

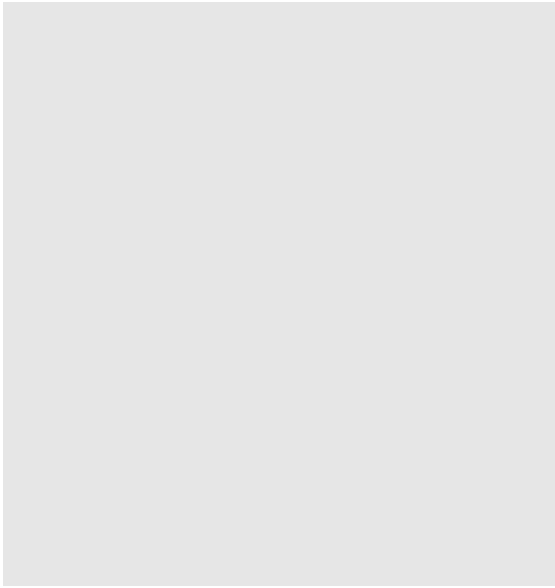
VOLUME 5

THE COLLECTED WORKS OF ARTHUR SELDON

Government Failure
and Over-Government

THE COLLECTED WORKS OF ARTHUR SELDON

- VOLUME 1 The Virtues of Capitalism
- VOLUME 2 The State Is Rolling Back
- VOLUME 3 Everyman's Dictionary of Economics
- VOLUME 4 Introducing Market Forces into "Public" Services
- VOLUME 5 Government Failure and Over-Government
- VOLUME 6 The Welfare State: Pensions, Health, and Education
- VOLUME 7 The IEA, the LSE, and the Influence of Ideas
(includes an index to the series)



Arthur Seldon

VOLUME 5

THE COLLECTED WORKS OF ARTHUR SELDON

Government Failure and Over-Government

ARTHUR SELDON

Edited and with a New Introduction
by Colin Robinson



LIBERTY FUND, Indianapolis

This book is published by Liberty Fund, Inc., a foundation established to encourage study of the ideal of a society of free and responsible individuals.



The cuneiform inscription that serves as our logo and as the design motif for our endpapers is the earliest-known written appearance of the word “freedom” (*amagi*), or “liberty.” It is taken from a clay document written about 2300 B.C. in the Sumerian city-state of Lagash.

New Robinson Introduction © 2005 Liberty Fund, Inc.

All rights reserved

Frontispiece photo courtesy of the Institute of Economic Affairs

“Change by Degree or by Convulsion,” from *The Coming Confrontation*, © 1978 by the Institute of Economic Affairs and reprinted with permission.

“Individual Liberty, Public Goods and Representative Democracy,” from *ORDO: Jahrbuch für die Ordnung von Wirtschaft und Gesellschaft* 30 (May 1979), © 1979 *ORDO* and reprinted with permission.

“Avoision: The Moral Blurring of a Legal Distinction Without an Economic Difference,” Prologue to *Tax Avoision*, © 1979 by the Institute of Economic Affairs and reprinted with permission. *The Dilemma of Democracy*, © 1998 by The Institute of Economic Affairs and reprinted with permission.

“Public Choice in Britain,” from *Government: Whose Obedient Servant?* © 2000 by the Institute of Economic Affairs and reprinted with permission.

“On the Liberal Emancipation of Mankind,” from *Vordenker einer neuen Wirtschaftspolitik* (a Festschrift für Christian Watrin), © 2000 The Friedrich A. von Hayek Institut and reprinted with permission.

Printed in the United States of America

09 08 07 06 05 C 5 4 3 2 1

09 08 07 06 05 P 5 4 3 2 1

Library of Congress Cataloging-in-Publication Data

Seldon, Arthur.

Government failure and over-government / Arthur Seldon; edited and with a new introduction by Colin Robinson.

p. cm.—(The collected works of Arthur Seldon; v. 5)

Includes bibliographical references and index.

Contents: Introduction—Change by degree or by convulsion—Individual liberty, public goods, and representative democracy—Avoision—The dilemma of democracy—Public choice in Britain—On the liberal emancipation of mankind.

ISBN 0-86597-546-9 (hard cover: alk. paper)—ISBN 0-86597-554-x (pbk.: alk. paper)

1. Democracy. 2. Welfare state. 3. Liberty. 4. Public goods. 5. Liberalism. 6. Social choice—Great Britain. 7. Great Britain—Politics and government—1979–1997. 8. Great Britain—Politics and government—1997– . I. Robinson, Colin, 1932– . II. Title.

JC423 .S433 2005

321.8—dc22

2004064927

LIBERTY FUND, INC.

8335 Allison Pointe Trail, Suite 300
Indianapolis, Indiana 46250-1684

CONTENTS

Introduction by Colin Robinson ix

CHANGE BY DEGREE OR BY CONVULSION 3

INDIVIDUAL LIBERTY, PUBLIC GOODS, AND REPRESENTATIVE DEMOCRACY 23

AVOISION: The Moral Blurring of a Legal Distinction
Without an Economic Difference 51

THE DILEMMA OF DEMOCRACY

Acknowledgements 71

Introduction 73

1. Democracy at the Crossroads 87
2. The Debilitating Disease of Over-Government 101
3. The Escapes from Over-Government 116
4. From Political Democracy to Individual Liberty 142

PUBLIC CHOICE IN BRITAIN

1. Public Choice or Political Sovereignty? 149
2. Government Intentions and Consequences 156
3. Over-Dependence on the Welfare State 161
4. The Weakening of the Family 172
5. Voters Versus Consumers 175
6. The Political Fate of Economic Federalism 179
7. The Escapes from Over-Government 186

ON THE LIBERAL EMANCIPATION OF MANKIND 193

Index 197

INTRODUCTION

Six works are featured in volume 5 of *The Collected Works of Arthur Seldon*. They are on a theme to which his writing constantly returns—the problem of over-government.

In representative democracies, such as the United States and the United Kingdom, governments claim legitimacy from their election by a majority (or a plurality) of the citizens of the country. Yet, once elected to office, usually on the broadest of policy platforms, they have a monopoly of policy making which leaves their actions largely unconstrained until the next election and sees them open to the influence of powerful interest groups that wish to obtain benefits for themselves at the expense of the rest of the community.

Seldon perceives serious dangers in the power of governments to coerce—for example, by taxing or by imposing regulations—which permits and indeed induces them to go beyond traditional functions of government (such as national defense, the maintenance of law and order, and the establishment and safeguarding of property rights). Governments plead the need to supply “public” goods and services, yet there is little “public” about much of their activity. Over-government is a constant threat and is very damaging: in Seldon’s view, government failure is ubiquitous, both because governments have insufficient knowledge to identify and achieve “public interest” goals and because, even if they could determine what is the “public interest,” they lack incentive to pursue it if it conflicts with their own aims. *Government Failure and Over-Government* contains two recent works on this subject—a book, *The Dilemma of Democracy*, published in 1998, and Seldon’s section of another book, *Government: Whose Obedient Servant?*, written in 2000, to which Gordon Tullock and Gordon Brady contributed the other two sections. These two very substantial pieces are accompanied by three articles from the late 1970s and one from 2000.

The first paper, “Change by Degree or by Convulsion,” written in 1978, is

taken from an Institute of Economic Affairs (IEA) collection (*The Coming Confrontation: Will the Open Society Survive to 1989?*, Hobart Paperback 12, edited by Ralph Harris and Seldon). In the preface to the collection, Seldon argues that, though the idea of the market is (in the late 1970s) back in public discourse, politicians are still trying to suppress markets, moving toward a closed society. Harris and Seldon therefore asked a number of distinguished scholars, including Friedrich Hayek, for their views on how difficult it would be to reopen society. These scholars were sent a “preamble” which, in effect, asked them whether, when whole sections of society have been closed, they could be reopened by argument alone or whether some kind of revolution might be required.

In “Change by Degree or by Convulsion” Seldon argues that, in a market economy with decentralized decisions, change tends to be gradual and peaceful as adjustment takes place to changes in underlying supply-and-demand conditions. Confrontations are small and are “solved by higgling and haggling over price, the peace-maker” (p. 3). By contrast, in a centralized economy, change is repressed and postponed so that, when it comes, it is “contrived, jerky, discontinuous, lumpy, convulsive” (ibid.). Markets can deal peacefully with change; however, under government control, incipient economic change produces strife and tension and possibly even civil war where change is suppressed.

Seldon goes on to identify some of the sources of resistance to economic change in Britain in the late 1970s. Government legislation, going back a hundred years, has given legal privileges to the labor unions that, not surprisingly, they use to obstruct change. State ownership of the fuel and transport industries and state control of education and health also inhibit change and make the industries vulnerable to labor union pressure. The monopoly power of the state corporations allows high-wage costs to be passed on to consumers. Failure to alter the law on trade unions and to denationalize state monopolies risks a major confrontation. The open society, says Seldon, “cannot long survive a power created or tolerated by Parliament that is invited to bargain with government” (p. 5). “The longer the disarmament of the monopoly unions is shirked, the more painful it will have to be” (ibid.). Governments have brought this problem on themselves by their encroachments on what used to be the private sector, using the false claim that they are providing “public goods.”

Yet, as usual, Seldon sees hope in growing resistance from the public to the interventions of the state. In the end, as Böhm-Bawerk foresaw, eco-

conomic laws will prove stronger than political power. People will find their way back to the market.

[T]he British, who have seen the market increasingly suppressed or repressed, and can now judge the results, will want to restore it—not least in medicine and education, where it was said to be least practicable. (p. 19)

Only a few years after Seldon wrote this, the Thatcher governments had, in the early 1980s, embarked on denationalization and a significant reduction in the legal privileges of trade unions, though it is only in very recent years that the first small steps toward markets in health and education have been taken in Britain.

The over-government theme continues in the second article in this volume, “Individual Liberty, Public Goods, and Representative Government: Lessons from the West and Escape for the East,”¹ originally published in 1979 in the German journal *ORDO*.

Seldon begins the article by quoting Hayek, including Hayek’s contribution to *The Coming Confrontation* (see above), which stresses the dangers of majority rule and the threat from sectional interests that influence government. Seldon points out that the state has expanded remorselessly even though most of the arguments used to support the case for “free” government provision of services are false. Political choices are crude and arbitrary:

if there is no market in which each man’s pound or dollar, or Deutschmark, or franc is the same as everyone else’s, access will be based on much more arbitrary differences in power, cultural or political, that are more difficult to correct or remove. (pp. 34–35)

Governments cannot accurately reflect public preferences: political majority decisions should be confined to genuine public goods.

One way of trying to reduce the size of government, says Seldon, is to impose cash limits on government departments. But a better approach is to use standard microeconomic principles, as he advocated in *Charge*²—to introduce prices for personal and private services supplied by governments so

1. A shortened version of this article appears under the title “Individual Liberty and Representative Democracy,” in Seldon’s *The State Is Rolling Back*, which is volume 2 of these Collected Works.

2. In volume 4 of these Collected Works.

that consumers can choose for themselves how much to purchase and therefore what the size of government should be.

Tax “avoision” is a word coined by Arthur Seldon to indicate the blurred distinction between the (legal) avoidance of tax and (illegal) evasion. The third article in this volume, “Avoision: The Moral Blurring of a Legal Distinction Without an Economic Difference,” is his prologue to a symposium on tax avoision assembled by the IEA in 1979 (*Tax Avoision: The Economic, Legal and Moral Inter-Relationships Between Avoidance and Evasion*, IEA Readings 22). In the prologue he emphasizes that, on economic grounds, there is virtually no distinction between avoidance and evasion because their causes and their consequences are the same. Nor are there clear lessons to be drawn about the morality of those who evade tax or those who merely avoid it but nevertheless appear to defy the spirit of the law.

Avoidance and evasion have become so widespread, according to Seldon, that they conceal a considerable part of economic activity and make national statistics misleading. There is a trend to make payments in cash as part of a subterranean economy created in response to government rules and restrictions, and a large tax avoision industry has appeared that consumes the time and talents of many people.

Seldon makes another important point about taxes that is often ignored in public discussion. They are a very blunt instrument because of the difficulty of distinguishing their incidence from their impact. Governments may intend to tax a particular group (for example, “soaking the rich” or levying a tax on a specific industry), but where the tax eventually falls (its incidence) depends on price elasticities of demand. Because of the uncertainty about incidence, one of Adam Smith’s “four canons of taxation” (certainty) can never be satisfied. Thus, “all taxation systems,” says Seldon, are “precarious as instruments of government policy” (p. 66).

The fourth work in this volume, *The Dilemma of Democracy*, is best seen as a companion to *Capitalism*.³ The latter explained the virtues of the capitalist system and the emptiness of the socialist critique, arguing at the same time that democratic governments had expanded their activities well beyond those that could be justified. In *The Dilemma of Democracy*, Seldon brings together and then expands the criticisms of democracy that are explicit or implicit in much of his earlier work, but particularly in *Capitalism*.

Democracy has failed, says Seldon. Lincoln’s vision—government of the people, by the people, for the people—has not anywhere been fulfilled.

3. In volume 1 of these Collected Works.

No democracy, certainly not in Britain, represents even indirect government of the people, the whole people, and nothing but the people. . . . No democratic government allows small groups of minorities to accept or reject its rules and regulations, laws and taxes, and to live as they wish, even where diversity to suit individuals, small groups and minorities is feasible. (pp. 88–89)

Majority rule has become the “source of arbitrary rule. Political democracy represents some of the people more than others” (p. 89).

Seldon uses the results of research by the public choice theorists to explain how over-government arises as members of governments pursue their own interests and are unduly swayed by the activities of interest groups that obtain privileges for their own members at the expense of the rest of the community. But, he points out, the power of government is not absolute. As it becomes bloated, so citizens seek to escape using markets. For example, rather than pay taxes they perceive to be excessive, they shift from the official economy to the “parallel economy” or they move to another country. As communications have improved, and especially as the Internet has developed, so has citizens’ power of exit been enhanced.

In part 3 of *Dilemma*, Seldon analyzes this power of exit in some detail, in terms of a number of “escapes” that are open to citizens who regard government as excessive. He considers, for example, escape to the “parallel,” or “shadow,” economy, which is evidence of “widespread alienation from democratic government” (p. 126). Other “escapes” Seldon discusses are by barter, by electronic money, by the Internet (which much improves the discovery process of competitive markets), and to other countries (which can now be achieved without moving because of the expansion of free trade and improved communications).

Governments are powerful, concludes Seldon, but they are not as powerful as market forces. As he stressed in the first article in this volume, in the end political power must yield to the laws of economics. The dilemma of democracy has been provoked by the “new inability of government to maintain its supremacy over the market” (p. 146). Governments should realize that they would be well advised to retreat before they are rolled back anyway by the will of the people.

Seldon’s view of the scale of that withdrawal is not merely some marginal reduction in the size of government. His agenda is much more radical—the state should halve its size relative to national income, shrinking from around 40 percent to nearer 20 percent.

“Public Choice in Britain,” the fifth paper in this volume, is Seldon’s contribution to *Government: Whose Obedient Servant? A Primer in Public Choice*, published in 2000 by the IEA as Readings 51, with coauthors Gordon Tullock and Gordon Brady.⁴ The book had been conceived in the mid-1980s, when Seldon was still at the Institute of Economic Affairs but did not come to fruition until the late 1990s.

Tullock, Brady, and Seldon each wrote separate sections of the book, which, as its subtitle implies, is intended to set out the elements of public choice analysis for students and others interested in economic principles. Seldon’s chapter follows an exposition of public choice analysis and its principal conclusions by Gordon Tullock, one of the founding fathers of public choice, and a discussion by Gordon Brady of some of the applications of the theory.

Seldon begins by explaining the problems inherent in collective choice when the decisions are made by representatives of the public rather than the public itself. As he says,

The indirect results that emerge in the politically-decided production of goods and services are usually very different from those that would be chosen directly by the public itself. (p. 150)

The present “democratic” regime embodies a voting system that does not faithfully reflect voters’ preferences, in which rent-seeking and log-rolling are endemic, and in which bureaucrats recommend policies that serve bureaucratic interests rather than the general public or the consumer. Hence government constantly expands, taxation is excessive, there is too much legislation, and “government persistently provides services which are clearly personal and family, though misleadingly described as ‘public’ or ‘social’” (p. 154).

Choice is denied, and the state supplies mediocre, standardized services for which citizens are increasingly reluctant to pay, indirectly by taxes or directly by charges. Government, says Seldon, “has been inflated beyond its optimum limits. It should be decentralised and confined to its irreducible boundaries” (p. 155).

Seldon goes on to explain why the “welfare state,” in particular, should be dismantled, allowing taxes to be reduced and permitting citizens to spend

4. A US edition of this book was published by the Cato Institute, Washington, D.C., in 2002, under the title *Government Failure: A Primer in Public Choice*.

their own money on goods and services they choose (rather than those chosen for them). There are three “crucial defects” in the state supply of “welfare” services. These services were introduced too soon, based on an ignorance of history and false arguments about the supposed superiority of state services; they became too large and failed to reflect individual preferences; and they were continued for too long after they had become superfluous because of the feasibility of private provision.

In his final chapter, “The Escapes from Over-Government,” Seldon returns to one of the main themes of *The Dilemma of Democracy* (see above). As government becomes burdensome, people will find means to escape it: he gives as an example the way British parents are escaping from the inadequacies of state education to private schools or to private tutors for their children.

The Hobbesian choice—between government or anarchy—is false, says Seldon. The alternatives are not “government or no government but too little or too much government” (p. 189). In the twenty-first century, political power will have to be used “in deference to the sentiments of the populace who will have new powers to challenge the state.” People will find “they can escape as they never could before” (p. 190).

The final article in the volume, “On the Liberal Emancipation of Mankind,” is a brief paper from a festschrift for Christian Watrin, which was published in 2000 in the Friedrich A. von Hayek Institute’s International Library of Austrian Economics series. The paper contains the essence of Seldon’s views on the extent to which government has over-reached itself and on the escape mechanisms which people are employing.

He goes beyond his earlier papers in arguing that Böhm-Bawerk’s question about the relative strengths of political power and economic law has been decisively answered in the 1990s. In a bold prediction, Seldon suggests that, in the first two decades of the twenty-first century, the growing escape from government will shrink the share of government in national income from 40 percent to not just 20 percent (as suggested in *The Dilemma of Democracy*) but to only 10 percent, both in North America and in Europe. “‘Democratic’ politicians have abused their powers to act as benefactors” (p. 195). State taxes are therefore “being rejected, its regulations bypassed, its rules flouted” (*ibid.*). The state is in retreat because of the superiority of the market.

The papers in this volume, covering a period of twenty-five years, show how Seldon's thought has developed into a more and more detailed critique of government action, especially when it involves "welfare" provision, leading him to foresee a radical reduction in the size of government as it cuts the functions it performs. According to Seldon, this reduction is inevitable because, if governments will not make the cuts voluntarily, they will be forced to do so by the actions of their citizens, who will increasingly escape through markets.

ON THE LIBERAL EMANCIPATION OF MANKIND

On the Liberal Emancipation of Mankind

Introduction

When some years ago Christian Watrin asked me to talk to his students my opening words in German seemed to surprise them. When we exchanged views about economic policies their fluent English surprised me. The German students were better linguists than the British; and I recognized in their teacher a worthy descendent of the German pre-war and post-war classical liberal economists.

In the twenty-first century economists of the classical liberal school will pass from studying what government should do to what it can do.

The question asked by Eugen von Böhm-Bawerk, “Macht oder Ökonomisches Gesetz” in 1914, best translated into “Political Power or Economic Law?,” had to wait until the last decade of the twentieth century for the decisive answer.

The acceleration in technological invention in the 1990s has finally answered Böhm-Bawerk’s question. In the twenty-first century, probably in the first two decades, 2000 to 2020, the escapes from superfluous government that has inhibited individual freedom and perpetuated poverty will have shrunken political control of economic life from 40% in Europe and North America, to 10%. Escape by the internet is a foregone conclusion. No single country, however large, or federal union, or continent, will be able to prevent its private citizens or adventurous entrepreneurs from trading with one another without political impediments. The lessons and warnings of the public choice school against the tolerance of political power have been learned too slowly. The long-outdated expansion of government is now ending. It has been expanded too soon without allowing the market to demonstrate its potential, expanded too far beyond the sphere of public goods, and continued too long after its plausible boundaries have been long exceeded. And it is now retreating too slowly before the compelling evidence that it is inferior to the mounting superiority of the market.

Its inevitable fate is to be abandoned through increasing escapes. The most fundamental is through rising incomes that enable more voters to replace its inferior schools, medicine, housing, pensions and insurance, its roads, transport and fuel, and to reject its low morals and high taxes. A little-noticed escape is through barter in the full range of private exchange from personal services to industrial swapping of surpluses of spare parts. Not the least escape that is growing imperceptibly is the parallel economy that is falsifying most of the official government statistics of national income, national output, the “social” statistics of poverty and inequality, the employment statistics of registered unemployment and the financial statistics of savings, investment, borrowings and prices.

The Failing Fiscal Sympathy

Taxes are best levied when government and people share the view that they are likely to be used to benefit the taxpayers: This shared sentiment has been weakened in Europe—and other continents—in recent decades. The recent growth of the “parallel” economy especially in Europe but also around the world is evidence of the weakening sympathy between governments and peoples. In Britain the deteriorating quality of state education, the “National” Health “Service” and other tax-financed industries has raised the question, long emphasized by liberal economists, whether these and other activities should ever have been provided by the state. The task is to identify whether the prime offender is the tax-payer for rejecting the poor quality of state services, or the state for demanding payment for services that deny choice by widely differing individuals and families and the freedom to escape to better services offered by markets in welfare, transport, fuel and “public” amenities.

Economic Liberals and Europe

Christian Watrin shares the anxieties of other classical liberals on the uncertainties and risks of progressively federalizing the sovereign states of Europe. Not least is the necessity of regional flexibility to accommodate agreed exchange rates.

Two potential advantages may receive less attention. Other federal unions—in the USA, Canada, Australia (and in Europe, Italy and Germany)—have reaped the economies of specialization facilitated by the abandonment of state obstruction to trade between the federated states. Low incomes, even

much poverty, lingers longer in continents with largely sovereign nation states.

The other potential advantage is the earlier warnings, or evidence, of potential “illiberal” national tendencies that conflict with the general shared liberal sentiments of nations that have accepted a degree of federal identity. The emergence of illiberal tendencies in the early 1930s in Germany was not detected in time to strengthen the liberal elements. In the European Union there is early opportunity to detect illiberal national tendencies that may conflict with the underlying liberal principles of the union.

Little wonder that state taxes are being rejected, its regulations bypassed, its rules flouted. If “democracy” has been weakened, the reason is that “democratic” politicians have abused their powers to act as benefactors.

The Historic Delusion

Talk of “the retreat of the state” creates apprehension among the many who have regarded it as the saviour of the sick and the poor. A dominant anxiety is that democracy has taught the doctrine of Thomas Hobbes that its creation of “sovereignty” (government power over economic life) is essential for the maintenance of good order and civilized life. The alternative to the political state with the power to regulate economic life and to coerce the people to conform to it, warned Hobbes, was “a state of nature” that would create perpetual “war of all against all” in which life would be “nasty, brutish and short.” This dire prospect has habituated the Western world into accepting and tolerating the political state with its over-government. Yet from the start of the twentieth century, or earlier, over-government has been an obstruction to the liberties that democracy was supposed to protect.

Hobbes wrote in the seventeenth century. His warning has long been overtaken by the technological advances of the nineteenth century with its massive rises in living standards. A century after Hobbes, at the end of the eighteenth century, it was still plausible for Thomas Paine to urge, in his classic *The Rights of Man*, an early structure of Beveridge Plan benefits from maternity grants through a form of school vouchers all the way to funeral expenses. In the introduction to the 1958 edition of *The Rights of Man* I wrote of Paine’s proposals:

In his day this was advanced thinking. In our day we have no sooner erected a structure of state provision for the needy than it has become out of date with rising personal incomes. The welfare state is, or in a free

society should be, a passing phase; but there is a danger that it will be erected into a permanent appendage: the crutch will be beaten into a shackle.

So it has been for forty years since 1958, and indeed for over a century and a half. The recent reforms in the welfare state provoke a reassessment of Hobbes' flawed warning. It was rejected by the inter-war scholar, A. D. Lindsay, the Master of Balliol College, Oxford, in his introduction to Hobbes' *Leviathan*. Law is not obeyed solely because it is created by the state; it is respected essentially because it is wanted by the people. This truth is still overlooked by the politicians of our day. A. D. Lindsay stated:

if Hobbes is right in maintaining that without some authority there can be no state . . . he forgets that the power of the sovereign, even though legally unlimited, depends upon the skill with which it gives expression to the general will; if it disregards the general will there will come a point at which *no amount of legal or constitutional machinery will avert disaster*. [My emphasis.]

The legal and constitutional machinery of the twentieth century has not prevented the emerging revolt of the masses.

Hobbes was earlier refuted by the seventeenth-century philosopher, Benedict de Spinoza. Lindsay repeats Spinoza's magisterial dictum:

A sovereign has right insofar as he has might, and he has might only insofar as he rules in such a way that his subjects regard rebellion as a greater evil than obedience.

The sovereign state is now having to retreat from social welfare and other superfluous functions. But it is retreating too slowly. The subjects are rebelling. And they will continue to rebel until government retreats sufficiently to liberate the freedoms created by economic advance.