Seventy-Two Percent

by William R. Nelson
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Over the entrance of the city hall in Gouda, Netherlands, built in 1448, is an engraved motto in Latin when translated says, “Listen even to the other side.”

Is big government a threat to our nation’s future? Seventy-two percent of Americans believe so, according to a Gallup survey released on December 18, 2013. Big Government is a greater concern than Big Business at 21% and Big Labor at 5%. Big Government is a threat to 52% of Democrats, 71% of Independents and 92% of Republicans. Americans’ concern about Big Government is the highest recorded since Gallup started the survey in 1966.

Concern about Big Government and the power of rulers is nothing new and has a long history going back to St. Augustine, Hobbs, Pascal, Spinoza, and Rousseau, who each attempted to understand and debated the true nature of man and rulers, “as he really is.” Man’s passions were frequently defined as a lust for money and possessions, a lust for power, and sexual lust. Rousseau wrote in the *Contract,* “Taking man as they are and the laws as they might be, I wish to investigate whether a legitimate and certain principle of government can be encountered.” Bacon and Spinoza hypnotized that a man’s and King’s passions “… can not be restrained nor removed unless by an opposed and stronger affect” and “No affect can be restrained by the true knowledge of good and evil insofar as it is true, but only insofar as it is considered an affect.” These insights contributed to our nation’s founding fathers design of our Constitution, creating our federal system with a distinct separation of powers between the executive, legislative and judicial branches of government and defining limited enumerated powers.

The centuries old debate continues today as seventy-two percent of Americans believe that Big Government is a threat to our nation’s future. I will discuss three interrelated strains of thought supporting the premise that Big Government is not a viable governmental and economic model if our nation and society is to succeed in an ever more competitive world for the long-term. **First**, a top down and government driven economic model is unable to operate efficiently and win in the world’s competitive markets. **Secondly**, leaders in government are not necessarily benign “public servants” solely fulfilling the “will of the people.” **Thirdly**, people are unable to make fully informed, unbiased decision about complex issues due to inherent psychological faults in decision-making processes. Many professionals invest their careers studying and researching each of these individual themes. However, this paper will address each from a broad, bird’s eye view. I am not providing many real life examples of the arguments to keep the essay a reasonable length. Current, real world examples of the activities of Big Government that fuel the public concerns that I mentioned earlier are plentiful in the news of the last few weeks and months if you keep an open mind toward the themes I will share with you tonight.

Government plays a crucial role in our society, and I am not suggesting that it is not necessary. However, we need to recognize that government, like all humans and institutions, is imperfect. In order for our democracy to thrive, we must be vigilant such that government (i) protects personal freedoms; (ii) ensures that our nation is ruled by law; (iii) protects our nation from international adversaries; (iv) offers an efficient safety net to the less able; and (v) fosters economic competiveness and innovation. As is required in any successful democracy, our citizens need to have continual conversations as to the best manner to achieve these objectives, while recognizing the reasons a large government is not the solution to our challenges.

Use of Information in Society

In order for a society and its members to prosper, knowledge needs to be continually created, shared and applied efficiently. Nobel Laureate Friedrich Hayek wrote in his essay "The Use of Knowledge in Society," "… the knowledge of the circumstances of which we must make use never exists in concentrated or integrated form but solely as the dispensed bits of incomplete and frequently contradictory knowledge which all the separate individuals possess." This postulate challenges the "high and mighty" who think they know how to attend to other people's affairs, often called "the pretense of knowledge." Leonard Reed's essay "I, Pencil" demonstrates the compelling argument that a nation's economy cannot be planned when it is impossible for an individual or a single company to manufacture a "simple" pencil. As "simple" as a pencil looks, it contains resources from around the world such as wood from northern California, graphite mined in Sri Lanka, clay mined in Mississippi, candelilla wax from Mexico, mined cooper, rubber from East Indies, castor beans for lacquer, energy sources from around the world to facilitate obtaining these resources, many modes of transportation, and the list goes on and on. In addition, multiple, dispersed skills and disciplines are required to convert these resources into finished components that will be eventually assembled together into the "simple" pencil. Leonard Reed's Pencil asked the question, "Does anyone wish to challenge my earlier assertion that no single person on the face of this earth knows how to make me?" I may add, if no single person or organization can make a simple pencil, nor can anyone provide direction to the economic system according to one unified plan.

How does society work to coordinate the knowledge dispersed among different individuals and share with the individuals the additional knowledge that they need to enable them to coordinate their plans with those of others? This occurs at different levels and within many communities. Hayek identified two kinds of rationalism: constructive rationalism and evolutionary rationalism. Constructive rationalism originated with Descartes with a focus on logical and mathematical deduction. It is applicable to scalable areas in which the actors are capable of being informed, though often imperfectly, such as building cars and buildings, preparing a firm's business model, making investments and operational plans, organizing armies, or a husband and wife planning their family's budget. Unfortunately, the success of constructive rationalism often leads to the conclusion that all human activities can and should be produced by this planning method.

Evolutionary rationalism or spontaneous order is the decentralized process by which ideas, rules, economic demand, supply, resource investment decisions, knowledge, values, customs, and languages develop and evolve through the communications and interactions among people. The market economy is a classic example of spontaneous order. People and organizations use constructive rationalism to plan their own activities and rules that enables them to make voluntary transactions with many parties. Through these voluntary transactions, market prices and rules are established that transmit information through the entire system or community. Such pricing information and rules enable all parties of the system to respond to the signals and adjust their plans and actions. The spontaneous order of the market employs the "knowledge of the particular circumstances of time and place" by transmitting signals to other actors who may or may not share the same information and by coordinating their actions. Using this information, established actors and startup entrepreneurs receive signals so they can innovate and adjust to the dynamic world, and thus all aspects of the society and economy will evolve and flourish.

Since no one is able to know all the specifics influencing the prices, rules and market behavior, no one is capable to plan economic activity while benefiting from the quantity and the quality of information provided by market transactions and competition.

Many of our fellow Chit Chat Club members have careers outside the commercial markets so I am going to provide an analogy that may bring spontaneous order closer to home. While in academia, my son loved the freedom of reviewing classic and recent papers, working with other economists with a wide variety of skill sets, thinking outside the box, and creating ideas for his research. However, it did not end there; working papers were often sent to colleagues for comments before submission to journals for peer review and approval for publication, which often required several iterations. Frequently, his analytical creativity and working with many colleagues lead to published papers. This is an example of the interactive environment of spontaneous order. Many of you likely have enjoyed similar freedom, creativity, analysis, feedback from known and unknown sources, a sense of accomplishment, and success. Can you imagine how your academic research and pleasures would have been stifled if your department chairman, university president, or the president of your discipline's association dictated topics for your research, its hypothesis, information sources, experiments, and the like?

The Nature of the Political Process

Conventional wisdom presumes that politicians, policy makers and government bureaucrats enter the political world to promote the "common good" and do not make any priority to enhance their own self-worth or benefits. I support a different view, man has passions, one of them is the “lust for power” and each man is chiefly motivated by his own self-interests. Man is motivated to maximize his own utility. The motivations of politicians, policy makers and government bureaucrats in the political process are no different from those in any other aspects of life or professions -- try to obtain personal gain whether economic, social status, more votes, or a higher political office. This is the basis of Public Choice, which “simply transfers the rational actor model of economic theory to the realm of politics.” Nobel Laureate James Buchanan emphasized that politics is a process of exchange, the tern he used is “politics as exchange,” and that the role of economists is to expose these exchange possibilities. The application of applying economic thinking to the evaluation of political behavior started in the 1950 and 60’s and was led by Nobel Laureate Kenneth Arrow, James Buchanan, Gordon Tullock, Mancur Olson and many others.

Our next step is to explore an example of Buchanan’s “politics as exchange” and some of its implications.

Gordon Tullock introduced the concept of “rent seeking” in a 1967 paper. Rent seeking is dependent on people’s unsurprising response to quantifiable incentives and predicts that if a person or organization can obtain value by becoming involved in the political system, they will invest time and money to acquire this value. The list of behaviors implementing rent seeking is almost unlimited. An example is a firm or an industry seeking tariff protections that benefits them at a great expense to the public. I experienced this situation while a marketing manger at C&H Sugar in the 1970's. During that time, sugar's world market price was about eight (8) cents a pound and the US domestic price was about twenty to twenty-five cents a pound due to sugar tariffs approved by Congress. A similar pattern has continued since that time. The sugar tariffs cost American consumers approximately $3.5 billion a year in higher prices and the benefits go to the domestic farmers and producers. Sugar tariff and agricultural subsidy legislation and textile-manufacturing trade protection could not pass without the logrolling bargains in which each group's representatives voted for each other's legislation. This tariff and legislation is a classic example where the benefits of government policy is concentrated in one small group but the cost are shared by many, hundreds of millions in these examples. Small, homogeneous groups with strong common beliefs and interests tend to be more effective in applying political pressure and support in raising funds and votes than large groups with diverse or lesser interests. The "vote motive" provides "reelecting-seeking politicians" with strong incentives to take action on the demands of small groups, and thus, "representative democracy leads to a tyranny of the minority." Using this basic concept of rent seeking, much of modern politics, such as pork barrel and logrolling, can be understood. A lot of the bureaucratic and regulatory agencies' behavior can also be explained by rent seeking as various interest groups and other political actors compete for political favors and promises for "discriminatory transfers of wealth."

The question arises about the wisdom of creating a government that can easily abuse its power and grow beyond a manageable size. In the private sector, there are two primary controls over firms. All individuals make a conscience choice to utilize and pay for the services of a firm, and the firms are competing for the privilege to service each individual. If an organization fails to please individuals, it fails. Conversely, the government is funded by mandatory taxes and faces no competition, thus greater reliance, than is necessary in the private sector, is placed on the "integrity, altruism, and diligence of elected officials" to prevent abuse. I think achieving this superhuman goal is humanly impossible given the nature of man and his self-interests. Secondly, in the private sector the size of an organization is controlled by its ability to become and remain competitive, efficient, innovative, and profitable. If an organization's fails in any of these areas, it will likely shrink or go bankrupt. Unfortunately, there are not competitive pressures, in the short term, to which the public sector must respond by adjusting its size, scope and finances. The long-term maybe a different story.

Mancur Olson in his book *The Rise and Decline of Nations (1982)* and Daron Acemoglu and James A. Robinson in their book *Why Nations Fail (2012)* independently hypothesize that societies and nations fail in different but related manners. Olson argues that interest groups such as farmers, social classes, industries, and labor unions have an incentive to enter the "rent seeking" process. These groups' historically have sought after polices that are generally protectionist and hurt economic growth because the benefits are concentrated and the cost are diffused, so there is little public resistance to them. As "distributional coalitions accumulate," burdens will grow and cause nations into economic decline. Europe is currently experiencing economic decline and is not economically thriving and competitive for the reasons that Olson predicted about fifty years ago. In *Why Nations Fail*, the authors summarize their conclusion, "Nations fail today because their extractive institutions do not create incentives needed for people to save, invest, and innovate. Extractive political institutions support these economic institutions by cementing the power of those who benefit from the extraction. Extractive economic and political institutions, though their details vary under different circumstances, are always the root of failure."

Inherent Psychological Faults in Decision-Making

You may embrace the belief that government policy makers and bureaucrats enter the political world to promote the "common good" and enhancing their own self-worth or benefits is not a priority. However, even if this hypothesis were true, would these people be able to make fully informed, balanced, impartial decisions? Recent psychological research reveals that people's decision-making ability is severely handicapped by many inherent faults. I will discuss only a few in this essay. My primary source material for this section is *Thinking, Fast and Slow* by Nobel Laureate Daniel Kahneman. His book is a readable, popular consolidation and overview of peer reviewed, academic papers, and I highly recommend it.

A common fault in many people's thinking may be summarized as, "What you see is all there is," or otherwise succinctly expressed as there is a "remarkable asymmetry between the ways our mind treats information that is currently available and information we do not have." In making quick decisions, our minds use readily available information and create the "best possible" story or rationale solely based on information availability and do not accommodate for any information that is not at hand. The amount and the quality of information on which the story is based are "irrelevant." The concept of "What you see is all there is" helps explain a diverse selection of biases of choice and judgments.

Another frequent fault in decision-making is the "law of small numbers." Many people are unsophisticated about statistics and research shows that people are "pattern seekers, believers in a coherent world" and most often mistakenly assign intentional design or cause and effect to what are truly random events. Daniel Kahneman states, "The exaggerated faith in small samples is only one example of a more general illusion-we pay more attention to the content of messages than to information about their reliability, and as a result end up with a view of the world around us that is simpler and more coherent than the data justify."

The “Illusions of Pundits” is the postulate that people are over confident in their ability to predict future events based on their perceived understanding of the past. Philip Tetlock’s twenty-year study of people who made their living “commenting or offering advice on political and economic trends” found that these “experts” performed worse than they would have if they had simply assigned equal probability to their predictions. The predictions among people with more knowledge were “less reliable” because these people develop “an enhanced illusion of her (their) skill and become unrealistically over confident.” Kahneman concluded, “The first lesson is that errors of prediction are inevitable because the world is unpredictable. The second is that high subjective confidence is not to be trusted as an indicator of accuracy…”

Here are some classic examples of this concept of the “Illusions of Pundits”:

> “The ‘telephone’ has too many shortcomings to be seriously considered as a means of communication. The device is inherently of no value to us.” Western Union internal memo 1876
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> “I’m just glad it’ll be Clark Gable who’s falling on his face and not Gary Cooper.” Gary Cooper on his decision not to take the leading role in “Gone with the Wind.”
>
> Stocks have reached what looks like a permanently high plateau.” Irving Fisher, Professor of Economics, Yale University, 1929
>
> “There is no reason anyone would want a computer in their home.” Ken Olson, President, Chairman and Founder of Digital Equipment Corp., 1977

Another bias effecting people's decision-making and information availability is the "confirmation bias." We all have our individual belief systems and view of the world and have the habit of absorbing information that confirms our current views and avoiding conflicting information. How many of us subscribe to and daily read the New York Times? How many of us subscribe to and daily read the Wall Street Journal? How many of us subscribe to and daily read both? If you do, please raise your hand. Confirmation bias lives with all of us daily. Several months ago while having a friendly dinner conversation at a Chit Chat meeting, I was going to contribute a comment from an economics professor's highly regarded blog. As background, this professor earned a Harvard PH.D., authored 21 books, published many academic papers, and was my son's advisor for his Ph. D. dissertation. In introducing the comment, I mentioned that he is a professor at George Mason University, and my friend interrupted me by saying that he must always "write with his right hand" and went on and on, and thus he prevented me from sharing the professor's insightful observations that may have questioned my friend's beliefs. We all unconscientiously practice the confirmation biases by the selection of our reading materials, professions, friends, and recreations.

This practice of "confirmation bias" is associated with another fault, the framing bias. How one views a situation or the manner in which a story is presented effects the decisions people make. Here is an example that Kahneman used in his experiments to study the "framing effects to the unjustified influences of formulations on beliefs and preferences."

“Would you accept a gamble that offers a 10% chance to win $95 and a 90% chance to lose $5?”

or

Would you pay $5 to participate in a lottery that offers a 10% chance to win $100 and a 90% chance to win nothing?”

Both of these offers represent identical bets, but the second choice solicits more people because “A bad outcome is much more acceptable if it is framed as the cost of a lottery that did not win than if it is simply described as a losing gamble.”

Another example is about how framing effects how people look at the facts of a situation and make a decision. Let’s say you were a leader of a labor union and you were preparing to negotiate a new four-year contract for your fellow members. Your members desire higher wages and benefits to support their families and prepare for retirement. Thus, they demand increased wages above the inflation rate, improved health and retirement benefits, and work rules that will save jobs and prevent layoffs. Your members are willing to strike to accomplish these goals. Your objectivities and strategy are very clear, especially since Joe Smith is going to run against you for your leadership position next year, and his agenda is to achieve the membership’s popular goals.

Now, let us frame the issue a little differently by taking a twenty-year perspective. The union's members have the same 4-year objectives as in the previous case. You are still the union's leader and realize that for your employer to retain its current union work force over this longer time horizon, your employer must successfully compete against new, ground-breaking competitors by constantly developing innovative products to fulfill customers' ever changing desires, refining its business model, and employing new technology to become more efficient and price competitive. Your union's goals, negotiating strategy, and issues may be very different with this alternative framing since you must facilitate your employer's success, if you want to increase the probability of maintaining the jobs for your union's current and future members. However, you are really stressed about what to do since Joe Smith is going to run against you for your leadership position next year. To translate the impact of the different framings and the consequences in the real world, think about decisions by company and union leadership that lead to bankruptcies, mergers, labor issues, manufacturing relocations, and reorganizations within the legacy airline, steel and the auto industries over the last few decades.

The point of this section is that all humans have many faults, only a few have been briefly reviewed, that effect their decision making abilities, and we should not place excessive faith in any one overconfident person or people to make decisions that will effect our freedom and well being; it is wiser to be humble.

Conclusion

To quote James Buchannan, we must look at "Government without Romance" and recognize that politicians and bureaucrats are not angels but people who are motivated by their own self-interests and those of their supporters, donors and rent seekers. These human passions lead many politicians to garner favor with the electorate by expanding government, bureaucracies and welfare systems, encouraging rent seeking, introducing rigid labor laws, and extending privileges to vested interests. These programs lead to extractive institutions and unintended consequences, such as a controlling government, losing individual freedoms, dominating labor unions, and protecting industries and firms, and very importantly, destructing of individuals' motivations to achieve life goals and being self-supporting. Society must navigate a fine line between (a) caring for people incapable or experiencing difficulty in becoming self-sufficient and (b) providing welfare support and entitlements that have unintended consequences such as destroying motivations to work and to be responsible for oneself and family. Extractive institutions, in the process of protecting their own status quo, inhibit individuals, firms and nations from succeeding, growing, and innovating in the competitive world. Extractive institutions protect their own interest and fight against change and Schumpeter's creative destruction. A democratic, limited, non-extractive government is necessary to allow free people to coordinate their diverse knowledge and activities and thus create a growing, innovative, prosperous society and economy that will benefit all.