What Is Government Failure?

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The phrase “government failure” as a term of art originated in the critique of government regulation that emerged in the 1960s. This critique premised that “market failures” were the only legitimate rationale for regulation. Although the phrase is a popular currency in scholarship and politics, people attribute to it different values. As a result, all seem to expect the government to fail, many believe that government inaction cannot constitute a failure, and alleged failures tend to be disputed. This essay seeks to establish a coherent meaning for the term “government failure” and its relatives (e.g., “government breakdown,” “regulatory failure”).

I. Introduction

In Capitalism and Freedom, Milton Friedman explained why “the scope of the government must be limited.”1 “The existence of a free market,” Friedman wrote, “does not . . . eliminate the need for government. On the contrary, government is essential both as a forum for determining the ‘rules of the game’ and as an umpire to interpret and enforce the rules decided on. What the market does is . . . minimize the extent to which the government need participate directly in the game.”2 Friedman firmly believed that it was not “an accident that so many . . . government reforms [go] awry.”3 The “central defect” of

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1 MILTON FRIEDMAN, CAPITALISM AND FREEDOM 2 (1962).

2 Id. at 15.

3 Id. at 196.
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regulatory measures, he argued, is that “they seek through government to force people to act against their own immediate interests in order to promote a supposedly general interest.” Under this thesis, the government is likely to fail whenever it interferes with the freedom of choice. Thus, since “pretty much all law consists in forbidding [people] to do some things that they want to do,” the failure is inevitable.

The concept of “government failure” is somewhat peculiar. People and institutions may fail in their actions, but they may also fail by not taking action. The phrase “government failure,” however, as it is commonly used, connotes ineffective government action, implying that less government action is necessarily better. In Milton Friedman’s words: “[T]he government solution to a problem is usually as bad as the problem and very often makes the problem worse.”

The phrase “government failure” emerged as a term art is in the 1960s with the rise of intellectual and political criticism of regul-

4 Id.
6 See also MILTON FRIEDMAN & ROSE FRIEDMAN, FREE TO CHOOSE: A PERSONAL STATEMENT 5-6 (1980).

In the government sphere, as in the market, there seems to be an invisible hand, but it operates precisely the opposite direction from Adam Smith’s: an individual who intends to serve the public interest by fostering government intervention is ‘led by an invisible hand to promote’ private interests, ‘which was no part of his intention.’

7 See, e.g., CLIFFORD WINSTON, GOVERNMENT FAILURE VERSUS MARKET FAILURE 2–3 (2006) (“Government failure . . . arises when government has created inefficiencies because it should not have intervened [in the market] in the first place, or when it could have solved a given problem or set of problems more efficiently, that is, by generating greater net benefits.”)


9 MILTON FRIEDMAN, AN ECONOMIST’S PROTEST 6 (1975). See also MILTON FRIEDMAN, WHY GOVERNMENT IS THE PROBLEM (1993).
Building on the premise that the only legitimate rationale for government regulation is market failure, economists advanced new theories explaining why government interventions in markets are costly and tend to fail. This line of literature supposedly established the theoretical foundations of the phrase “government failure.”

Despite their growing popularity, the phrase “government failure” and its relatives (e.g., “government breakdown,” “regulatory failure”) do not have any clear meaning. Some use these phrases to describe government intervention in the private domain that results in undesirable outcomes. For others, these phrases may also mean lack of or inadequate government regulation. Yet, many identify a government failure in any perceived societal problem. Thus, people who use the phrase “government failure” often disagree with each other about what a failure means. Neither the prevalence of studies of government failures nor the use of the phrase “government failure” necessarily says much about the standards of “failure.”

This essay intends to clarify the general meaning of the term “government failure” by focusing on a few properties of failures.

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11 See Francis M. Bator, *The Anatomy of Market Failure*, 72 Q. J. ECON. 351 (1958). Executive Order 12,866 states that “material failures of private markets to protect or improve the health and safety of the public, the environment, or the well-being of the American people” may establish a “compelling public need” for regulation. Exec. Order No. 12,866 § 1.

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II. Inaction as a Failure

_Can government inaction ever be a failure?_ A byproduct of the controversy over regulation is an artificial distinction between action and inaction. On one side of the controversy, people see over-regulation. On the opposite side, people observe insufficient regulatory safeguards—too little regulatory action or frequent inaction. These opposite perspectives delineate the approaches to government inaction. Some posit that inaction cannot be scrutinized, let alone considered a failure, while others maintain that similar rules should apply to action and inaction.

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13 For the methodology and its limitations, see Jean-Baptiste Michel et al., _Quantitative Analysis of Culture Using Millions of Digitized Books_, 331 SCI. 176 (2011).

14 The analysis of the distinction is of course rather old. For example, Thomas Aquinas distinguished between sins of commission and sins of omission, arguing that the latter are “less grievous” than sins of commission, but stressed that inaction may constitute a sin. _THOMAS AQUINAS_, 1 _THE SUMMA THEOLOGICA_ 316-20 (Fathers of the English Dominican Province trans., 1981).


The reasons for [the general unsuitability for judicial review of agency decisions to refuse enforcement] are many. First, an agency decision not to enforce often involves a complicated balancing of a number of factors which are peculiarly within its expertise. [T]he agency must . . . assess whether a violation has occurred, . . . whether agency resources are best spent on this violation or another, whether the agency is likely to succeed if it
Superficially, both positions may appear plausible. Indeed, both positions have strong expressions in the case law of the U.S. Supreme Court, and in the academic literature. Several legal standards—such as standing, the interpretation of legislative inaction, acts, whether the particular enforcement action requested best fits the agency’s overall policies, and [other factors]. . . .

In addition[, . . .] when an agency refuses to act it generally does not exercise its coercive power over an individual’s liberty or property rights, and thus does not infringe upon areas that courts often are called upon to protect. . . .

See, e.g., Bagley & Revesz, supra note 15.

See, e.g., DeShaney v. Winnebago County Dept. of Soc. Servs., 489 U.S. 189 (1989) (holding in a 6-3 decision that a local social service worker’s failure to prevent child abuse did not violate the Due Process Clause although the social worker “had reason to believe” abuse was occurring.); Massachusetts v. EPA, 549 U.S. 497 (2007) (holding in a 5-4 decision that the EPA’s denial of a petition for rule making was “arbitrary, capricious, or otherwise not in accordance with law”); Caperton v. A.T. Massey Coal Co., Inc., 556 U.S. 868 (2009) (holding in a 5-4 decision that a judge’s failure to recuse, when a “probability of actual bias” exists, may make him subject to disqualification).


See, e.g., Allen v. Wright, 468 U.S. 737 (1984) (denying standing to petitioners who sought to challenge agency inaction, specifically the agency’s failure to adopt standards for denying tax exemptions from racially segregated private schools); Lujan v. Defenders of Wildlife, 504 U.S. 555 (1992) (denying standing to petitioners that sought to challenge agency inaction—the Secretary of Interior’s refusal to enforce certain requirements of the Endangered Species Act); Massachusetts v. EPA, 549 U.S. 497 (granting standing to petitioners that sought to challenge agency inaction—The EPA’s refusal to regulate greenhouse gas emissions).

and the un-reviewability presumption\textsuperscript{22}— frequently serve as tools for dismissing critique of inaction.

But the distinction is artificial and analytically flawed. Values and other preferences often shape views regarding its relevance. For example, consider action and inaction of individuals. Assume an individual can take an action that would prolong her life, but some individuals do not take such action. Should the state require action? In \textit{Cruzan v. Missouri}, Justice Antonin Scalia was willing to “acknowledge that the distinction between action and inaction has some bearing.”\textsuperscript{23} “It would not make much sense”, he explained, “to say that one may not kill oneself by walking into the sea, but may sit on the beach until submerged by the incoming tide; or that one may not intentionally lock oneself into a cold storage locker, but may refrain from coming indoors when the temperature drops below freezing.”\textsuperscript{24} Justice Scalia, therefore, argued that the distinction between action and inaction might be utterly irrelevant.\textsuperscript{25}

In \textit{National Federation of Independent Business v. Sebelius (“NFIB”)}, the Court considered a similar issue: the validity of the so-called “individual mandate,” a minimum coverage of health insurance policy. Writing for the Court, Chief Justice John Roberts declared that “[t]o an economist, perhaps, there is no difference between activity and inactivity[, but] the distinction between doing something and doing nothing would not have been lost on the Framers, who were ‘practical statesmen,’ not metaphysical philoso-

\textsuperscript{22} The un-reviewability presumption supposedly shields agencies’ inaction from judicial review. See Heckler v. Chaney, 470 U.S. 821, 832-33 (1985) (holding that an administrative agency’s decision not to take action is “presumptively unreviewable; the presumption may be rebutted where the substantive statute has provided guidelines for the agency to follow in exercising its enforcement powers.”) In \textit{Massachusetts v. EPA}, the Court clarified—effectively narrowed—the presumption, distinguishing rulemaking denials from decisions not to enforce and holding that the former are subject to judicial review. Massachusetts v. EPA, 549 U.S. 497.


\textsuperscript{24} Id.

\textsuperscript{25} Id. at 296-97.
phers.” In *NFIB*, Justice Scalia agreed with the Chief Justice on this point.

Moreover, government inaction means, among other things, accommodation of externalities. The underlying logic of exempting government inaction from scrutiny is that “government actions can violate the Constitution, but government failures to act against private wrongdoers cannot.” Under this premise, for example, environmental regulation violates polluters’ constitutional rights, while government inaction on environmental issues does not violate the rights of those affected by pollution. Similarly, gun control measures abridge Second Amendment rights, but government inaction concerning gun control does not abridge victims’ rights. Or, restrictions on tobacco sales infringe constitutional rights of businesses, whereas inaction on tobacco does not infringe the public rights. And so on.

In sum, the distinction between action and inaction is often a matter of framing, and cannot be depicted as substantive. When applied to the government, the distinction narrows the government’s fundamental duty to “restrain men from injuring one another.” If government inaction cannot constitute a failure, than people are free to harm each other, including by imposing one’s costs on society.

III. Imperfection as a Failure

*What degree of imperfection defines a government failure?*

Thomas Aquinas taught believers that “[t]o sin is to fall short of a

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29 See, e.g., Thomas Jefferson, Inaugural Address, 10 ANNALS OF CONG. 763, 765 (1801) (“[A] wise and frugal Government, which shall restrain men from injuring one another, shall leave them otherwise free to regulate their own pursuits of industry and improvement, and shall not take from the mouth of labor the bread it has earned.”)
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perfect action” and that “sinning is . . . a deviation from that rectitude which an act ought to have.” Today, people understand that the pursuit of perfection is impractical. For example, in corporate law, fiduciary duties and the business judgment rule emphasize that officers and directors can make mistakes. Yet, people sometimes perceive deviations of public policies from ideal norms or theoretical solutions as government failures. Such perceptions, the so-called nirvana fallacy, are common among both critics and advocates of regulation. In effect, they reflect unrealistic demands for perfection in the spirit of Thomas Aquinas.

In this spirit, many critics of regulation focus on ideal norms of liberty and freedom, and believe that most regulatory measures are imperfect and fail society; that is, “government is the problem.” Likewise but with different values, many advocates of regulation are troubled by “problems”—imperfections in our world—and believe that society can address such problems with regulations.

The references to the invisible hand and the precautionary principle as plausible guidelines for public policies illustrate these perspectives. Invisible hand arguments ordinarily propose that mar-

30 AQUINAS, supra note 14, at 138.
31 Id. at 312.
32 See, e.g., HERBERT A. SIMON, MODELS OF MAN 198 (1957) (“The capacity of the human mind for formulating and solving complex problems is very small compared with the size of the problems whose solution is required for objectively rational behavior in the real world.”)
35 See Barak Orbach, What Is Regulation?, 30 YALE J. REG. ONLINE 1, 6 (2012) (defining “regulation” as “state intervention in the private domain, which is a byproduct of our imperfect reality and human limitations.”)
Kets are generally efficient and government actions burden and disrupt them.\(^{37}\) The precautionary principle prescribes that activities that pose certain risks to the environment or human lives should be banned until safety is established.\(^{38}\) Both concepts offer reliance on simplistic frameworks that never have proved themselves, or more precisely, have proved their ineffectiveness.\(^{39}\) Proponents of these concepts will always identify government failures. Under invisible hand theories, government regulation is unwarranted intervention in markets. Under the precautionary principle, the government is unlikely to do enough to prevent all activities that pose risks to lives and the environment.


Imperfection is not all about the degree of government conduct; it may also be about the form. Two general forms of imperfections are commonly used to define government failures: a deviation from adequate cost-benefit analysis and a mismatch between normative expectations and public policies.\textsuperscript{40}

Cost-benefit analysis as a standard for government failures underscores the inability to define ex ante precise criteria for government failures and potential misuse of hindsight.\textsuperscript{41} When undesirable outcomes materialize, we can supposedly employ a Learned-Hand-like formula (or a more sophisticated analysis) to examine whether the government adequately invested in precautions to address the risk.\textsuperscript{42} Such inquiries do not account for budgetary con-

\textsuperscript{40} See, e.g., Bus. Roundtable v. S.E.C., 647 F.3d 1144, 1148-49 (D.C. Cir. 2011):

[The SEC] acted arbitrarily and capriciously for having failed once again . . . adequately to assess the economic effects of a new rule. Here the Commission inconsistently and opportunistically framed the costs and benefits of the rule; failed adequately to quantify the certain costs or to explain why those costs could not be quantified; neglected to support its predictive judgments; contradicted itself; and failed to respond to substantial problems raised by commenters.

Com. v. Wasson, 842 S.W.2d 487, 501 (Ky. 1992):

By 1974 [when Kentucky enacted its anti-sodomy law] there had already been a sea change in societal values insofar as attaching criminal penalties to extramarital sex. The question is whether a society that no longer criminalizes adultery, fornication, or deviate sexual intercourse between heterosexuals, has a rational basis to single out homosexual acts for different treatment.


\textsuperscript{42} United States v. Carroll Towing Co., 159 F.2d 169 (2d Cir. 1947) (Hand, J.). \textit{See generally} Mark Grady, \textit{Untaken Precautions}, 18 \textit{J. L. STUD.} 139
straints, ex ante knowledge of risks, and available precautions. Therefore, such inquiries may be reasonable for certain domains but not for others.

Mismatches between normative expectations and public policies may also establish perceptions of government failures. Examples of such perceptions may include the inability of the federal government to address child labor until 1938, the endorsement of eugenics and the maintenance of eugenics programs until 1974, and the choice to ignore irrational exuberance during the housing bubble of 2000s. The existence of a mismatch implies that the underlying normative expectation is not in consensus. For some portion of the public there is no mismatch. But those, whose normative views


44 North Carolina, the last state to engage in eugenics, sterilized people “for the best interest of the[ir] mental, moral or physical improvement” until 1974. N.C. Ch. 1281 § 35-36 (1973). See The Governor’s Task Force to Determine the Method of Compensation for Victims of North Carolina’s Eugenics Board: Final Report (Jan. 2012); Kim Severson, Thousands Sterilized, a State Weighs Restitution, NY TIMES, Dec. 10, 2011, at A1. See also Buck v. Bell, 274 U.S. 200 (1927) (Holmes, J.) (“It is better for all the world, if instead of waiting to execute degenerate offspring for crime, or to let them starve for their imbecility, society can prevent those who are manifestly unfit from continuing their kind.”).


46 Lawrence v. Texas stands for the potential normative mismatch that the majority may have to tolerate. Lawrence v. Texas, 539 U.S. 558, 577 (2003) (“[T]he fact that the governing majority in a State has traditionally viewed a particular practice as immoral is not a sufficient reason for upholding a law prohibiting the practice.”).
clash with existing public policies, may perceive the contrast as a
government failure. Normative contrasts of this type begin with the
general controversy over regulation: For some a government failure
is a consequence of too much regulation, while for others it is a result
of too little regulation.\footnote{See supra Section I; Orbach, \textit{What Is Regulation?}, supra note 35.}

In sum, every government failure represents some imperfection in
government performance, but not every imperfection in government
performance is a failure. Although we often “see” government
failures, threshold standards that separate tolerable imperfections from
government failures do not exist. In corporate law, only extreme situations of improper intent, conflict of interest,
carelessness, and inattention or a failure to be informed of all facts
material to a decision may result in liability for decisions made or not
made.\footnote{See supra note 33.} By contrast, under some theories, the government fails
whenever it acts because of the inevitable imperfections. Such theories are impractical.

IV. Defining Failure

\textit{What government’s actions and inaction ought be considered
government failures?} When “bad things” happen, such as a natural
disaster hits a major city, a financial bubble bursts, or a Ponzi scheme
unravels, a government failure is often declared.\footnote{See, \textit{e.g.}, \textit{Hurricane Katrina Lessons Learned}, Staff, The
such public verdicts is that “the public stewards . . . ignored warnings and failed to question, understand, and manage evolving risks . . . to
the well-being of the American public.” Such failures supposedly refer to substantial imperfections in government performance.

Designed by humans for a complex reality, regulations tend to be imperfect. Government failures, including a lack of, or inadequate regulation, merely reflect the imperfect nature of regulation. Indeed, the phrase “government failure” as a term of art was born in critique of regulation.

“Government failure” as a concept in regulation refers to substantial imperfection in government performance. Such imperfections are comprised of inadequate actions and unreasonable inactions. The scope of the imperfection is related to the level of a disregarded risk, inadequacy of cost-benefit analysis, deviation from popular normative expectations, and magnitude of misallocated resources. In essence, government failures are accidents that cannot be eliminated, but their costs can be reduced.

\footnote{INQUIRY REPORT, at xvii.}