Why Government Can't Run a Business

By JOHN STEELE GORDON

The Obama administration is bent on becoming a major player in -- if not taking over entirely -- America's health-care, automobile and banking industries. Before that happens, it might be a good idea to look at the government's track record in running economic enterprises. It is terrible.

In 1913, for instance, thinking it was being overcharged by the steel companies for armor plate for warships, the federal government decided to build its own plant. It estimated that a plant with a 10,000-ton annual capacity could produce armor plate for only 70% of what the steel companies charged.

When the plant was finally finished, however -- three years after World War I had ended -- it was millions over budget and able to produce armor plate only at twice what the steel companies charged. It produced one batch and then shut down, never to reopen.

Or take Medicare. Other than the source of its premiums, Medicare is no different, economically, than a regular health-insurance company. But unlike, say, UnitedHealthcare, it is a bureaucracy-beclotted nightmare, riven with waste and fraud. Last year the Government Accountability Office estimated that no less than one-third of all Medicare disbursements for durable medical equipment, such as wheelchairs and hospital beds, were improper or fraudulent. Medicare was so lax in its oversight that it was approving orthopedic shoes for amputees.

These examples are not aberrations; they are typical of how governments run enterprises. There are a number of reasons why this is inherently so. Among them are:

1) *Governments are run by politicians, not businessmen.* Politicians can only make political decisions, not economic ones. They are, after all, first and foremost in the re-election business. Because of the need to be re-elected, politicians are always likely to have a short-term bias. What looks good right now is more important to politicians than long-term consequences even when those consequences can be easily foreseen. The gathering disaster of Social Security has been obvious for years, but politics has prevented needed reforms.

And politicians tend to favor parochial interests over sound economic sense. Consider a thought experiment. There is a national widget crisis and Sen. Wiley Snoot is chairman of the Senate Widget Committee. There are two technologies that are possible solutions to the problem, with Technology A widely thought to be the more promising of the two. But the company that has been developing Technology B is headquartered in Sen. Snoot's state and employs 40,000 workers there. Which technology is Sen. Snoot going to use his vast legislative influence to push?

2) *Politicians need headlines.* And this means they have a deep need to do something ("Sen. Snoot

Moves on Widget Crisis!"), even when doing nothing would be the better option. Markets will always deal efficiently with gluts and shortages, but letting the market work doesn't produce favorable headlines and, indeed, often produces the opposite ("Sen. Snoot Fails to Move on Widget Crisis!").

3) *Governments use other people's money.* Corporations play with their own money. They are wealth-creating machines in which various people (investors, managers and labor) come together under a defined set of rules in hopes of creating more wealth collectively than they can create separately.

So a labor negotiation in a corporation is a negotiation over how to divide the wealth that is created between stockholders and workers. Each side knows that if they drive too hard a bargain they risk killing the goose that lays golden eggs for both sides. Just ask General Motors and the United Auto Workers.

But when, say, a school board sits down to negotiate with a teachers union or decide how many administrators are needed, the goose is the taxpayer. That's why public-service employees now often have much more generous benefits than their private-sector counterparts. And that's why the New York City public school system had an administrator-to-student ratio 10 times as high as the city's Catholic school system, at least until Mayor Michael Bloomberg (a more than competent businessman before he entered politics) took charge of the system.

4) *Government does not tolerate competition.* The Obama administration is talking about creating a "public option" that would compete in the health-insurance marketplace with profit-seeking companies. But has a government entity ever competed successfully on a level playing field with private companies? I don't know of one.

5) *Government enterprises are almost always monopolies and thus do not face competition at all.* But competition is exactly what makes capitalism so successful an economic system. The lack of it has always doomed socialist economies.

When the federal government nationalized the phone system in 1917, justifying it as a wartime measure that would lower costs, it turned it over to the Post Office to run. (The process was called "postalization," a word that should send shivers down the back of any believer in free markets.) But despite the promise of lower prices, practically the first thing the Post Office did when it took over was . . . raise prices.

Cost cutting is alien to the culture of all bureaucracies. Indeed, when cost cutting is inescapable, bureaucracies often make cuts that will produce maximum public inconvenience, generating political pressure to reverse the cuts.

6) *Successful corporations are run by benevolent despots.* The CEO of a corporation has the power to manage effectively. He decides company policy, organizes the corporate structure, and allocates resources pretty much as he thinks best. The board of directors ordinarily does nothing more than ratify his moves (or, of course, fire him). This allows a company to act quickly when needed.

But American government was designed by the Founding Fathers to be inefficient, and inefficient it most certainly is. The president is the government's CEO, but except for trivial matters he can't do anything without the permission of two separate, very large committees (the House and Senate) whose members have their own political agendas. Government always has many cooks, which is why the government's broth is so often spoiled.

7) *Government is regulated by government.* When "postalization" of the nation's phone system appeared imminent in 1917, Theodore Vail, the president of AT&T, admitted that his company was, effectively, a monopoly. But he noted that "all monopolies should be regulated. Government ownership would be an unregulated monopoly."

It is government's job to make and enforce the rules that allow a civilized society to flourish. But it has a dismal record of regulating itself. Imagine, for instance, if a corporation, seeking to make its bottom line look better, transferred employee contributions from the company pension fund to its own accounts, replaced the money with general obligation corporate bonds, and called the money it expropriated income. We all know what would happen: The company accountants would refuse to certify the books and management would likely -- and rightly -- end up in jail.

But that is exactly what the federal government (which, unlike corporations, decides how to keep its own books) does with Social Security. In the late 1990s, the government was running what it -- and a largely unquestioning Washington press corps -- called budget "surpluses." But the national debt still increased in every single one of those years because the government was borrowing money to create the "surpluses."

Capitalism isn't perfect. Indeed, to paraphrase Winston Churchill's famous description of democracy, it's the worst economic system except for all the others. But the inescapable fact is that only the profit motive and competition keep enterprises lean, efficient, innovative and customer-oriented.

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