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Rules of the Game

HOW GOVERNMENT
WORKS AND WHY IT
SOMETIMES DOESN'T

Professor Phillip Magness
George Mason University
and
Professor Paul Weissburg
Augustana College



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How Government Works and Why It Sometimes Doesn't

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Course Syllabus

Rules of the Game: How Government Works and Why It Sometimes Doesn't

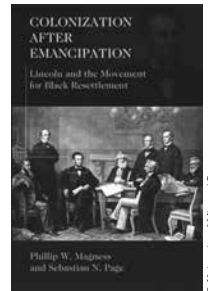
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About Your Professor

Phillip Magness

Phillip Magness is a policy historian at George Mason University's Institute for Humane Studies. His research covers a diverse array of topics, including administrative history, the history and politics of international trade and taxation, and the abolitionist movement in the nineteenth-century United States. He is the coauthor with Sebastian N. Page of a critically acclaimed book on the presidency of Abraham Lincoln, *Colonization After Emancipation: Lincoln and the Movement for Black Resettlement* (University of Missouri Press, 2011). Professor Magness previously taught public policy and administration at George Mason University and at American University in Washington, D.C.

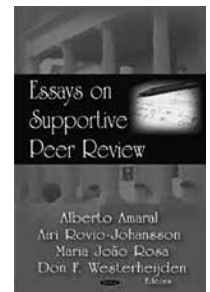




About Your Professor

Paul Weissburg

Professor Paul Weissburg currently teaches at Augustana College, where he heads the Public Policy/Public Administration concentration of the Political Science Department. Before teaching at Augustana, Professor Weissburg taught at the Pädagogische Akademie des Bundes (Vienna, Austria), George Mason University, and American University. He has written extensively on industry self-regulation, private governance, and the U.S. system of accreditation of higher education. His publications have been published in *Liberal Education*, *Review of Policy Research*, and *Cases in Business Management* as well as a chapter in *Essays on Supportive Peer Review* (Nova Science Publishers, Inc., 2008).



Past work experiences include consultant work for the Office of the Inspector General and the U.S. Postal Service. He also has worked as a facilitator/coordinator for the Building One Neighborhood project, which actively promotes dialogue between African-Americans and Korean-American merchants in the Ward One district of Washington, D.C.

Dedication

This work is dedicated to A. Lee Fritschler and Catherine E. Rudder.

Acknowledgement

Professor Paul Weissburg thanks the following students of Augustana College for their contributions to this project. Some submitted articles that provided useful examples. Others helped to further his understanding of this material through insightful questions and comments. This list is by no means exhaustive, and Professor Weissburg says that it has been his good fortune to teach at a college that attracts so many high-caliber students.

Aaron Alberico	Marie Dienhart	Alexander Mikos	Taylor Pouliot
Ellen Adams	Matthew Hallberg	Ryan McVickers	Kaitlin Schultz
Amanda Beveroth	Jennifer Head	Michael O'Brien	Amanda Seifert
Gabriel Bouzard	Nicholas Hulsey	Jorie Ollenburger	Kalin Showers
Sabrina Coffey	Nicole Imparato	John Porter	Jonathan Wallace

My creed is that public service must be more than doing a job efficiently and honestly. It must be a complete dedication to the people and to the nation with full recognition that every human being is entitled to courtesy and consideration, that constructive criticism is not only to be expected but sought, that smears are not only to be expected but fought, that honor is to be earned, not bought.

~Margaret Chase Smith (1897–1995)
U.S. Senator from Maine, 1949–1973



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Introduction

The writers of the United States Constitution attempted to design a “rulebook” for a new kind of nation. They wanted a central government that would be powerful enough to maintain order yet fractured enough to ensure that no faction could ever impose its will upon the rest of the country. They wanted a democracy in which the voice of the majority would reign, but where the rights of the minority would be protected. They had to contend with state governments, which—though they (mostly) saw the need for a strong federal government—were reluctant to surrender any of their sovereign powers.

Faced with these contradictory goals, the founders of the United States managed to write one of the most influential and revolutionary constitutions this world has ever seen. They designed a system of government that has survived for more than two hundred years and which, even today, struggles to maintain a precarious balance between efficient administration and the preservation of individual rights amidst a multitude of conflicting policy goals.

But the U.S. Constitution was written at a time when the United States—and its role in the world—was fundamentally different than it is today. And while the rules have been amended and added to over time, it has been done in a patchwork fashion. The president, Congress, and the Supreme Court have reacted to situations as they have arisen, often with conflicting notions of how the United States should function. The results have been mixed.

If the founders of the nation could see what the United States of America has become, they would be—at the very least—surprised.

Today, even those working within the United States political system are eager to distance themselves from it, vehemently agreeing with voters that the system is broken. Candidates present themselves as “Washington outsiders” and “mavericks” who, if elected, will bring dramatic change to the way that things are done. Few of them have a kind word to say about the political system that they are, paradoxically, so eager to join.

Political conflict dominates the present dialog about government. The rich portray themselves as the victims of tax-and-spend politicians, while the poor believe that the entire political system has been bought by wealthy campaign donors. Meanwhile, the middle class argues that the government has betrayed them, forcing them to foot the bill for tax breaks given to the rich and welfare provided for the poor. Corruption, collusion, and ineptitude are the charges emanating from the political landscape, regardless of who holds power, and it shows in record negative approval ratings for Congress and the president alike. Everyone seems to complain about the growing influence of distant and self-interested special interest groups, though few admit to belonging to any. Analysis and reasoned debate have given way to furious diatribes and paranoid rants.

There is much that is wrong with the current system, yet interest groups, corruption, and a “throw the bums out!” mentality are nothing new. In fact, they typify much of American history and strike at the core of how our constitutional system of government operates. Where do laws and regulations, both good and bad, come from? Why are special interests sometimes able to “capture” control of the government, and what are the consequences? Why does Congress sometimes appear to be trapped in perpetual gridlock, and why do presidents see their policy goals thwarted by members of their own administration? What is reform, and how has the American system adapted to times of crisis in the past?

To improve our political system it is first necessary to understand how that system is *supposed* to work, how it actually *does* work, and how it has changed over time. The “rules of the game” described in this course will hopefully provide a common starting point from which constructive debate can develop.

Lecture 1

What Are the Rules of the Game and Why Do They Matter?

Professor Phillip Magness and Professor Paul Weissburg

The Suggested Reading for this lecture is Alexander Hamilton, John Jay, and James Madison's *The Federalist Papers*.

Dueling Perspectives

Discussions of U.S. government and politics are often sidetracked into a debate between two political positions. The first of these two positions is sometimes referred to as neoliberalism, and it is a general faith in the free market system and a strong sense of skepticism regarding government. This perspective is generally ascribed to libertarians, conservatives, and the Republican Party and was perhaps best articulated by former president Ronald Reagan in 1981 when, during his first inaugural address, he stated, "Government is not the solution to our problem. Government is the problem."



The second political position reverses the underlying assumptions of the first position. This perspective, which is most commonly associated with liberals in the United States and which is sometimes referred to as progressivism, argues that without proper government regulation, market forces will inevitably lead to inequality, monopolies, fraud, and environmental devastation. Progressives are in favor of the free market system, but with increased government intervention to help level the playing field and to protect the public from some of the most detrimental side effects of capitalism.

It is almost impossible to discuss American government and politics without being accused of favoring one perspective over the other and, therefore, being biased. Rather than try to ignore this political division, this series of lectures addresses these two differing positions directly by using two professors with two very different perspectives. Dr. Phillip Magness is a Texas libertarian while Dr. Paul Weissburg subscribes to a much more liberal ideology. Throughout the course, issues will be considered from both perspectives.

"Rules of the Game": The Melding of Five Academic Fields

This course utilizes several different fields of study, each of which provides a somewhat different perspective. If this were a college course, it might be categorized as public policy, public administration, American history, U.S. government, or private governance. Each of these fields plays an important part in understanding how the U.S. government works and why it sometimes doesn't.

Public policy is the study of the decision-making process through which government makes the rules, laws, and policies that affect the general public. For example, in a public policy course, one might look at the different policy alternatives that faced the United States government immediately following its invasion of Iraq in 2001. There were many different policies that might have been enacted following the fall of Saddam Hussein. The United States might have chosen to withdraw its military entirely. Or they might have gone the opposite route and tried to take over the country of Iraq, making it a U.S. colony or territory. Instead, a decision was made to attempt to rebuild Iraq and to put together a coalition government that would transition into a government that would be democratically elected by the Iraqi people. A scholar of public policy might analyze whose decision that actually was, the process through which the decision was made, and how that decision was finally implemented and became official U.S. policy.

Public policy is the decision-making process of what to do; public administration is how that policy is actually done. Returning to the Iraq example, once the decision was made to attempt reconstruction, a scholar of public administration would ask how best to do it. Decisions would have to be made regarding the role of the Iraqi people in rebuilding their country, which tasks should be given highest priority, and how to avoid the most common pitfalls in nation-building. Regardless of whether or not one agrees with the policy decision to stay and rebuild Iraq, the public administration aspect of the problem is essential to a favorable outcome.

American history is not simply a litany of events placed in chronological order; it is the study of how those events transform the rules of the game and how changes in the rules of the game affect future events. In order to develop realistic goals in Iraq, it is essential that one understands the history of the United States in relation to the Middle East region and how that history has helped to shape the current situation. Additionally, the United States has involved itself in numerous conflicts in foreign countries in the past several decades; the outcomes of those interventions have deeply affected the attitude of the American people toward sending the U.S. military into foreign lands. This, in turn, helps set the boundaries of how long the U.S. government can expect public support for the reconstruction effort. Going back in time a little further, to the outcome of the Vietnam war, one can see that certain options that might be open to other countries—such as reinstating the draft—are not viable options for the United States, which, in turn, sets limits on the resources that the U.S. government will be able to expend on the reconstruction of Iraq.

The study of U.S. government focuses on how the government functions. It asks which institutions have which powers and what checks and balances are in place to limit those powers. A scholar of United States government might ask who in the government is going to have the authority to make the key decisions throughout the process of reconstruction. The president of the United States may have the authority to declare war, for example, but he or she does not control the budget and so cannot fund a war that Congress refuses

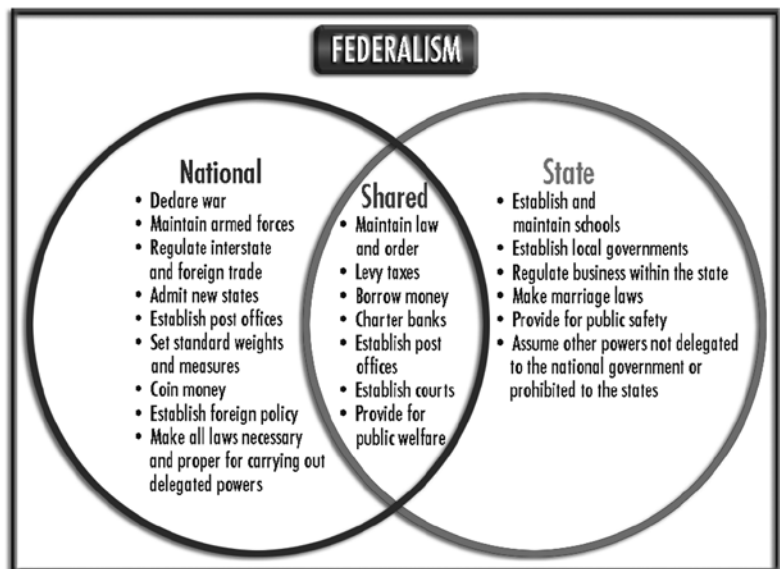
to support. Further, countless government agencies have been involved in the U.S. reconstruction effort; the relationship of these agencies to the executive and legislative branches is complex and oftentimes counterintuitive. Further, the role of the attorney general became increasingly important as questions were raised regarding the legal limits of what actions the U.S. government could take.

Finally, private governance considers the role of the private sector in creating—and then implementing—public policy. In this particular example, the role of Halliburton and other private contractors has had a far more significant impact on the reconstruction efforts than is widely recognized. The role of the Blackwater operatives provides another example of the potential complications and issues of accountability that can arise when government functions are outsourced to the private sector.

Setting the Stage

Before undertaking a more thorough examination of how government operates, it is necessary to first define a few basic features of the Constitution—the formal “rules of the game” under which government operates. The American constitutional system is built around the theory of federalism. Simply stated, a federalist system of government is one that divides the sovereignty of the governing mechanism, and along with it the functions and powers of the state, across multiple levels. The object of this system, at least when it works right, is twofold. First, it divides the functions of government to the level where it makes the most sense. Therefore, local policing, firefighting, utilities, and local codes are often handled on the town, city, or county level. The states traditionally handle policy establishing standards of criminal law in their borders, or implementing major statewide infrastructure and transportation projects. The defense of the whole nation is a different matter; therefore, military policy is usually handled on the national level.

Second, and with equal importance, federalism seeks to divide the power of government itself so that no single party, interest group, or other faction accumulates complete control over



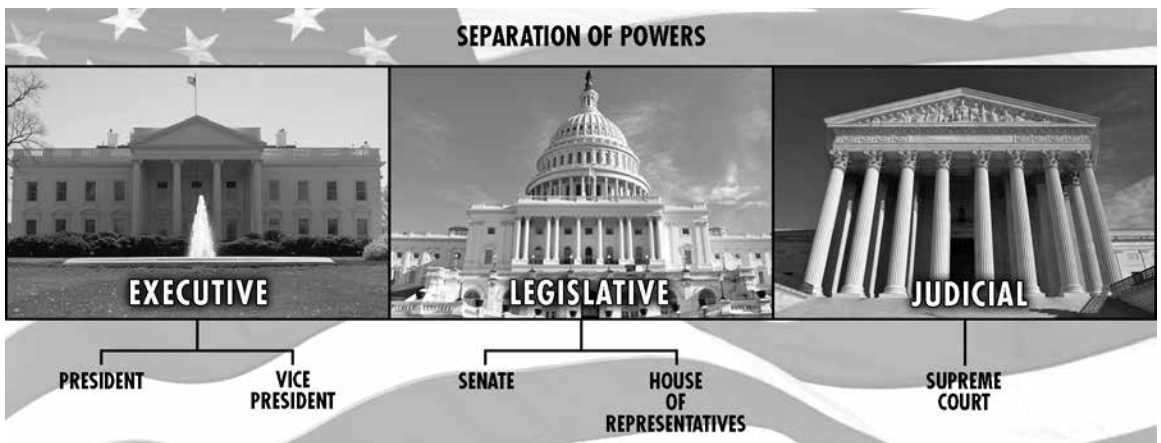
The basics of federalism as adopted in the United States.

Adapted from the Educational Resources Information Center, Bloomington, IN

the entire government. The framers of the Constitution were deeply skeptical of centralized power, having recently revolted against the colonial British system that administered the North American continent from afar in London. By dividing the tasks of government along local, state, and national lines, they also sought to decentralize the exercise of power and, with it, preserve the diversity of competing interests across multiple levels of society. Since different levels of government are responsive to different constituencies and different groups of voters, the theory holds that a division of powers will serve as its own check against abuse.

A related concept in the American constitutional system holds that the tasks of government should be further divided between three distinct and separate branches of government, each of which may constrain the actions—and excesses—of the other two through a system of checks and balances. First consider the three branches. The legislative branch, or Congress, consists of two chambers—a House of Representatives, chosen by district and allocated by population, and the Senate, chosen by state with each receiving two members. Congress is the primary lawmaking body of the government—it debates policy, codifies it into law, and directs and funds its implementation. The executive branch, or the president, is chosen nationally by way of an indirect electoral college based on votes cast in each state. The president is charged with executing, or implementing, the laws of Congress and overseeing their implementation. The judicial branch, or federal court system, is appointed by the president and confirmed through the Senate. Its primary constitutional task is to evaluate the constitutionality of laws passed by Congress, and the legality of executive implementation, when a legal dispute arises about either.

Notice that each of these three branches possesses certain mechanisms to check the exercise of power by each of the other two. Congress may pass laws, but they require a presidential signature and must pass muster before the Supreme Court. Presidents have the ability to veto the laws of Congress as well as substantial discretionary power on their implementation, but they must yield to court rulings on legality. They may also



have their vetoes overridden, their budgets cut by Congress, and their appointments rejected by the Senate. The Court may similarly exercise its jurisdiction in determining the constitutionality of laws and the legality of government actions, but its members are subject to appointment by the president and confirmation by the Senate, while Congress also controls their statutory jurisdiction.

The cumulative function of these checks and balances, along with the federalist system, is constraining and consensus-building. Stated differently, the American constitutional system assumes that each branch of government and each level of government represents a different interest and constituency. Representatives are elected by and accountable to a different and more localized group of voters than Senators, and both differ still from the nationally accountable president. Governors, state legislators, and local sheriffs, mayors, and members of a county commission each represent different groups of their own. In order to pass muster, any new policy must acquire the support and consensus of several of these units. A bill needs the House, Senate, and a presidential signature to become law, and then must withstand any challenges before the courts before it can become a uniform national standard.

Furthermore, as part of the federalist system, at lower levels policies are anything but uniform. Different states have different laws on the regulation of abortion, gay marriage, death penalties, tax systems, and even road-funding formulas. They even occasionally come into conflict with federal policies, as has occurred with immigration and medical marijuana. How these conflicts play out and what these differences entail for intergovernmental relationships are all part of the current discussion about the proper role, size, and scope of government.

One final complication bears mention: the so-called “Fourth Branch” of government, or the administrative state. While this function traditionally falls under the scope of the executive branch, many presidents have learned the hard way that administrative government does not always synchronize with executive policymaking priorities. The size, scope, means of appointment, budget, and differing missions of the administrative bureaucracy all affect the way policies are written, interpreted, and implemented and must be taken into consideration when examining how government works—or why it sometimes fails.



For Greater Understanding

Questions

1. What is federalism and how is it different from political systems in other countries? What are some of its advantages and what are some of the problems inherent in a federalist system?
2. Why did the Founding Fathers of the United States choose a federalist system? How has it changed since then?
3. Do you think that too much power has accumulated at the federal level? Why or why not?

Suggested Reading

Hamilton, Alexander, John Jay, and James Madison. *The Federalist Papers*. The Classic Original Edition. Lindenhurst, NY: Tribeca Books, (2010) 1788.

Other Books of Interest

Ellis, Joseph J. *Founding Brothers: The Revolutionary Generation*. New York: Vintage, 2002 (2000).

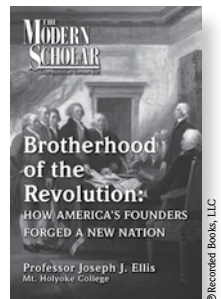
Zinn, Howard. *A People's History of the United States: 1492 to Present*. Rev. and updated. New York: Harper Perennial, 2001 (1980).

Website of Interest

The *Constitution Society* website provides the text of the *Federalist Papers*. —
<http://www.constitution.org/fed/federa00.htm>

Recorded Books

Ellis, Joseph J. *Brotherhood of the Revolution: How America's Founders Forged a New Nation*. The Modern Scholar Series. Prince Frederick, MD: Recorded Books, LLC, 2004. (UC008)



Lecture 2

In Defense of the Spoils System

Professor Phillip Magness

The Suggested Readings for this lecture are Kenneth D. Ackerman's *Boss Tweed: The Rise and Fall of the Corrupt Pol Who Conceived the Soul of Modern New York* and George W. Plunkitt's *Plunkitt of Tammany Hall: A Series of Very Plain Talks on Very Practical Politics*, edited by William L. Riordan.

Government, a Supplier of Jobs?

It is natural to think of government through the ways it interacts with the public or its “products.” Broadly speaking, this consists of the services it provides and the activities it regulates. Some of these products are controversial, like medical entitlements, farm subsidies, defense buildup, and welfare. Others are widely seen as the proper domain of the state, like roads and fire departments. Regardless of where one stands on each of these programs, most people know government through (1) what it takes from them in taxes, (2) what it provides for them in return, and (3) how it regulates them, or, put differently, what it prevents them from doing.

Yet all of these “products” of government also require a widely varying and diverse array of personnel to function—personnel ranging from classroom teachers, to police, to IRS auditors, to the highest ranking general in the army, to the lowliest counter bureaucrat at the Department of Motor Vehicles. Added up across local, state, and federal levels, these “products” entail the expense of trillions of dollars annually, and part of that inevitably goes to the expenses of administration. Administration, in turn, means personnel tasked with supplying those “products,” or simply public sector jobs.

Consider the vast size of public sector employment today, a term that encompasses all professions that receive their funding from a public source and directly perform a government function. As of 2008, the federal government employed 2.7 million people, excluding the military. State governments employed an additional 2.5 million, and local governments paid the salaries of 5.8 million more. That's over 11 million people who are currently employed at some level of government in the United States. But consider what happens when the definition is expanded. The public education system employs another 5 million, the military has about 1.5 million active duty personnel, and, while it is more difficult to measure, an estimated 10 to 15 million additional people are “private” sector workers who contract with the government at some level. In total, between 20 and 30 million Americans are employed through the functions of government in some form or another. Regardless of political beliefs about the proper size of government, its total share of the job market—and impact on the economy—is astronomical.

How are government jobs allotted? Most of them follow standard practices of employment. They require professional credentials for certain roles, like teaching or management, and employees often advance through the ranks of public organizations not unlike those of a private sector company. Sometimes government employment has a political dimension—the top-level heads of most state and federal agencies are often political appointments by a president or governor. And public sector unions for teachers, police, and firefighters can be highly organized and politically engaged organizations.

The Rise and Decline of Spoils

Now imagine if most of those 20 to 30 million jobs were the direct reward of a political campaign, determined by and changing with the outcome of every election. Though unrealistic in the modern day, that is the logical extreme of the “spoils system”—the notion that to the victor of an election go the spoils of the battle.

It is also the underlying premise of political-machine politics for much of the nineteenth century, the most famous being New York’s Tammany Hall. Organizations such as Tammany served as mechanisms to allocate the administrative positions of government, and did so unapologetically. To advocates of machine politics, the delivery of patronage was the driving motivation of a vibrant electoral system. George Washington Plunkitt, a state senator and Tammany boss at the turn of the twentieth century, put it thusly: “I acknowledge that you can’t keep an organization together without patronage. Men ain’t in politics for nothin’. They want to get somethin’ out of it!” And get something is exactly what he did. A corrupt and colorful yet strangely endearing character to those who knew him, Plunkitt granted to a newspaper in 1905 a series of very frank political interviews on the workings of his machine. The reporter met him in public—in fact outside of New York City Hall on a shoe-shining stand where the ward boss preferred to conduct business. But that was Plunkitt’s style—he peddled his patronage out in the open, defending a system that most today would recognize as corrupt, though he also recognized the boundary between simple corruption and reckless extravagance—a distinction he called “honest,” as opposed to “dishonest,” graft.

An honest graft is loosely defined as a political action that betters the self, in addition to the public at large. Plunkitt told one such story about how he learned the city was planning to build a new park in a neighborhood in his district. Armed with insider knowledge, he went to work

Photograph of George Washington Plunkitt (1842–1924) on his rostrum at the New York County Court bootblack stand, which appeared as the frontispiece of the first edition of *Plunkitt of Tammany Hall*, in 1905.



Public Domain

assembling adjacent parcels that he purchased at a discount, then sold the tract at a profit to the government for its park. The transaction certainly benefitted Plunkitt financially, but he also insisted he helped the public by greasing the wheels of the project. The park project was a simple opportunity to profit, and far from a dishonest graft—defined as stealing from the public treasury or falsifying expenses—he insisted that he only saw that opportunity and took it before someone else beat him to it.

Plunkitt's self-deprecating defenses aside, machine politics frequently went hand in hand with both forms of graft, including his own Tammany. Formed as a fraternal political organization in the late 1700s, Tammany Hall rose steadily as the machine wing of the Democratic Party in New York City. Under Mayor Fernando Wood, elected in 1854, Tammany quite literally functioned as a means of allocating jobs within the city government. Wood made extensive use of this practice in his appointments to the New York Municipal Police, drawing in particular upon the growing Irish immigrant population that formed a core of Tammany's base. Operating under the flag of reform but also seeking to empower a rival political machine, the Republican state government in Albany retaliated in 1857 by disbanding the Municipals and ordering the creation of a new Metropolitan police force. When a new Metropolitan police commissioner carrying an appointment from the governor arrived at City Hall, Wood had him physically evicted from the building with Municipal police and announced his intent to appoint a rival commissioner out of patronage.

The clash brought about a riot between two competing, patronage-peddling police forces. The Republican-backed Metropolitans succeeded in obtaining a warrant for Wood's arrest, yet over three hundred Tammany-backed Municipals holed up in City Hall to defend the mayor. An ensuing brawl between the rival police left some fifty policemen injured and Wood temporarily arrested until he was able to post bail. He avoided any further charges from a friendly local court system.

For all the violence of Wood's police riot, the heyday of Tammany arrived with one of his successors as "Grand Sachem" of the society—William "Boss" Tweed. The familiar and infamous Tweed took graft to the level of extravagance warned against by the later Plunkitt, as could be seen in the "Tweed Courthouse"—or New York County Courthouse—constructed at the peak of his power in the



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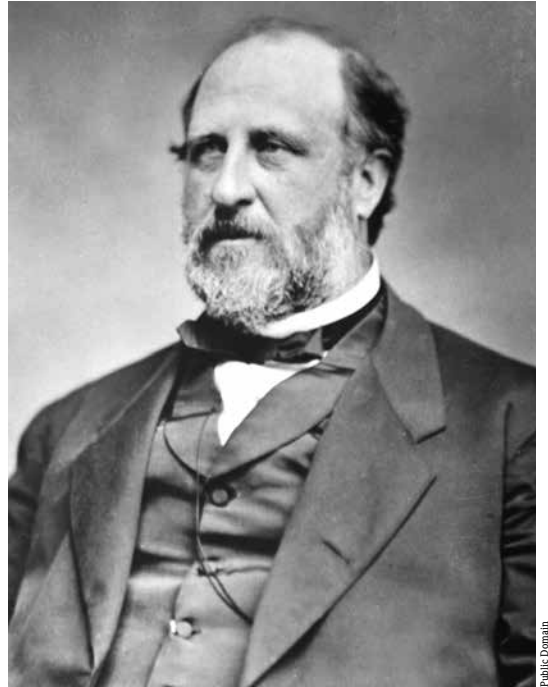
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Mayor Fernando Wood (1812–1881) as photographed by Matthew Brady ca. 1859 is shown above an illustration of fighting at City Hall between Municipal and Metropolitan police officers during the Police Riot of 1857. The illustration appeared in *Recollections of a New York Chief of Police* by George W. Walling (1887).

1860s. Tweed utilized the project to enrich his Tammany beneficiaries. Though originally budgeted at \$250,000, the total project cost \$13 million to complete, the equivalent of over a tenth of the entire federal budget in 1861—the year construction began.

Tweed ensured that all construction expenses went to Tammany contractors, including himself—he owned a stake in the quarry where the building’s massive marble pillars were extracted. Tammany carpenters, plasterers, and stoneworkers are known to have received six-figure salaries for a few weeks of work. Tweed even capitalized upon a city investigation of the courthouse cost overruns by funneling a printing contract for their report to a Tammany-owned shop, and then overcharging the investigation committee. Having essentially walked away with millions in personal graft, Tweed then set out to replicate the strategy elsewhere in the city by pushing for the construction of a shoddily built branch courthouse in Harlem, as well as its replacement four years later when the original was condemned after a boiler accident.

Boss Tweed’s eventual downfall came not from his flagrant political corruption, but a political misstep. Tammany’s decision to permit a parade of Protestant Irish Ulstermen in 1871 sufficiently angered its Irish Catholic constituency that some disgruntled Tammany subordinates handed over extensive documentation of Tweed’s crooked accounts to the *New York Times*. He initially met the charges with characteristic derision and managed to retain his seat in the New York state senate due to the popularity of Tammany in his district. As Tweed explained while assailing political cartoonist Thomas Nast: “Stop them damned pictures. I don’t care so much what the papers say about me. My constituents don’t



William Marcy “Boss” Tweed, ca. 1870.
(1823–1878)



The New York County Courthouse at 52 Chambers Street in New York City is also known as the “Tweed Courthouse.” This photo of the main façade was taken in 1979. The building received a top-to-bottom renovation beginning in 2000 and is now home to the New York Department of Education.

know how to read, but they can't help seeing them damned pictures!" Still, with the *Times* stories, a sensational public scandal erupted.

Reports of the extent of Tweed's graft even threatened the city's finances as investors abandoned municipal bonds on account of the misappropriations. Tweed was eventually tried and convicted on over two hundred counts of fraud in 1873, sentenced to more than a decade in jail, and sued by the state to recover its embezzled funds. Apparently undeterred, he managed to stage an escape during a supervised visit to his home and sparked an international manhunt. He was apprehended in Spain while disguised as a sailor after being identified from his likeness in a Nast cartoon. Those "damned pictures" caught up with him at last.

Tammany survived Boss Tweed, likely because of the way it reorganized itself in his destructive wake. Later ward bosses like Plunkitt knew when to set limits on their own graft and patronage and actually thrived under the machine system for another half century. As Plunkitt put it, patronage was a means of providing service to the electorate both in the hard sense—administrative jobs—and the soft, or a variety of charitable and constituent services provided by the political machine.

The plain-spoken Plunkitt viewed efforts to reform the Civil Service as a fraud, but not simply because they threatened to disrupt his livelihood. To him, reform was simply a denial of human nature. It did not "cure" government of the graft and other ills. It only served to obscure it, and in so doing worsened its effects. Plunkitt likened the reformers of his day to a rocket, shooting off with a flash of light and energy and a promise to "fix" a system it did not understand. Yet the system always won just as the rocket always came down—human nature and gravity were immutable laws. The reform candidate would either find himself in an impossible battle of self-delusion, or eventually yield—Plunkitt might even say wisen up—to those laws and operate within them.

Money is to politics what the collection box is to a church, Plunkitt insisted. Both are the means that keep their organization operating, and Tammany itself had its own missionary work. In one memorable conversation Plunkitt outlined a day of his job as a Tammany ward leader. It began at two a.m. when a constituent woke him for money to post bail at a police station. From there he commenced a whirlwind of a day taking him to weddings, funerals, and fairs, along with several stops to the courthouse to assist a constituent with paying fines, escaping eviction, or simply staying out of trouble. Part politicking, part charity, part graft, and part problem solving, he considered each of these activities to encompass the traits of a politician.



"Boss" Tweed (the fat character to the left) and members of the Tammany Ring point accusing fingers at one another in this Thomas Nast cartoon from an 1870 issue of the *New York Times*.

Plunkitt's brazenness should not be confused with excess, though. Like his honest graft parable, he distinguished himself from the excesses of Boss Tweed by way of a self-imposed boundary. The political "looter," to his own eventual demise, crosses that boundary—he "goes in for himself alone without considerin' his organization or his city." The proper politician, by contrast, "looks after his own interests," as is inescapable, but also "the organization's interests, and the city's interests all at the same time." "I ain't no looter," he insisted while openly admitting his honest graft. "The looter hogs it. I never hogged it. I made my pile in politics, but, at the same time, I served the organization and got more big improvements for New York City than any other livin' man. And I never monkey with the penal code." Thus, Plunkitt's model Tammany boss was not the ostentatious William Tweed, but the comparatively less known Charles F. Murphy, who ran the organization for over two decades in the early twentieth century and transformed it into a highly functioning, and at times even respectable, political organization at the height of the reform movement's Progressive Era influence.



A photo from the October 1902 issue of the *American Monthly Review of Reviews* of Charles Francis Murphy (1858–1924), who was the leader of the Tammany Hall organization from 1902 to his death in 1924.

The difference between Plunkitt and the reformers thus boils down to the question about the nature of government jobs. The need for administration ensures that they exist, and filling them is a question of means. Who, or what, determines employment in an administrative position? Plunkitt would answer with politics and assert that they are inescapable whether peddled openly, as he advocated, or cloaked in the guise of expertise, professionalism, and reform. His delivery may have been bound in time to a more permissive electoral climate than the present, though the question he raises persists. Is it possible to separate politics from administration?

With 20 to 30 million people currently employed by some level of government, the answer is bound to differ by position and agency. What is certain, though, is that the products of reform—a more professionalized civil service and an expanded administrative state—frequently clash with the pressures of politics. Whether it is a teacher's union battling a budget committee over pension reform, a private contractor donating to the campaigns of the politicians who hire them, or even a national fiscal stimulus policy premised on the idea of resolving unemployment through public sector hires, Plunkitt's arguments may offer greater insight to the modern political climate than their initial presentation suggests.

For Greater Understanding

Questions

1. How has the prevailing view of administrative government changed since the days of Tammany Hall?
2. George W. Plunkitt suggested a moral line exists between the “honest graft” and “dishonest graft.” Is there any validity to this distinction? Or was he simply making excuses for corruption?
3. Defenders of the political machine system frequently argued that civil service reformers were naïve, disingenuous, or both, and that their policies misunderstood human nature. Is this an accurate assessment?

Suggested Readings

Ackerman, Kenneth D. *Boss Tweed: The Rise and Fall of the Corrupt Pol Who Conceived the Soul of Modern New York*. New York: Carroll & Graf Publishers, 2005.

Plunkitt, George W. *Plunkitt of Tammany Hall: A Series of Very Plain Talks on Very Practical Politics*. 100th anniv. ed. Ed. William L. Riordan. New York: Signet Classics, 1995.

Website of Interest

New York City’s *Office of the Mayor* website provides a short history on the “Boss Tweed” Courthouse. — http://www.nyc.gov/html/om/html/tweed_courthouse.html

Lecture 3

Half-Breeds, Stalwarts, Mugwumps, and Assassins

Professor Phillip Magness

The Suggested Readings for this lecture are Kenneth D. Ackerman's *Dark Horse: The Surprise Election and Political Murder of President James A. Garfield* and H.G. Hayes and C.J. Hayes's *A Complete History of the Life and Trial of Charles Julius Guiteau, Assassin of President Garfield*.

A Forgotten Assassin

Looking back at the late nineteenth century it may seem strange to note that most of the groundwork for the modern administrative state, and virtually all of its formal academic study, came about during the high-water mark of political machine corruption and the spoils system. Civil Service reform was undoubtedly a backlash against these excesses, but the main trigger event was the oft-forgotten assassination of President James Garfield.

While known for little else today than his short presidency, Garfield's political career was heavily intertwined with the "spoils system" politics in the decade after the Civil War. He rose to political prominence during the notoriously corrupt Ulysses S. Grant administration of the 1870s. In fact, Garfield almost saw his political career cut short by one of the most far-reaching political scandals in American history—the Crédit Mobilier affair. This railroad stock manipulation scheme collapsed in 1872 when a disgruntled executive leaked evidence about discounted railroad stocks given as favors to politicians in exchange for government contracts. The scheme implicated Grant's vice president Schuyler Colfax, Jr., and some thirty members of Congress, including Garfield.

Despite a challenging reelection campaign caused by the scandal, Garfield survived, though also with a lesson of caution over the rising political liability of the graft. The patronage abuses took their toll on the Republican Party as well, which began to factionalize around the issue of civil service reform. Defenders of the spoils system formed the self-styled Stalwart faction around political machine boss and New York Senator Roscoe Conkling. The civil service reformers, by contrast, were derisively dubbed the Half-Breeds.

In this Joseph Keppler editorial illustration from Frank Leslie's *Illustrated Newspaper*, of March 8, 1873, Uncle Sam directs senators, representatives, and other government and business officials implicated in the Crédit Mobilier scheme to commit (political) *harakiri*.



Public Domain

In 1877, Grant's successor as president, Rutherford Hayes, cast his lot with the reform wing of the Republican Party and used his discretion in political appointments to challenge the Conkling machine. In one noteworthy example, Hayes used the recess appointments power to purge the Conkling-controlled customs house of New York City, an overstuffed bastion of spoils system political jobs. Yet Hayes's efforts to press his reforms into legislation met with staunch opposition from the Stalwarts and ultimately stalled by the time he left office. The 1880 campaign to nominate his successor effectively turned the Republican Party convention into a battle between the Stalwarts and the Half-Breeds, pitting Conkling against Half-Breed adversary James G. Blaine. As a compromise the Stalwarts received the vice presidential nomination in the person of Chester A. Arthur, none other than the former New York City customs collector who had been fired by Hayes. The Half-Breeds picked Garfield, who had cast his lot with reform since *Crédit Mobilier*.

The Garfield administration was short lived, though, due to a patronage-seeking madman named Charles J. Guiteau. Like many job seekers, Guiteau had worked on Garfield's campaign, though at its periphery. At some point before the 1880 presidential campaign he latched onto an aborted Stalwart effort to renominate former president Grant from retirement and penned a rambling, incoherent speech entitled "Grant versus Hancock," intended for delivery against Democratic hopeful Winfield Scott Hancock. Undeterred by the compromise that placed Garfield on the Republican ticket, he simply altered the title of the speech to "Garfield versus Hancock" and paid to have it printed as a campaign flier.

A hallmark of the patronage system is its ability to use the spoils of the election to reward campaign workers with government positions. When the ticket of Garfield and Arthur won the presidency, Guiteau expected nothing less than a job in return. He traveled to Washington with dozens of printed speeches in hand to seek out a desired though unrealistic ambassadorship to the Austro-Hungarian Empire, although he informed the State Department that he would settle for France as his second choice.

Charles Guiteau's office-seeking crusade brought him into contact with James Blaine—the Half-Breed leader who was now serving as Garfield's secretary of state. His badgering of Blaine in particular became such an irritation that the secretary gave him an ultimatum to leave his sight and never again solicit him for patronage.

Guiteau's rejection triggered the inner demons of his already deluded psyche. If Garfield's right-hand man was ungrateful for his campaigning, then Garfield needed to be removed. Guiteau plotted his assassination scheme as if it were a personal obsession. He stalked the president's movements around Washington, even aborting his strike at one point because he did not want Mrs. Garfield to witness her husband's death. He openly intimated his intentions to the president, demanding Blaine's resignation in a letter lest he "come to grief," though the vague signal was ignored. Guiteau also attempted to visit the jail so that he might see the cell that awaited him, and he even chose his murder weapon hoping it would "look good in a museum."

Guiteau's planned strike came on July 2, 1881, as President Garfield was boarding a train en route to a summer retreat. After casually approaching the presidential party on the station platform, he drew his pistol and shot Garfield from behind at point-blank range. In a determined calm, Guiteau then marched toward the exit of the station, where a nearby police officer apprehended him. Turning to the confused and horrified crowd, Guiteau shouted his purpose: "I am the Stalwart of Stalwarts! Arthur is President!"

Guiteau's act was both deliberative and deranged, seeking a political end in defense of the spoils system yet also doing so under complete murderous delusion. He openly expected the Stalwarts to welcome him as a hero of their movement. In one act of insanity Guiteau even wrote General William T. Sherman of the army, asking him to "order out your troops" and spring him from jail.

It's difficult to overstate the political liability of Guiteau's ramblings for Chester A. Arthur, the Stalwart Vice President, whose cause was now being championed by a madman. While in prison he wrote a Stalwart senator from Pennsylvania, demanding a \$500 reward for elevating the pro-patronage faction into the White House. His opening statement to the court chastised Arthur for not immediately availing himself of the "gift" that had been placed before him. This "Stalwart of Stalwarts" repeatedly declared himself an instrument of divine will and, in his troubled mind, seemed to genuinely believe in the "justice" of his act.

Yet Garfield did not die from the gunshot, or at least not immediately. By modern standards and perhaps even those of the day, he should have survived. His troubles largely came from his doctors, who attempted repeatedly to extract the bullet but failed to locate it, all the while subjecting the president to the prodding of unclean instruments and fingers. Inventor Alexander Graham Bell even assisted with the search by offering treatment with



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James A. Garfield
(1831–1881)

Engraving of the Garfield assassination at the Baltimore and Ohio railroad depot in Washington, D.C., July 2, 1881. President Garfield is at center right, leaning after being shot in the back. He is supported by Secretary of State James G. Blaine. Assassin Charles Guiteau (upper left) is restrained by members of the crowd.

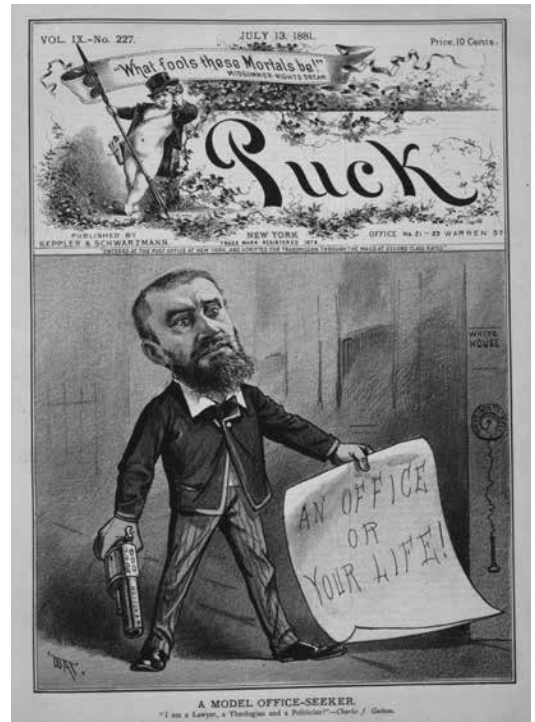
Charles J. Guiteau
(1841–1882)

an early type of metal detector. The device malfunctioned because of the president's metal bed frame. Garfield lingered in pain for eighty days before eventually succumbing to blood poisoning and infection.

Guiteau came to trial shortly after the president's death and practically relished in the media spectacle of the case. He testified in his own defense, claiming his act was a realization of divine will and declaring himself "Guiteau the Patriot" for saving patronage. He sang songs from the witness stand and often delivered his statements in rhyming verse. At one point he was permitted an interview with the *New York Herald* and availed himself of the opportunity to announce his eligibility as a bachelor seeking a "nice, young Christian woman about thirty years of age." At another he declared his intent to run for president himself, anticipating that the nation would welcome him as a hero. The bizarre spectacle even followed Guiteau to the hangman's gallows. Given an opportunity to state his final words, he opted for a song of his own composition entitled "I am going to the Lordy."

The madness of Charles Guiteau transformed the civil service system of the United States government, though not as he intended. Chester A. Arthur reacted to Guiteau's apparent endorsement of his presidency in the only way he could—a repudiation of the excesses of patronage and an unexpected embrace of the lingering reformer agenda. Riding a tide of popular sentiment provoked by the assassination, a reformer coalition of Republican Half-Breeds and anti-patronage Democrats passed—with Arthur's help—the Pendleton Civil Service Reform Act of 1883. This landmark piece of legislation imposed limited albeit precedent-setting restrictions on political party influence over appointments while also setting up a structured hierarchical scale for government positions, contingent upon a merit-based civil service exam.

It also contributed to an emerging political party realignment in the federal government built around the notion of reform and a professionalized administrative service. By the 1884 election even the Half-Breed sentiment was under attack for its corruption. A group of reform-minded Republicans known as the Mugwumps bolted from the former Half-Breed



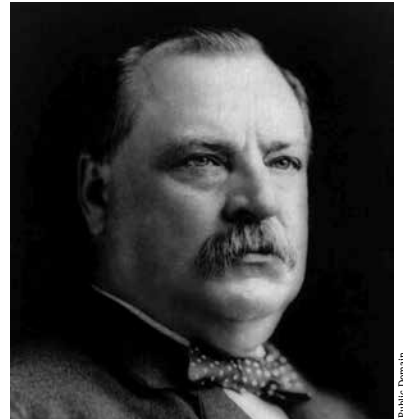
The cover of the July 13, 1881, issue of *Puck* magazine featured a full-color cartoon of assassin Charles J. Guiteau holding a British Bulldog pistol (as he used in the shooting) and a note demanding "An Office or Your Life!" at the White House door. The caption beneath the image says, "A Model Office-Seeker: 'I am a Lawyer, a Theologian, and a Politician'—Charles J. Guiteau."

standard bearer James Blaine amidst his own presidential aspirations, throwing their weight instead to Grover Cleveland and the “Bourbon Democrats”—a similar-minded faction across the aisle that followed a platform of free trade, civil service reform, economic non-intervention, and an end to the “crony capitalism” of federal tariffs and subsidies.

In many respects, this new Mugwump-Bourbon Democrat alliance represented a new way of thinking about government. Some parts of it were conservative, especially an underlying appeal to the Jeffersonian decentralization of the founding era. But it also took a new tact toward government where factions were concerned—one that consciously tried to raise the virtues and behaviors of the political class beyond the tumultuous and scandal-plagued 1870s. James Blaine was ironically its first target. When the Mugwumps bolted from his candidacy, they widely cited Blaine’s own reputation for corruption and characterized him as nothing more than a watered down and disingenuous version of the old way of doing things.

Blaine’s undoing was partially attributable to a set of documents known as the Mulligan Letters, published by a disgruntled railroad employee some years prior in an attempt to sink his political career. Among other things, the letters showed a suspicious transfer of stocks to Blaine from the Spencer Rifle Company at the peak of the Civil War. When Spencer received a subsequent contract to provide arms for the Union, it was charged that Blaine offered them patronage for profit. His critics also seized upon an instruction he left in one of the letters, urging its recipient to burn the paper. Democrats and Mugwumps alike would hound him throughout the campaign by marching in mock military formation at campaign rallies to the slogan: “Left. Left. Blaine will be left! Burn. Burn. Burn this letter!”

Grover Cleveland, by contrast, was a candidate ripe for reformer embrace. After being elected governor of New York in 1882 he shunned machine politics and turned away a stream of spoils seekers who believed they were owed a political office for campaign work. Enraged Tammany bosses would follow him for the remainder of his political career, threatening to defect from the Democratic ticket for this perceived betrayal. As it happens, the public tide of opinion was turning against the machines and, in the wake of the Guiteau Affair, it had soured significantly on patronage. Cleveland was thus portrayed as successfully staring down his own party’s more corrupt elements.



Stephen Grover Cleveland
(1837–1908)



James G. Blaine
(1830–1893)

Political Science Responds

The formal academic study of administration was born directly in the wake of the reform sentiments that followed from Garfield's assassination, and in particular a young college professor who took a keen analytical interest in its fallout. To a young college professor named Woodrow Wilson, Guiteau's mad act was a direct symptom and even likely consequence of the "poisonous influences which had long been gathering about the system of appointments to office." He interpreted the Pendleton Act as not a partisan measure, but a popular one in which the electorate literally reclaimed its stake in government from the extravagance of Tammany, the brazenness of Conkling, and the madness of Guiteau.

In 1887, Wilson penned a seminal article on the science of administration, having the backdrop of some six years' reflection since Garfield's death. That short period had produced the country's first substantive civil service system. It birthed the underpinnings of a reform-minded partisan realignment as the "Mugwumps made Mr. Cleveland President" under the belief, as Wilson stated, that "he would purify the civil service and bring in a new day in which parties should concentrate their purposes on practical questions of the present" rather than the jobs they could dispense. That same year saw the creation of the Interstate Commerce Commission, hailed by academics as the first "modern" and "scientific" federal bureau, and tasked at least ostensibly with regulating anti-competitive scheduling and collusive pricing arrangements between railroads over state lines.

Deeming administration the "most obvious part of government" owing to its connection to the day-to-day functions of the state, Wilson set out to correct in theory what he saw as the deficiencies of the administrative state in practice: "the poisonous atmosphere of city government, the crooked secrets of state administration, [and] the confusion, sinecurism, and corruption ever and again discovered in the bureaux at Washington." Simply stated, he sought to develop an administrative system that is "removed from the hurry and strife of politics." To Wilson, an administrator was a professional, an expert in his field who served not the "irresponsible minister" of the political state but the public.

His proposed solution was surprisingly open-ended. He called for a study of best practices abroad to uncover the attributes of administrative efficiency and function, then adapt them to the American constitutional model. Yet Wilson also knew the path of study he initiated was far from certain, stirred only by recent events. The 1880s civil service reform, triggered in an entirely unexpected manner by a national tragedy, was but a "prelude" to the science of administration—a "clearing of the moral atmosphere of public life by" instilling an administrative position with public trust rather than private gain. What that trust entailed, or whether administrative government could even maintain it, remained to be seen and discovered.

For Greater Understanding

Questions

1. What were the Stalwart, Half-Breed, Mugwump, and Bourbon Democrat factions? Who were the major figures associated with each, and what positions did they stand for?
2. How did the public conceptualization of administration change in response to the assassination of President Garfield and the subsequent civil service reform?
3. The study of public administration is a relative latecomer to the field of political science. Why do you think this is the case?

Suggested Reading

Ackerman, Kenneth D. *Dark Horse: The Surprise Election and Political Murder of President James A. Garfield*. New York: Carroll & Graf Publishers, 2004.

Hayes, H.G., and C.J. Hayes. *A Complete History of the Life and Trial of Charles Julius Guiteau, Assassin of President Garfield*. Aurora, CO: BiblioLife/Bibliographical Center for Research, 2010 (1882).

Websites of Interest

1. The Ashbrook Center for Public Affairs at Ashland University's *Teaching American History.org* website provides the complete text of Woodrow Wilson's essay "The Study of Administration," which initially appeared in *Political Science Quarterly*, vol. 2, no. 2, June 1887, pp. 197–222. —
<http://teachingamericanhistory.org/library/index.asp?document=465>
2. The Georgetown University Library features correspondence, affidavits, and printed material by and about assassin Charles J. Guiteau from the Charles J. Guiteau Research Collection at Georgetown University. —
<http://gulib.georgetown.edu/dept/speccoll/cl133.htm>
3. *History House: An Irreverent History Magazine* website features an amusing history of Charles Guiteau and the death of President Garfield. —
http://www.historyhouse.com/in_history/guiteau/

Lecture 4

Between Public Interests and Private Interest Groups

Professor Phillip Magness

The Suggested Readings for this lecture are Arthur Fisher Bentley's *The Process of Government: A Study of Social Pressures*, James Madison's "Federalist #51," Mancur Olson's *The Logic of Collective Action: Public Goods and the Theory of Groups*, and Frederick Winslow Taylor's *The Principles of Scientific Management: The Fundamentals*.

Are Administrators Different?

A basic and pervasive assumption of serving the public interest lies at the heart of administrative theory. Part reaction to the excesses of the Gilded Age, part ideology of the reformers in its own right, the reorientation of government around a call to public service characterized most administrative theory at the turn of the twentieth century. Woodrow Wilson went so far as to call this new breed of bureau the "Science of Administration," stating its purpose "shall seek to straighten the paths of government, to make its business less businesslike, to strengthen and purify its organization, and to crown its dutifulness."

The political scientist and sociologist Max Weber went even further in his taxonomy of the bureau, itself an attempt to identify and cultivate the best practices of administrative efficiency through a rational and well-ordered hierarchical structure. To Weber, an administrator was a vocation and the very antithesis of sinecure represented by the old ways of the spoils system. An administrative office came with the implicit acceptance of "a specific obligation of faithful management." This new type of administrator is a highly professionalized creature indeed, enjoying a distinct "social esteem" derived from his expertise and education credentials—his main qualification for holding an office in the public trust. He also operates in an ordered system where rank and salary correspond directly with experience.

Professional and public-minded calls to "service" came to typify administrative theory in the wake of the Garfield assassination, implicitly rejecting the old ways of favoritism as a human shortcoming to be perfected with reform and a new, proper way of doing things. The Pendleton Act gave a direct statutory injection of expertise and professionalism into the federal workforce. It sought to counter the perceived "irrationality" of politically motivated



Senator George H. Pendleton, D-Ohio
(1825–1889)

"Gentleman George" Pendleton had a long political career, including a term in the Ohio Senate, a term in the U.S. House of Representatives, vice-presidential candidate (running with George B. McClellan against Abraham Lincoln and Andrew Johnson), a term in the U.S. Senate, and serving as an envoy to Germany. He was the primary sponsor of the Civil Service Reform Act of 1883 that bears his name.

patronage appointments by establishing a Civil Service Commission to administer the federal workforce. Administrative jobs under its purview were the subject of qualification requirements. The Act established “open, competitive examinations for testing the fitness of applicants for the public service.” The exams, in turn, would “relate to those matters which will fairly test the relative capacity and fitness of the persons examined to discharge the duties of the service into which they seek to be appointed.” The act also prevented politicians from demanding political payment in exchange for civil service jobs, and it set up a system of ranks and grades within the federal civil service. Needless to say, theorists such as Wilson looked upon its results approvingly.

The call to public service still echoes strongly in the national psyche, as does the notion that the administrative functions of government are or should be above the political fray. By this view, bureaus and regulators exist to protect the public from market failures—from unsafe foods and medicines or pollution and environmental degradation. They exist to reign in snake oil salesmen, predatory lenders, con-artists, and corporate malfeasance, all driven by a motive of service and advocacy for the “general welfare” of the nation as a whole. And when a regulatory agency fails in its duty or neglects the public interest, it is a symptom of a faulty design. It is to be corrected by internal investigation and legislative tweaking to right the course of an intrinsically public mission.

But is this view accurate? Is professionalism and a service-minded vocation the answer to the ostentatious fraud of Tweed, the “honest graft” of Plunkitt, and the patronage-induced madness of Guiteau? Some within the political science profession would say no, and that even a well-ordered bureaucracy with stringent professional qualifications is subservient to political influence by interest groups.

The Rise of the Interest Groups

According to James Madison, interest groups or “factions” are defined as any “number of citizens, whether amounting to a majority or a minority of the whole, who are united and actuated by some common impulse of passion, or of interest, adverse to the rights of other citizens.” The troublemaking tendency of a faction comes from its divergence with the general public interest of a nation. Factions essentially collude through the government to divert public resources and laws in a way that benefits their membership, often at the expense of other people or the taxpayers at large.

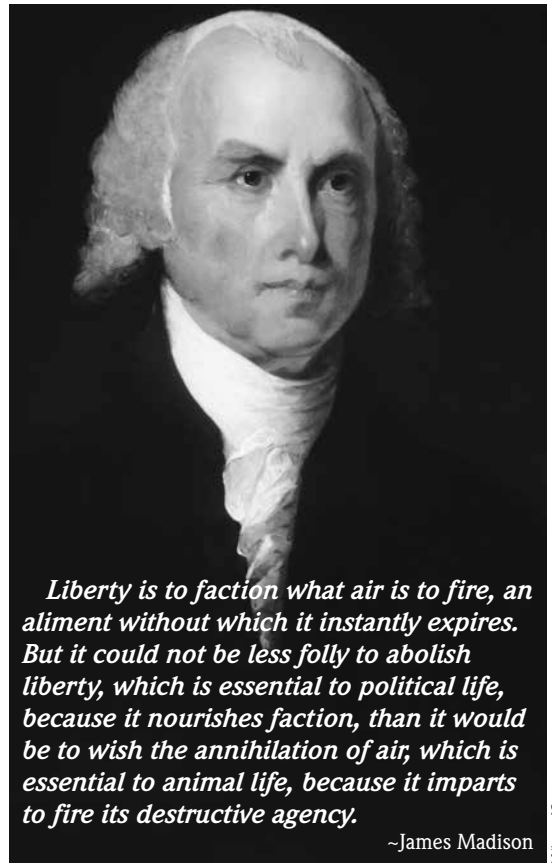
A cartoon labeled “The True Meaning of Republican Harmony” by Bernhard Gilliam appeared in the March 11, 1883, issue of *Puck* magazine. President Chester A. Arthur (arm upraised, dressed in black at the left) and notable Republican congressmen and senators are shown sacrificing the lamb of Civil Service Reform for “Spoils,” “Patronage,” and “Offices.”



Madison believed that factions went hand in hand with self-government, and the question of what to do about them formed the basis of his constitutional theory. His system of government, implemented through the Constitution and explained in the *Federalist Papers*, sought to temper their ravages by (1) not destroying factions, but encouraging their proliferation and (2) forcing those factions into constant competition with each other. A multitude of factions, he reasoned, would keep other factions in check—“ambition must be made to counteract ambition.”

Note that Madisonian interest group theory is an entirely different creature from the dispassionate expertise of Wilson’s public-minded administrator. Though he predates modern conceptualizations of the public/private distinction, Madison’s arguments provide the formative basis for what might be called the “interest group” theory of government, or in modern parlance the “Public Choice” school. They look to human nature with a skeptical eye and try to trace the manner in which self-interested, factionalized decisions will manifest themselves in policy. Madison’s means of controlling these features is not to sidestep them through professionalism and expertise, but to allow them to check each other’s expansion by making policy itself difficult to adopt. Called the concurrence principle, its object is to make the threshold of enacting a law or policy sufficiently high that it cannot happen without widespread political support from multiple factions at multiple levels of government. Therefore to obtain a successful policy, the House of Representatives must concur with the Senate, which must concur with the president, and all must pass constitutional scrutiny before the Supreme Court.

Though it occupies a spot at the center of constitutional checks and balances, Madison’s theory was not without its complications. When the very first Congress met in 1789, Madison played eyewitness to a factional breakdown on his own bill—the first tax law of the United States. Already one of the most prominent members of the Congress owing to his leading role in the Constitutional Convention, Representative Madison took the lead on what was intended to be a very simple and noncontroversial revenue bill. His proposal occupied only a few paragraphs on a single



Liberty is to faction what air is to fire, an aliment without which it instantly expires. But it could not be less folly to abolish liberty, which is essential to political life, because it nourishes faction, than it would be to wish the annihilation of air, which is essential to animal life, because it imparts to fire its destructive agency.

~James Madison

piece of paper, stating little more than that the “rate of taxes on all goods imported into the United States shall be _____ percent.” He opened debate by asking Congress to fill in that percentage. After a short discussion tossing out several proposals an otherwise little-known congressman from Pennsylvania named Thomas Fitzsimons rose and offered an amendment. Fitzsimons was an industrialist and merchant by trade with close connections to the Pennsylvania iron industry. His suggestion entailed imposing a different, slightly higher rate on certain iron goods for the purpose of penalizing the foreign competitors of this nascent home industry. Within moments all of chaos broke loose, and Congress spent weeks sorting through a flurry of similar amendments as manufacturing factions from around the nation made their case that they too should be protected. Madison could only stand there at a loss as the factional nature of politics ravaged his bill, both vindicating his earlier warnings and showing its inescapable presence in the very system he designed to reign it in.

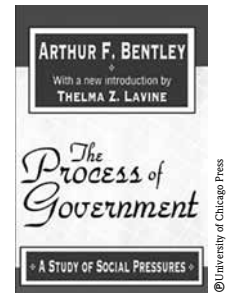
By the early twentieth century, “public interest” rather than “interest groups” dominated the national discussion. The Civil Service reform treated factions as something to escape and separate from, not account for within. Rather, their emphasis focused on administrative design. Illustrative of this movement, in 1912 Congress invited Frederick Winslow Taylor to testify about how the methods and practices of a well-oiled industrial operation could be adapted to administrative bureaus. Already a well-known engineer and manufacturing consultant in the private sector, Taylor carried a business card that identified his trade: “Systematizing Shop Management and Manufacturing Costs a Specialty.” He developed a system of managerial techniques in which an administrator could optimize the relationship between upper management and workers, constantly organizing around its specific tasks by studying the efficiency of implementation techniques and continuously training employees. Though originally intended for private sector factories, Taylorism found many applications in the hierarchical and professionalized administrative state where method, expertise, and continuous progressive advancement through the ranks of the bureau were paramount.



Frederick Winslow Taylor
(1856–1915)

Factions did not dissipate through system design, though. Amidst this backdrop of a political system captivated by the “public interest” approach, the academy produced a strikingly new iteration of the interest group theory of government in the form of Arthur F. Bentley’s 1908 work, *The Process of Government*. Bentley’s critique of the “public interest” view was surprisingly simple and intuitive. He argued that the concept of “public interest” itself was a masquerade for little more than a mass aggregation and competition of private and factional interests. To Bentley, practically every activity in society right down to the individual level entails some expression of an interest. It literally has to in order to be rational. Since interests diverge between individuals and their groups or associations, two

or more competing views on how to do something will eventually collide. When operating in a system of structured rules—namely government and its political arena—these interests will tend to reach states of equilibrium. In other words, various semi-stable political coalitions or majorities of shared interests emerge and fluctuate as their components continue to compete and posture themselves. The whole of government, to Bentley, then, is “the process of the adjustment of a set of interest groups in a particular distinguishable group or system.”



Notice the difference between this approach and the rule and task-oriented methods of the professionalized administrative system, the hierarchical bureau of Weber, and the scientifically tuned managerial strategy of Taylor. Bentley would say “yes, the rules exist.” But they do not fine-tune the performance of the bureau or make it any more public-minded. Rules are really just a mechanism to shape how interest-group politics play out in the course of competition. The way to understand government, then, according to Bentley, is to study the interest groups.

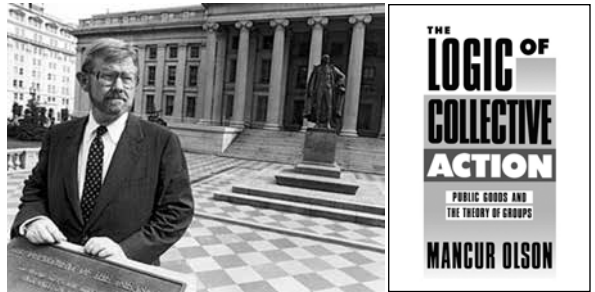
The “Public Interest” and “Interest Group” theories of government have both left a lasting impression on American government. Countless examples exist of administrators and public officials who exhibit the characteristics of “civic mindedness.” Yet interest groups clearly shape political outcomes as well. Consider the fact that many academic experts agree that trade barriers harm the global economy, that corn and dairy subsidies distort food prices in ways that hurt the poor, that certain patents and intellectual property laws are heavily skewed toward large corporate interests, and that public sector labor unions often function as a roadblock to firing bad employees in the bureaucracy—sometimes even those caught breaking the law. In most of these cases a relatively small but politically cohesive interest group supports policies and administrative practices that strike most people as inefficient and undesirable, if even contradictory. Why, for example, does the federal government simultaneously fund public health campaigns against cigarette smoking as well as crop subsidies to tobacco farmers? Interest-group theorists would argue that both policies represent the concentrated pressures of their respective beneficiary factions.

Not surprisingly, the public interest/interest group debate continues to play out in the halls of American government today and expectedly so given the rapid expansion of the “professional” side of the administrative state. Whereas the Pendleton Act of 1883 originally covered less than 10 percent of the government, the civil service of the 1930s extended to over 80 percent of federal employees.

This new growth also bred complexity, and with it more opportunities than ever before for interest groups to involve themselves in the processes of government. One post-Bentley theorist from the “interest group” camp bears particular note, as his arguments turned much of the conventional wisdom about factional behavior on its head. Recall that Madison’s system envisioned a proliferation of factions constantly hammering away at

each other in competition for political control of the state. The anticipated result is highly majoritarian. If interest groups abound and constantly require consent to advance a policy, only policies that gather a broad coalition of multifaceted interests should succeed.

Writing in 1965 and citing Bentley's critique of the "public interest" approach, a political scientist named Mancur Olson questioned whether the Madisonian proliferation of factions was even possible to attain. Olson theorized that interest group participation beyond the individual level takes energy, time, and resources. If individual voters value their energy, time, and resources, they will only devote themselves to causes that yield a tangible return to their investment.



Mancur Lloyd Olson Jr. (1932–1998) in front of the United States Treasury building in Washington, D.C., ca. 1980s, and the cover of his seminal work, *The Logic of Collective Action*.

Furthermore, interest groups come in different sizes and character. If the benefit they provide—or the piece of the public pie they lobby for—is concentrated, valuable, and shared only by the members who receive it, interest group cohesion will be strong. Otherwise the benefits will tend to be diffuse and nonexcludable to those who don't contribute to a lobbying effort. This is why most Americans are willing to pay a few pennies more for sugar than the rest of the world, even though price supports for the American sugar industry cost consumers more than they benefit their recipients—the sugar farmers.

Olson's principle often carries through to the bureau, including its most specialized, expert-driven components. While Wilson's expertise persists and even flourishes in the federal bureaucracy, the interest groups of Madison, Bentley, and Olson continue to complicate its mandate for "public service."

For Greater Understanding

Questions

1. What are the basic assumptions of the “Public Interest” and “Interest Group” theories of government? How do they differ, and is it possible to reconcile the two?
2. For all his efforts to devise a system that reigned in factions by competition, James Madison witnessed the triumph of interest groups firsthand in 1789. Did he miscalculate in his design?
3. Arthur Bentley and Woodrow Wilson were contemporaries at the top of their fields of study, yet they held very different views of government and the influence of interest groups. Who do you think made the stronger case and why?

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Madison, James. “Federalist #51.” *The Federalist Papers*. Alexander Hamilton, John Jay, and James Madison. The Classic Original Edition. Lindenhurst, NY: Tribeca Books, (2010) 1788.

Olson, Mancur. *The Logic of Collective Action: Public Goods and the Theory of Groups*. Rev. ed. Cambridge, MA: Harvard University Press, 1971 (1965).

Taylor, Frederick Winslow. *The Principles of Scientific Management: The Fundamentals*. Reprint. Seattle, WA: CreateSpace, 2011 (1913).

Websites of Interest

1. The National Archives and Records Administration *Our Documents* website provides a short description of the Pendleton Act, images of the original handwritten Senate bill, a transcript of the act, and a PDF of the final document. —
<http://www.ourdocuments.gov/doc.php?flash=true&doc=48>
2. The Library of Congress’s *American Memory* website provides an overview of the James Madison Papers. —
http://memory.loc.gov/ammem/collections/madison_papers/
3. The Stevens Institute of Technology’s (Hoboken, NJ) *Samuel C. Williams Library* website features the Frederick Winslow Taylor Collection. —
<http://www.stevens.edu/library/collections/fwtaylor.html>
4. The *Independent* (London) newspaper obituary on Mancur Olson from March 2, 1998, provides a biography including an analysis of his scholarly work. —
<http://www.independent.co.uk/news/obituaries/obituary-professor-mancur-olson-1147952.html>

Lecture 5

How Whiskey Captured the Pure Food Movement

Professor Phillip Magness

The Suggested Reading for this lecture is Clayton Anderson Coppin and Jack C. High's *The Politics of Purity: Harvey Washington Wiley and the Origins of Federal Food Policy*.

The Theory of Regulatory Capture

Money permeates politics and often goes hand in hand with interest group theory. It takes the form of campaign contributions, independent expenditures, lobbying fees, and, in the era of political machines and spoils, even bribes. Money is expended on the political process for one simple reason: the products of government are usually valuable.

The things government does are not always worth money to everybody at all times and quite the contrary. Some of them are well within the accepted norms of things government should be doing, though others are more controversial. What they all have in common, though, is that individually the activities of government are usually of value to somebody somewhere. When government purchases a good or service, someone somewhere gets the contract and profits from it. When government regulates a new product, someone somewhere bears the cost of compliance while someone else in a less-regulated industry finds himself with a new—and valuable—edge over his competitor. The fact that they have value to somebody somewhere usually means there is a buyer for the “products” of government. It means that interest groups exist, are willing to pay to obtain a favorable regulation, subsidy, or other type of public support, and will generally do so.

This process of “buying” goods through the political process is referred to by political scientists as “rent seeking.” And rent seeking is exactly what it sounds like—the means by which private interests seek out ways for the government to give them a “rent,” that is to say, an advantage over somebody else. In short, rent seeking is a manipulation of the way market exchanges work through the regulatory tools and expenditures of government. Notice that the value of a government “product” is neutral. By critiquing “rent seeking,” the object is not to suggest that a road contractor should fill potholes for free, or that it is inherently imprudent for the government to fund any type of public works project whatsoever. Rather, it is an observation that when government commits itself to a policy, its implementation is usually redistributive in favor of the party that seeks it out.



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So how does the allocation process of the policies and powers of government work? All joking about corrupt politicians aside, there are not many public free-for-alls where policies and privileges are doled out by the government for wads of cash—at least not directly. But goods and favors are exchanged in the halls of power all the time, most of them in perfectly legal ways even if most observers deplore the method. Campaign finance reform, though seldom effective, is often a politically popular call to make.

The explanation for this exchange of government goods and services was originally developed by economist George Stigler, who later won the Nobel Prize in part for his theory. According to Stigler, the government is a supplier of regulatory goods and services, and the electorate is full of consumers who demand regulation (or expenditures or subsidies). Sometimes they demand it for perfectly legitimate and commendable reasons. Yet Stigler was also cognizant of a situation known as regulatory capture, where a highly concentrated subset of the population is able to demand a regulatory favor that advances itself at the expense of the rest. Recall that most activities of government have a value to somebody somewhere, and it becomes apparent how the prospect of effecting some sort of capture is the main motive behind rent seeking. Or stated another way, government is the auctioneer of its own services and various participants in the political system, those who want certain types of products or regulations from the government, are its demanders, its clients, who pay with their votes and lobbying and political support.

Though the formal concept is relatively new, the process of rent seeking is as old as government itself. In the United States, the earliest days of the republic were marked by attempts of private interests to extract favors through the tariff system—the tax of imported goods from abroad—and through federal land sales, industry subsidies, and the ever-popular “internal improvements” expenditures on projects such as canals, harbor improvements, and the transcontinental railroad. For over a century politicians quite literally struck deals with home-industry interest groups and producers over how much their competitors should be taxed, or what government contracts they should receive. In legislative halls, the cumulative effect of this sort of deal-making goes by the name of logrolling. Individual members of Congress agree to support political rents and favors in neighboring districts in exchange for similar favors to their own. To quote Benjamin F. Butler, a nineteenth-century congressman, “if you vote for my interest, I will vote for yours. That is how these tariffs are log-rolled through.”



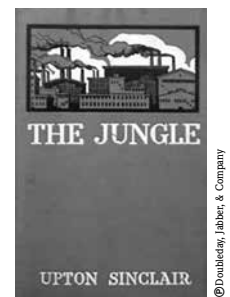
Rent seeking also took place in more flagrant forms in the past, albeit by another name—the graft of Boss Tweed and Tammany Hall, where the political process served as a means of determining the beneficiaries of government expenditures in an overpriced courthouse. Thus the civil service reforms of the late 1800s were really an attempt to reign in the extravagance of a nineteenth-century variation of rent seeking. They sought to do so in all the ways Woodrow Wilson and others described the administrative state—to take the politics out of administration and build a professionalized scientific concept of a bureau. Like Woodrow Wilson, Max Weber, and Frederick Winslow Taylor, they valued expertise and knowledge, and they sought to construct the government around a well-ordered professional hierarchy in place of spoils and political connections.

The Origin of the Food and Drug Administration

One famous example of this new administrative class official came in the person of Harvey Washington Wiley, better known as the first commissioner of the Food and Drug Administration. A long-time academic, medical doctor, and Harvard-trained chemist, Wiley was the walking definition of an expert in his field. He began as a professor at Butler College in 1868 while his medical training was still ongoing. In 1874, he took a faculty position as chair of the chemistry department at Purdue University. For the better part of the next decade he lived an academic's life at the top of his field, specializing in chemical analysis of sugars and syrups. In 1882, at the peak of the Civil Service Reform movement, Wiley was hired to become the chief chemist at the U.S. Department of Agriculture. Sugar and its derivatives being closely linked to American agriculture, the department specifically sought an academic expert to oversee its own experiments on the chemical and nutritional characteristics of food products.

Wiley lived in a world of rapid technological change surrounding food production. The development of new packaging techniques extended agriculture's products, previously localized and only seasonally available, to an entire nation. Aided by chemistry and technology, companies could mass-produce, package, and preserve meats, fish, corn, tomatoes, and any other variety of “perishable” products in ways unthinkable only a generation prior. The emerging food market was not free from fault, though, as evidenced by the muckraker journalist Upton Sinclair, whose sensationalist yet compelling novel about the unsanitary conditions of the meatpacking industry, *The Jungle*, only affirmed the worst fears of the public about processed food.

With a keen eye to popular sentiments and a knack for navigating the Washington bureaucracy, Wiley sought to increase his department's regulatory oversight on the products of American agriculture. He began with his area of specialty—sugar—conducting experiments on its refinement and associated dietary effects. He then moved into preservatives, conducting widely publicized studies on the human body's reaction



First-edition cover of Upton Sinclair's *The Jungle*, 1906.

to preservatives added into packaged and canned food perishables. As the “Pure Food” movement grew, the call for federal oversight of some form reached a new level of ripeness. Here was a popular product—food safety regulation—that the government could offer, and, like most activities of government, this product had its own associated values.

Scientific experiments on food may be value-neutral, but their political administration may not be as objective. This is precisely what happened during Wiley’s tenure at the Chemistry Bureau and early Food and Drug Administration, according to the research of historians Jack High and Clayton A. Coppin. Wiley recognized there was a political value associated in deeming a product “safe” or “unsafe” and requiring it to carry a label stating so. Thus Wiley began to mix his science with more worldly political pressures, particularly from those who backed the Pure Food legislation.

According to High and Coppin, Wiley’s big break came in 1903 at the behest of the whiskey industry. Though generally thought of as outside of the FDA’s purview today, whiskey was at the center of the “Pure Food” discussion at the time and Wiley moved to include it in his regulatory mandate. Whiskey was a massive industry at the turn of the century. In the year 1893, alcohol taxes alone funded an astounding 40 percent of the entire federal government. The political value of regulating whiskey derived from a then-recent development in the distilling process that split the industry into two camps. Historically, distillation was a trade art where select blends of grain—rye, corn, barley, and wheat—are mashed and fermented, followed by distillation to separate the ethanol or drinkable alcohol from other impure—and indeed poisonous—by-products of the fermentation process. The resulting whiskey is then matured in wooden barrels, where it gains much of its flavor distinctions as the liquid interacts with the lining and certain remaining impurities—called fusel oils or heavy alcohols—are absorbed in the wood. The entire process is a craftsmen’s trade, requiring years of training to produce the proper recipe and taste.

Industrial technology rapidly changed whiskey production in the late 1800s, with mass distilling permitting a process known as rectification. Whiskey rectifiers would redistill their product to hasten the extraction of fusel alcohol, allowing a shorter maturation time, though at the expense of taste. This in turn was supplanted by blending multiple whiskeys together for a more uniform flavor, and occasionally adding coloring and other aromas to heighten the rectified whiskey’s appeal. Naturally, rectified products were significantly cheaper and easier to mass-produce, though their quality also varied greatly. Some of the “rot-gut” of the era was rumored to have barely any resemblance to typical whiskey tastes at all.

The traditional “straight” whiskey distillers entered the Pure Food Movement debates in 1903 by approaching Wiley, who was actively working to steer new regulatory jurisdiction over food into his own Chemistry Bureau as opposed to other competing proposals and agencies. They sought a fairly simple regulatory product from the government, though one of immense value to their own market. Holding traditional “straight” whiskey to be the only “true” and “authentic” whiskey, they sought—in the name of purity—to have their

rectified whiskey competitors declared “imitation whiskeys” by federal regulation. Bearing a label that deems your product an “imitation” is an instant killer for business, and therein came the value of this proposed regulation. It sought to shift consumption over to the more expensive traditional straight-whiskey producers by regulating a part of their competition out of business!

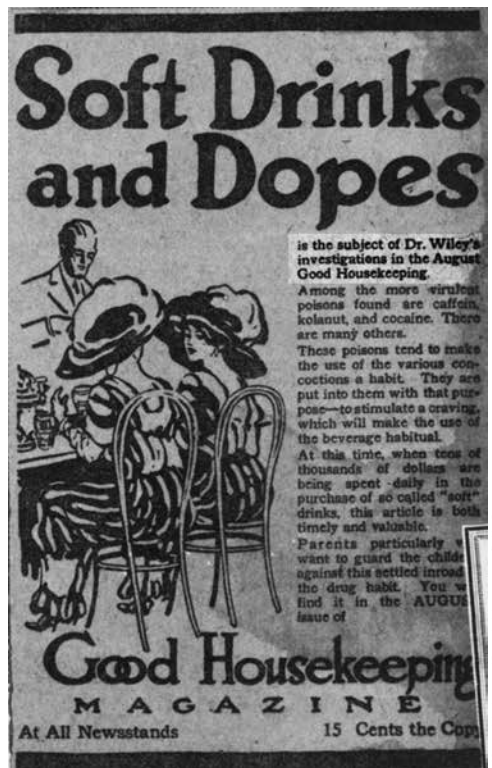
Wiley saw much appeal in the offer of the straight-whiskey producers. They pledged financial support and political pressure for his desired bill in Congress, naturally expanding the oversight and budget of his own bureau into what became the FDA. High and Coppin even document that he was paid, in some instances, with free “samples” of their product. In exchange, Wiley used his reputation and stated expertise to assail their rectified competition as “unsafe” and “impure” and “adulterated” and therefore deserving of punitive regulation. Yet objective science was against him. Higher-end rectified blends tasted very similar to straight whiskey, and even the cheaper mass-produced whiskeys he wished to deem “artificial” were almost identical on a chemical level, differing only in the lack of a matured taste. Indeed, the rectification process was actually more efficient than traditional aging at the removal of fusel oil and therefore was more chemically uniform and pure. It simply tasted worse, as price also reflected. This did not stop his publicity campaign, though, and Wiley railed against the health threats of allegedly “impure” and “imitation” rectified whiskey, even attempting to have the American Medical Association declare them unfit for prescription medicinal alcohol.



Harvey W. Wiley (1844–1930) working in the lab at the Bureau of Chemistry, ca. 1903 (left); a label from Hellman's Jockey Club whiskey (middle), ca. 1907, displaying the National Pure Food and Drugs Act guarantee, and a cartoon from *Harper's Weekly* (right), ca. 1906, showing Uncle Sam's approval of “Old Doc Wiley's Sure Cure” after passage of the 1906 Act.

The support Wiley obtained from his whiskey allies and other similarly situated industries was substantial, and it aided him as he lobbied intensely for the passage of the Pure Food and Drug Act of 1906 as well as the installation of himself at its helm. The immediate results were stunning. Historians High and Coppin note that Wiley expanded the size of his agency from 110 staffers in 1906 to 425 only two years later, while also increasing his budget six-fold. The FDA he established was by no means completely subservient to pure political interests, but the rent seeking that tinged elements of its formation was difficult to deny.

Ironically the rent sought from the straight whiskey producers was not to last. Wiley's "imitation whiskey" labeling regulation did not endure very long, being rescinded in 1910 by presidential order just before Wiley resigned his own post to take up an alleged "consumer advocate" role at *Good Housekeeping* magazine. One of his last attempted regulatory targets at the Chemistry Bureau was also the subject of his first journalistic exposé in his new job. Angry that its manufacturer had switched its contract away from one of his old sugar industry friends, Wiley sought to penalize Coca-Cola for an "impure" product and deceptive labeling. The chemical "impurity" he referred to was caffeine. The alleged deception was the product's name, for as Wiley pointed out to a company representative, tests of Coca-Cola produced insufficient evidence that it contained cocaine.



Ad for an article scheduled to appear in a future issue of *Good Housekeeping* magazine, in which the editors advise Dr. Wiley will investigate the poisons contained in soft drinks.

For Greater Understanding

Questions

1. Why did a sector of the whiskey industry favor regulation of its products? How does this compare to the theory that government regulation exists to protect consumers from businesses?
2. How well does Harvey Washington Wiley fit the ideal “model” of a bureaucrat from a public administration standpoint? In what ways was he different?
3. Based on Wiley’s example and what you know about regulatory theory, can you think of an example of an administrative agency today that is frequently subjected to regulatory capture?

Suggested Readings

Coppin, Clayton Anderson, and Jack C. High. *The Politics of Purity: Harvey Washington Wiley and the Origins of Federal Food Policy*. Ann Arbor: University of Michigan Press, 1999.

Other Books of Interest

Tullock, Gordon. “The Welfare Costs of Tariffs, Monopolies, and Theft.” *Virginia Political Economy: The Selected Works of Gordon Tullock, Vol. 1*. Ed. Charles K. Rowley. Indianapolis: Liberty Fund, Inc., 2004 (1967).

Article of Interest

Stigler, George. “The Theory of Economic Regulation.” *Bell Journal of Economics and Management Science*. Vol. 2, no. 1, Spring 1971, pp. 3–21.

Website of Interest

The *Center for the Study of Public Choice* website at George Mason University in Fairfax, Virginia, provides a single location where eminent scholars conduct innovative research, publish their findings and conclusions in a variety of print and electronic media, and teach the science of public choice. — <http://www.gmu.edu/centers/publicchoice/>

Lecture 6

Federalism: Two Sovereign Governments for the Price of One

Professor Paul Weissburg

The Suggested Reading for this lecture is Richard A. Clucas's *Readings and Cases in State and Local Politics*.

Federalism: A Historical Overview

The federalist system of government is a two-tiered structure; there are two levels of government—state and federal—and each level has sovereign power over specifically designated areas. Article 1, Section 8, of the U.S. Constitution explicitly details the powers of the federal government; these are known as the enumerated powers. The tenth amendment of the U.S. Constitution, which was ratified in 1791, adds that the “powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.” In theory, then, if the U.S. Constitution does not explicitly state that the federal government has a particular power, it does not have that power. The reality, however, is far more complex.

There are countless historical reasons for the expansion of the power of the federal government. For one, the economies of the states are far more interlinked now than they were in the days before one could travel by train, car, or plane, or people could communicate instantly by telegraph, telephone, or Internet. It has been argued that, just as globalization has necessitated the development of international treaties and legal standards, the modern United States of America requires an expansion of the laws and standards by the U.S. federal government. Additional events that have contributed to the expansion of the federal government include the Civil War and the subsequent battle for civil rights, the Great Depression and the New Deal programs that followed in its aftermath, the dominant role now played by the United States on the international stage, and growing awareness of environmental issues that many argue will require a comprehensive federal response.

Some scholars have therefore argued that the U.S. federal government must be granted powers beyond those provided by the Constitution. Such scholars, commonly referred to as *loose constructionists*, argue that the framers of the Constitution could not have anticipated the events of the past two hundred years; it is therefore necessary, they say, to adapt certain aspects of the Constitution to better reflect the underlying intentions of the Founding



Fathers. Loose constructionists frequently point to the Commerce Clause and to the Necessary and Proper Clause to bolster their argument.

The “Elastic” Clause

The Necessary and Proper Clause is sometimes referred to as the “elastic clause” because it has been used to stretch the powers granted to Congress. The actual clause reads as follows:

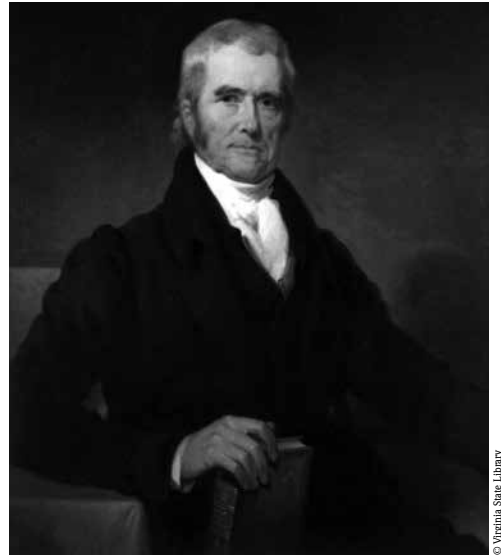
To make all Laws *which shall be necessary and proper* for carrying into Execution the foregoing Powers, and all other Powers vested by this Constitution in the Government of the United States, or in any Department or Officer thereof.

The Necessary and Proper Clause has been used to justify an expansion of federal power beyond that which is described within the enumerated powers. This precedent was established in the Supreme Court ruling on *McCulloch v. Maryland* (1819). The case dealt with the question of whether or not Congress had the constitutional authority to charter a national bank. Chief Justice John Marshall acknowledged that the national government was limited to the powers enumerated by the Constitution, but then added that Article 1 specifically states that the national government has the power to make any laws necessary and proper to carry out those enumerated powers. He wrote the following:

If the end be legitimate, and within the scope of the Constitution, all the means which are appropriate, which are plainly adapted to that end, and which are not prohibited, may constitutionally be employed to carry it into effect.

Although, among the enumerated powers of government, we do not find the word “bank” or “incorporation,” we find the great powers to lay and collect taxes; to borrow money; to regulate commerce; to declare and conduct a war; and to raise and support armies and navies . . . But it may with great reason be contended, that a government, entrusted with such ample powers . . . must also be entrusted with ample means for their execution. The power being given, it is the interest of the nation to facilitate its execution.

Clause 3 of the enumerated powers, generally referred to as the Commerce Clause, grants Congress the power to “regulate Commerce with foreign Nations, and among the several States.” The combination of the Necessary and Proper Clause with the Commerce



Chief Justice John Marshall, 1831
(1755–1835)
by Henry Inman

© Virginia State Library

Clause has been used to justify a tremendous expansion of federal power, since it can be argued that almost every policy issue is somehow relevant to either domestic or foreign commerce. One controversial example of this is the Interstate Domestic Violence Act, a piece of federal legislation designed to treat domestic violence as a federal crime rather than a local one. This law states, in part, as follows:

A person who causes a spouse, intimate partner, or dating partner to travel in interstate or foreign commerce . . . by force, coercion, duress, or fraud, and who, in the course of, as a result of, or to facilitate such conduct or travel, commits or attempts to commit a crime of violence against that spouse, intimate partner, or dating partner, shall be punished (18 U.S.C. § 2261[a][2]).

The Constitution says nothing about Congress's power to punish domestic violence crimes, but the Commerce Clause was invoked in this case to justify federal involvement in those cases in which state lines were crossed. In the case of *United States v. David M. Larsen* (2009), David Larsen attacked his wife, tied her up, threw her in the back of his pickup truck, and then drove to a self-storage unit where he left her body. In the process of transporting her to the unit, Larsen crossed state lines.

When charged with having violated the Interstate Domestic Violence Act, Larsen argued that the federal law did not apply because there was no economic component to his crime; there was no commerce involved. The Supreme Court, however, disagreed. The fact that Larsen crossed state lines was considered sufficient to invoke the Commerce Clause, thereby permitting the federal court to try Larsen for his crime.

There is no doubt that Larsen's crime was reprehensible and that he deserved to be punished. One might reasonably question, however, if the writers of the Constitution intended for the Commerce Clause to be used as a justification for federal involvement in crimes of domestic violence.

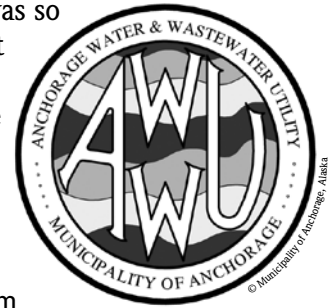
Arguments For and Against Decentralization of Power

Over the past several decades, there has been a growing demand within the United States for a greater decentralization of power. It has been argued that Congress—with the help of the Supreme Court—has seized power that rightfully belongs to state and local governments. Putting aside the legal question of how to interpret the Constitution, there are several reasons why one might support a decentralization of power.

One argument is that the federal government has a tendency to legislate with a one-size-fits-all sensibility that overlooks significant economic, geographical, and cultural differences among the states. A report by the Heritage Foundation cited two particularly egregious examples involving the Environmental Protection Agency (EPA).



In the first example, the sewage inflow for Anchorage, Alaska, was so clean that the municipality could not meet Congress's requirement that all sewage treatment facilities reduce incoming organic waste by at least 30 percent. Still, the EPA insisted that the city meet the arbitrary standard. Anchorage's response was to arrange for two local fisheries to dump fish viscera into the river so the city could remove them.



In a second example, Arizona legislators complained that the Clean Air Act is too strict even for the naturally occurring dust from Arizona's deserts, let alone automobile emissions. Then-Arizona House Majority Leader Brenda Burns commented: "The Clean Air Act's one-size-fits-all standard cannot work in Arizona. We could take every car off the road and still not be in compliance. I suppose we could pave the desert, but I don't think that would be realistic."

This is only anecdotal evidence, but the incidents described above do illustrate how policies developed at the federal level may prove inappropriate when implemented at the state level.

Another argument for decentralization of power is that it encourages innovation and experimentation. This was the reason provided for the Personal Responsibility and Work Opportunity Reconciliation Act of 1996, which replaced a federal welfare program with block grants to states and the requirement that they create their own welfare programs. The idea was that states would then be able to try new ideas and experiment with different policies. Best practices could be emulated and comparisons could be drawn by looking at the outcomes of the various policies that were being attempted.

One of the arguments against decentralization of power is that, rather than resulting in innovation, it may lead to a "race to the bottom" in which states compete with one another to the detriment of the general public. Those who opposed the Reconciliation Act warned that states would compete to provide the fewest possible benefits out of fear that welfare recipients would emigrate to those states with the most generous programs.

This same dynamic occurs when states compete with each other to attract businesses by lowering their corporate tax rate. If one state lowers its corporate tax rate, neighboring states are then pressured to further lower their own so that companies will not be tempted to move across the state border. This leads to a cyclical trend of reduced corporate taxes that benefits corporations but is detrimental to states, which lose an important source of revenue. And the "race to the bottom" does not only occur with welfare programs and corporate taxes; it can also lead to a competition for a constant reduction in environmental standards, labor safety standards, unemployment benefits, state minimum wage, and more. In other words, the "race to the bottom" generally benefits corporations and the wealthy at the expense of the poor, thereby increasing income disparity and worsening poverty.

There are other arguments against decentralization of power. Negative externalities, such as the air pollution emitted from factories, have serious health and economic effects on neighboring states; it is therefore argued that these kinds of issues need to be dealt with on a federal level. Another argument against the decentralization of power is the “weakest link in the chain,” which applies to situations in which each state may pursue its own policy but all states end up sharing the disadvantages of that which does the least. An example of this would be state policies to secure the U.S.-Mexico border against illegal immigrants. If California and Arizona, for example, invest heavily in a wall to prevent illegal immigration but Texas does not, workers seeking to enter the United States will do so through the weakly enforced borders of Texas. From there, it is easy for the illegal immigrants to enter California and Arizona; the investment that the two states have made in border security is rendered useless by the lack of similar investment by Texas.

Finding the Proper Balance

There is no simple answer to the issue of federalism and the growing imbalance of power between federal and state governments. Although strict constructionists argue that the original intent of the founders of the U.S. Constitution should be obeyed, the country has changed drastically since that time and it is not always clear what those intentions were or how they should be applied to modern circumstances. Legal battles and debates over the health care mandate, gun control, gay marriage, abortion, legalization of marijuana, and the growing reliance of the federal government on unfunded mandates all reflect the tension that exists between the two tiers of government.



A portion of a wall erected on the Sonoran Desert at the Arizona-Mexico border near Sontoya, Mexico. The steel wall is eighteen feet high. A hardware store in Sontoya sells twenty-five-foot high ladders for about \$15.

For Greater Understanding

Questions

1. What is federalism and how is it different from political systems in other countries?
2. What are some of its advantages and what are some of the problems inherent in a federalist system?
3. Why did the Founding Fathers of the United States choose a federalist system? How has it changed since then?
4. Do you think that too much power has accumulated at the federal level? Why or why not?

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Note: This article and the EPA case study related herein were first brought to my attention by my former student Ellen Adams. Ellen also educated me about the role of Vermont during the Revolutionary War, discussed in the audio lecture.

Lecture 7

Bureaucracy and Its Many Dysfunctions

Professor Paul Weissburg

The Suggested Reading for this lecture is James Q. Wilson's *Bureaucracy: What Government Agencies Do and Why They Do It*.

Max Weber on Bureaucracy

In discussing bureaucracies, one must begin with Max Weber, the famous German sociologist. His book, *Economy and Society* (1922), was the first serious study of bureaucracies and in it he analyzed the ancient bureaucracies of Egypt, Rome, and the Byzantine Empire as well as the more modern bureaucracies that Weber observed in Western Europe in the late 1800s and early 1900s. From Weber's perspective, calling someone a *bureaucrat* was definitely not an insult. In fact, it was a very high compliment.

According to Weber, bureaucracies are systems of rules that have been written down and that are applied consistently in all cases. In today's society, we often complain that bureaucracies are dehumanizing because government bureaucrats tend not to treat us as individuals. They don't want to hear about our special circumstances. Instead, the government bureaucracy seems to apply a one-size-fits-all standard to everyone it meets. That can be incredibly frustrating, but from Weber's perspective, this was a huge improvement over a system in which your case was decided on the basis of whether or not the official handling your case liked you personally—or if perhaps that official had just gotten in a big fight with his wife and now felt the need to take out some of his personal frustration.

Another quality of bureaucracies that Weber observed was that they are hierarchical, which means that there is a clear line of authority and of responsibility. This may not seem like such a radical idea, but the tragic aftermath of Hurricane Katrina in 2005 helps to highlight the importance of a clear chain of command and well-established procedures. In that particular case, the Federal Emergency Management Agency (FEMA) had the necessary resources to rescue the people of New Orleans. That wasn't the problem. The problem was that no one could decide who was in charge. There was no clear chain of command. The bureaucracy failed, and over a thousand people died as a result.



Karl Emil Maximilian "Max" Weber
(1864–1920)

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Finally, Weber noted that being a bureaucrat was a vocation; it was something that one trained to do. In the late eighteenth and early nineteenth centuries, the most important qualification for someone to work for the government was character. This generally meant that the bureaucrat came from a wealthy family and that his parents had sent him to college, where he learned to speak Latin, read the classics, and develop an appreciation for music and art. Later, with Andrew Jackson's administration, came the spoils system in which party loyalty became the key characteristic of a government employee. Government jobs were given as rewards to the people who helped politicians get elected. Then, with civil service reform, merit tests started being used to distinguish those candidates who possessed the necessary skills to become government employees. By the early twentieth century, Frederick Taylor and his system of scientific management had led to a belief in the value of merit testing and neutral expertise. Weber agreed with this image of the ideal government bureaucrat as someone who followed the rules without exception. According to Weber, the bureaucrat should pass through a firmly proscribed course of training, pass examinations, and gradually move up the hierarchy as he developed seniority. Most importantly, the ideal bureaucrat does not go into government work with the intention of exploiting his position to become rich. Weber states the following:

[T]he position of the official is in the nature of a duty . . . Legally and actually, office holding is not considered a source to be exploited for rents or emoluments, as was normally the case during the Middle Ages and frequently up to the threshold of recent times . . . Entrance into an office, including one in the private economy, is considered an acceptance of a specific obligation of faithful management in return for a secure existence.

He adds that loyalty to an office did not translate into loyalty to a specific person, but rather "Modern loyalty is devoted to impersonal and functional purposes." By this he meant that the days of the patronage system were—or at least should have been—at an end. In a person's capacity as a government bureaucrat, loyalty was not to the person who got the bureaucrat the job, but rather to the office itself and to the responsibilities that go with it.

Weber has an almost idealized notion of what a government bureaucrat should be. But that idealized notion, seen from another perspective, is very similar to the modern-day negative stereotype most of us have of the government bureaucrat. In other words, Weber is largely correct in identifying the characteristics of a bureaucracy and of a civil servant functioning within a government bureaucracy, but he is very much focused on their positive aspects. That makes perfect sense, given the alternatives. It makes sense that he would prefer a bureaucracy that treats everyone equally to one that plays favorites or that discriminates against particular individuals. It makes sense that a clear hierarchy would be preferable to a system where no one knows who they are supposed to report to, or who is in charge of making the big decisions.

Merton's Perspective

In 1940, Robert K. Merton published an article that looked at these same characteristics of a bureaucracy but from an entirely different perspective. His article “Bureaucratic Structure and Personality” is extremely critical of Weber’s ideal bureaucrat and argues that bureaucracies are actually highly dysfunctional. Merton agrees with Weber about the merits of bureaucracies.

The chief merit of bureaucracy is its technical efficiency, with a premium placed on precision, speed, expert control, continuity, discretion, and optimal returns on input. The structure is one which approaches the complete elimination of personalized relationships and non-rational considerations (hostility, anxiety, affectual involvements, and so on).

The point of disagreement between Merton and Weber is that Merton thinks that these same characteristics often lead to what he calls *dysfunctions of bureaucracy*. One of the dysfunctions identified by Merton is *trained incapacity*. Trained incapacity occurs when “actions based upon training and skills which have been successfully applied in the past may result in inappropriate responses *under changed conditions*” (italics Merton’s). In other words, it is when someone decides “This is what I did last time, and it worked then, so the same thing will probably work in this situation too.” That is fine if the two cases are similar, but this tendency can lead the bureaucrat to overlook important differences between the two cases. An example of this would be the old saying that “Generals are always preparing to fight the previous war.” The strategies that worked so well in World War II had disastrous consequences when applied to the wars in Korea and in Vietnam. That’s because those were completely different situations. The goals were different, the terrain was different, and the technology was different.

According to Merton, the bureaucracy does not adapt quickly to changed circumstances. Rather, because the bureaucracy is designed to treat each case the same as the last, it is almost impossible for bureaucrats to be proactive in updating their responses to situations. This is one reason why the U.S. Postal Service has been so remarkably slow to adapt to new technology—or even not-so-new technology. The Postal Service is a huge bureaucracy and has a

The St. Vrain, New Mexico, post office was closed in September 2011 after one hundred two years of operation in the same location. In the summer of 2011, the U.S. Postal Service published a list of more than three thousand post offices that it identified as candidates for closure because of shrinking business. The St. Vrain office became one of the first to close.



Robert K. Merton
(1910–2003)

© Sandra Still/Columbia University



© United States Postal Service

tendency to continue doing things the same way that it always has because that is what bureaucracies do.

Merton also considers *displacement of goals* to be a common dysfunction of bureaucracy. This occurs when adherence to the rules—which were constructed to achieve a specific goal—becomes more important than the goal itself. An example of this has been the tendency in public education to focus on test scores rather than on actual learning. The “No Child Left Behind” program in particular has placed such importance on test scores that many public schools are reportedly cutting the amount of time spent on critical thinking skills so that they can focus more on teaching students how to do well on multiple-choice tests, a practice commonly referred to as “teaching to the test.” The fact that schools are focusing more on test-taking skills than on actual content completely undermines the goal of that legislation, which was to improve education.

Anthony Downs and the Life Cycle of Bureaus

The trend toward broader delegations of power, growth in the size and budgets of the federal bureaucracy, and expanding administrative complexity in its policy areas is not new. A half century ago, political scientist Anthony Downs formulated what he called the “Life Cycle” theory of bureaucracy. He began from the premise that public administrators are NOT the dispassionate and politically disengaged experts of Woodrow Wilson’s theory and the Civil Service Reform movement’s attempt to instill meritocracy in the appointment process. Bureaucrats are rational human beings. They are certainly interested in the administrative mandate of their task and its implicit expertise, but they also live in an inextricably political realm. They know their budgets, their staff sizes, their expected deliverables, their discretionary authority, and even the continuation of their bureau are dependent upon political decisions made in the halls of Congress and the White House. Downs therefore predicts that bureaucratic decision makers will take these factors into account and behave accordingly.

Once established, a new bureau almost immediately finds itself needing to justify its own existence. An agency must demonstrate its worth to the legislative and executive branches of government, which in turn funds and staffs it out of a perceived belief that it has political support justifying its continuation. One strategy often enlisted to sustain this support is a push for autonomy through growth and expansion. An early bureau chief will identify his or her clientele—the regulatory demanders—and stake out a claim to undisputed jurisdiction in providing its service. Ostensibly redundant agencies therefore identify and promote niche characteristics about their functions to distinguish themselves from other



Anthony Downs (1930–) speaking at a suburban Washington, D.C., transportation conference in 2009.

© The Brookings Institute

parts of the government—or emphasize their role in establishing a parent department's foothold on a desirable and lucrative, though highly sought after, policy area such as national security or energy.

Downs associates certain personality types with the successful establishment of a bureau. Conservers tend to protect their staked-out jurisdiction and slowly advance their organizational needs and budgets, whereas climbers tend to push for aggressive and rapid growth into new policy areas. Not surprisingly, budgetary structures in the government tend to reward climbers, as they are more aggressive in seeking out constituents to their services, who can in turn provide the political support to sustain and expand them.

Though successful bureaus usually start with a bang and aggressively expand their own policy jurisdiction, growth will inevitably slow at some point. Downs calls these fluctuations accelerator and decelerator effects, and he attributes them to a multitude of factors. Rapidly growing agencies tend to attract attention, including competitive attention from other departments.

Most administrators, be they conservers or climbers, are well aware that the future of their bureaus is tied to the political will to fund them. This recognition naturally incentivizes expansion, a characteristic that Downs describes as “inherent” to any public agency. Expansion has many benefits, both internal and external. A bureau that is perceived to be “on the rise” or at the center of the action will attract stronger and more capable personnel. There is a reason why foreign service placements in diplomatic hotspots are highly competitive and sought after, whereas a small bureau in the Department of Housing and Urban Development might seem like a bureaucratic backwater.

Perhaps more importantly, though, expanding bureaus are able to command larger budgets, hire more people, exert more power, and project higher status. As an agency scales up its activities it continues to “prove” itself as indispensable from a political spectrum. There is a reason why Medicare and Social Security are considered the “third rails” of American politics today. They administer funds in the hundreds of billions of dollars, have tens of millions of constituents in the voting public, and are generally perceived to deliver a desirable service: subsidized medical care and retirement income. Thus short of a national budgetary catastrophe, the political will to drastically alter them is usually difficult to muster—even in times when we recognize serious and substantive funding shortfalls in the future.

As Downs notes, bureaus are large, complex, and multifaceted. Complex institutions are difficult to dismantle without substantial disruption, thus the very same drive to expand itself and cultivate political constituents within the government and public is itself an entangling device that inhibits drastic change. When viewed from afar, the administrative functions of the state appear unwieldy, often horrendously so. They seldom operate with a mindset for efficiency, but that is due to the relative absence of an incentive to do so. Rather, budgets and expanding staffs serve as a means of expansion and demonstrating

worth to legislators, so long as basic expectations are met and discretionary mandates become a means of adjusting functionality to stay relevant and develop new constituent interests. For these reasons, established bureaus constantly compete with each other, carve out overlapping jurisdictions, reinvent their own missions, and seek to expand into new areas of policy and spending. Over time they have aggregated into the massive modern administrative state. But what they seldom do, even in obsolescence, is sanction their own dismantling, as to do so would entail ceding a competitively acquired stake in budgetary resources and administrative power. It is for this reason that old bureaus rarely die.

Lessons Learned?

The works of Weber, Merton, and Downs provide a more nuanced understanding of the benefits of government bureaucracies as well as their potential dysfunctions. Although it appears that certain problems may be inherent to bureaucracies, such problems may be mitigated with the proper precautions. For example, one way to avoid *trained incapacity* might be the use of an occasional forced rotation of department heads. A new set of eyes can help avoid the tendency to cling to outdated practices.

Bureaucracies appear to be most useful when their objectives lend themselves easily to standardization. They may be less appropriate, however, in situations requiring subjective judgment and when the specific details of individual cases must be taken into account. A well-structured government bureaucracy may be very helpful in those places where corruption and preferential treatment are major problems but may prove counterproductive if one is trying to encourage behaviors—such as learning or working well with others—which cannot be simply quantified. The bureaucracy tends to overlook such behaviors entirely, focusing instead on actions that can be easily standardized and counted, such as numbers of customers served or the scores on multiple-choice exams.

The potential exists for bureaucracies to be either useful or dysfunctional; it depends entirely on how they are used.



For Greater Understanding

Questions

1. What is a bureaucracy and under what circumstances are bureaucracies most useful?
2. On what points do Weber and Merton agree? On what points do they disagree?
3. According to Downs, what are some of the main phases of a bureau's life-cycle?

Suggested Reading

Wilson, James Q. *Bureaucracy: What Government Agencies Do and Why They Do It*. New York: Basic Books, Inc., 1989.

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Merton, Robert K. *Social Theory and Social Structure*. New York: The Free Press, 1968 (1957).

Websites of Interest

1. The *Official Website of Anthony Downs* provides lists of articles and speeches archived from 2006 to 2010. — <http://anthonydowns.com/>
2. The *Garfield Library* website at the University of Pennsylvania in Philadelphia provides selected works, papers, and historical information of Robert K. Merton. — <http://www.garfield.library.upenn.edu/merton/list.html>
3. Professor Frank Elwell maintains the *Sociology of Max Weber* website at Rogers State University in Claremore, Oklahoma, which features introductory text on the studies and theories of the German sociologist, links, and bibliography. — <http://www.faculty.rsu.edu/users/f/felwell/www/Theorists/Weber/Whome.htm>

Lecture 8

Administrative Policymaking: Who Makes the Laws?

Professor Paul Weissburg

The Suggested Reading for this lecture is A. Lee Fritschler and Catherine E. Rudder's *Smoking and Politics: Bureaucracy Centered Policymaking*.

Who Makes the Laws?

The majority of American government texts state that laws in the United States are made by the legislative branch of the government. That is, the laws are made by Congress. Article 1, Section 1, of the United States Constitution states “All legislative Powers herein granted shall be vested in a Congress of the United States, which shall consist of a Senate and House of Representatives.”

In reality, however, only a small number of laws created every year are made by Congress. The vast majority of new laws—over 95 percent, in fact—are written by government workers. These government workers can be divided into two groups: civil servants and political appointees. Civil servants are public-sector employees who work for government departments or agencies. They may be scientists who monitor carcinogen levels for the Environmental Protection Agency, accountants working for the Internal Revenue Service, receptionists at the Department of Treasury, and so on. Most government workers are civil servants.

The second category of government employees includes political appointees. Appointees fill a variety of roles, the majority of which are leadership positions for government departments and agencies. Political appointees are chosen by the head of the executive branch. On the federal level, that means that they are appointed by the president of the United States; on the state level, they are chosen by the governor, and on the local level those positions are filled by the mayor.

One thing that civil servants and political appointees have in common is that neither group is directly accountable to the public in the same way as elected officials. Political appointees must answer only to the leaders of the executive branch. That is the person who appointed them to their government position and it is the one person who can remove them. Civil servants—much like



Government Employees

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employees in the private sector—are accountable to their bosses, who are themselves either political appointees or civil servants.

Initially, the administrative state—which is made up of these government employees—was a very small component of the U.S. government, consisting mostly of postal system employees and soldiers. In 1816, there were only 4,837 civilian employees in the executive branch of the federal government. Today there are over 2.6 million.

How Does the Administrative State Create Laws?

Although administrative policymaking has grown exponentially in the past one hundred years, this delegation of policymaking power to government workers can be traced back to the origin of the United States. Dr. A. Lee Fritschler and Catherine Rudder write:

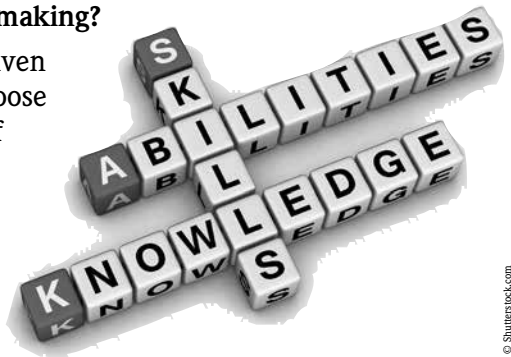
[F]rom the time the Constitution was adopted, Congress recognized that it could not effectively handle the intricacies of policymaking. In 1789, the first Congress delegated to Alexander Hamilton's newly organized Department of the Treasury the authority to set benefits and establish reimbursement policies for disabled Revolutionary War veterans. Even in those early years, it was recognized that there are natural limitations on legislatures that make them incapable of acting as effective policymakers under conditions where details are complex and unclear.

Of course, the power to decide how benefits will be awarded to veterans is not really policymaking; it would be more accurate to describe that as the implementation of an existing policy. It was, however, the beginning of a trend that would expand throughout the nation's history. Congress would create laws but would then delegate the implementation of those policies to government agencies created for that purpose.

Government agencies today determine access to television and radio airwaves, legal limits of air and water pollution, the details of immigration policies, and which drugs can be sold over-the-counter, which require a doctor's prescription and which cannot be sold at all. They set occupational health and safety standards as well as standards for the use of pesticides, the treatment of the mentally ill, and the safe disposal of toxic waste. In other words, they determine the majority of laws, standards, and rules in the United States.

Why Does Congress Permit Administrative Policymaking?

It may seem odd that Congress, which has been given rulemaking authority by the Constitution, would choose to delegate that power away; normally, one thinks of politicians as being reluctant to share power. The delegation of rulemaking powers to government employees makes sense, however, when one considers the overwhelming number of laws and rules that must be created—and then updated—every year.



It is simply not feasible for the members of Congress to become experts in medicine, environmental standards, accounting standards, and agricultural techniques, to name just a few. Those sorts of policy decisions must be made by people who are experts in the relevant subjects.

When Congress creates a new government agency, the legislation establishing that agency includes a mandate, which defines that agency's function and the policy goals that it should pursue. These mandates are often extremely broad. For example, the legislation that created the Federal Communications Commission (FCC)—the government agency responsible for regulating radio and television broadcasting—states that the FCC should exercise the power delegated to it by Congress in “the public convenience, interest, or necessity.” Clearly, this leaves quite a lot open to interpretation.

Objections to Administrative Policymaking

There have been numerous objections to administrative policymaking in the United States. One rather significant problem is that it violates the United States Constitution. Article 1 of the Constitution states that “All legislative powers herein granted shall be vested in a Congress of the United States.” It does not permit Congress to delegate those legislative powers to some other government body. However, the Supreme Court has generally been reluctant to limit Congress's ability to delegate legislative power to government agencies—despite the inherent Constitutional violation—because this delegation of power is clearly necessary in order for the government to function. In theory, the Supreme Court could deal with each individual case of delegated authority to determine under which circumstances government agencies have overstepped their legislative boundaries. In practice, however, this would be extremely difficult because congressional legislation defining government agencies' powers and functions are often deliberately vague. There is no clear basis by which to determine which instances of administrative policymaking should be considered legitimate and which should not.

A second major objection to administrative policymaking is that it places legislative, executive, and judicial powers within the same government agencies; this conflicts with the principle of checks and balances. The United States Constitution deliberately places different powers within different branches of the government. This was done to prevent the abuse of power. James Madison wrote in the *Federalist Papers* that “The accumulation of all powers legislative, executive, and judiciary in the same hands . . . may justly be pronounced the very definition of tyranny.”

In Gary Lawson's article *The Rise and Rise of the Administrative State*, he provides the following example of a single government agency exercising multiple powers, in this case the Federal Trade Commission:

The Commission promulgates substantive rules of conduct. The Commission then considers whether to authorize investigations into whether the Commission's rules have been violated. If the Commission authorizes an investigation, the investigation

is conducted by the Commission, which reports its findings to the Commission. If the Commission thinks that the Commission's findings warrant an enforcement action, the Commission issues a complaint. The Commission's complaint that a Commission rule has been violated is then prosecuted by the Commission and adjudicated by the Commission. The Commission adjudication can either take place before the full Commission or before a semi-autonomous administrative law judge. If the Commission chooses to adjudicate before an administrative law judge rather than before the Commission and the decision is adverse to the Commission, the Commission can appeal to the Commission.

A third objection to administrative policymaking is that it reduces accountability. In the United States, the citizenry votes to decide who has the authority to make laws. If the public objects to the laws that are being made, they can vote those lawmakers out of office in the next election. This ability to vote for—or against—the people who make our laws helps to ensure a high degree of accountability. Administrative policymaking subverts this system, however. If the FCC makes a rule that upsets the public, there is no direct mechanism by which the public can directly punish the responsible party. This lack of accountability is exacerbated by the fact that so few people realize that the majority of laws are being made through administrative policymaking and not by elected officials.

External Checks on Administrative Policymaking

Although the voting public has almost no direct control over government employees or the administrative policymaking process, there are some external checks on this power. For one, Congress has the power of the purse; that is, they control the budget. If a government agency oversteps its boundaries or somehow agitates the members of Congress, that agency may find its budget drastically cut the following year. This provides an excellent incentive for government employees to remain mindful of the policy goals of those serving in the legislative branch. Further, if Congress becomes sufficiently agitated, they have the option of writing new legislation to limit an agency's authority or even disband it entirely. An example of this occurred in the 1960s when the Federal Trade Commission (FTC) attempted to require that cigarette packages carry a health warning. Congress, which was being heavily lobbied by the tobacco industry, opposed this legislation and consequently passed the Cigarette Labeling and Advertising Act of 1965, which reduced the FTC's power and specifically banned them from regulating the advertising of tobacco for the following four years.

The president has almost no direct control over the civil servants working in government agencies, but he does have the authority to appoint the heads of most governmental agencies and departments. The power to select—or remove—appointees can be used to greatly curb the use of administrative policymaking or to shift the direction of that power's use.

Finally, the judicial system provides an additional check on administrative policymaking. Although courts have generally been reluctant to rule on the legality of administrative

policymaking itself, the legal system has been used in cases in which individuals' fundamental rights have been violated.

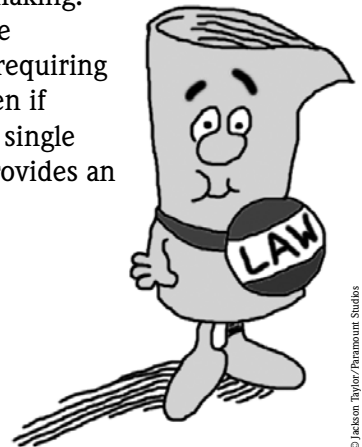
One thing that these checks on administrative policymaking all have in common is that, although none of them are used very often, their very existence is generally sufficient to discourage any abuse of power. Administrative policymakers understand that the power they have is not without limits and that if they overstep their boundaries, that power may be revoked. Although it is true that civil servants and political appointees are not directly accountable to the public, the same is not true of elected officials. Therefore, it behooves government employees not to agitate the public to the point that pressure will be brought to bear on the members of Congress or the president, for that pressure will almost certainly then be passed on to the offending agency.

Conclusion

The existence of administrative policymaking appears to violate the U.S. Constitution and to undermine democratic values. However, there is a general consensus that the delegation of rulemaking power to government agencies is necessary. It is not feasible for Congress or state legislatures to make all the laws themselves. Even if elected officials could find the time to vote on every single law, their lack of expertise would prove disastrous.

Some steps have been taken to help limit the policymaking power of government employees. Most government agencies are subject to the guidelines set by the Administrative Procedure Act (APA) of 1946. In cases of formal rulemaking, the APA requires that a public notice of rulemaking be provided, that the public be invited to comment on the proposed rule, and that thirty days' notice be provided before a rule goes into effect. It also establishes rules for petition. As a result, there is a high degree of transparency and due process.

Finally, it has been argued that the U.S. system of checks and balances may actually be strengthened by the existence of administrative policymaking, since it provides additional venues through which the public may seek to influence policymaking. For example, when elected officials proved unwilling to regulate tobacco, it was government agencies that seized the initiative, requiring warning labels and limiting the advertisement of cigarettes. Even if the legislative and executive branches are both dominated by a single political party or interest group, administrative policymaking provides an additional venue through which other voices may be heard.



For Greater Understanding

Questions

1. Who makes the laws in the United States of America? How does the answer to this question differ from what we're generally taught?
2. Why does Congress delegate policymaking power to the administrative state?
3. Is administrative policymaking unconstitutional? Why or why not?

Suggested Reading

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<http://www.heritage.org/research/reports/2007/11/the-birth-of-the-administrative-state-where-it-came-from-and-what-it-means-for-limited-government>

Websites of Interest

1. The *United States Environmental Protection Agency* website features information on its many activities. — <http://www.epa.gov/>
2. The *Office of Information and Regulatory Affairs* (Office of Management and Budget) website provides information and resources on the regulatory activity of agencies of the United States Government. — <http://www.reginfo.gov/public/jsp/Utilities/index.jsp>

Lecture 9

Congress versus the Bureaucracy

Professor Phillip Magness

The Suggested Readings for this lecture are Dennis C. Mueller's *Public Choice III* and Amity Shlaes's *The Forgotten Man: A New History of the Great Depression*.

Legislative Power and Delegation

The framers of the Constitution devoted more effort to defining the powers of Congress than any other component of the government. Whereas presidential and judicial authority are only vaguely defined in terms that reflect their anticipated development after the first meetings of Congress, the legislative authority of the government is specified across eighteen enumerated powers, along with accompanying constraints on their use. From a strict textual perspective, this list includes a variety of powers in which Congress has uncontested constitutional domain.

Consider the following four excerpts in which the Constitution instills a specific power squarely with Congress: “To regulate Commerce with foreign Nations,” “To coin Money, [and] regulate the Value thereof,” “To declare War,” and “To pay the Debts and provide for the common Defence and general Welfare of the United States.” These powers are vast and familiar, encompassing the Congress’s clear stake in (1) international trade, (2) monetary policy, (3) national defense, and (4) taxes and budgeting, or fiscal policy. Yet the history of the legislative branch is also one of delegation, generally in the direction of the executive but more specifically toward the administrative aspects of the state. Taking each policy in turn, let us look at their administrative history.

The power to “regulate commerce with foreign Nations” is among Congress’s oldest; indeed, it is the subject of one of the very first pieces of legislation adopted by the first Congress in 1789. For over a century Congress legislated directly in this area by taxing and regulating the import of foreign goods. Yet since 1934 it has all but abdicated its former leading role in trade. The reason was something called the Smoot-Hawley Tariff Act of 1930—a policy blunder in which Congress plunged the United States into a global trade dispute at the peak of the Great Depression. Congress became so crippled by interest-group pressures that they began ceding this power to the president in 1934. The result is the vast administrative component that drives trade policy today.

The power to “coin money” is still technically retained by Congress, yet the value of money is determined by the



Rep. Willis C. Hawley, R-Oregon (left), and Sen. Reed Smoot, R-Utah (right), posing for a photo shortly after the passing of the Smoot-Hawley Tariff Act by Congress in 1930.

© Library of Congress

amount in circulation and other factors governing its availability, use, and lending. Here, Congress is almost entirely deferential to an administrative agency created in 1913 for the specific purpose of regulating the money supply: the Federal Reserve.

The power to “declare War” historically engaged the direct attention of Congress. Yet a war has not been formally declared by the United States since 1941, though many have been fought. Since World War Two, Congress has increasingly yielded to presidential prerogative as the Commander-in-Chief to make military decisions and commit troops abroad. They still retain budgetary control and approve “resolutions” of support for most military operations, but the initiating decisions for war are almost entirely driven by the president and military command.

The budget of the United States is still well within the purview of Congress. Yet the process of its adoption has become highly dependent upon the fiscal needs of a vast and growing administrative state. Since the 1920s, the executive branch has maintained an internal agency responsible for collecting and preparing the annual budget requests of every bureau in the government on a schedule fixed by statute. It is currently known as the Office of Management and Budget, and it has the lead role in delivering budgetary requests to Congress.

As these four examples illustrate, even the most basic constitutional obligations of Congress require the input of the administrative state. Some aspects, such as monetary policy, have been all but entirely ceded to an administrative agency such as the Federal Reserve.

Administrative delegation has a complex and controversial history. For much of the nineteenth and early twentieth century a debate raged among constitutional theorists about how much power a bureau could assume from a congressional mandate, or whether Congress could even voluntarily relinquish its powers. Proponents of what came to be known as the “non-delegation” doctrine held that Congress may only bestow narrow and explicit discretionary authorities on the executive agencies of the government.

At times the Supreme Court agreed. During the New Deal, Congress granted vast and sweeping powers to the National Recovery Administration (NRA) to set standards of competition and even regulate the prices at which certain items could trade. The bill gave widespread discretionary power to the agency to establish “codes of fair competition” and allowed them to be enforced as matters of law. In 1935, the Supreme Court struck down this agency on the grounds that its enabling statute was overly broad, and its delegated powers were not properly defined. The most famous of these rulings was known as the “Sick Chicken Case,” or *Schechter Poultry Corp. v. United States*.



All images: © National Archives and Records Administration

In her book *The Forgotten Man*, Amity Shlaes tells the story of the Schechter brothers, two kosher poultry salesmen in New York. A new NRA regulation codified how coops of chickens could be sold and at what price. One of the regulations inadvertently violated the Schechter brothers' kosher practices for removing sickly birds from their stocks by requiring coops to be sold intact. When the Schechters under-priced their competitors despite the code a swarm of bureaucratic virtuosos from the NRA bombarded them with inspections and quickly cited them for over sixty code violations. These included “unfair” competition through lower chicken prices—a curious proclamation in the midst of the hungry and starving conditions of the Great Depression—and for the presence of a sickly bird, which regulations ironically prevented them from separating from a coop.

Facing massive fines, they sued and won. The Supreme Court found that the widespread discretionary mandate given to the NRA had violated the principle of non-delegation. Congress had failed to specify the parameters of regulation under the NRA and instead permitted “virtually unfettered” administrative power.

Since the Schechter case, Congress has tended to craft its delegations of power with much greater nuance and specificity. The result is a heavily delegated but also highly complex and closely monitored administrative state, operating under congressional supervision and guidance. Understanding this relationship requires a closer examination of how these two facets of government—legislative and administrative—interact.

Routine and regular congressional committee oversight of a delegated power in the hands of an executive agency is one of the ways they have kept the courts happy and remained, for the most part, on the right side of the non-delegation doctrine. The resulting interaction between these two parties—a congressional committee and a federal agency—is one of the most complex and intriguing manifestations of interest-group theory in all of political science.

Iron Triangles, Oversight, and Regulatory Control

Recall George Stigler's theorem and the “capture theory” of the bureau, which holds that regulations emerge when an interest group demands them and the government supplies them in exchange for votes and political support. One variation of this capture theory applies specifically to the relationship between Congress and the bureau, and this

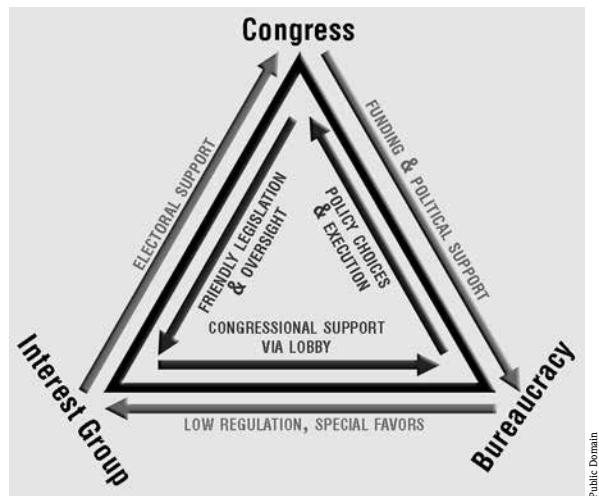


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Schechter Brothers Celebrating Court Victory

The Schechter brothers, poultry dealers who won out over the government by the decision of the Supreme Court in the NRA case involving the live poultry code, are shown above in the office of their lawyer after the court ruling that virtually crushed the NRA was announced. Left to right are Martin Schechter; Aaron Schechter; Joseph Heller, the Schechter brothers' attorney; Joseph Schechter; and Alex Schechter.

is called the Iron Triangle. Simply put, an Iron Triangle forms when the political interests between a regulatory bureau, its oversight committee on Capitol Hill, and its constituent interest group all align. Here a bureau and its constituent strike a Stiglerian bargain of favorable regulatory practices, and they are thus funded and sanctioned by Congress in exchange for campaign support. The bureau in turn receives its own additional funding and staff resources from Congress in the form of an increased budget—its reward for complicity in the regulatory capture.



The “Iron Triangle” of American politics.

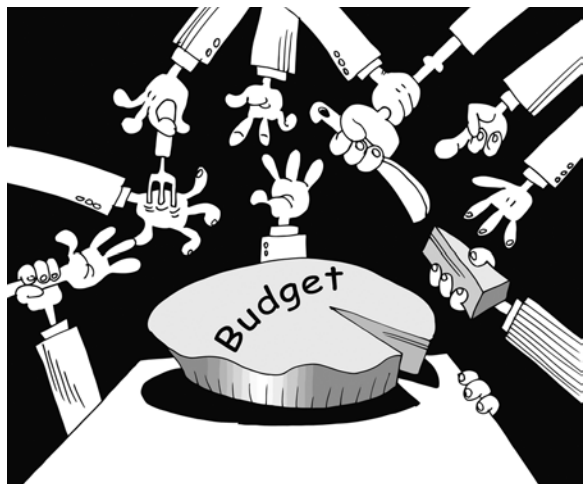
Real-life examples of Iron Triangles may be seen on a fairly regular basis, particularly between agriculture subcommittees. These committees tend to be populated by members from agriculture-producing districts, who in turn favor subsidies for certain farm and dairy products, usually administered through the Department of Agriculture. Milk, cheese, corn, sugar, and tobacco support have accordingly become some of the most intractable programs in the entire government, even as less powerful constituent groups elsewhere such as consumer interests and the free-trade movement cite their disruptive effects upon global trade and commerce.

Yet legislative hearings also attest that the interests and political priorities of bureaus and Congress do not always align. Congress frequently calls on administrative chiefs from the executive branch to testify about their operations and even makes a habit of publicly chastising them on national television if a program is not up to par. To explain this legislative-executive relationship, political scientists have developed two competing theories of bureaucracy.

Bureau Dominance

The first is known as the theory of bureau dominance. It holds that most public administrators—be they honest or corrupt, effective or incompetent—share one attribute in common. They are budget maximizers. Budgets give them the discretionary resources to affect policy as they desire, as well as relative comfort in doing so—a large enough staff to get the job done, a line item for travel or advertising, or even newer and better computers and desks and office supplies. In a way, budgets are both a perk of working in the public sector in addition to salary and a toolbox to get the job done (or, conversely, waste on political patronage and personal comfort so long as one flies underneath the radar of public scrutiny).

Since Congress supplies the budget, the theory of bureau dominance predicts that administrators act in ways that will lead to the long-term maximization of their financial resources as well as the discretionary power to use them. One of the most powerful tools of growing a budget is information. Since most bureaus are highly specialized by design they also know their own functions and capacity better than anyone else in the government. A budget-maximizing bureaucrat will use this information to his advantage, even when negotiating with Congress. They know that Congress makes funding decisions based on the information cues provided by the bureau itself—information that summarizes its accomplishments and policy goals, estimates its budgetary needs, and often offers prescriptive direction on how to “improve” its own operations.



According to this theory, most hearings, testimony, and reports from a bureau to Congress are actually a forum to make the argument for more funding. A skilled administrator therefore monopolizes the way Congress receives information and intentionally over-projects his budgetary needs, knowing that a cost-conscious committee will “trim the fat” while still leaving the bureau within its desired operating levels. If he plays his cards right and avoids the negative attention of excess or scandal, an administrator can effectively maneuver a legislative committee into funding desired programs and policy priorities.

Congressional Dominance

The competing theory of congressional dominance expresses an opposite view of the legislative-administrative relationship. According to this theory, bureau chiefs do indeed signal Congress for more money and resources, but they do so precisely because they recognize that Congress has the final say on budgeting and uses it to advance policy priorities. The successful bureau is not necessarily the one that expands its budget outright, but rather it is the one that signals to Congress that it is worthy of an investment. Skilled administrators therefore do not try to manipulate their budgets upward so much as they attempt to sell particular legislators on the idea that their bureau is worth funding to accomplish a desired project or outcome.

According to congressional dominance, bureaucrats will spend their time cultivating a favorable relationship with select legislative committees and particularly powerful congressmen on those committees, such as the chairman or ranking member. They also tend to be highly risk averse and therefore avoid taking any action that will draw the ire

of a powerful legislator. Congress in turn exercises its dominance through a variety of oversight mechanisms—essentially “sticks” to prod the bureau along and reward agencies that advance their priorities. They hold legislative hearings, which are essentially signals of their own to the bureau on how it should be spending its resources. If an administrator steps out of line, a hearing can even be used to conduct a public shaming—to embarrass an executive branch official or force a resignation following a political debacle. Hearings do not always accomplish immediate policy changes in their targets, but they do constitute a powerful and public signaling device for legislators.

Congress also has the ability to offer new legislation, both threatening the redesign or abolition of a poorly performing agency or rewarding a politically popular and successful one. And in the case of the Senate, it has the ability to confirm or reject some presidential nominees to head a bureau. These tools are less frequently utilized than oversight hearings or requests for information from a bureau, though proponents of the theory of congressional dominance might argue that this is a result of the effectiveness of these other, more routine tools of exerting influence and direction.

Who Dominates?

Is it possible to know whether Congress or the bureau will dominate a policy area? Like bureaucracy itself, the answer is complex. It is not difficult at times to see both factors in play between different committees and different agencies. The level and type of policy also matters. As the general pattern of ceded authority in the area of congressional war powers attests, Congress often yields to administrative requests for funding from the Defense Department in times of war. A combination of highly specialized and even secretive knowledge, common to the intelligence field, and the political popularity of “funding the troops” augments this deferential approach—even during politically unpopular wars like Vietnam. Conversely, Congress often takes a heavy hands-on approach with transportation policy, where active administrative oversight also determines if a new highway or bridge gets built in a member’s home district.

The resulting relationship is often characterized by some degree of deference and some exertion of political clout by both parties. Congress’s delegation of power to the administrative branch has opened up wide channels of discretion and administrative influence, yet at the end of the day it also holds the purse strings.



For Greater Understanding

Questions

1. Describe the principle of non-delegation. In what ways does it limit Congress's ability to make policy? In your opinion, is it too restrictive or not restrictive enough?
2. What is the theory of congressional dominance? Of bureau dominance? Which do you think is the more accurate representation of how Congress and the administrative state interact?
3. Why do Iron Triangles form around certain congressional committees but not others? What might be done to combat them?

Suggested Readings

Mueller, Dennis C. *Public Choice III*. 3rd ed. Cambridge: Cambridge University Press, 2003.

Shlaes, Amity. *The Forgotten Man: A New History of the Great Depression*. New York: Harper Perennial, 2008.

Website of Interest

The *Center for Responsive Politics* is the nation's premier research group tracking money in U.S. politics and its effect on elections and public policy. —

<http://www.opensecrets.org/>

Lecture 10

Presidential Management, Presidential Frustration

Professor Phillip Magness

The Suggested Reading for this lecture is *The Managerial Presidency*, edited by James P. Pfiffner.

The Trouble with Executive Delegation

Bureaucratic design is intentionally hierarchical, and its object is to implement the policies of the government. It seems natural then that the administrative functions of the state would fall to the president, and traditionally that is where they have been seated. For all their prominence in the daily activities of government, though, administrative bureaus do not directly appear at any place in the United States Constitution. They are merely implied by the mandate that the president must faithfully execute the laws of Congress, as well as his power to “appoint Ambassadors, other public Ministers and Consuls.” The clearest articulation of the administrative power from the founding era is specific though also scant given what flowed from it in subsequent generations. Alexander Hamilton, in *Federalist Paper* #72, envisioned “executive details” in the “province of the executive branch.” As he put it, these included persons “considered as the assistants or deputies of the chief magistrate” who “ought to be subject to his superintendence.”

Hamilton’s phrase “subject to his superintendence” reinforces the notion of administrative hierarchy. Yet the federal bureaucracy is far from a personal political tool of the executive branch, and many presidents have felt the frustration of an administrative state that seems either unable or unwilling to implement its will. Presidents often find themselves struggling to engage their own administration in a policy priority due to the inertia of the bureaus under their command.

Bureaucratic complexity and size often preclude the attention of even the most capable president. Presidents accordingly delegate by necessity, and each step of delegation introduces an additional decision maker to the administrative process. Often the White House Chief of Staff becomes the President’s arbiter of managerial decision making. In choosing a chief of staff the president essentially vests his strategy or management approach in a single person. He functions as a point man for interdepartmental disputes,



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a coordinator of information and access into and out of the Oval Office, a delegator of executive-level decisions and tasks, and an executor of presidential dirty work—the person who hires, fires, rewards, and chastises upper-level officials over issues of performance and political compliance alike. The key to understanding this relationship is information flow. Since information is abundantly available and difficult for any one person to acquire, the president's managerial staff must necessarily prioritize what information they think merits the attention of the president, what requires cabinet attention only, or what may be handled entirely on a lower agency level. Chief of staff figures, cabinet secretaries, and upper-level agency heads accordingly function as information gatekeepers.

The bureau's size also affects its ability to process information from above—a task that has frustrated many presidents. Even when hierarchical chains of command are theoretically in order on paper, the execution phase of a presidential directive must still process the information provided to the lower levels of the bureau. Breakdowns in this exchange seldom end well. Look at the Bush administration's widely perceived bungling of the Hurricane Katrina aftermath in 2005, where perfectly well-meaning subordinates appeared aloof of the situation in New Orleans as a breakdown of communications occurred between federal, state, and local officials on the ground in Louisiana for several days after the disaster. Barack Obama encountered similar troubles along the Gulf Coast during the Deepwater Horizon oil spill of 2010, when a distant Louisiana field office of the Minerals Management Service

Top: President George W. Bush and FEMA director Michael D. Brown discuss the government's efforts in response to Hurricane Katrina devastating much of New Orleans (background) in August 2005. On reaching New Orleans, President Bush famously said, "Brownie, you're doing a heck of a job," despite what was widely viewed as an incompetent response by FEMA and Brown.

Bottom: President Barack Obama and Secretary of Homeland Security Janet Napolitano listen while FEMA administrator Craig Fugate briefs them on relief efforts associated with flooding caused by Hurricane Irene in August 2011. In the background, the Deepwater Horizon oil rig burns while fire ships attempt to put out the blaze at the beginning of the British Petroleum oil spill crisis in the Gulf of Mexico, May 2010.



Background images © Shutterstock.com; President Bush image © Associated Press; President Obama image © Los Angeles Times

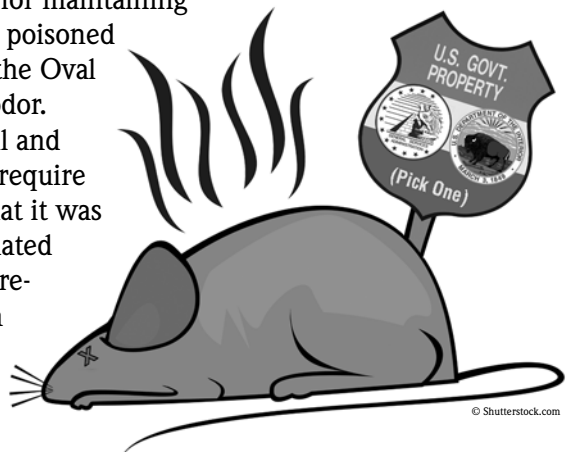
fell slipshod on its inspection schedule and may have contributed to the failure to detect problems. It did not help that the spill occurred only weeks before an investigative report revealed that office had received “gifts from oil and gas companies,” along with invitations to sporting events, skeet-shooting contests, fishing trips, and crawfish boils with company executives.

Bush did not cause Katrina, and Obama did not order the Gulf oil spill. In some respects, both events occurred beyond the scope of reasonable administrative expectation. Accidents and natural disasters happen. Yet both presidents suffered immensely in their popularity as a result of the lack of a clear, effective, and timely administrative response to the disasters once they had occurred. In part, this has to do with the fact that federal administration is massively complex, and strong executive will alone is not enough to manage it.

The size of the federal bureaucracy is simply immense. Agencies alone number in the tens of thousands, spread out over more than twenty major departments and cabinet-rank administrative commissions. Sometimes they even share jurisdiction with other similarly tasked bureaus, if not even replicating their work. More often than not, the public is entirely unaware that certain bureaus even exist, much less what they do. How many people knew about the Minerals Management Service’s Louisiana field office before the Deepwater Horizon oil spill? And how many people know about it now, even in the wake of a large and widely publicized environmental disaster?

To get a sense of this complexity, consider the number of federal agencies involved in the intelligence and security sector, along with its well-known multitude of alphabet soup acronyms. The list includes the CIA, DIA, NSA, FBI, and DHS, among others, each of which has hundreds of divisions and sub-agencies in its hierarchy. Where bureaus exist, complexity often follows.

Jimmy Carter actually learned a lesson in administrative duplication firsthand when a common field mouse moved into the White House in 1977. After observing the rodent running across the floor of the oval office, Carter contacted the General Services Administration (GSA)—the agency responsible for maintaining the White House building. The GSA apparently poisoned the mouse, which then died inside the wall of the Oval office and naturally began to produce a strong odor. When Carter asked the GSA to cut into the wall and remove the rodent, though—a task that would require much more work and effort—they answered that it was out of their jurisdiction. Since the mouse originated from the White House lawn, they claimed that removing the rodent’s body fell to the jurisdiction of a separate bureau, from the Department of the Interior, that managed the grounds outside of the building. Both agencies shirked the task



asked of them out of concern that cutting a hole in the wall would consume their own budgetary resources and establish, by precedent, who had the responsibility for all future dead mice found in the White House. Exasperated, Carter exclaimed, “I can’t even get a damn mouse out of my office!”

Consider another dimension of administrative management—what motivates a bureaucrat? There is no single answer or operative theory, but administrators usually fall in one of two classes. The first consists of the most visible—the political appointees of the president. These consist of cabinet members, undersecretaries, agency heads, and other figures that require Senate confirmation. These appointments seldom outlast a term in office and are the president’s most direct method of effecting his policies on the administrative level—what Alexander Hamilton meant by the phrase “subject to his superintendence.” The second class of administrators consists of entrenched officials, or career members of the civil service. Their tenure often covers a working lifespan and does not change from administration to administration.

A Managerial Problem

Political scientists Joel Aberbach and Bert A. Rockman similarly split administrators into two roughly parallel categories, or “perspectives,” through which they approach the tasks of the government. The first is called the “mandate perspective” and typifies both high-level appointees and lower-level bureaucrats who share the political vision of the president. Members of this class tend to view the object of administration as the fulfillment of the political will of a democratically elected executive. They exist to implement the policy decisions of the president.

A second “mandarin perspective” more closely resembles the outlook of many administrative careerists. Taking its lead from the professionalized administrator of Wilsonian progressivism, this viewpoint holds that administrators are a “democratic mandarin.” The term is borrowed from the Mandarin class of imperial China—the learned officials of the government who shaped its daily administration as institutional repositories of knowledge. In its American application, the mandarin perspective summarizes the view that administrators are supposed to serve the “national interest” through the continuity of government. They are a stabilizing force to the whims of partisan politics, above its fray, and they ensure that a bureau’s mission continues beyond a four- or eight-year term.

These two perspectives are not always congruent, thus presidents must deal with the problems that emerge when they clash. This often happens when an overzealous presidential appointee attempts to push a slow and plodding agency of career bureaucrats in an aggressively political direction, or when the civil service “mandarins” resist an attempt to engage or retool their agency in proactive ways that exceed tradition or institutional culture. Since the administrative branch of the government houses both types, the implementation of policy (or its failure) often depends upon their competition for dominance within a bureau or administrative domain.

Bureaucrats are also motivated by another factor that curiously seems to transcend the perspectives through which they view their own jobs: the budget, which in turn determines the way in which they execute their responsibilities. Public budgets represent an investment in a policy by Congress and the president, whether aggressive or routine. Whether a political official or a career civil servant, most administrators recognize the central role of funding to the fulfillment of their missions. According to economist William Niskanen, the budget of a public agency shapes the way that it completes its tasks and how it allocates its time. The inclination of any good bureaucrat is to spend the money invested in his or her agency, regardless of whether it is in surplus.

An administrator with the ear of the president usually has no shortage of funding. Surplus funding in turn means a discretionary resource to improve the conditions, influence, and effectiveness of a bureau. Some of this money may be available for comfort, such as the purchase of new office furniture or equipment. In other cases it may be used to operate a program above and beyond legislative expectations with the hope of gaining more funding next year, or cultivating a constituent interest through patronage. These and other “perquisites of office” are seldom directly included in an agency’s mandate, yet they are both common and expected by year’s end. Since most administrators are in competition for funds with other agencies, they know future funding depends upon justifying its current level, which in turn means spending all that is allotted to them.

Notice that regardless of political alignment, a budget-maximizing bureaucrat’s objectives differ at least slightly from the president’s decision to fund or prioritize his agency. When the president invests in a bureau he desires a policy objective. Budget-maximizing administrators desire the continuation, health, and comfort of their own agency. At times this even sparks division between a president and his political appointees. In 1980, Ronald Reagan campaigned against the Department of Education and called for its dismantling to reduce the deficit. This proved a nonstarter in Congress despite being highlighted in Reagan’s campaign, and for the latter part of his administration the department actually expanded in size and function under the tutelage of Secretary William J. Bennett. As a highly public figure and advocate for conservative education reform conducted through the tools of his department, Bennett effectively solidified the permanence of his agency and expanded the very same budget that Reagan initially set out to cut.

The picture of the administrative state that begins to emerge from these observations is fairly daunting, if not unmanageable. Holding that most presidents expect their administrative will to carry through the bureaucracy, there is a challenge created by the presence of (1) divergent perceptions of administrative purpose and (2) a difference of incentives in which bureaucrats respond more to the budgetary enticement of self-preservation than the policy wishes of their superiors. The administrative presidency is also a managerial conundrum.

Since the mid twentieth century, most presidents have sought to cope with this challenge through a variety of administrative strategies of their own. Sometimes success or failure

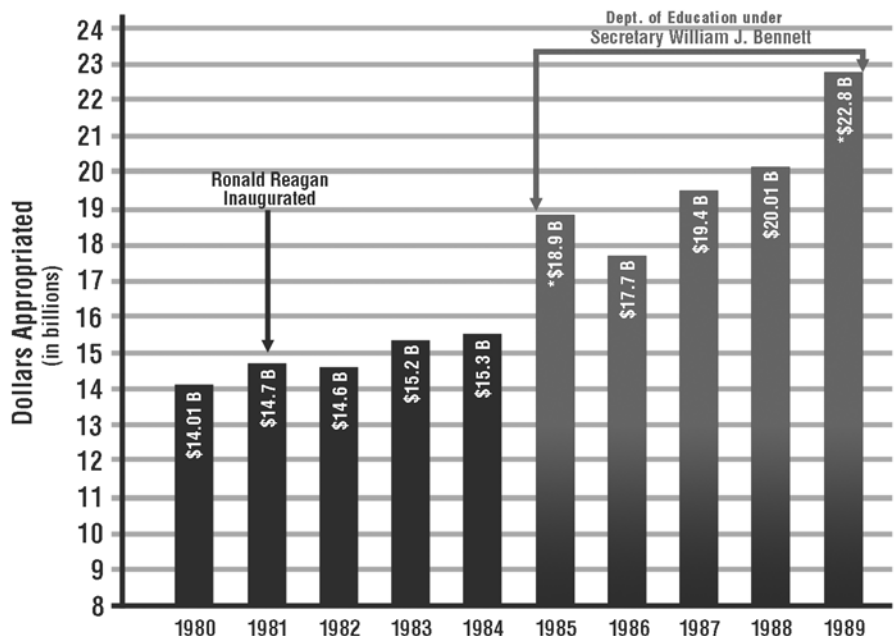
turns on a simple matter of style in how presidents arrange and manage their immediate subordinates. Franklin Roosevelt, for example, adopted a competitive managerial strategy that tended to arrange multiple administrators around a task and rewarded those who performed. Dwight D. Eisenhower, himself a product of military hierarchy as allied commander in World War II, preferred a structured, orderly, and well-defined executive branch. Gerald Ford viewed the presidency as if it were the center of a wagon wheel, with various departments and their representative expertise functioning as its spokes. Ronald Reagan used a delegation model of administrative government, surrounding himself with and often deferring to specialized expertise in each department. Bill Clinton, by contrast, resisted delegation and used his chief of staff as an emissary of sorts between himself and different department heads.

Of course, none of these presidents solved the managerial puzzle outright; rather, their respective approaches resemble coping strategies for an otherwise unwieldy system. Presidential scholar James Pfiffner summarizes the paradox of presidential leadership thusly: “It is notable that many of the embarrassing blunders that have done the most damage to recent presidencies were not the result of external ‘enemies’ sabotaging the president but resulted from the actions of loyal subordinates in the White House.” A president can only devote so much time to directing those below him. The information they provide is distorted by the processes and incentives of its communication. It is therefore up to the managerial president to decipher the cues of the bureau and sort out his own priorities from the vast and noisy competition for his time, all the while depending upon those around him to see his policies through.

The Department of Education appropriations from Congress grew from \$15.3 billion to nearly \$23 billion under the administration of Secretary William J. Bennett. By 2011, the appropriation for this department had grown to \$43.9 billion.[†]

*The 1984 and 1989 appropriations were based on budget requests from the Reagan Administration with input from Secretary Bennett.

† Source: U.S. Dept. of Education's “Education Department Budget History Table: FY 1980–FY 2012.” — <http://www2.ed.gov/about/overview/budget/history/index.html>



For Greater Understanding

Questions

1. Why is the presidency sometimes described as a managerial problem?
2. Compare and contrast the mandate and mandarin views of administration. Which is closer to Woodrow Wilson's conceptualization of the ideal administrator?
3. What is a budget maximizing bureaucrat, and why might this motive cause trouble for the implementation of a president's policy agenda?

Suggested Readings

Pfiffner, James P., ed. *The Managerial Presidency*. 2nd ed. College Station, TX: Texas A&M University Press, 1999.

Article of Interest

Aberbach, Joel, and Bert A. Rockman. "Mandates or Mandarins? Control and Discretion in the Modern Administrative State." *Public Administration Review*. Vol. 48-2, March-April, 1988.

Website of Interest

The White House *Office of Management and Budget* website provides information for the public about current and past budgets, an organization chart, regulatory and information policy, legislative information, and links to blogs and other government websites. —

<http://www.whitehouse.gov/omb/>

Lecture 11

The Privatization Movement: Falling in Love with Big Business

Professor Paul Weissburg

The Suggested Readings for this lecture are Ronald C. Moe's "Exploring the Limits of Privatization" and Bethany McLean and Peter Elkind's *The Smartest Guys in the Room: The Amazing Rise and Scandalous Fall of Enron*.

Ronald Reagan and the Privatization Movement

In January 1981, during his first inaugural address, newly elected president Ronald Reagan said, "Government is not the solution to our problem. Government is the problem." This quote reflected a growing sense of frustration with the inefficiencies of the U.S. government. Increasingly, economists have argued that the private sector is capable of serving many of the same functions and providing many of the same services as the government, and they can do so more efficiently and for a lower cost. The two fundamental arguments underlying the Privatization Movement are the efficiency argument—that contracting out government functions to the private sector results in cost-efficiency—and the ideological argument that privatization is inherently desirable because the shift from public sector to private sector increases choice and, therefore, individual liberty.

The efficiency argument is that the free market system facilitates competition, which ultimately leads to higher quality, lower costs, more innovation, and greater customer satisfaction. The reason for this is that when companies are forced to compete with each other for customers, their very survival depends on their ability to satisfy customers' demands. They must work to constantly improve their product and to keep their prices as low as possible while still making a reasonable profit. If one company becomes complacent, its customers will abandon it and purchase its competitors' products instead. In pursuing one's own self-interest, then, everyone will produce those goods and offer those services that are most highly valued by society. This incentive structure, it is argued, leads to constant innovation and economic progress.



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These market forces do not work on government agencies for several reasons. One problem is that government employees seldom face competitive pressure to constantly innovate or to focus on customer satisfaction. Oftentimes the government has monopoly status, and this leads to complacency. Further, there is only a minor correlation—if any—between the wages of government employees and the quality of their work. Generally speaking, the incentives in the public sector compel workers to continue doing things as they have always been done. There is no reward structure for innovation. A person will not lose his or her job for sticking with old procedures, but the same may not be true if someone tries something new and it fails.

The Ideology of Privatization

Further, there is an ideological argument that lies behind the Privatization Movement. The Cold War was often framed as a competition between the free market forces of the United States and the central planning of the Soviet Union. The Soviet Union had all but eliminated the private sector; the Communist governments determined what was produced, where it was sold, and at what price. By way of contrast, an American citizen is free to choose how to earn money and how to spend it. The free market system, then, is seen as being fundamentally linked to personal liberty.

This ideology continues to dominate debates about privatization in the United States. Most Americans are fervent in their defense of the free market system and their fear of government interference. Attempts by the government to involve itself in areas traditionally handled by the private sector—such as President Obama's recent attempt at health insurance reform—are decried by opponents as being Socialistic.

Related to this historical conflict between the United States and Communism is the fact that market forces result in more choices than centrally planned economies. In a free market system, each individual is free to choose how to earn money and how to spend it. Visitors to the United States, upon visiting a grocery store, are often shocked at the incredible variety of products from which to choose. The American consumer can choose among dozens and dozens of different brands and flavors of chips, cereal, frozen dinners, and so on. Similarly, there are numerous different car companies and each company provides a wide selection of types of cars. By way of contrast, in the Soviet Union, consumers were unable to choose what kind of car they wanted to purchase. There was generally one type



of car available and often it was only offered in one color. The freedom to choose what to produce and what to consume, then, is considered by many to be a fundamental element of individual liberty.

This ideological component of the debate has resulted in a blurring of the lines between the economic and the political. Scholars as well as politicians often base their opinions of privatization on their self-ascribed political ideology rather than focusing on case-by-case distinctions. Republicans and Libertarians almost always support privatization; Democrats generally oppose it. The result has been an unfortunate tendency for policymakers to overlook crucial distinctions among cases. This tendency to fall back on broad ideologies, rather than a thoughtful analysis of individual cases, has been an ongoing problem, obstructing any real progress in the privatization debate.

The Limits of Privatization

One crucial difference between the public and private sectors is that the public sector must function with a deliberate system of checks and balances that—although it may hinder expediency—alleviates the tendency for power to accumulate and corrupt. Graham T. Allison, in his study of the differences between public and private management, notes:

In business, the functions of general management are centralized in a single individual: the Chief Executive Officer. . . . In contrast, in the U.S. government, the functions of general management are constitutionally spread among competing institutions: the executive, the two houses of Congress, and the courts. The constitutional goal was “not to promote efficiency but to preclude the exercise of arbitrary power,” as Justice Brandeis observed.

This distinction between the two sectors is particularly important to keep in mind when the functions that are being contracted out to the private sector via privatization result in the delegation of decision-making authority.

In an influential article titled *Exploring the Limits of Privatization*, scholar Ronald Moe acknowledges the benefits of privatization, noting that—in addition to the actual efficiency gains resulting from the contracting out of public functions to the private sector—the Privatization Movement has also had the positive effect of forcing government agencies to increase their own efficiency. However, he warns that the private sector is not a panacea to all of society’s woes. Moe suggests a couple of possible criteria to apply when facing the question of whether or not to privatize.

One criterion that Moe identifies is the use of coercive power. The government, as a sovereign power, has the authority to use coercive power when necessary. For example, the government can imprison individuals who violate laws; the private sector does not have this power. The government can force individuals to pay taxes by deducting money directly from their income; the private sector cannot. Moe argues that the authority to use coercive power should not be delegated to the private sector.

A recent example of the privatization of coercive power is the use of Blackwater mercenaries to provide security in Iraq. The decision to contract out diplomatic security services to Blackwater Worldwide has proved highly controversial, particularly after Blackwater employees were accused of shooting and killing twenty unarmed Iraqi civilians on September 16, 2007.



Blackwater Worldwide has gone through several name changes because of adverse publicity associated with its operations as a government contractor in Iraq and Afghanistan. It is now known as Xe Services.

Another example of the delegation of the authority to use coercive power is the use of for-profit prisons. In the past few decades, there has been an increasing tendency for states to outsource their need for prisons to the private sector. These for-profit prisons claim to be more cost-efficient; that claim has yet to be conclusively proven or disproven, but what has been clearly established is that they are extremely profitable for the prison companies but can be quite dangerous for the inmates.

The Corrections Corporation of America (CCA) is the largest for-profit prison company in the world. Private prisons are largely unregulated; one of the many practices employed by CCA but not by public prisons is the housing of violent and nonviolent inmates together. The CCA determines which prisoners are subjected to solitary confinement, what kind of food prisoners eat, how much time they are permitted to spend outside, what kind of medical care they receive, what kinds of safety mechanisms are provided for prisoners living alongside violent felons, and what sorts of rehabilitative services—if any—will be offered. Because CCA is a for-profit corporation, their decisions are based on cost-cutting and not on the well-being of the prisoners or concerns about helping with a smooth integration when prisoners are finally released back into society.



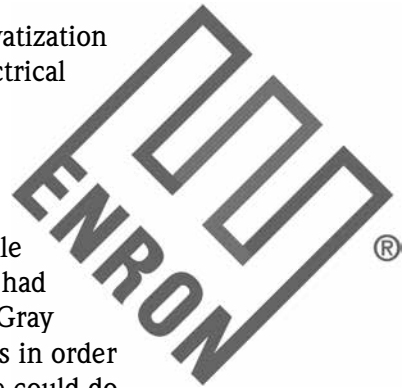
The Corrections Corporation of America manages approximately 75,000 inmates, including males, females, and juveniles at all security levels, in more than sixty facilities under contract for management in nineteen states and the District of Columbia. Pictured above is the sign at the entrance to the CCA-operated Stewart Detention Center in Lumpkin, Georgia. It is listed as a 1,752 bed, male only, medium-security facility with a customer base defined as "Immigration and Customs Enforcement."

To build a prison, one need only purchase land and build a prison. There is no licensing process and there are no specific rules regarding how the prison will be run. Many states suffer from serious overcrowding in public prisons and so are generally eager to send prisoners to for-profit prisons. Advocates of privatization point out that these private companies are providing a necessary service. Others argue, however, that the life-and-death power held by the CCA over its prisoners is not only dangerous, it also violates the democratic principles upon which the United States was founded.

A second criterion that Moe suggests should be applied to cases being considered for privatization is concern for public safety. Moe gives the example of a law that prevents the Department of Defense from contracting with a commercial enterprise to guard chemical weapons. Moe supports this law, arguing that public safety cannot always be entrusted to “the lowest commercial bidder.”

There are other cases in which privatization may prove problematic. One example is natural monopolies. A natural monopoly occurs in those industries that—by their very nature—tend to result in a lack of competition. Electrical grids, railroad systems, and water utilities are all commonly cited as natural monopolies. The problem with monopolies is that the benefits of the free market system are negated because those benefits are the result of competitive forces. If there is a monopoly, there can be no competition. If there is no competition, there is no incentive to keep prices low and quality high. Even if the customer is dissatisfied, there may be no viable alternatives.

One of the most infamous, contemporary examples of privatization occurred when California deregulated and privatized its electrical grid. Within two years of privatization, the majority of the electrical grid was controlled by Enron, which manipulated that power and deliberately created brown-outs across the state; this provided Enron with an excuse to drive up the price of electricity. Before privatization, California’s wholesale electricity costs were \$7 billion; two years later, those costs had risen to more than \$26 billion. Even though then-governor Gray Davis suspected that Enron was artificially creating shortages in order to increase the price of electricity, there was nothing that he could do. Once a private corporation has gained exclusive control over an essential resource—such as electricity or water—options become extremely limited.



Other reasons cited for increased government intervention in the private sector include moral arguments, negative externalities, information failures, and “public good” arguments. Moral arguments refer to normative goals that the citizens of a nation may consider to be more important than economic efficiency. Compassion and equality of opportunity are two examples of values that may be considered valid reasons for government activity. That is why, in the United States, there are welfare programs for the poor and there is a system of free public education through high school.

Negative externalities refer to situations in which a third party is affected by a transaction. The most common example of a negative externality is pollution; one may be negatively impacted by the air pollution produced by a car factory even if one does not purchase a car. In such a situation, it may be necessary for the government to protect the rights of the individual citizen.

An information failure occurs when the consumer lacks sufficient knowledge to pursue his or her own self-interest. For example, if the Food and Drug Administration did not exist to test prescription drugs for side effects, most individual consumers would not know which drugs are safe and which are not.

A public good is something that is nonexcludable and nonrivalrous. This means that the good is either available to all people who want it or else it is available to none of them; it is not possible for it to be available to some people while others are excluded. The classic example of a public good is national security. If a nation is protected by a missile defense system, it is not possible to selectively choose specific citizens to exclude from that protection. Because it is impossible to exclude individuals from receiving a public good, the private sector lacks the means to force consumers to pay for that good. For that reason, the private sector is incapable of providing public goods.



Privatization Today

The fundamental principle that lies behind the Privatization Movement is that outsourcing government functions to the private sector will lead to economic growth as well as increased individual liberty. To date, however, no clear set of criteria has been developed by which to determine which functions are best fulfilled by the public sector and which by the private sector. Conservatives generally argue for the increased efficiency of the free market system while liberals often point out the problems that can occur when crucial services are entrusted to organizations that are primarily concerned with making a profit, rather than serving the public interest. In those cases in which the public interest and the profit motive neatly coincide, the private sector does seem to perform better than the public sector. But, again, there is little agreement on which cases those are.

In his famous essay, “The Study of Administration,” Woodrow Wilson stated the following:

It is the object of administrative study to discover, first, what government can properly and successfully do, and, secondly, how it can do these proper things with the utmost possible efficiency and the least possible cost either of money or energy.

Moe has argued that, while scholars have praised Wilson’s essay, they have not yet taken him up on his challenge.

For Greater Understanding

Questions

1. How is the private sector different from the public sector? What are some of the strengths of the private sector?
2. What is privatization and what are its advantages?
3. What are some of the criteria that Ronald Moe suggests may be important when deciding whether or not to privatize? Can you think of any important ones that he has missed?

Suggested Reading

McLean, Bethany, and Peter Elkind. *The Smartest Guys in the Room: The Amazing Rise and Scandalous Fall of Enron*. New York: Portfolio, 2003.

Moe, Ronald C. "Exploring the Limits of Privatization." *Public Administration Review*. Vol. 47: 453–60, Nov/Dec 1987.

Other Books of Interest

Allison, Graham T. "Public and Private Management: Are They Fundamentally Alike in All Unimportant Respects?" Chapter 10, pp. 282–88. *Public Administration: Concepts and Cases*. 5th ed. Ed. Richard J. Stillman, III. Boston: Houghton Mifflin Company, 1992.

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Kennedy, Sheila S. "When Is Private Public? State Action in the Era of Privatization and Public-Private Partnerships." *George Mason University Civil Rights Law Journal*. Vol. 11, no. 2, Spring 2001.

Mahon, Nancy. "The Problem with Private Prisons." *The Washington Post*. November 1, 1998. P. C08.

Wilson, Woodrow. "The Study of Administration." *Political Science Quarterly*, vol. 2, no. 2, pp. 197–222, June 1887.

Suggested Viewing

Enron: The Smartest Guys in the Room. Directed by Alex Gibney. Magnolia Pictures, 2005.

Websites of Interest

1. An article in the *Guardian* newspaper from February 13, 2009, detailing why Blackwater Worldwide changed its name to Xe Services. — <http://www.guardian.co.uk/world/2009/feb/13/blackwater-changes-name-xe>
2. The *Corrections Corporation of America* website. — <http://www.cca.com/>

Lecture 12

GSEs and Other Strange Hybrids

Professor Paul Weissburg

The Suggested Reading for this lecture is Laurence H. Meyer's *A Term at the Fed: An Insider's View*.

There is a widely held consensus that—under the right circumstances—the free market system results in greater innovation, increased efficiency, lower costs, and more choice for the individual than the same functions as performed by the public sector. The reason is simple: producers operating in the free market must constantly struggle to keep their costs lower and the quality of their product higher than their competitors. Otherwise, they risk losing their customers and going bankrupt.

For almost a century, the United States government has attempted a variety of strategies for harnessing the benefits of the private sector and using them to achieve some of the policy goals of the public sector. These public-private sector hybrids are diverse in terms of governance structure, function, and the balance of power that is maintained between the two sectors, but all such hybrids are attempts at using the strengths of the private sector to serve the goals of the public sector.

Government Sponsored Enterprise: Fannie, Freddie, and Sallie

Government sponsored entities (GSEs) are congressionally chartered, for-profit corporations that receive certain legal privileges and exemptions—such as not having to pay state and local taxes—in return for fulfilling a specific public policy function. Two of the best-known GSEs are Fannie Mae and Freddie Mac, which were created by the U.S.

government to increase home ownership in the United States. Fannie Mae was created as a federal agency in 1938 and then converted into a private corporation in 1968; Freddie Mac was created in 1970 to provide competition for Fannie Mae. Throughout the 1970s and up until 2008, both organizations were private corporations serving public policy goals while simultaneously pursuing a profit.

Fannie and Freddie were designed to facilitate home ownership in the United States by purchasing mortgages from banks and then selling them at a profit. By providing a secondary market for mortgages, Fannie and Freddie made it easier—and more profitable—for regular banks to issue additional housing loans to consumers. This, in turn, increased the number of people who could purchase houses, thereby fulfilling the function of the GSEs.



Fannie and Freddie had several advantages over normal corporations as a result of their status as GSEs. One huge benefit of their quasi-governmental status was that both corporations were exempt from state and local income tax. Another advantage they held was their ability to borrow directly from the U.S. Treasury; as a result, they had access to almost unlimited credit.

Perhaps the greatest advantage that Fannie and Freddie had over their competitors was the universally held perception that the debt held by both corporations was guaranteed by the U.S. government. This meant that the securities that they issued were considered to be as safe as U.S. Treasury Bonds. It was an article of faith that the U.S. government would never permit either Fannie or Freddie to go bankrupt or to default on their debts. Granted, the federal government never explicitly stated that they would guarantee Fannie and Freddie's bonds; in fact, some Congressional representatives outright denied it. Nonetheless, no one doubted that Fannie and Freddie's status as government sponsored enterprises meant that the federal government would never allow them to fail. This belief was tested during the recent financial crisis when, as anticipated, the federal government chose to bail out the two GSEs rather than risk them defaulting on their loans.

A consequence of the perception that the U.S. government guaranteed the debt of Fannie and Freddie was their ability to pay lower-than-market interest rates on the money that they borrowed. The interest rate that is charged for borrowed money is largely a function of perceived risk; the greater the risk of default, the higher the interest rate. If a corporation's debt is covered by the U.S. government, the risk of default is close to zero and so the interest rate charged on such loans is lower than it would be for any normal corporation. This, of course, conferred a huge advantage to Fannie and Freddie over their competitors. Their ability to borrow money at lower rates than anyone else meant they could also lend at lower rates than anyone else while still making a significant profit. As a result, they easily dominated the market. In the summer of 2008, shortly before they were bailed out by the U.S. federal government, Fannie Mae and Freddie Mac controlled approximately 50 percent of the entire U.S. mortgage market.

For many years, Fannie and Freddie were considered by many to be a case of GSEs done right. They were successful in increasing home ownership in the United States; at the same time, they were highly profitable. Politicians who believed that home ownership was good for the country—and for the economy—were able to achieve their policy goal without spending any taxpayer money.

There were others, however, who foresaw the problems developing at Fannie Mae and Freddie Mac. One problem was that the GSEs were given three different objectives that did not always coincide neatly. First, they were created to increase home ownership in the United States. Second, they were supposed to minimize risk to the U.S. government by maintaining a financially safe operation. Third, they had a legal obligation—as do all corporations in the United States—to maximize profit for shareholders. The easiest way to maximize profit, however, was to increase the volume of their business and to focus on

high-risk loans, which offer higher returns than safer loans. There was minimal actual risk to Fannie or Freddie since their debt was all-but-guaranteed by the U.S. federal government.

The two GSEs further increased their investment in high-risk loans as a new financial instrument, collateralized debt obligations (CDOs), started to become more popular in the late-1990s. Fannie and Freddie were able to purchase high-risk loans from banks, bundle those loans into mortgage-backed-securities, and then turn around and sell those securities to investment banks, which put them into the CDOs they sold to investors and to each other. By doing this, Fannie Mae and Freddie Mac were able to make a fortune for their shareholders and for their top management; they also helped to perpetuate the housing bubble and subsequent financial crisis that almost unraveled the global economy in 2008.

Conflicting incentives are a common problem for GSEs. GSEs are created to serve a policy goal, but they are also expected to make a profit. The advantages conferred to GSEs by their quasi-governmental status give them a tremendous advantage over their competitors, which means that GSEs often end up dominating a given market.

In the case of Sallie Mae, which was designed in 1972 to create a secondary market for student loans, the GSE's management chose to privatize when they realized that doing so would further increase their profit. The privatization of Sallie Mae raised the question of how to handle GSEs after the completion of their congressionally chartered policy goals. On the positive side, Sallie Mae helped achieve the goal for which it was created; the market for student loans is far larger today than it was in 1972. This is partially because congressional legislation has passed since that time, but no one disputes that Sallie Mae was successful in increasing access to affordable student loans previous to that legislation's passage. Further, this policy goal was accomplished at no cost to taxpayers. To many, Sallie Mae is therefore considered a GSE success story.



Critics, however, argue that Sallie Mae's current domination of the student loan market borders on being monopolistic and is the result of unfair advantages conferred to Sallie Mae during its time as a GSE. Both the Consumer Bankers Association and the American Banking Association opposed the privatization of Sallie Mae and a 2007 report by the American Enterprise Institute states the following:

Sallie Mae achieved economies of scale as a GSE, especially with respect to servicing, that permit it now, as a company without GSE status, to maintain a cost structure below other competitors.

The government's failure adequately to address the issue of market structure in Sallie Mae's transition to non-GSE status will have consequences for the student loan market for many years . . . In 2006, the company held almost 35 percent of federal guaranteed student loans, compared to the 8 percent share of the next-largest private competitor.

The most important lesson is that GSEs can distort the marketplace and displace activities of the firms—here competing lenders and guaranty agencies—that they originally were created to support.

The Federal Reserve Bank

The Federal Reserve Bank is another example of a public-private sector hybrid, although it is structurally and functionally quite different from the GSEs. The Federal Reserve Bank was created through the Federal Reserve Act of 1913 and was designed by a group of bankers who were working with government officials to create a central banking system. Today, the Fed's duties—according to its own website—are as follows:

- Conducting the nation's monetary policy by influencing the monetary and credit conditions in the economy in pursuit of maximum employment, stable prices, and moderate long-term interest rates.
- Supervising and regulating banking institutions to ensure the safety and soundness of the nation's banking and financial system and to protect the credit rights of consumers.
- Maintaining the stability of the financial system and containing systemic risk that may arise in financial markets.
- Providing financial services to depository institutions, the U.S. government, and foreign official institutions, including playing a major role in operating the nation's payments system.

The Federal Reserve Bank is one of—if not *the*—most powerful institutions in the world. It is not, however, run by the government. It is run by bankers.

On the Federal Reserve's website, its quasi-governmental status is described:

The Federal Reserve System is considered to be an independent central bank because its decisions do not have to be ratified by the President or anyone else in the executive branch of government. The System is, however, subject to oversight by the U.S. Congress. The Federal Reserve must work within the framework of the overall objectives of economic and financial policy established by the government; therefore, the description of the System as “independent within the government” is more accurate.

Ben S. Bernanke was a tenured professor at Princeton University until he was named as a member of the Federal Reserve Board of Governors in 2002. In 2005, he was named chairman of the Council of Economic Advisers in the Bush administration. President Bush appointed him as chairman of the Federal Reserve in 2006. He was reappointed by President Obama in 2010.



Critics of the Fed argue that it is undemocratic to delegate so much power to the banking industry; further, some of the Fed's critics have questioned whether or not those bankers truly have the best interests of the general public at heart.

Supporters of the current structure counter that elected politicians cannot be trusted to control the monetary supply because they would not be able to resist the temptation to increase the supply of money shortly before elections. Doing so lowers the cost of borrowing and often provides a short-term boost to the economy; it is almost always popular, therefore, to increase the supply of money. The problem is that if the money supply is increased too often, the result is inflation and a devaluing of the currency. At a certain point this can lead to hyperinflation and, ultimately, economic ruin. Therefore, supporters of the status quo argue, the Federal Reserve Bank cannot be under the control of the public sector.

A third faction argues that neither the public sector nor the private sector can be trusted with control of the money supply and that the best solution is to shut down the Federal Reserve Bank and let the supply of money be decided by market forces. The danger of doing so, however, is that this would greatly limit the country's options when faced with a financial crisis.

Concluding Thoughts: Do Public-Private Hybrids Work?

It is not difficult to understand the appeal of using the private sector to achieve public policy goals. Market forces—when properly harnessed—may lead to greater innovation, higher quality, and lower costs than when the same tasks are performed by the public sector. The primary goal of the private sector is to make a profit, however, and that objective does not always coincide with the public interest. GSEs and other public-private hybrids can result in the delegation of power to private citizens who are not accountable to the public in the same ways as members of the public sector. Advantages conferred to private organizations that have been tasked with serving public policy goals may be misused in order to increase personal profit.

This does not mean that the attempt to combine the strengths of the two sectors should be abandoned. Despite the problems with GSEs, the Federal Reserve Bank, and other public-private hybrids, there is little consensus on how better to achieve the policy goals that they have been created to fulfill. Rather than dispose of public-private sector hybrids entirely, the solution may lie with greater oversight of these quasi-public institutions. Legislation designed to limit the use of delegated power might also help to mitigate future problems. There is no denying the tremendous potential that exists in public-private hybrids; the challenge now is to learn how best to utilize them.

For Greater Understanding

Questions

1. What are GSEs? To what extent have they been successful in accomplishing the policy goals for which they were created?
2. What does the Federal Reserve Bank do? How does it do it?
3. Why was the Federal Reserve Bank designed to be largely independent of the public sector?

Suggested Reading

Meyer, Laurence H. *A Term at the Fed: An Insider's View*. New York: Harper Paperbacks, 2006.

Articles of Interest

Koppell, Jonathan G.S. "Hybrid Organizations and the Alignment of Interests: The Case of Fannie Mae and Freddie Mac." *Public Administration Review*. Vol. 61, issue 4, pp. 468–482, July/August 2001.

Lea, Michael J. "Privatizing a Government Sponsored Enterprise: Lessons from the Sallie Mae Experience." *Networks Financial Institute Policy Brief*. No. 2006-PB-09, April 2006. Available at the *Social Science Research Network* website. —
<http://ssrn.com/abstract=923461>

Thompson, Helen. "The Political Origins of the Financial Crisis: The Domestic and International Politics of Fannie Mae and Freddie Mac." *The Political Quarterly*. Vol. 80, no. 1, January-March 2009.

Websites of Interest

The websites of the government sponsored enterprises discussed in this lecture provide information on their services and history. —

1. FannieMae — <http://www.fanniemae.com/kb/index?page=home>
2. FreddieMac — <http://www.freddiemac.com/>
3. SallieMae — <https://www.salliemae.com/>
4. The Board of Governors of the Federal Reserve System —
<http://www.federalreserve.gov/>

Lecture 13

Private Governance: Taking the Government Out of Governance

Professor Paul Weissburg

The Suggested Reading for this lecture is Arthur M. Cohen's *The Shaping of American Higher Education: Emergence and Growth of the Contemporary System*.

What Is Private Governance?

In theory, it is the government that makes the laws and determines public policy. The truth, however, is far more complex. Private governance is the study of rulemaking, standard-setting, and policymaking by people and organizations outside of the public sector. Rather, they belong to either the private sector—corporations and businesses—or the nonprofit sector, which includes non-governmental organizations (NGOs) and transnational networks. The fact that there are rules, standards, and public policy decisions being made outside of the government is not widely understood; nonetheless, it is a rapidly growing phenomenon, not only within the United States but also globally.

By way of definition, the term *Private Governance* refers to the development and enforcement of binding policies, rules, and standards by organizations, groups, and networks functioning outside the public sector. Despite the fact that private governance organizations (PGOs) are not sovereign powers (that is, they are not a part of any government), they are widely perceived as having legitimate authority—often based on their expertise—and the effects of their policies, rules, and standards extend beyond their own membership, impacting the general public in a variety of ways.

The following case studies will help illustrate what private governance is, how it works, and why it matters.

Case Study 1: The MPAA

The movie rating system helps determine which films will be seen by which audiences. In the United States, the organization that assigns these ratings is the Motion Picture Association of America (MPAA). The MPAA operates outside of the public sector and is therefore considered to be an example of private governance.

The MPAA was created in 1922 and its primary function was—and still is—to further the business interests of Hollywood's largest movie studios. Today, the MPAA is controlled by Walt Disney Motion Pictures Group, Sony Pictures Entertainment, Paramount Pictures, 20th Century Fox, Universal Studios, and Warner Bros. Other filmmaking studios do not have any representation in the MPAA, yet they are subject to its rating system.

There is no due-process system for filmmakers who feel that their films have been rated unfairly and the process by which those ratings are assigned lacks any transparency. Filmmakers operating outside of the six studios that control the MPAA receive no

explanation of why their films receive the ratings that they do or what they would need to change in order to get a different rating. The names of the people who serve on the MPAA are a secret. The standards that they use are a secret.

There have been accusations that the MPAA provides more market-friendly ratings—that is, ratings that will allow a larger audience to go see a movie—to films produced by the six studios that control the MPAA, and that they are far more stringent when rating films produced independently. There is also evidence that the ratings are based as much on personal bias as on any objective standard. For example, it had been noted that sexual acts performed by same-sex partners are rated far more stringently than the exact same sexual acts when performed by heterosexual partners. The MPAA has neither confirmed nor denied these accusations and—as a private organization—they are under no obligation to do so.

The MPAA is a relatively minor case of private governance. It is true that their rating system helps determine which movies will find an audience and which do not and, therefore, helps to determine which movies will receive funding to get made in the first place. However, their rating system is not legally binding. It is—at least in theory—strictly voluntary. No filmmaker is required to subject a film to the MPAA and movie theaters are not legally required to enforce the standards of the MPAA. The MPAA's power is drawn entirely from the acquiescence of the free market system and, if enough people felt strongly about the issue, its rulings could be completely ignored.

Case Study 2: The Credit Rating Agencies

One of the many causes of the recent financial crisis was the inaccurate ratings placed on complex financial instruments by the three largest credit-rating agencies in the world: Moody's Investors Service, Standard & Poor's Corporation, and Fitch Ratings. Credit-rating agencies assess the credit worthiness of borrowers; investors use these ratings to determine the risk involved in purchasing different types of bonds. The first credit rating agencies, Moody's and Standard & Poor's, arose in the 1920s to assess the credit worthiness of bonds that were issued by corporations that were seeking to raise money through the sale of bonds. Over time, credit rating



MOTION PICTURE ASSOCIATION OF AMERICA

The MPAA has five main ratings that are assigned to films.

G for General. There is nothing that would offend parents for viewing by their children.

PG for Parental Guidance. Parents are urged to give “parental guidance.” The film may contain some material parents might not like for their young children.

PG-13 for Parental Guidance, 13+. Parents are urged to be cautious as material in the film may be inappropriate for pre-teenagers.

R for Restricted. The film contains some adult material. Parents are urged to learn more about the film before taking their young children with them.

NC-17 for No Children Under 17 Admitted. The film is patently adult. Children are not admitted.

Other Ratings

NR for Not Rated. A film is either not classified by the MPAA, or has not been rated.

UNRATED. An uncut release of a film, usually a film that had parts cut to obtain an MPAA rating below R or NC-17. Not an *official* rating.

agencies branched out into other related fields, such as rating the ability of governments to meet their debt obligations.

The ratings of these agencies can have a major impact on the ability of foreign governments to raise money. If a country's rating is downgraded, lenders will charge a higher interest rate. This gives the credit rating agencies a substantial amount of power. At first glance, however, this power appears to be based solely on the strength of the agencies' reputations. After all, lenders can choose to ignore the ratings of the big three credit rating agencies, if they wish.

However, that is not entirely true. In response to the financial instability of the Great Depression, then-Comptroller of the Currency James Francis Thaddeus O'Connor decided that Federal Reserve member banks could not hold high-risk bonds—that is, bonds that were below investment grade—in excess. Holding limits were set to compensate for the additional risk associated with such bonds. To determine which bonds were below investment grade and which were not, O'Connor instructed the banks to use the established rating agencies of that time: Moody's, Fitch, and the two predecessors of Standard & Poor's. It was a sensible policy and it successfully limited the risk of future financial instability, but it had the unintended consequence of delegating tremendous power to the credit rating agencies. If a financial institution wanted to be able to sell its bonds to a bank, it would need to use one of the credit-rating agencies identified by O'Connor. Since that time, a variety of other institutions have followed O'Connor's lead. Today, the ratings of Moody's, Standard & Poor's, and Fitch are used by state insurance regulators, federal pension regulators, and the Securities Exchange Commission (SEC).

One of the causes of the 2010 financial crisis was the inaccuracy of the ratings assigned by the big three credit-rating agencies to collateralized debt obligations (CDOs), which consisted primarily of high-risk mortgages. There has been much debate regarding the cause of these inaccuracies. Some argue that the credit rating agencies had no way of knowing the true value of the CDOs while others place the blame on a conflict of interest; credit-rating agencies are paid by the sellers of CDOs and bonds, not by investors. Regardless of the actual cause, there is no question that the mistakes of Moody's, Standard & Poor's, and Fitch Ratings—all of whose ratings federal pension regulators, the SEC, and others are legally required to

CREDIT RATINGS SCORES		
High ↑ ↓ Low	AAA	Most likely that debt obligations will be honored.
	AA (+-)	High likelihood that debt obligations will be honored.
	A (+-)	Reasonable likelihood that debt obligations will be honored.
	BBB (+-)	There is a likelihood that debt obligations will be honored, but compared to the higher rating (A), there is the possibility of a diminished likelihood of debt repayment.
	BB (+-)	Repayment does not pose a problem at present, but may become problematic in the future.
	B (+-)	Probability of repayment is weak, with cause for concern.
	CCC	Repayment is uncertain and there is the danger of debt obligations as a real possibility.
	CC	High likelihood of default on debt obligations.
	C	Extremely high probability of default on debt obligations.
	D	Defaulting on debt obligations.

Note: Credit ratings range from AAA to D, and are further subdivided into a total of twenty ratings by the use of plus (+) and minus (-) signs for ratings AA to B.

use—were a major cause of the ensuing financial crisis. The blame for those mistakes lies with the credit-rating agencies themselves, but the fact that those mistakes had such devastating consequences for U.S. finance is a direct consequence of the decision by the U.S. government to legally delegate that decision-making authority to the private sector.

Case Study 3: The Accreditation of Higher Education

Originally, the federal government did not involve itself in higher education at all. The United States Constitution does not mention education and so decisions regarding elementary school, high school, and college were left to the individual states. State governments, in turn, generally adopted a hands-off policy toward higher education. Early colleges were founded by religious organizations and the separation of state and church was therefore extended to higher education.

Over time, several colleges found it beneficial to meet and coordinate their admissions policies. Together, they worked to form general standards regarding the purpose and structure of higher education and how it differed from high school. Later, this self-regulation became more formalized as colleges began to form accreditation organizations. The primary function of the accreditation system was to protect the reputation of the profession. If a college was accredited, it provided evidence to the consumer that it was a legitimate place of education and not a fraudulent, fly-by-night program.

The federal government did not begin to directly involve itself in the regulation of higher education until the passage of the G.I. Bill of Rights, in June 22, 1944. The original purpose of the act was not to initiate a new, more federally active policy toward higher education, but rather to prevent massive unemployment following the return of millions of veterans at the end of World War II. The result, however, was a massive surge in the number of students attending colleges and universities.

The G.I. Bill stated that the veterans were free to choose any “approved educational or training institution,” but the details regarding how schools would be approved were left to the state governments. The act further stated the following:

From time to time the Administrator [of veterans’ affairs] shall secure from the appropriate agency of each state a list of the educational and training institutions . . . within such jurisdiction, which are qualified and equipped to furnish education or training . . . , which institutions, together with such additional ones as may be recognized and approved by the Administrator, shall be deemed qualified and approved to furnish education or training to such persons as shall enroll under this part [of the Act].



This was only the first step in a very gradual transformation of the relationship between institutions of higher education and the federal government. As the government has increased the funding it provides to colleges and universities, it has demanded greater accountability. Thus far, the federal government has relied heavily upon the accreditation system developed by colleges and universities to maintain this accountability. As in the case of the credit-rating agencies, however, this has resulted—somewhat unintentionally—in the delegation of power to accreditation organizations. Accreditors determine which schools are eligible for government funding and which are not. For institutions that have traditionally felt excluded from the accreditation system, such as vocational colleges, this has led to accusations that the current system provides an unfair advantage for some schools over others.

The reasons for private governance in the case of higher education are compelling. The federal government has no constitutional authority over the education profession. Further, there are concerns that government should not be permitted to dictate curriculum or to develop hiring and firing policies for colleges; it has been argued that the ensuing political pressures on schools would result in censorship. Further, it has been argued that higher education, much like medicine, is a profession best left to the experts.

That said, the current arrangement is not without its problems. In addition to accusations that the accreditation system benefits some schools over others, there is also a concern that the societal importance of higher education, as well as the substantial amount of money invested by the federal government into higher education, justify—and possibly necessitate—greater accountability. As often happens in cases of self-regulation, critics of the accreditation system argue that its standards are too flexible and too lenient. Some argue that self-regulatory systems are inherently flawed.

Reasons for—and Dangers of—Private Governance

Given the potential dangers of private governance, one might ask why the government continues to delegate standard-setting and rulemaking powers to the private sector. There are several reasons, however, why the use of private governance is increasing both nationally and globally.

First, there is the issue of expertise. Congress often delegates lawmaking power to government agencies so that complex policy decisions can be made by people who are knowledgeable about the subject. Although the credit-rating agencies failed to accurately assess the risk involved in purchasing certain financial instruments, one might reasonably ask if government officials would have done better. Similarly, the need for expertise helps explain why decisions about the standards of medical practice are left to the American Medical Association, universities are evaluated by their peers rather than by a government agency, and why accounting standards have generally been set by the private sector. The delegation of power in all three cases may raise questions of accountability, but the potential dangers of private governance do not always outweigh its usefulness.

Related to this is the fact that there are certain decisions that the general public would not want to leave in the government's hands. The standards used by the MPAA to rate movies are questionable, but leaving those decisions to Congress or to a government agency could lead to far more serious problems. Questions of political bias would be inevitable if the federal government put itself in charge of movie ratings and there would be constant accusations of censorship.

Additionally, private governance may be the only option in certain cases. There is no international, sovereign government to set global standards. This void, often referred to as the global governance gap, has resulted in problems to which private governance is currently the only existing solution.

Private governance can be highly problematic, however. Private organizations are not subject to the same requirements as the public sector regarding transparency and due process. As seen in the MPAA case study, this can result in rules being set in complete secrecy and with no viable system for appeals. From an ideological perspective, this is the very opposite of a democratic system. Also, private governance can be used by industries as a method of preempting government regulation. It has been suggested that the international labor safety standards set—but neither monitored nor enforced—by PricewaterhouseCoopers may be an example of this, as well as the Chemical Manufacturer Association's Responsible Care program. Finally, firms within an industry may use standard-setting power to discriminate against competitors and to raise barriers to entry, thereby preventing new competitors from entering the field. For example, the American Medical Association has been accused of using their standard-setting power to discriminate against midwives, thereby preventing midwives from competing with physicians.

Best practices to help mitigate the problems inherent in the use of private governance include the use of third-party oversight accompanied with enforcement power, transparency and due process requirements, and the maintenance of viable alternatives to the existing private governance system so that sanctions can realistically be applied if power is abused. Perhaps the greatest guard against such abuses, however, is an educated public. If U.S. and global citizens are educated about the existence—and potential danger—of private governance, it will greatly increase accountability. Private governance organizations cannot legally require governments to accept their rules and standards. Most governments, in most cases, have the option of reclaiming that power from PGOs.

Private governance serves a necessary function in many cases, but if it is going to prove beneficial to society, rules of proper conduct must be developed and enforced, just as the Administrative Procedure Act helped to define and limit the power of administrative policymakers in 1946. At the moment, there are no guidelines to facilitate the proper use of private governance. Private governance is a reality of the contemporary world and its use is steadily increasing; the time has come for a comprehensive discussion of how best to utilize PGOs while also preventing them from abusing their power.

For Greater Understanding

Questions

1. What is private governance?
2. How does private governance challenge our desire for accountability and democracy?
3. Why do governments sometimes choose to defer to the private sector when it comes to standard-setting and regulation?

Suggested Reading

Cohen, Arthur M. *The Shaping of American Higher Education: Emergence and Growth of the Contemporary System*. San Francisco: Jossey-Bass Publishers, 1998.

Other Books of Interest

Cutler, A. Claire, Virginia Haufler, and Tony Porter, eds. *Private Authority and International Affairs*. Albany, NY: State University of New York Press, 1999.

Young, Kenneth E., Charles M. Chambers, H.R. Kells, and Associates, eds. *Understanding Accreditation*. London: Jossey-Bass Publishers, 1983.

Podcast of Interest

This American Life: The Watchmen episode explains the role played by the credit rating agencies and how the government inadvertently delegated power to them. —

<http://www.thisamericanlife.org/radio-archives/episode/382/The-Watchmen>

Articles of Interest

Eaton, Judith. The president of the Council for Higher Education Accreditation provides an overview of accreditation in the United States. —

<http://www.chea.org/Research/index.asp#InsideAccred>

Finkin, Matthew W. "The Unfolding Tendency in the Federal Relationship to Private Accreditation in Higher Education." *Law and Contemporary Problems*. Vol. 57, no. 4 (Autumn 1994): 89–120.

Suggested Viewing

This Film Is Not Yet Rated. Directed by Kirby Dick. DVD. Magnolia Home Entertainment, 2009.

Websites of Interest

1. The *Credit Ratings 101* website provides information on the three major credit rating agencies and information on the meaning of credit ratings. —

<http://www.creditratings101.com/credit-rating-agencies/>

2. The *Council for Higher Education Accreditation* website features information on the work of the council. — <http://www.chea.org/>

Lecture 14

Putting It All Together: The Financial Crisis Case Study

Professor Phillip Magness and Professor Paul Weissburg

The Suggested Reading for this lecture is Thomas Sowell's *The Housing Boom and Bust*.

The financial crisis of 2008 has been used by neoliberals to demonstrate the failings of government and by progressives to show that the private sector cannot be trusted to self-regulate. In other words, there are two completely contradictory conclusions that are being reached from a single case study. The lessons of the financial crisis seem to depend on which elements of the story one chooses to emphasize. Both sides make legitimate points.

This lecture uses the financial crisis to pull together several different concepts. Private governance, public-private hybrids, rent seeking, regulatory capture, private interest theory, dysfunctions of bureaucracies, scientific administration, and the limitations of both the public and the private sectors are all important to understanding what happened and why.

First, the neoliberal argument is presented. This position states that the financial crisis arose because of flaws inherent to the U.S. political system and that the primary culprit is the government. Next, the progressive argument is discussed. This version of the story demonstrates that the financial crisis occurred as a result of deregulation and that the primary culprit is the private sector. Both versions of the story rely upon the same set of facts, although each emphasizes different aspects and suggests different causal connections.

It is left to the listener to determine which story most accurately identifies the underlying causes of the financial crisis.



The Neoliberal Argument

The financial crisis of 2008 is not easily attributable to any single cause, or even a well-defined group of causes. It came about as a result of multiple complex economic and political factors, some of them dating back years or even decades, as well as a bit of bad timing and bad luck. That noted, a reasonably strong case may be made that the crisis and resultant economic downturn were the natural extension of poor policy decisions by regulatory agencies and bureaus within the government. In more than one instance, public administrators made decisions according to their political incentives rather than the nation's general welfare. Viewed in this light, the financial crisis is a prime example of how public sector administration can succumb to factional pressures, rent seeking, and regulatory capture—all signs of the interest group, rather than “public interest,” theory of government.

The Federal Reserve may be a prime example of this tendency. Though it frequently straddles a unique space between the public and private sectors, the Federal Reserve is a quintessential example of government by “scientific administration,” supposedly conducted separate and apart from the pressures of politics. The Federal Reserve is staffed and administered by highly skilled academic economists. It is ostensibly “independent” of the government's political mechanisms, even passing itself off as a private entity at times even though it was chartered by law, receives its appointments from the president, and exercises statutory authority over federal monetary policy. Yet experience illustrates how the Federal Reserve is closely connected to the political sphere, even becoming collusive at times when political pressure exists for a specific policy or economic result.

Pressure of this type did exist prior to and during the onset of the financial crisis. Since the health of the economy walks hand in hand with electoral politics, the political functionaries of the government in Congress and the White House typically prefer policies that ensure short-term growth, even if they entail future expenses. And like any rationally acting agency, the Federal Reserve met these preferences with almost two decades of easy credit in the 1990s and early 2000s. This occurred in the form of low interest rates, shaped by the Fed's internal lending rate for commercial banks and a “loose” monetary policy that effectively lowered the cost of borrowing money in both the public and private sectors.

Recall the competing theories of bureau and congressional dominance, as either could apply to the Federal Reserve's behavior while yielding a similar result. If congressional dominance theory holds true and the Fed is primarily responsive to Congress, then its policies were a reaction to cues from the political sector indicating its preference for short-term growth and easy credit. If bureau dominance applies, then the Fed's policies of the 1990s and early 2000s were a means of signaling the political sector of its administrative capabilities as a relatively autonomous entity. Either scenario is problematic, though, as loose short-term credit usually spells long-term economic problems.

Stated simply, a sustained and ongoing policy of loose credit and low interest rates often yields the illusion of a healthy economy, but it also has undesirable long-term consequences. Most notably it incentivizes risky borrowing and risky lending. Why?

If credit is easy to obtain, so is money. And if money is easy to obtain, the cost of misallocating it on wasteful or risky uses is lessened. There is no steep interest penalty for wasteful spending if more credit is always easily obtainable, and profligate spending is incentivized by government policies in the name of economic growth. On an analogous note, the misuse of public sector resources carries little consequence if public debt is plentiful and easily obtained. The first causes private sector individuals to undertake risky investments, and the second causes government officials to make wasteful expenditures, or incentivize them, with little to no immediate political consequence.

Each of these factors came to a head in 2008 with the bursting of an economic bubble in the housing market. Again, no single factor spurred the rapid growth of housing over the 1990s and early 2000s, but government policies certainly played a harmful role. On a broad level, the Federal Reserve's preference for loose credit, spurred by political demands for short-term economic growth, filtered through the entire economy and into private-sector consumer habits. Housing in particular was the subject of additional government policies adopted between the 1970s and 1990s.

This housing policy sought to increase the availability of lending for home purchase to low-income individuals, but it also had the unintended effect of encouraging banks to take on high-risk and marginal, or "subprime," mortgages to satisfy these political pressures and incentives. In a similar fashion, two ostensibly private yet federally chartered mortgage security companies, Fannie Mae and Freddie Mac, aggregated an unsustainable volume of these subprime mortgages, possibly encouraged by the moral hazard created through their government backing. Lenders, both private and public, certainly respond to the profit motive. But they are also more willing to take on high-risk investments if they believe (1) the credit environment is loose and widely available, as was the case with the Federal Reserve's policies, and (2) the government will bail them out in the event of failure.



While some political figures blamed the housing and larger financial crises on a deregulatory environment, the policy response to both has been almost uniformly to increase the government's managerial role in the economy. This practice too is not without peril, as it risks expanding and exacerbating many of the very same misaligned incentives and public-private collusions that produced the crisis in the first place. To use an analogy, the financial crisis resembled a period of binge drinking for the economy, with public-private collusion serving as the primary intoxicant. The use of additional regulatory collusion, multi-billion-dollar bailouts, pork-laden "stimulus" spending, and a continuation of a loose monetary policy by the Federal Reserve are all akin to "curing" the hangover by returning to the same bottle that caused it.

The Progressive Argument

The financial crisis has many causes and there is plenty of blame to go around. It is disingenuous of the neoliberals, however, to claim that the leading cause of the crisis was too much government intervention when, in fact, the crisis was preceded by thirty years of massive deregulation. Indeed, the recent financial crisis—much like the Great Depression and the Savings and Loan crisis of the 1980s and 1990s—illustrates the inevitable consequences of a largely unregulated, free market system.

Among the protections that were stripped away prior to the crisis was the Glass-Steagall Act. Originally passed in 1933, Glass-Steagall was created as a response to the conflicts of interest within the banking industry that led to the Great Depression. Among other things, Glass-Steagall drew a line between deposit banks and investment banks. Deposit banks provide low interest on personal deposits but are supposed to be highly secure. Glass-Steagall helped to establish the Federal Deposit Insurance Corporation (FDIC), which insures deposit banks. By providing insurance for deposit banks, the FDIC ensures that, in the event of a financial crisis, citizens who have placed their trust in the banking system will not lose their life savings. In return for this insurance, those deposit banks that chose to become members of the Federal Reserve Banking System agreed to limit their exposure to high-risk investments.

On the other side of the line are the investment banks. Investment banks are different from deposit banks in that they offer a potentially much higher return but also deal with a much higher risk ratio. Deposit banks are where you place your life savings; their main function is to provide a safe place to store your money. Investment banks are where you gamble with your excess wealth; you may make a large profit, but there is also a possibility that you may lose it all. The FDIC was created to insure deposit banks but not investment banks.

Beginning in the 1980s, Citicorp, J.P. Morgan, and other banks lobbied Congress to loosen the restrictions placed on them by Glass-Steagall. They argued that there was no longer any danger of the banking system encountering the sorts of difficulties it experienced during the Great Depression because today's investors were far more knowledgeable than they had been in the 1920s. Additionally, the banking industry argued that the SEC and the credit rating agencies provided sufficient "outside checks" on the banking system. Glass-Steagall, in other words, was no longer necessary.

Glass-Steagall was further weakened by Alan Greenspan, who was appointed as chairman of the Federal Reserve Board by then-president Reagan in 1987. Greenspan was a former director of J.P. Morgan and subscribed to a strict neoliberal



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ideology. Indeed, he has been quoted as having stated that the government should not even regulate fraud in the private sector. It was his belief that the free market system, if left to its own devices, would make whatever adjustments were necessary to ensure economic prosperity.

Through the combined efforts of the financial industry, which spent more than \$300 million on lobbying efforts, and Chairman Alan Greenspan, Glass-Steagall was finally repealed in 1999. From this point onward, the line separating deposit banks from investment banks was almost nonexistent. As a result, when investment banks started going bankrupt in 2008, the crisis immediately spread to deposit banks as well. This meant that it was not only investors who stood to lose everything; people who had placed their money in allegedly secure deposit banks were also in danger of losing their life savings. It was for this reason that the federal government finally felt compelled to step in and bail out investment banks that, in theory, were not insured by the government. The contagion effect resulting from the dismantling of Glass-Steagall left the government in a position of either bailing out private investment banks or else watching as the entire United States banking system collapsed.

Glass-Steagall is one example of government regulation that has helped the private sector to function better. For several decades, Glass-Steagall succeeded in creating a secure banking system and preventing a financial collapse from occurring. A mixture of neoliberal ideology and greed led to its demise. A few years after it was repealed, the banking system collapsed, resulting in the current financial crisis.

Glass-Steagall is not the only example of how the deregulation movement has helped to create, and then greatly exacerbate, the current financial crisis. Congress was heavily lobbied, and eventually persuaded, to pass the Commodity Futures Modernization Act of 2000, which left derivative transactions—among them credit default swaps—completely unregulated. Credit default swaps are complex financial instruments that, again, were instrumental in the near-collapse of the financial system after the housing bubble popped. The passage of the Commodity Futures Modernization Act was largely the doing of Senator Phil Gramm, once described as the “high priest of deregulation” and currently the vice chairman of the Investment Bank division of a global financial services company. Phil Gramm, like Federal Reserve Chairman Alan Greenspan, is an ardent—and unapologetic—neoliberal. When confronted with his role in helping to create the current financial crisis, Gramm denied that the crisis existed, stating, “You’ve heard of mental depression; this is a mental recession. We have sort of become a nation of whiners, you just hear this constant whining.”

Neoliberals have responded to progressives by arguing that the fact that government allowed itself to be bullied and bribed into excessive deregulation—thereby failing to prevent the financial crisis—further demonstrates that the government is inefficient and cannot be trusted to act in the public’s interest. Therefore, they conclude, its regulatory powers should be even further diminished. This sort of circular argument is not uncommon to neoliberal critiques of government institutions. An analogous situation would be

criticizing an underfunded police force for its lack of effectiveness, arguing that its ineffectiveness demonstrates that money spent on police protection is largely wasted and so should be further cut. After further cuts in the police force result—inevitably—in still fewer arrests and an even higher crime rate, these same critics point to the increasing rate of failure as proof that still more cuts should be made.

Progressives argue that the way to avoid future financial crises is to reinstate the Glass-Steagall Act and to enact sensible regulations on the sales of derivatives. The free market system will not regulate itself. Despite what investment banks and their lobbyists may claim, the financial sector has clearly not evolved beyond the need for regulation.

There is no question that the government has made errors and bears some responsibility for the current financial crisis. The primary failure of the government, however, has been to allow itself to be swept up in the neoliberal ideology that began in the 1980s and continues to this day. The government has a responsibility to pass the necessary legislation to ensure a smoothly running free market economy. The United States government is responsible for placing the public interest before the profit motive; that is something that the private sector cannot be expected to do. The citizenry, in turn, has a responsibility to not reelect politicians who have placed the needs of corporate lobbyists before those of the nation.

Conclusion

The reality of the current financial crisis is far too complex to reduce to a single, ideological argument about the proper role of the government. Neither the public sector nor the private sector is free of blame. The financial crisis provides a useful case study precisely because it demonstrates many of the strengths and weaknesses of government sponsored enterprises (Fannie Mae and Freddie Mac), private governance (the credit rating agencies), public-private sector hybrids (the Federal Reserve Bank), Congress, and the precarious balance of power between the public and private sectors. Depending on the lens through which it is viewed, the financial crisis can be seen as a vindication of neoliberalism, progressivism, or any number of other political-economic ideologies.

It is easy to look at the American political system in the twenty-first century and to conclude that the “rules of the game” need changing. The challenge is to not succumb to cynicism but rather to become engaged in the political process. The rules of the game are deeply flawed, but the game has been designed so that those rules can be changed by the players. It is not sufficient to complain that government is broken or that politicians are all corrupt; we have a cumulative responsibility to study our current political system, determine which aspects of that system need changing, and then become politically active in order to ensure that the necessary changes are made.



For Greater Understanding

Questions

1. What was the Glass-Steagall Act and how was it relevant to the financial crisis?
2. What was the Community Reinvestment Act and how was it relevant to the financial crisis?
3. What are the main differences between the neoliberal and the progressive explanations of what caused the financial crisis?

Suggested Reading

Sowell, Thomas. *The Housing Boom and Bust*. New York: Basic Books, 2009.

Other Books of Interest

Cohan, William D. *House of Cards: A Tale of Hubris and Wretched Excess on Wall Street*. New York: Anchor, 2010.

Podcasts of Interest

1. *This American Life: The Giant Pool of Money* episode about the housing crisis. — <http://www.thisamericanlife.org/radio-archives/episode/355/the-giant-pool-of-money>
2. *This American Life: Bad Bank* explains the collapse of the banking system. — <http://www.thisamericanlife.org/radio-archives/episode/375/bad-bank>
3. *This American Life: Inside Job* episode is an investigative report that tells the inside story of one company that made hundreds of millions of dollars for itself while worsening the financial crisis for the rest of us. — <http://www.thisamericanlife.org/radio-archives/episode/405/inside-job>

Suggested Viewing

Inside Job. Directed by Charles Ferguson. DVD. Sony Pictures Classics, 2011.

Frontline: Inside the Meltdown. Directed by Michael Kirk. DVD. PBS. 2009.

Frontline: The Warning. Directed by Michael Kirk. DVD. PBS. 2010.

Websites of Interest

1. The PBS website provides a history of the Glass-Steagall Act entitled “Long Demise of Glass-Steagall.” — <http://www.pbs.org/wgbh/pages/frontline/shows/wallstreet/weill/demise.html>
2. American Public Media’s *Marketplace Whiteboard* website provides a series of short, online videos that explain complex aspects of the 2008 financial crisis (and finance in general). — <http://marketplace.publicradio.org/whiteboard/>

COURSE MATERIALS

Suggested Readings

- Ackerman, Kenneth D. *Boss Tweed: The Rise and Fall of the Corrupt Pol Who Conceived the Soul of Modern New York*. New York: Carroll & Graf Publishers, 2005.
- . *Dark Horse: The Surprise Election and Political Murder of President James A. Garfield*. New York: Carroll & Graf Publishers, 2004.
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- Hayes, H.G., and C.J. Hayes. *A Complete History of the Life and Trial of Charles Julius Guiteau, Assassin of President Garfield*. Aurora, CO: BiblioLife/Bibliographical Center for Research, 2010 (1882).
- Madison, James. “Federalist #51.” *The Federalist Papers*. Alexander Hamilton, John Jay, and James Madison. The Classic Original Edition. Lindenhurst, NY: Tribeca Books, (2010) 1788.
- McLean, Bethany, and Peter Elkind. *The Smartest Guys in the Room: The Amazing Rise and Scandalous Fall of Enron*. New York: Portfolio, 2003.
- Meyer, Laurence H. *A Term at the Fed: An Insider’s View*. New York: Harper Paperbacks, 2006.
- Moe, Ronald C. “Exploring the Limits of Privatization.” *Public Administration Review*. Vol. 47: 453–60, Nov/Dec, 1987.
- Mueller, Dennis C. *Public Choice III*. 3rd ed. Cambridge: Cambridge University Press, 2003.
- Olson, Mancur. *The Logic of Collective Action: Public Goods and the Theory of Groups*. Rev. ed. Cambridge, MA: Harvard University Press, 1971 (1965).
- Pfiffner, James P., ed. *The Managerial Presidency*. 2nd ed. College Station, TX: Texas A&M University Press, 1999.

- Plunkitt, George W. *Plunkitt of Tammany Hall: A Series of Very Plain Talks on Very Practical Politics*. 100th anniv. ed. Ed. William L. Riordan. New York: Signet Classics, 1995.
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- Sowell, Thomas. *The Housing Boom and Bust*. New York: Basic Books, 2009.
- Taylor, Frederick Winslow. *The Principles of Scientific Management: The Fundamentals*. Reprint. Seattle, WA: CreateSpace, 2011 (1913).
- Wilson, James O. *Bureaucracy: What Government Agencies Do and Why They Do It*. New York: Basic Books, Inc., 1989.

Other Books of Interest

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- Cohan, William D. *House of Cards: A Tale of Hubris and Wretched Excess on Wall Street*. New York: Anchor, 2010.
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