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BOOK REVIEW

The Politics of Good Intentions

Failure and Progress: The Bright Side of the Dismal Science. By Dwight R. Lee & Richard B. McKenzie. Washington, D.C.: Cato Institute, 1993. Pp. xiv, 155.

*Michael DeBow**

I. INTRODUCTION

Why has American government grown so rapidly during the twentieth century, and why does its growth show no signs of abating? The dominant impulse of the American political system — its constant erosion of the free market in favor of the politicization of society — is particularly curious at this point in history. Americans are now debating drastic expansions of our welfare state, including the socialization of the health care industry, at the same time that the most extreme form of statism — the Soviet bloc — is universally regarded as a complete failure, and the Western European models for the welfare programs now urged here are proving increasingly unworkable and

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unaffordable.¹ What accounts for our penchant for government growth?

In the United States, the dramatic expansion of the size and scope of government is most often justified in terms of helping either (1) poor people, or (2) businesses, small or otherwise, and their employees, threatened by "unfair" competition. In other words, the conventional wisdom holds that the current size and scope of American government is due to our collective desire to shelter people in these two categories from the most destructive effects of unbridled capitalism. On this view, our present-day Leviathan is the result of the politics of good intentions, and in its absence many if not most of us would be "losers" in the crush of competitive markets.

Now come Professors Dwight Lee and Richard McKenzie to argue, in effect, that the conventional wisdom is all wrong. In their book, *Failure and Progress: The Bright Side of the Dismal Science*, Lee and McKenzie raise serious questions about the belief that government can and should protect us from what Joseph Schumpeter identified as "the essential fact about capitalism," namely its "perennial gale of creative destruction."² For many readers, particularly lawyers and law students more familiar with the conventional wisdom than with its critics, *Failure and Progress* will be a wild ride. It is full of unconventional arguments and facts in support of them, and it reaches conclusions that many readers will find disagreeable, jarring. It is, in short, well worth a look.

II. AN OVERVIEW: LEE AND MCKENZIE'S DEFENSE OF FAILURE

At the beginning of the book, Lee and McKenzie explain that their "central thesis can be stated succinctly: failure is the nursemaid of progress, and vice versa."³ Further, they argue that the role of failure in the efficient functioning of the market is underappreciated and understudied,⁴ and that the entrepreneurial freedom necessary for

¹ For brief discussions of the financial difficulties faced by Western European welfare systems, see Jay Branegan, *Farewell to Welfare*, TIME, Nov. 22, 1993, at 51; Robin Knight, *Laying Off Nanny: Economic Hardship Forces Western Europe to Shrink the Welfare State*, U.S. NEWS & WORLD REP., Oct. 25, 1993, at 41.

² JOSEPH A. SCHUMPETER, CAPITALISM, SOCIALISM and DEMOCRACY 83, 84 (3d ed. 1942).

³ DWIGHT R. LEE & RICHARD B. MCKENZIE, FAILURE and PROGRESS: THE BRIGHT SIDE OF THE DISMAL SCIENCE 2 (1993).

⁴ Economist Michael Jensen echoes Lee and McKenzie on mainstream economics' neglect of the subject of failure: "Although efficient exit — because of the ramifications it has on productivity and human welfare — remains an issue of great importance, research on the topic has been relatively sparse since the 1942 publication of Schumpeter's [*Capitalism, Socialism and Democracy*]." Michael C. Jensen, *The Modern Industrial Revolution, Exit, and the Failure of Inter-*

economic growth is best protected by a system in which no one has the right to a government bail-out of his or her failure. Accordingly, for Lee and McKenzie it is unfortunate that "there is a strong tendency, systemic within the political economy, to overestimate the harm of economic failure and the benefit of political solutions."⁵

By explaining "the positive contributions to our economic well-being that flow from failure," the authors hope "to develop a more informed and tolerant public opinion on failure" that will help "counter the public pressure that causes government to respond to failure with public policies that retard economic progress and promote greater failure."⁶ Because of the negative effects that the continued growth of government has on economic growth, Lee and McKenzie present the paradox that "the best hope for a compassionate government lies with public opinion that is skeptical of government attempts to be compassionate."⁷ In this book Lee and McKenzie seek to contribute to the further development of public opinion "that is unsympathetic to the use of the political process to obtain protection against failure in the marketplace."⁸ For Lee and McKenzie the creation of such a public attitude offers the "only hope" against the continued growth of government.⁹

Lee and McKenzie first sketch the role of failure in the marketplace in chapters 1-6. They devote chapters 7-9 to their critique of the political response to failure. In chapter 10 they offer a summary and concluding remarks.

III. THE NATURE OF FAILURE, AND ITS VIRTUES

Failure is all around us. As Lee and McKenzie aptly put it, "All of life exists on the brink of failure."¹⁰ On one level, we realize this. It is clear that any new advance in technology creates losers as well as winners. For every successful invention, there is an existing product that will be at least partially displaced by the new product. For every advance in technology that produces a more efficient alternative to human labor, there are workers who will lose their jobs. For every new business that succeeds, several fail. Examples of these truths are

nal Control Systems, 48 J. FIN. 831, 833 (1993). Jensen cites only seven economic articles on "exit." *Id.* at 833 n.1.

⁵ LEE & MCKENZIE, *supra* note 3, at 13.

⁶ LEE & MCKENZIE, *supra* note 3, at 2.

⁷ LEE & MCKENZIE, *supra* note 3, at 103.

⁸ LEE & MCKENZIE, *supra* note 3, at 102.

⁹ LEE & MCKENZIE, *supra* note 3, at 102.

¹⁰ LEE & MCKENZIE, *supra* note 3, at 36.

legion. "Talkies" displaced silent movies (and silent movie actors), hand held calculators displaced mechanical ones (and the workers who manufactured them), and so on. But failure is not limited to those who find themselves behind the times: most pioneering entrepreneurial efforts fail. For every Bill Gates or Colonel Sanders there are thousands of Ralph Kramdens, whose business dreams fail utterly.

In chapter 2, Lee and McKenzie explain failure in terms of the fundamental principle of scarcity. As they put it, "Failures occur frequently because the successes that are occurring in the economy deny resources to the ventures that fail."¹¹ In particular, it is the scarcity of useful information that explains failure, as chapter 3 explains. Lee and McKenzie draw on the work of Friedrich Hayek and Israel Kirzner, among others, to argue that failure is inevitable, inherent in the human condition. The act of acquiring information is costly; as a result no one ever knows when they have gathered "enough" information to make the best decision possible under all the circumstances. The upshot is clear, although it is also overlooked: "As long as people seek less-than-perfect information, they should not be expected to do everything right. People make mistakes. They think they are choosing correctly, whereas they may not be."¹² Further, since we are creatures with only limited, bounded capacities to process and act on the scarce, imperfect information we can assemble, we will certainly experience life as something short of a complete success.¹³

This may seem an obvious point, but consider for a moment one of its primary implications. If failure is a constant threat to human endeavor, then no form of political or economic organization can deliver us from it. This too may seem obvious, until one realizes that many of the criticisms of free market capitalism implicitly assume that government can "solve" the problem at hand. However, if the problem is rooted in imperfect information and the resulting possibility of failure, government cannot eliminate the problem. It *may* be able to ameliorate it, but this point should not simply be assumed without considering the evidence for such a claim, pro and con.

Lee and McKenzie's case for the market, even with the failure it entails, is grounded in Friedrich Hayek's notion of the market economy as a means of dealing with the scarcity of information and the

¹¹ LEE & MCKENZIE, *supra* note 3, at 17.

¹² LEE & MCKENZIE, *supra* note 3, at 33.

¹³ The work of Herbert Simon is also clearly relevant to this discussion. *See, e.g.*, HERBERT A. SIMON, *REASON IN HUMAN AFFAIRS* (1983).

limited cognitive abilities of human beings. Their description of Hayek's analysis is worth quoting at length:

The localized information that is possessed in small amounts by each of millions of individuals spread around the globe must somehow be brought together and coordinated, a point that Nobel prize-winning economist Friedrich Hayek has long stressed. There is no reason to expect the process of coordination to be conducted with perfection, simply because no one in the process can be fully informed as to what others can do or want to do with the information they possess. As a consequence of the complexity of the coordinating process (and of rational ignorance), failures are certain. Some people fail and thereby possibly cause a chain reaction of failures. At the same time, much is learned by people in the coordinating process, even though mistakes and failure are endemic to the process.¹⁴

The market system is remarkably good at addressing the problem of coordinating information. The threat of failure and the promise of profits provides the market's mainspring. As Lee and McKenzie put it "the failures that markets impose, as well as the successes they bestow, provide informational and motivational signals that create this coordination."¹⁵

Consider this claim about the market system in a comparative light. If markets do a better job of coordinating information than alternative forms of economic organization, then market-based economies will produce higher levels of material well-being than economies based on alternative forms of organization. To put it mildly, the competition between capitalism and socialism during this century provides some strong evidence to support this claim. It is clear that relatively small failures ("microfailures") can occur within a system that is enjoying overall success compared to the available alternatives, such as state socialism. As Lee and McKenzie put it, the failures generated by the market system "amount to a loss only as a deduction from an unachievable income level. The income level actually achieved — net of the losses from failures — is still greater than what might have been achieved" in alternative economic systems.¹⁶

Microfailure is thus an integral part of capitalism's success, a relation that is explored further in chapter 4.¹⁷ In short, we cannot have a

¹⁴ LEE & MCKENZIE, *supra* note 3, at 34 (citing Friedrich A. Hayek, *The Use of Knowledge in Society*, 35 AM. ECON. REV. 519 (1945), reprinted in FRIEDRICH A. HAYEK, *INDIVIDUALISM AND ECONOMIC ORDER* 77 (1948)).

¹⁵ LEE & MCKENZIE, *supra* note 3, at 41.

¹⁶ LEE & MCKENZIE, *supra* note 3, at 34.

¹⁷ Chapter 5 applies the analysis to questions arising in the transition out of socialism in former Soviet bloc countries.

working capitalist system without failure, which raises the likelihood that government attempts to ameliorate microfailures will have a negative effect on the macroeconomy.

The paradox is clear: capitalism's vitality and success also generates failures; microfailure contributes to macrosuccess. The important point to keep in mind when contemplating this fact is simply, "Compared to what?"¹⁸ Capitalism's microfailures would appear to be an acceptable price for avoiding the macrofailure of socialism. The question Americans face at this point in our history comes to this: Are we willing to run the risk that incremental additions to our governmental apparatus for blunting the effect of failure — the health care issue is clearly the most pressing example of such an accretion of government power — will reduce microfailure only at the expense of some significant macrofailure?

Even if capitalism is more productive than the alternatives, and even if individual failures are necessary for capitalist systems to function, a moral objection to failure and a government's refusal to respond to failure may be lodged. Thus, a recurring question about the discipline of failure in the marketplace is simply this: Is failure fair? Does it conform to our sense of justice? Do the U.S. auto workers who lost their jobs to import competition "deserve" to fail? Do farmers who lose their farms "deserve" bankruptcy? Lee and McKenzie address the fairness of failure in chapter 6.

Lee and McKenzie take the fairness arguments very seriously because, in their view, "[a]s long as people focus on the dark side of economic failure and see it as unfair, the dynamics of the democratic political process practically guarantee that government action will increase failure in the name of reducing it."¹⁹ Lee and McKenzie argue "if discussions of fairness are to be more than an exercise in disagreement, the focus of fairness has to be on rules and on people's behavior with respect to rules,"²⁰ rather than on particular outcomes (including failure) under a set of rules. The comparison of "rules versus out-

¹⁸ Certainly left-leaning economists and other critics of capitalism like to point out capitalism's penchant for generating failure. To take one example, a leading Marxist economist titled his restatement of Marx's economic philosophy "Free to Lose," tweaking the imperfections of capitalism and punning the title of Milton Friedman's 1980 paean to capitalism, "Free to Choose." See JOHN E. ROEMER, *FREE TO LOSE: AN INTRODUCTION TO MARXIST ECONOMIC PHILOSOPHY* (1988). It is hardly necessary to point out that the "compared to what" question has considerable force with respect to the Marxist alternative to capitalism.

¹⁹ LEE & MCKENZIE, *supra* note 3, at 65, 69 (explaining why the authors "believe it is a mistake for economists to dismiss fairness as not being a legitimate economic concern").

²⁰ LEE & MCKENZIE, *supra* note 3, at 73.

comes" that Lee and McKenzie offer is very important, and is done quite well.²¹

The authors borrow a page from John Rawls²² to analyze the choice of rules by imagining people behind a "veil of ignorance" as to their own position in the game they are defining:

Even though the outcomes of a process cannot be agreed upon, the rules that determine the process can be. Why can people with opposing interests easily agree to a set of rules even though it is impossible for them to agree beforehand on the result of the rules? One important reason is that it is always possible to come up with rules that generate outcomes that cannot be known in advance. Knowing the rules to a game generally provides only very incomplete knowledge about what to expect from any particular play of the game. A large number of factors will come into play in determining a particular outcome, not the least of which is luck. . . . [This] uncertainty makes it more difficult to favor some at the expense of others by rigging the game. Therefore, people with conflicting interests in outcomes can all see the advantage in agreeing on a set of rules that determine outcomes.²³

With this framework in mind, Lee and McKenzie then argue that "the rules of the market would have a strong attraction to those who somehow found themselves having to choose an economic system with full knowledge of how alternative systems work but with no knowledge of their particular circumstances in the system chosen."²⁴ The authors then succinctly describe the institutions of private property and voluntary contract as the core of the market system.²⁵ They then provide a

²¹ LEE & MCKENZIE, *supra* note 3, at 71-76.

²² JOHN RAWLS, *A THEORY OF JUSTICE* (1971).

²³ LEE & MCKENZIE, *supra* note 3, at 71-72.

²⁴ LEE & MCKENZIE, *supra* note 3, at 75.

²⁵ LEE & MCKENZIE, *supra* note 3, at 79-80. John Rawls, of course, reaches a much more egalitarian result than Lee and McKenzie. Rawls reasons that individuals behind the veil of ignorance would unanimously adopt a rule he calls the "difference principle," designed to maximize the welfare of the worst-off individual in society, even at the expense of the average individual's welfare. See RAWLS, *supra* note 22, at 61-83.

Empirical research on what people would do behind the veil of ignorance tends to support Lee and McKenzie's analysis over Rawls'. The results of one set of experiments "strongly indicate" that individuals would "take into account not only the position of the worst-off individual but the potential expected gain for the rest of society. The overwhelmingly preferred alternative [to Rawls] is maximizing the average income with a floor constraint." Norman Frohlich et al., *Laboratory Results on Rawls's Distributive Justice*, 17 BRIT. J. POL. SCI. 1 (1987). A recent article stated that the weight of evidence in this literature "highlights popular attachment to desert as a major criterion for income distribution and suggests that a distribution based on this criterion is potentially more stable than one that aims to raise the position of the worst-off group regardless of considerations of desert and need." David Miller, *Distributive Justice: What the People Think*, 102 ETHICS 555, 580 (1992).

very interesting, almost Kantian, perspective on the morality of adhering to the rules of the market.²⁶

Does this analysis leave no room at all for government assistance to those who fail? Not necessarily. "It is certainly possible to conceive of rules for a political economy that provide for a market economy and at the same time give authority to the government to cushion the harshness of economic failure. . . ."²⁷ However, while such a set of rules "could qualify as being fair if they defined a process that people could agree was generally beneficial[.]"²⁸ Lee and McKenzie note three problems with this approach. In the first place, no workable system could provide enough of a cushion against failure to satisfy many of the market's critics. Secondly, there is no reason to think that the government's efforts could be fine-tuned so as to produce specific, targeted outcomes. And most importantly, "reliance on the political process to provide protection against failure can quickly become counterproductive."²⁹ The evidence for this point is discussed in chapters 7-9. In concluding chapter 6, the authors make the following transitional claim:

The case for the fairness of markets is not a case for reducing government assistance to those who have been most hurt by economic failure. Personally, we would like to see the truly unfortunate in our market economy benefit more from government action, not less. In our view, however, that government is more likely to help those who most need help if there is both a widespread belief that markets are fair and an equally widespread skepticism that government can increase the fairness of the economy by helping directly the victims of economic failure.³⁰

IV. THE POLITICS OF FAILURE

While the failure of others is likely to strike us as unfortunate, it is also likely that most of us would agree that others' failures, necessarily generated by economic progress, are not too high a price for a society to pay for increased standards of living. The rub comes, of course, when we are asked to bear the costs of our *own* failures.

It is entirely predictable that individuals and firms will ask for government protection from their failures, regardless of the economic

Readers interested in the relation of ethics to economic theory, and vice versa, should read Daniel M. Hausman & Michael S. McPherson, *Taking Ethics Seriously: Economics and Contemporary Moral Philosophy*, 31 J. ECON. LIT. 671 (1993).

²⁶ LEE & MCKENZIE, *supra* note 3, at 82-83.

²⁷ LEE & MCKENZIE, *supra* note 3, at 83.

²⁸ LEE & MCKENZIE, *supra* note 3, at 83.

²⁹ LEE & MCKENZIE, *supra* note 3, at 84.

³⁰ LEE & MCKENZIE, *supra* note 3, at 84.

system in which they operate. The problem seems particularly acute to capitalism, however, and for an odd reason. Since failure is an inevitable side effect of progress, then the greater the progress in an economy, the larger the number of failures. Paradoxically, capitalism's success in generating more economic progress than other economic systems also means that it generates the appearance of a large number of failures. And all who can will seek government shelter from the Schumpeterian storm of "creative destruction" that is generated by a free market system.

Failure in a capitalist system is, obviously, a very broad subject. In chapters 7-9, Lee and McKenzie talk about two kinds of failure — business failure and the failure of the poor — without explicitly dealing with the similarities of and differences between these two categories of failure, and the politics that surround efforts to blunt them. There seems to be a significant difference between assisting failed businesses, or those near failure, and assisting low-income individuals who have, in a sense, failed modern life. Different passions and different politics are stirred in bailing out Chrysler *versus* trying to help unemployed single mothers. *Failure and Progress* would have benefited from a better developed taxonomy of failure.³¹ This is, however, a minor flaw in the analysis.

A. The political response to business failure

Chapter 7 opens with a recognition of the necessity of government. That is, the classical move from a "state of nature" to a civil society with a government that enforces property rights and provides for domestic order and civil defense greatly improves the lives of the people under it. By defining the institutions of private property and free exchange as the basic rules of the economic "game," government can clearly promote the general welfare. However, as Lee and McKenzie explain clearly, there is a problem with this escape from the Hobbesian dilemma:

Because government possesses coercive power and is expected to use that power, it is by necessity exempt from certain rules that apply to all other players in the game. For example, government has the power to violate property rights to some degree by forcing citizens to relinquish some of their wealth in the form of taxes. Also, government not only enters the game under a less restrictive version of the rules than that imposed on other players but must enforce those rules on all players, including government. In any game, government's position of having to

³¹ Of course, the categories of business failure and personal failure can overlap, with the former triggering the latter via unemployment.

judge its own [infractions] creates temptations that seldom if ever are resisted entirely.³²

It is this combination of the taxing power and the irreducible element of discretionary authority that enables the government to confer benefits on politically powerful private interests. The ability of government to force transfers of money and property rights from one group to another is an awesome temptation to those people who can effectively exercise political clout. In the state of nature people could acquire wealth only through their own work or by theft. In a civil society, a third alternative exists; people can acquire others' property by asking government to take it and redistribute it to them. As America's government grew, it became more and more a "transfer society," in which a plethora of interest groups seek government-mandated transfers of property rights.³³ The pursuit of such governmentally-conferred favors — in the form of subsidies, tax breaks, legal protection from competitors, and the like — is now the most significant part of American politics. In recent years economists of the "public choice" school of thought have extensively studied the pursuit of government transfers — an activity they call "rent-seeking" — and many now hold the view that this aspect of American politics has a significant, negative effect on social welfare and economic growth.³⁴

It is a great strength of *Failure and Progress* that Lee and McKenzie present a very readable summary of the highlights of the economic explanation of rent-seeking in chapter 7.³⁵ An understanding of this phenomenon is necessary to a full appreciation of the rest of the book, not to mention most of American politics.

How is it that rent-seeking appeals — which amount, in effect, to asking the government to sanction the involuntary rearrangement of assets between donors and recipients — are ever able to gain approval in a representative democracy? The basic explanation lies in three features of political decision-making.³⁶

³² LEE & MCKENZIE, *supra* note 3, at 88.

³³ Good treatments of this history include TERRY ANDERSON & PETER J. HILL, *THE BIRTH OF A TRANSFER SOCIETY* (1980); ROBERT HIGGS, *CRISIS AND LEVIATHAN: CRITICAL EPISODES IN THE GROWTH OF AMERICAN GOVERNMENT* (1987); JONATHAN R.T. HUGHES, *THE GOVERNMENTAL HABIT REDUX* (2d ed. 1991).

³⁴ See generally Kevin M. Murphy et al., *Why Is Rent-Seeking So Costly to Growth?*, 83 AM. ECON. REV. PAPERS & PROC. 409 (1993).

³⁵ See especially LEE & MCKENZIE, *supra* note 3, at 88-103.

³⁶ The public choice literature on this topic is based on pioneering studies by Anthony Downs, Gordon Tullock, Mancur Olson, and Robert Tollison. Several of the key articles are cited by Lee and McKenzie, who themselves have made significant contributions to this literature.

First, the broad public will likely remain “rationally ignorant” of most of what the government is doing. This is true for a number of reasons, not least of which is the limited amount of time most people can afford to spend monitoring their elected and unelected government officials and the very low probability that any such efforts will ever have any effect on the processes of politics or government.³⁷

Second, relatively smaller groups have a decided advantage over relatively larger groups in terms of the ease with which they can organize and act in the political arena. It is much easier to coordinate the efforts of U.S. sugar producers to seek (and maintain) government barriers against competition from imported sugar than it is to coordinate the efforts of U.S. sugar consumers to oppose these barriers.

Third, the transfer sought will be from a large group (at the limit, the public at large, through higher prices or higher taxes) to a small group (typically the owners and employees of favored firms). As a result, each member of the large group will pay a relatively small price to provide the transfer, which will effect the wealth of each of the members of the small group in a much more significant way. This combination of “dispersed costs and concentrated benefits” means that each member of the large group has only a small stake in the political decision up for grabs, while each member of the large group has a much greater stake, thus reinforcing both the rational ignorance phenomenon and the phenomenon of small group cohesion, noted above. It is the combination of these three aspects of political decision-making that provides a fertile field for rent-seeking and the further growth of the transfer society.

Perhaps the most easily grasped example of this phenomenon is U.S. trade law, which seeks through tariffs, quotas, and other barriers to limit the competition U.S. firms face from foreign firms. It is clear that the costs paid by U.S. consumers in the form of higher prices and reduced product availability are quite high.

A recent study³⁸ estimates that in 1990 American consumers paid \$70 billion in higher prices because of tariffs and other trade restrictions. Of this amount, \$16 billion went into the federal government’s coffers via tariff revenues. Of the remaining \$54 billion, \$43 billion

³⁷ Lee and McKenzie also argue that some voters will support redistributive programs even though the programs will raise their taxes, because voting for candidates who favor the programs is a relatively cheap way to express your views and feel good about your selflessness. Lee and McKenzie refer to this phenomenon as “the low cost of political compassion.” LEE & MCKENZIE, *supra* note 3, at 94-98.

³⁸ GARY C. HUFBAUER & KIMBERLY A. ELLIOTT, MEASURING THE COSTS OF PROTECTION IN THE UNITED STATES (1994).

went to the firms in 21 protected industries. Only about \$4 billion, less than 10% of the total take, wound up in the pockets of blue collar workers in these industries who retained their jobs as a result of protectionist policies. The result is that "[o]n the average, the cost to consumers for saving these jobs is an astounding \$170,000 a year — or six times the average annual pay (wages plus benefits) of manufacturing workers."³⁹ Moreover, the implicit costs of protectionism — including the distortion of the market and its resulting perverse effects on other firms and other industries — almost certainly outweigh the explicit costs captured in studies of price changes due to import protection.

Although protectionist trade laws harm the general public, all three characteristics of the political process discussed have the effect of encouraging politicians to vote for such measures: The public cannot be expected to spend a large amount of its time learning the pros and cons of free trade, the parties seeking protection constitute a much smaller group to organize politically than the general public that will bear the price of the policy, and the policy means a great deal more to each individual beneficiary than it would to any given individual consumer/taxpayer. A moment's reflection on the recent debate over the North American Free Trade Agreement, which involved the Administration in a great deal of "horse trading" to round up a majority of votes in the House of Representatives, should reinforce this point.⁴⁰

While the story of grossly inefficient and inequitable government meddling in the marketplace is perhaps most familiar in the context of trade law, it applies equally to most forms of government regulation and many forms of government spending. (Lee and McKenzie use agricultural subsidies as their primary example.⁴¹) The benefits from bad policies are transferred from the public to a relatively small group of employees and shareholders, the amount of the benefit is less than

³⁹ Hobart Rowen, *Calculating the High Price of Protecting Jobs*, BIRMINGHAM NEWS, Jan. 19, 1994, at 9A.

For more information on the social costs of U.S. trade laws, see Michael Mussa, *Making the Practical Case for Freer Trade*, 83 AM. ECON. REV. PAPERS & PROC. 372 (1993); Morris E. Morke & Kenneth Kelly, *Perspectives on the Effects of Unfair Imports on Domestic Industries*, 61 U. CIN. L. REV. 919 (1993).

⁴⁰ See generally *The Flying Arkansan*, ECONOMIST, Nov. 20, 1993, at 25:

Mr Clinton struck numerous little deals aimed at the special interests of wavering congressmen. There was a development bank to please Latinos; there were concessions to appease wheat-farmers near the Canadian border, wine-producers in California, and citrus- and vegetable-farmers in Florida; there was a bit of extra protection for the textile industry as well as for sugar-producers and peanut-growers.

⁴¹ LEE & MCKENZIE, *supra* note 3, at 96-98.

the amount paid by the public at large, and the public will most likely remain ignorant and/or politically indifferent to these facts. In sum, government can and does routinely adopt policies that harm the public at large in order to protect firms and their employees from failure in the marketplace.

Accordingly, Lee and McKenzie close chapter 7 with the statement that “[t]he best protection against the erosion of the market process — which serves the long-run interests of all citizens — is a public attitude that views with skepticism those who attempt to use government to obtain special privileges.”⁴²

B. The political response to chronic poverty

But what about the “truly needy”? As Lee and McKenzie recognize, “[i]t is accepted almost universally that government should take direct action to alter the income distribution of the poor.”⁴³ The problem is that this attitude toward poor relief begs the question whether the government is capable of “actually . . . alter[ing] the income distribution in favor of the poor.”⁴⁴ In chapters 8 and 9, Lee and McKenzie marshal evidence that supports their conclusion that “government can do little to alter the distribution of income, and . . . what the government can do to help the poor is necessarily modest.”⁴⁵

Chapter 8 explains the limited effectiveness of direct government assistance to the poor by reference to three side-effects of such assistance. First, the provision of income transfers to the poor reduces their incentives to work.⁴⁶ Second, the use of the taxing power to fund these transfers reduces the incentives to the non-poor to work, thus reducing national income, and also “crowds out” voluntary contributions to the poor relief efforts of private charities. As a result, the net effect of publicly-financed charity is much less than the amount apparently transferred.⁴⁷ Third, and most significantly, the politics of poverty relief programs tends to result in wider and wider definitions of the class of people entitled to benefits, as well as increases in the types and amounts of benefits provided. The costs of the programs thus grow dramatically over time, as witnessed in the histories of Medicaid,

⁴² LEE & MCKENZIE, *supra* note 3, at 103. It is perhaps important to note here that Lee and McKenzie do not object at all to private charitable giving to aid those affected by business failure.

⁴³ LEE & MCKENZIE, *supra* note 3, at 106.

⁴⁴ LEE & MCKENZIE, *supra* note 3, at 106.

⁴⁵ LEE & MCKENZIE, *supra* note 3, at 107.

⁴⁶ LEE & MCKENZIE, *supra* note 3, at 109-14.

⁴⁷ LEE & MCKENZIE, *supra* note 3, at 114-17.

AFDC, and food stamps. As the costs of these programs retard economic development and growth, the ability of the poor to work themselves out of poverty is compromised.⁴⁸ The current proposals to “reform” health care offer a very clear example of proposals masquerading as poor relief that are virtually certain to turn into a bazaar of rent-seeking behavior if adopted.

In chapter 9, Lee and McKenzie ask whether government transfer programs have, on balance, helped the poor. They conclude that the evidence does not support an affirmative answer. In particular, they note that the degree of inequality in the distribution of income in the U.S. has not changed since 1950, despite the expenditure of billions of tax dollars on poverty programs.⁴⁹

The negative effect that growth in government transfer programs has on economic growth also contributes to Lee and McKenzie’s assessment that this activity has, overall, harmed the poor. The pursuit of short-run changes in income inequality can have a negative effect in the long-run that swamps the short-run improvements in the relative position of the poor. A simple numerical example makes this point vividly.⁵⁰

Properly understood, then, Lee and McKenzie are as concerned with the effects of failure as the self-styled compassionate critic of capitalism; their time horizons are quite different, however. While the critic seeks — often in vain — to confer immediate relief on the victims of failure, Lee and McKenzie argue the importance of safeguarding the health and well-being of the economic system, whose growth over the long run benefits everyone, including the poor.

Furthermore, the creation of a government structure large and powerful enough to effect transfers to the poor necessarily involves the creation of discretionary authority that will attract the efforts of interest groups other than the poor. The business and labor rent-seekers discussed in chapter 7 will attempt, with some degree of success, to commandeer the discretionary coercive power of the government to serve their own ends. The poor will help pay for the resulting policies.

Lee and McKenzie make an interesting case against the efficacy of government poverty programs. However, the literature on poverty and government programs addressing the problems of the poor is vast, and *Failure and Progress* does not purport to be a survey of all the

⁴⁸ LEE & MCKENZIE, *supra* note 3, at 117-31.

⁴⁹ LEE & MCKENZIE, *supra* note 3, at 136-37.

⁵⁰ LEE & MCKENZIE, *supra* note 3, at 143-44.

evidence on poor relief.⁵¹ Readers who are firmly committed to the idea that some effective form of poor relief must be possible will not likely be persuaded by the evidence adduced by Lee and McKenzie to the contrary. Others will at least be given pause. In particular, the claim that government transfer programs *taken as a whole* do not benefit the poor seems very plausible. This reinforces Lee and McKenzie's central point that the poor would be better off if the government ceased *all* its transfer programs — those to businesses as well as those to the poor.

V. CONCLUSION: THE FUTURE OF FAILURE AND THE FUTURE OF POLITICS

"I'd hoped we'd broken away from that silly, wasteful, philosophical debate about the roles of government and industry."

— U.S. Secretary of Commerce Ronald H. Brown, 1994⁵²

In this brief, well-written book, Lee and McKenzie do an admirable job of explaining the role of failure in bringing about the success of the free market system, as well as the difficulties and problems which inhere in political attempts to blunt such failures. In the process, they bring into question many of the welfare state's attempts to legislate an end to failure.

However, Lee and McKenzie offer no grand strategy for changes in our economic or political systems to thwart the politics of good intentions and the seemingly inexorable growth of government.⁵³ They express the hope that an increased public awareness of the negative aspects of the transfer society, coupled with an appreciation of the positive aspects of failure, will serve to stop the growth of transfer activity and, ideally, eventually reduce the amounts transferred. It is not clear how optimistic Lee and McKenzie are about this possibility. Certainly they are not optimistic about the alternative:

⁵¹ It is odd, though, that it contains no reference to the work of Charles Murray, a critic of poverty programs. See CHARLES MURRAY, *LOSING GROUND: AMERICAN SOCIAL POLICY, 1950-1980* (1984). Readers interested in the literature on poor relief should consult Nicholas Barr, *Economic Theory and the Welfare State: A Survey and Interpretation*, 30 J. ECON. LITERATURE 741 (1992) (multinational survey). An interesting recent essay on the subject is Lyn Squire, *Fighting Poverty*, 83 AM. ECON. REV. PAPERS & PROC. 377 (1993).

⁵² Quoted in Peter Behr, *GOP Vows to Block Increased R&D Aid*, WASH. POST, Mar. 12, 1994, at C2.

⁵³ In an earlier book, the authors did make some suggestions for governmental reform, including the adoption of the "balanced budget amendment" to the U.S. Constitution and a new system of Congressional compensation, keyed to deficit reduction. See DWIGHT R. LEE & RICHARD B. MCKENZIE, *REGULATING GOVERNMENT: A PREFACE TO CONSTITUTIONAL ECONOMICS* 154-62 (1987).

[A]s long as there exists widespread sympathy for using governmental power to solve a wide range of social problems, two unfortunate and related consequences will follow. First, discretionary government power will be created that will be abused by organized interest groups. Second, government will attempt to do a host of things that it is either incapable of doing or capable of doing only poorly and at costs that exceed the benefits.

That suggests that a necessary condition for controlling the harm done by special-interest political influence is a widespread distrust, even hostility, toward discretionary government power, not unlike that which existed at the time the U.S. Constitution was drafted and which continued to characterize public opinion for the first 150 years of U.S. history.⁵⁴

How likely is it that Lee and McKenzie's wished-for change in public attitudes will occur? Clearly there is today a good deal of public distrust of government, if government is abstractly conceived. When government is personalized and made local — when, for example, voters are asked whether they approve of their incumbent Congressman rather than Congress as a whole — the distrust disappears. Members of Congress are reelected at very high rates, even while the public expresses contempt for Congress as an institution. The easiest explanation for this is also the most depressing: people vote the narrow self-interest of their district, defined in terms of their incumbent's success in bringing home pork-barrel projects and the like, regardless of the overall effect of this attitude on American politics.⁵⁵ Predictions of a "voter revolt" are routinely disproved. Many voters seem to be trapped by the same short-run illusion that afflicts the defenders of massive (short-run) income redistribution to the poor.

Accordingly, it is hard to be optimistic with respect to Lee and McKenzie's hopes for a revival of thoroughgoing skepticism about government.⁵⁶ If such a revival does occur, books such as *Failure and Progress* will doubtless have played a significant role. Perhaps in this case ideas will have (welcomed) consequences.

⁵⁴ LEE & MCKENZIE, *supra* note 3, at 150.

⁵⁵ This would probably go a long way toward explaining Rep. Daniel Rostenkowski's (D-Ill.) recent lopsided primary victory, even as he fought ethics charges.

⁵⁶ Schumpeter may turn out after all to have been right about capitalism containing the seeds of its own decline, but for rather different reasons than the ones he identified. See SCHUMPETER, *supra* note 2, at 81-87. That is to say that capitalism may ultimately be undone by a fear of failure (expressed in both corporate and personal welfarism) rather than by the onslaught of socialism.

Along these lines, see Jonathan R. Macey & Geoffrey P. Miller, *The End of History and the New World Order: The Triumph of Capitalism and the Competition Between Liberalism and Democracy*, 25 CORNELL INT'L L.J. 277, 285 (1992) ("The central historical question of the twenty-first century may well be whether capitalism can survive the interest-group proclivities that threaten private property rights in advanced democracies.").

One thing is clear: our society will experience a lot of failures in the future. These failures will generate political pressure for more government protection. Take the economic changes that followed — and will follow — the collapse of Communism in the Soviet bloc. In his 1992 presidential address to the American Finance Association, Professor Michael Jensen noted that the collapse of the Soviet Union “is likely to generate huge changes in the world economy over the next several decades. These changes promise to cause much conflict, pain, and suffering as world markets adjust, but also large profit opportunities.”⁵⁷ Specifically, Jensen predicted that

While the changes associated with bringing a potential 1.2 billion low-cost laborers onto world markets will significantly increase average living standards throughout the world, they will also bring massive obsolescence of capital (manifested in the form of excess capacity) in Western economies as the adjustments sweep through the system.⁵⁸

Jensen warns:

We should not underestimate the strains this continuing change will place on worldwide social and political systems. In both the First and Second Industrial Revolutions, the demands for protection from competition and for redistribution of income became intense. It is conceivable that Western nations could face the modern equivalent of the English Luddites who destroyed industrial machinery (primarily knitting frames) in the period 1811 to 1816, and were eventually subdued by the militia.⁵⁹

Our future will certainly include continued economic change, probably at an accelerated rate. (Consider the force of Jensen’s predictions as applied to the eventual release of China from the communist yoke.) As a result, actual or threatened failure will lead to increased political agitation for protection in the coming years. Lee and McKenzie have written a timely and important book that makes a real contribution to our understanding of the political dynamics of the relationship between failure and progress, and between failure and politics. In so doing they may have increased the chances that we can retake some measure of control over our collective response to the politics of good intentions.

In addition, *Failure and Progress*’ deft analysis of the role of failure and the political response to it highlights the differences between the market system and the political system. And, as the nation enters the second half of the Clinton Presidency considering numerous pro-

⁵⁷ Jensen, *supra* note 4, at 843.

⁵⁸ Jensen, *supra* note 4, at 844.

⁵⁹ Jensen, *supra* note 4, at 845 (footnote omitted).

posals to substitute politics for markets, Lee and McKenzie offer their readers a very clear exposition of what is at stake in these debates.