the acid rain problem, and was an important achievement of the G. H. W. Bush administration. It succeeds partly because it changes private incentives, but it also distributes the burden in a way perceived as fair (polluters pay), and addresses the common interest in reducing acid rain. But Schuck does not include any environmental programs on his list of government successes, and Sunstein's focus on government interaction with individual citizens turns his attention away from programs like emission trading.

When it comes to greenhouse gasses, CBA is unlikely to be much help. For conventional pollution, it is possible to measure health benefits, effects on tourism, agriculture, forestry, and other natural resource based industries. But even that misses the long run value that should be attached to biodiversity and ecological stability. And that's not the worst of it. When it comes to valuing the catastrophic long-run effects that are the predicted consequences of continued global warming, there is no reasonable answer.

We also face a serious crisis over the degree of economic inequality in our country, and the growing reality of a class-bound society. Again, efficiency-oriented tools like cost-benefit analysis are not capable of addressing a fundamentally distributional problem, but it is clear that the magnitude of the problem is growing. We know how to address distributional issues: higher minimum wages, greater bargaining power for labor, more educational opportunities, more stable jobs, better social insurance, and more progressive taxes. Polls indicate increasing public concern about this issue. Leadership, across business and government, should summon the will to do something. A few businesses have made progressive moves, but much deeper change is needed.

If these are the great problems that are facing us, then we need government regulation of markets, made effective by social consensus and cooperation, to solve them. How can such regulation work in the face of intractably self-interested behavior, the impossibility of measuring benefits convincingly, and the political impracticality of constructing market-like devices, taxes, prices or subsidies to bend the curve toward solutions? We must begin to understand that we do not have only individual self-interests, interests based on a system in which what is mine is not yours, and what benefits you must cost me. Taking account of others' individual interests is important to making the economy and the government function well, but it is not all that is needed. We must understand that we have common interests, things that will benefit all of us at the same time, but only if we put aside an individualistic perspective and work together.

In the current political and social atmosphere in the United States, it is hard to imagine this happening. It will take an extraordinary brand of leadership to take us out of ourselves, to bridge the enormous ideological and theological divides that have emerged in our society, and to get us to work together. The financial crisis of 2008 and the Great Recession did not drive us to work together, the way the world wars and Great Depression of the twentieth century did. The political leadership we have today does not seem to be able to articulate the issues, and private leaders do not recognize their public responsibilities.

The two books at hand, with their focus on government and its relationships with individuals, do not give us the tools to deal with these larger problems. The problem is not confined to government. Schuck hints at the private sector's role and the importance of values and consensus, but takes it no further. Economic incentives, better information, and streamlined official bureaucracy will not do the job. These two books are so limited by their focus on traditional economic analysis that they miss the heart of the problem.

It is not just business and government that have a role in maintaining society, but also the moral-cultural sector, which includes the academy and the church. Academic economics has made a tradition of emphasizing individual interests and not talking about common interests. This preoccupation with individual incentives and rational expectations led straight to the financial crisis. The institutional Protestant churches, which played a major role in forming the social consensus of the 1950s and 1960s, have backed away from involvement in controversial political and economic issues in recent decades. The time has come for new leadership and new direction. Maybe it is servants of the church and the academy, perhaps people with legal training, rather than training in theology, philosophy, or economics, who will be able to start this work.

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