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Citizen Warranties and Majorities

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I. INTRODUCTION

What can citizens do when their governments are nonresponsive or ineffective, and what can a good government or politician do to increase the chances that it will serve all its citizens well? The conventional answers to these questions are reflected in constitutions and in increasingly complex statutory and judge-made schemes. Lawyers might focus on opportunities for litigating against governments, large and small, while political scientists and public-choice-minded academic lawyers are drawn to thoughts of the political checks that keep governments in line. Political leaders impress us when they set our sights on the moon and then get us there on schedule. They frustrate us when we look closer to our ghettos, and see mortality, crime, and literacy rates that appall us even in the face of enormous public expenditures. My aim here is not to explain the combinations of success and failure that we find but rather to explore the idea of improving performance with modest incentives.¹ I explore the possibility that a government decisionmaker, or the majority coalition that is behind it, might be motivated by the requirement that it pay for failure.

The strategy is one of offering a guarantee to citizens, or quasi-warranty, by which I mean some sort of payment by the service provider, in this case the government, so that the government has an economic incentive to perform well. Much as we might think of commercial warranties as encouraging private firms to make good products if only to avoid liability under a warranty, so too public warranties might constitute useful incentives. The analogy is highly imperfect. The *government* is not a person or firm with clear motives; com-

* Dean and William B. Graham Professor of Law, University of Chicago Law School. This article is a revised and expanded version of the Mason Ladd Lecture delivered at the Florida State University College of Law in February 2003. I am grateful for the opportunity and conversations enjoyed there, and for the generous spirit and intellectual energy that was conveyed by the Dean, faculty, students, and staff.

1. Nor is my aim to argue for privatization. There are, of course, political hurdles to privatization, as we see with school voucher experiments, and the effects of privatization are likely to depend on the government service that is involved. In any event, I put privatization to one side here and ask how that which is done poorly by governments might be improved. I do introduce an element of privatization below with the suggestion that private parties might bid for warranty payments. *See infra* text p. 421 following note 11.

mercial warranties offer consumers insurance and, as we will see, these citizen warranties will succeed only by offering little or no insurance. But much as commercial warranties can combine with firms' reputational interests to improve performance, so too citizen warranties might reinforce political checks.

Part II begins with the question of why political checks might fail, so that governments might repeatedly underperform in some areas. Part III explores the form a citizen warranty might take. The focus is on substandard schools, but it could just as well be directed at crime or a number of other areas of government involvement. The discussion explores a warranty that extracts resources from the underperforming government unit, but it also considers a version in which the economic incentive is maintained at no long-run cost to the taxpayers. Part IV then turns to the positive question of why warranties might be a sensible approach when even private markets do not generally offer warranties for services. Some discussion of the *product-service distinction* is for this reason relevant. Part V concludes.

II. THE 60/40 PROBLEM OF A REPEATEDLY UNDERSERVED MINORITY

The focus here is on poorly performing local governments. In principle, citizen warranties could be applied to average governments and to state and federal governments, but the easiest illustrations concern patently poor results for a government facing nearby competitors. As we will see, the idea advanced here might be better applied to governments that face no competition. And it might be an effective means of improving upon even very good government performance. But I leave such thoughts and illustrations for future work.

Consider, by way of a central example, a failing public school or set of such schools under the control of a local government. It is not uncommon to find a city with some good neighborhood schools and a number of very poor schools. These may be schools where half the students are reading two or more years below grade level. There are many measures of school performance. We might wish to take expenditure levels into account, although these are sometimes difficult to observe on a school-by-school basis. The problem of poor public schools is of course an enormous social concern. Underperforming schools doom students who live in the attached neighborhoods unless they have truly unusual parents, are inspired by a remarkable teacher, have the means to escape the system and go to a good private school, or are unusually self-directed and talented. Their misfortune presages a grave social cost in the future.

What explains the persistent underperformance of many such schools? Simplistic positive political theory imagines a market for

politicians in which voters will rise up and eliminate political representatives who do not serve them well.² If the schools are absorbing hundreds of millions of taxpayer dollars, and the schools are much worse than private alternatives or public schools in other areas, then the taxpayer-voters will bring on new politicians in short order. Alternatively, aspiring politicians will point to the underperforming schools and encourage voters to make room for new leadership.

It is useful to compare a malfunctioning public school system where there are, say, twenty failing schools, with a poor traffic system where commuting times are unusually high, traffic signals malfunction, and so forth. At one level, it is much easier to explain the frustrating traffic situation. Dispersed voters might face a collective action problem in gaining political attention; they may not be sure that their elected leaders can do much about the problem; and politicians will survive because of their success in providing other services well and in improving selected subsets of the traffic problem. The return to present-day politicians from marginally improving traffic flow might be low. Schools, on the other hand, absorb enormous resources of the directly observable kind, are amenable to comparison with other school systems, are more likely to affect local property values, and more.

It may be useful to emphasize the puzzle of failing schools. It might not be a failure of the political market if a jurisdiction chose to spend very little on its schools, but many of the school systems we observe spend a great deal and perform very poorly.³ A political majority might simply decide to spend little on schools (despite evidence that investments in education are worthwhile). The apparent puzzle is that many jurisdictions spend high and attain low, so to speak, at least in some schools. Moreover, these failures are highly observable. Mobile families exit these schools in favor of private alternatives or other neighborhoods (or jurisdictions) with better services.

2. WILLIAM H. RIKER & PETER C. ORDESHOOK, AN INTRODUCTION TO POSITIVE POLITICAL THEORY (David Easton ed., 1973).

3. In Fiscal Year 2002, Chicago Public Schools' operating expenditures were \$8,482 per student. Chicago Public Schools, CPS at a Glance, at <http://www.cps.k12.il.us/ata glance.html> (last visited Oct. 10, 2003). Per capita expenditures in the country's largest school districts went as high as \$11,040 (though they can run twice that in smaller, ambitious jurisdictions) and averaged \$6,278. National Center for Education Statistics, Characteristics of the 100 Largest Public Elementary and Secondary School Districts in the United States: 2000-2001, at http://nces.ed.gov/pubs2002/100_largest/table_10_1.asp (last visited Oct. 10, 2003). These are, of course, substantial sums, and they do not include investments in physical facilities. Tuitions for elite private schools are greater than these amounts, but many private schools spend less. To be sure, private schools may not offer special education and other costly programs; at the same time, some private schools offer programs and activities that public schools do not. My aim here is not to enter the fray over the efficiency of public schools but rather to set the stage for thinking about systems with dramatically varying performance.

Nor should we be too quick to believe that the exit of some students causes a downward spiral that dooms a school. It is likely true that the departure of a good student imposes a cost, as it were, on those students that remain, but it is also true that in many school systems each departure leaves the remaining students with more resources per student. The idea is that with substantial fixed costs in facilities and the like, departures provide a windfall to the public system and its remaining students. Put differently, if 250 students enter a public school district or school, we are likely to bemoan the burden on the system in terms of larger class sizes and the like. At the same time, if 250 students depart for the private sector, we are likely to sympathize with the public schools because of the new, perhaps inferior mix of students or the reduced revenue that comes because of some per-student allocation of funds. It is unlikely that these two reactions are both correct. Short-term transitional difficulties aside, if contraction is bad, then expansion is probably good news, or the other way around. Our generous reactions to public school underperformance likely reflect wishful thinking and the perception that bad publicity will hasten the exit of mobile students.

Similar observations might be made with regard to crime fighting, street maintenance, and a variety of other public services. Crime rates are relatively high in some neighborhoods and in some jurisdictions, and yet we do not have really good explanations for the variance in crime rates. We are quick to guess that social and cultural factors explain the rates we experience, but it is hardly radical to suggest that there may be an underlying lack of political will. Crime rates are low in many neighborhoods that border high crime areas. There are pockets of affluence and low crime rates in all major cities with high crime rates nearby, and yet the resources spent on private police forces are modest compared to the enormous expenditures on public policing. It seems likely that more motivated politicians could re-deploy resources or eliminate corruption or take other steps to fight crime more efficiently.

I have tried to allude to a political problem that might *explain* serious inefficiencies in the public sector. It is one that views the school-traffic comparison from a different perspective and suggests that some politicians might be more motivated to care about traffic than about schools. I refer to the fact that political survival depends only, or even at most, on a majority of the electorate. An optimistic view of politics imagines shifting coalitions, so that everyone has political power. Today's loser in a 51-49 vote can make deals with some members of the majority so that a new majority emerges, and no one is powerless.⁴ Today's loser can easily be tomorrow's political winner.

4. WILLIAM H. RIKER, *THE THEORY OF POLITICAL COALITIONS* (1962).

But we are familiar with the idea that some voters or groups of voters might be regular losers. Our legal system or general culture accepts the likelihood of discrete and insular minorities that somehow lose too often or with whom other groups are unwilling to forge alliances. Constitutional protections are afforded to such groups.⁵ There is no reason to think that the idea of repeat losers is limited to racial minorities. It is plausible that geographic and other factors can make other, unrecognized groups into regular losers. Clever politicians also play some role. I do not mean to rush to the conclusion that a politically astute mayor or other politician with control over local schools would thrive by appealing to 51% of the electorate and—or by—exploiting the other 49%. It is too risky inasmuch as coalitions can shift, and the 49% can and will find allies from amongst the 51%. They can *pay* these parties well to join their new winning coalition.

But it may well be that in some jurisdictions it is an excellent strategy for a politician to favor something on the order of 60% or 70% of the population at the expense of the rest. I will call this the 60/40 problem, and by this I mean that rather than serving the entire population and rather than being responsive to all voters either out of a sense of moral obligation, constitutional fidelity, or mere fear of shifting coalitions, a political system might come to exploit 40% in order to benefit 60%.

This argument is akin to Buchanan and Tullock's famous idea regarding the imposition of "external costs" on a minority.⁶ It is not necessary that the 60 exploit the 40, imposing external costs along the way, for it is bad enough if the 60 and their representatives are simply indifferent to the well being of the minority. The problem is that a politician might do just fine (or even better) by caring for 60% of the schools (or neighborhoods) and allowing 40% to fail. The cost of poor education is externalized on to the underserved students as well as society at large; little of the cost falls on the local jurisdiction. Citizens who are thus underserved, and who care about this, and are able to do something about their situations may move to better schools or even to jurisdictions where they can enjoy the status and services due the majority. But many residents will be left behind and, even if some do not care much about education, the society as a whole loses because good education is patently valuable as a social matter. To add insult to injury, if the residents left behind do not vote or are indifferent, the politician's strategy will seem all the more clever (though not socially desirable).

5. See LAURENCE H. TRIBE, *AMERICAN CONSTITUTIONAL LAW* 1673-87 (2d ed. 1988) (discussing a model of constitutional argument based on structural considerations).

6. JAMES M. BUCHANAN & GORDON TULLOCK, *THE CALCULUS OF CONSENT: LOGICAL FOUNDATIONS OF CONSTITUTIONAL DEMOCRACY* 63-91 (1962).

The 60/40 problem is a serious redistributive problem, and perhaps one of initial rent-seeking as well,⁷ but it is also a problem of grave misallocation of resources. At one level, this is obvious. Continuing with the example of public schools, education is an important investment, and it is socially inefficient to have thousands of children mature into illiteracy and, more generally, into life patterns that fail to take advantage of their productive potential. The other level is somewhat less apparent. It is that politicians and the majority coalition will tend to push more goods into the public sector than is socially efficient. True public goods are efficiently provided by government because there is joint consumption and it is difficult to exclude users. If we are to have national defense, for example, it must almost surely be provided by the public sector—or at least the public sector must decide on the level of production, even if it chooses to contract out some of this production.

It might be noted in passing that pure public goods could also suffer from the 60/40 problem. The decisionmaker might appeal to the preferences of the majority while ignoring those of the minority. Thus, 60% of the population might value a manned mission to Mars, and so a government that goes to Mars may well be using resources that would be better spent on something else. Ninety percent of the population might strongly prefer foreign aid over lower taxation and the retention of private resources, while 60% very strongly prefer the Mars mission. Yet the government might choose the latter even though the former is probably to be preferred under most philosophical theories. More generally, the government might simply provide goods that the 60% desire, but not enough to want if charged the true price per person. Thus, imagine a local government that provides fireworks displays, with no possibility of excluding viewers, where there are 1000 local residents. If 600 of them would pay \$10 for the display and the display costs, say \$5000, then the provision of this public good (out of the public fisc) is a redistributive decision. The 600 would have paid for the good, but now all 1000 pay \$5 each (if we can imagine a simple tax system and ignore the inefficiencies it might bring about). The problem is that the town might provide the display even where the 600 would only have paid \$8 each. The public good is oversupplied because part of it can be charged to the 40%. The problem is much worse if a tax system can be devised that taxes the 40% and not the 60%.

For the most part, however, serious misallocation problems will be avoided if the government limits itself to the business of providing

7. The problem will be one of groups seeking to position themselves or to draw political boundaries so as to enjoy the 60/40 situation. The process of seeking this state of affairs is itself wasteful.

true public goods, where there is no option of charging user fees. Where pure public goods are concerned, and where there are legal constraints that prevent disproportionate taxes on the minority, the 60/40 problem is limited to cases where the ruling coalition's tastes are different from the minority's. But where the government can provide other goods, the 60/40 problem is much more common because even when preferences are uniform (or distributed in a variety of ways across the majority and across the minority), the decisionmaker can favor the majority simply by providing goods unequally or by enforcing rights unequally. I should add, quickly and emphatically, that it is not my aim here to argue that government should be limited to pure public goods. There are good arguments for government involvement in education and in health care and in many other areas, especially where there is some competition from the private sector or from other government units. The point here is simply that as governments broaden their mandates beyond traditional public goods, the scope of the 60/40 problem grows.

This focus on the 60/40 problem draws attention to the claim that the 40 might form a set of recurring losers. The constant question, of course, is how often this is plausible, so that the put-upon minority does not form new coalitions and escape its disadvantaged status. On the flip side, the question is why enterprising politicians do not appeal to new majorities, unseating incumbent politicians in the process, by rescuing the losers of the 60/40 problem in a way that builds an alliance between these losers and some subset of the old majority coalition. Thus, where the 600 enjoy fireworks worth \$4800 but (inefficiently) made possible by a tax of \$5 on each of 1000 citizens, the aspiring politician has an attractive promise to make to attract supporters. The 400 can be offered a lower tax of \$1, rather than the old \$5, and the aspiring politician can promise to take the \$1000 in revenue and spend it on a project that appeals only to a subset of 200 citizens drawn away from the old majority. These 200 swing voters would give up the benefits of fireworks worth \$8 to them but costing only \$5 each, in return for paying \$1 in tax and receiving a per-capita benefit of, say, \$5 (the \$1000 divided among the 200 voters). If we think deals like this one are easy to fashion and reliably carried out, then the political market *works* and the 60/40 problem will disappear. And yet, a quick look around our cities and in various other segments of society suggests that this market does not always work. Some groups seem to be left out. It may be that political promises are seen as unreliable; that some parents do not sufficiently take their children's futures into account; that some voters do not trust politicians or government-run institutions; and that transaction costs are high.

In any event, my focus here is on such things as primary and secondary public schools and on violent crime rates, and in both these contexts there can be little doubt but that there are many locales where higher literacy (or educational attainment) rates or lower crime rates would yield enormous social gains. The suggestion is that we look at problems that are very serious, where there is widespread agreement that improvement would yield substantial gains to the citizens directly involved as well as to the society at large, and where it is easy to identify some sort of political failure. My claim is not that with some sort of citizen warranty we can get more socially efficient fireworks displays. It is that with relatively modest—but dramatic—experiments we might be able to break out of equilibria where we are almost surely wasting billions of dollars (and many lives) that need not be lost.

An important objection to the idea advanced here is that if there is indeed a 60/40 problem, then it cannot be solved by a suggestion that itself requires a government program—unless it is somehow imposed by courts or by the electorate in some sort of constitutional moment, which seems most unlikely. The majority will not agree to a plan that ends its advantage, so to speak. If the 60 can exploit or ignore the 40, and keep it that way for some time, then it seems incredible that the 60 would suddenly agree to some socially minded solution to a problem that is of their own making and advantage.

There are several responses to this objection. First, it is possible that a government would agree to a solution, or warranty plan, that only took effect at some point in the future. A government may be uncertain as to its own expected longevity, and there may be political gain in promising a future experiment, and then also substantial political costs to anyone who tries to abort the experiment. Second, the warranty idea may permit ambitious, insurgent politicians to formulate a platform for their own election. These players may have trouble settling on an *offer*, or potential coalition, to break the ruling majority, but the warranty might offer a (seemingly) neutral plan that allows many voters to think they will be better off with change.

Third on this non-exhaustive list is the possibility that the judiciary will bring about citizen warranties where government services are seriously substandard. There are of course occasional malpractice and breach of contract suits brought against governments.⁸ But

8. Courts have traditionally been resistant to these types of suits. In what appears to be the first decision regarding a tort cause of action, a California court rejected a theory of educational malpractice based on the difficulty of establishing any breach of duty and for public policy reasons, specifically that imposing liability would do more harm than good to an already beleaguered school district. *Peter W. v. S.F. Unified Sch. Dist.*, 131 Cal. Rptr. 854 (1976) (rejecting malpractice theory in case brought on behalf of functionally illiterate graduate). Later courts agreed with this rationale. See *Donohue v. Copiague Union Free*

nearly all of these suits fail.⁹ Plaintiffs might complain if, for example, they are illiterate after twelve years of government-provided schooling, but governments can assert a sovereign immunity defense or can point to other products of the educational system by way of blaming the plaintiff.¹⁰ There are other defenses as well. The spirit of the defense has much to do with measurement problems. Much as doctors might lose suits after specific malpractice events but rarely if ever lose simply because a patient is not well, so too governments are fairly safe in court when plaintiffs simply point to their own disappointment with the end product. Among other things, it is difficult to show any causal connection between the plaintiff's injury, if it is that, and the government's negligence, if it is that. Even where the plaintiffs can point to a specific decision, such as inadequate reading instruction, poor facilities, or poor diagnostics, it is easy for the government to claim that there is no industry standard for the best way to teach reading or the best way to teach math to a struggling student, and so forth. Nor is a plaintiff likely to find it easy to point to any one of these decisions (or more than one) and convince a court that the government's decision or entire educational system *caused* the plaintiff's poor state.

Then there are problems in fashioning remedies. Courts are unlikely to grant much structural relief because they are not in the business of running schools and because there is indeed little consensus as to how exactly to run schools. Meanwhile, monetary remedies are difficult to fashion or at least so imperfect as to be troubling. Suc-

Sch. Dist., 391 N.E.2d 1352 (N.Y. 1979) (regarding the entertainment of such claims of "educational malpractice" as poor public policy). Breach of contract actions generally involve private educators and have been found to be deficient because of a lack of any specific promise and breach detailed in the complaint. *See* *Cavaliere v. Duff's Bus. Inst.*, 605 A.2d 397 (Pa. Super. Ct. 1992) (finding against plaintiff who attended course for court reporters); *Wickstrom v. N. Idaho Coll.*, 725 P.2d 155 (Idaho 1986) (finding against plaintiff who was disappointed with auto repair course). The Massachusetts Supreme Court did find for a plaintiff on a theory of educational malpractice. That holding, though, was based specifically on language in the Massachusetts Constitution and likely its reasoning would not apply elsewhere. *McDuffy v. Sec'y of the Executive Office of Educ.*, 615 N.E.2d 516 (Mass. 1993) (finding for illiterate plaintiffs who sought restitution). Specifically, the Court interpreted Part II, clause 5, section 2 of the Massachusetts Constitution, "it shall be the duty of the legislatures and magistrates . . . to cherish . . . public schools," to establish a duty to ensure that the public schools achieve their object and educate the people. *Id.* at 517. By way of comparison, the Florida Constitution's passage on education does not instruct the legislature to cherish anything, but rather "to make adequate provision for the education of all children." FLA. CONST. art. IX, § 1(a). Reasonable courts could interpret these constitutional provisions differently, and perhaps the Massachusetts experience is of little predictive value when it comes to Florida, other states, or even differently constituted courts in Massachusetts.

9. See cases cited and discussion *supra* note 8.

10. Conventionally, plaintiffs will need to show a duty owed, a breach of duty, damages, and proximate cause. The last requirement on its own is probably the most difficult to prove because defendants can say that failure is the product of many causes, including home environment, medical problems, and much more.

cessful plaintiffs might, under some kind of restitution theory, be awarded the cost of private school tuition or perhaps the per-student subsidy that the underperforming school received from the state or school board. But these sorts of funds might discourage the very lawyers that courts are, by assumption, seeking to encourage or at least align themselves with.

I do not intend to argue here or elsewhere that courts ought to impose (what I will call) citizen warranties, or quasi-warranties, on governments. Nor do I think they will. But it is plausible that, in the face of liability threats from courts, governments will on their own try offering warranties. It is even possible that some sort of warranty scheme, once explained, could be offered by one party or other as a structural or injunctive remedy. And if, for example, warranties come into being because governments fear monetary liability, then it would be misleading to say that courts had nothing to do with the birth or imposition of these warranties.

III. STRUCTURING THE WARRANTY

The idea advanced here is meant to stimulate some thought rather than serve as a blueprint for a particular political or social plan. Still, it is useful to set out more specifically what a citizen warranty might look like. The notion, as already explained, is to choose something that a government seems to do poorly and then structure an economic incentive and promise to see if citizens might be better served. Consider three examples in a kind of side-by-side comparison: street maintenance, educational quality, and crime fighting. In all these areas we can defend the proposition that some governments appear to shortchange subsets of constituents in repeat fashion. It is in this sense that political markets can be said to fail.

What if a government offered a warranty that streets would be pot-hole free, and that any shortfalls in service would be remedied within three days? And what, if similarly, a government promised some substantial payment to students who tested far below grade level or to victims of violent crime? One problem with the pot-hole idea is that no remedy has been stated for breaking the promise. If the government offers a payment to the nearest property owner or to persons living within a certain distance of a pot-hole exceeding some specified size, there is the moral hazard problem that property owners might actually create or expand holes in order to qualify for the payment. The same might be true in the education and crime examples, where it is plausible that some selfish or desperate profit maximizers (so to speak) will use or fake educational failure or crime affecting their families in order to receive monetary rewards. People may or may not be sensitive to economic incentives when it comes to

these things, but it seems reckless to offer incentives that might discourage crime prevention or deter families from encouraging their children to read and to use available tutoring services and so forth.

There are, roughly speaking, three ways of dealing with these moral hazard problems. One is to be careful to make payments that are low enough so as not to tempt victims or those around them. A moment's thought will show that this is not easy to do in these settings. The second is to impose very harsh penalties on anyone who creates accidents or losses in order to generate promised payments. The usual problem with this approach is that enforcement is imperfect. The third is to develop a remedy, even for something structured in the form of a warranty of sorts, that does not reward persons who could possibly be in a position to influence the rate of loss. This last strategy is in fact the one I pursue below.

Note that the moral hazard problem is not avoided by simply privatizing these government functions, though it is possible that a government will be better at monitoring a private contractor than at providing a service itself. Thus, a newly elected government might respond to complaints about poor street maintenance by contracting out for private firms to pave roads and fill holes. In turn, the private company might owe damages or otherwise be evaluated by the number of unfilled holes. But the private firm will be unwilling to do this to the extent that the government might be tempted to create potholes in order to receive payments under the terms of the contract. Of course, it is possible that the government can induce other private firms to monitor the firm that is awarded a contract, perhaps because once the market is opened up, various firms will compete for the government contract. Alternatively, the government might award several contracts to different private firms and then reward the firms by ranking the performance of these parties. But it is not my intention here to turn a discussion of government-offered warranties into one of privatization: the point is simply that a monetary remedy for subpar performance raises a moral hazard danger that is not avoided simply through privatization.

A warranty, which is to say a promise and requirement to pay when a product or service does not meet specified standards, can compensate buyers (to be sure), but the focus here is on the expectation that encourages the provider to perform well. Warranties are like liability rules in this sense, as they aim to internalize costs and benefits in one party. Politicians gain from promising and providing services to the electorate, or even to a portion of it, and this presumably encourages them to make more promises or to provide good and desired services. Similarly, if the service is poor or if promises are broken or if things that ought to be supplied to all citizens are only given to some, politicians ought to feel some of this burden in

order to discourage this sort of tactic. Parties are expected to take the implications of what they do more seriously if made to pay for consequences. To be sure, when organizations (including governments) are made to pay, there is room to doubt the internalization logic because there are agency problems and other barriers between the expected payments and that which motivates the actors on the front line who act in the name of the firm or government. And yet there is no doubt that monetary burdens will eventually have an impact on governmental actions, either because officials care about their budgets or because news of the required payments generates political pressure on politicians.

The idea, then, is that a government that may not fear political checks, perhaps because of the 60/40 problem, might better respond to economic incentives. It may be that interest groups seeking to make claims on government revenues will encourage the government not to *waste* resources on warranty payments, or it may simply be that politicians will see no gain in making warranty payments and would prefer to save resources for projects of their own choosing. Either way, the notion is that a government that pays for losses suffered where there are high crime rates, or indeed for all crime, might do a superior job at fighting crime, or budgeting the resources necessary to do so. And a government might do a better job with respect to education if it paid something when some of its schools were doing poorly. The thought here is that some governments are very sensitive to crime and to educational performance and to other matters when troubles beset some citizens or some neighborhoods, but not when they affect others. Economic incentives might solve the 60/40 problem.

For purposes of this exercise I will set out one possible plan, or thought experiment. Imagine a government warranty that was built around standardized tests taken by high school graduates. The school board or local government might promise that any school with more than 10% of the students receiving a failing score on a given exam or more than X percent not able to be admitted to a standard college program would trigger a warranty payment. The payment might be \$10,000 for every student above the 10% trigger. However, the money would not go to these students but (for example) to a scholarship fund at the local state university earmarked for students from this school district.

We might improve on the plan (and save budgetary resources) by choosing a number of third parties, such as universities—but perhaps completely unrelated for-profit firms—and offering them the opportunity to bid for the right to receive these warranty payments. Each year these outsiders would assess the government's likely liability under its own warranty plan and would then pay to the government

an amount less than this expected revenue. The government could use this money for education or other purposes, but it would retain the economic incentive to perform well and to minimize or completely avoid warranty payments.

This is hardly the place to insist on one form of warranty scheme over another, with the one just sketched fairly described as a form of insurance, following Porat and Cooter's work on this subject in contract law.¹¹ But it should be noted that, from a public choice perspective, the third-party bidders will likely make the plan more attractive politically (as it need not cost the jurisdiction money), but less attractive functionally. The disadvantage is that decisionmakers might not be terribly pressured by a scheme that did not impose net costs. It is true that improving schools would lead to lower payments (and leave the system with more money in hand for present projects), but then this improvement would reduce the revenue from bidders in the next time period. For now, I simply leave open the possibility that this warranty system could be a revenue neutral scheme in the long run.

This plan resembles a warranty in requiring payment from the party most entrusted with performance. On the other hand, a warranty would normally make a disappointed consumer whole, while this scheme gives the money to other deserving parties and not to the failed consumer. The point of such a quasi-warranty is to avoid the moral hazard problem. Indeed, we might want to extract payment from the families of failing students in order to get them to exert more effort on or on behalf of their children, but given the variety of causes of failure such a step seems too harsh and perhaps counter-productive.

The \$10,000 figure is obviously illustrative. One might look for a compensatory figure, but again the idea is not to compensate the failed students. The scheme might be restitutionary and look to the resources that the governmental unit should have but did not expend on behalf of these failing students. The schools in question might simply pay out the funds normally received by them on a per-student basis, as a kind of unjust enrichment payment. The figure could also be remedial, though the moral hazard problem arises if we earmark the money for remedial educational programs.

As a political matter, the best strategy might be to earmark some money for the failing students, but require that they actually spend the money on remedial or vocational education, and give the rest to a

11. Robert Cooter & Ariel Porat, *Decreasing Liability Contracts* (Univ. of Chicago Law Sch., John M. Olin Law & Economics Working Paper No. 193, 2d series, 2003) at <http://www.law.uchicago.edu/Lawecon/index.html> (last visited Oct. 24, 2003) and (Univ. of Cal. at Berkeley Sch. of Law, Public Law Research Paper No. 134, 2003) at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=428162 (last visited Oct. 24, 2003).

third party (like the university scholarship program) that is unlikely to be able to influence the failure rate at the local high schools. Again, the third party could bid for the right to this revenue, and if this insurance-quasi-warranty version is the one used, then the third party could even be an insurance company or other profit-oriented firm. Of course, if there is a danger that school officials or teachers will prefer to generate failing students in order to enjoy the increased funding for state university scholarships, then the beneficiary must be yet further removed from the source of the problem. In an extreme case, the money paid out by failing schools in one state could go to programs in another state under some sort of reciprocal agreement.

This strategy can be varied according to circumstances and even according to social problem. In the case of violent crime, for example, Kyle Logue and I have suggested that a government could or perhaps should make payments to third parties when the violent crime rate was much worse than average—but that small amounts would be paid to victims with the bulk of the payments going to relatively remote charities.¹² It should be noted that in the crime context, the reduction in payments to the victims surely makes the system as a whole politically less attractive. In contrast, it is plausible if ironic that, in the educational context, payments to third parties (like college scholarship programs) might make the warranty plan more politically viable. Selfish voters will most prefer that their government not owe money: they can hardly count on being beneficiaries of the scholarship program. But they might favor the warranty in the first place because of the possibility that the scholarships will go to people like them.

The warranty idea can extend of course to street maintenance, where very substandard street maintenance might trigger payments to third parties. But in this context the measurement task is somewhat more difficult. Pot-holes per mile would not do as a measure because of the hazard that the government would allow large pot-holes to grow in the interest of reducing the absolute number of holes. Other measures are difficult to carry out. An outside monitor might rank street maintenance programs, perhaps including snow removal, but as we resort to such measures we will often be inclined to revert to public programs with a political check or to fuller privatization—with its own measurement problems, as discussed earlier.

The warranty idea could also be extended to purer public goods. Thus, if the government aims to keep a space station aloft or to send a human to Mars failure could be well-specified and then trigger a quasi-warranty payment to some program that does not benefit any-

12. See Saul Levmore & Kyle Logue, *Insuring Against Terrorism—and Crime*, 102 MICH. L. REV. (forthcoming Nov. 2003).

one in a position to influence the success or failure of the space program. One reason to draw the line between education and space is because the latter is much in the public eye and the political check is more potent. But another, more systemic, reason to think that the political check is more robust in one case than in the other is that when a space program fails, the majority that might have initially supported it is disappointed and inclined to look carefully at its political representatives. In contrast, when some schools fail, there may be little political pressure brought to bear by the majority whose own schools are just fine. The 60/40 problem is not present with respect to pure public goods. The majority may of course choose programs that are of little value to the minority, as discussed earlier, but at least the majority will care about the government's performance. In contrast, for most other government provided goods, not only may the majority choose what to provide in a self-serving fashion, but also the majority may not care about substandard services provided to the minority.

IV. THE PUBLIC-PRIVATE DISTINCTION

I have sketched the idea of public warranties—where majorities are suspect—and I leave for another effort the question of whether there is any limit to these warranties or whether they are best thought of as legislative or judicial tools. I also leave for another discussion one glaring weakness of the warranty idea, namely that we should be skeptical of such warranties inasmuch as private firms that offer *similar* goods do not offer warranties. But because this question is an especially interesting one, it is useful to sketch it—and some possible responses—here.

One way to criticize these citizen warranties is to point out that it is not as if the government is marketing a defective product or even a lemon of a product. Instead, the government is offering services and it is surely noteworthy that private firms that offer similar services do not generally, if ever, offer warranties. Thus, there are private security companies that operate alongside or in the shadow of police departments, and they do not offer damages or warranties in the event that their presence fails to deter crime or even in the event that with their guards present the customer experiences a much higher than average crime rate. Nor do private schools offer warranties in the event that its students fail to pass or do well on state exams. One can imagine private schools promising that graduates will be admitted to good colleges or high schools, but none seem to make such promises. The moral hazard problem is somewhat limited because tuition is a formidable entry requirement, and its payment reflects the student's (or family's) commitment, but still warranties are

neither implied by law nor voluntarily offered. Why should the government offer warranties where private parties do not? It is possible, after all, that the private market offers no warranties because performance is hard to measure, in which case we would not wish for the government to tread where private parties fear to go.

The question reminds us that there is a larger and more familiar product-service distinction in play here. In most areas where private parties provide services there are normally also no warranties either by private contract or by legal imposition.¹³ Law firms, doctors, private grade schools, movie theaters, and amusement parks are not known for their warranties. They may face liability in the event of malpractice or other tortuous injury, but the failure to perform well or to deliver services effectively does not lead to liability. Product warranties have grown through contract and through law, but they have not appeared with respect to most services. Thus, we might say that government failure to warrant is not remarkable, for this is generally true for services, and we might be skeptical of any attempt to foster the use of warranties, even where government services are wanting.

It is useful at this juncture to understand this product-service distinction in the private sector. If we can make sense of the distinction there, then perhaps it will cast some light on whether product warranties are appropriate or not in the public sector. What then is the reason for product but not service warranties, generally speaking? One fairly conventional explanation, or distinction, returns us to the question of moral hazards. For most products, the warranty gives the disappointed consumer a replacement product or the equivalent so that, for example, a poor tire is replaced by a new one, but the consumer pays some money in order to be put in the same position as a consumer who had a perfect tire with (what have become) somewhat worn treads. There is no incentive for the consumer to puncture the tire or do anything that triggers the warranty. But with respect to most services, the consumer would enjoy the service rendered and then claim that he had not done so, in which case there is the moral hazard of causing bad service results, or simply the redistributive and fraud danger of dishonestly complaining about the service. Thus, we think differently of the restaurant patron who complains about the food after consuming it than we do of the patron who tastes a morsel and objects. Somewhat similarly, where we do see service warranties, as in some overnight package delivery services, the warranty does not make the customer better off than if he or she had not

13. See *La Sara Grain v. First Nat'l Bank of Mercedes*, 673 S.W.2d 558, 565 (Tex. 1984) (distinguishing services from products).

contracted in the first place. Still, it is noteworthy that the government never offered a warranty for its postal service.

There are counterexamples. The L.L. Bean Company famously replaces (even) very used products with new ones if the consumer claims to be dissatisfied.¹⁴ No public school system could afford to do that, and I dare say no automobile manufacturer could create such a trusting relationship with its customers. But by and large it is not profitable to complain about a product, while it can be quite profitable to complain (and collect) regarding services if warranties attached to them.

There are other easy product-service distinctions. The use and quality of products may be much easier to measure. Thus, it is difficult to know whether one received good legal advice and more difficult still to know whether one received services equal to the value of a ticket to the theater. But other illustrations would not put the distinction in such a positive light, and the distinction is often illusory. The claim here is that the worst public school in the country is indeed one that should be covered by a warranty, and yet if one can show that the computer bought last month is the worst one made in the country because it is relatively slow, crashes frequently, and often needs repair, one does not simply receive money for a new computer.

It may also be that we give warranties—or something akin to warranties—where there may be personal injuries caused by poor products (and services), and most services do not threaten bodily harm. But this, like the preceding explanations, raises more questions than it answers.

Perhaps the best available answer to the question of why warranties are associated with products and not with services, or even why the Uniform Commercial Code is limited in this way to products rather than services, is that markets for services are generally characterized by reputational value and repeat play, and it is these features that do the job of encouraging good service.¹⁵ Legal warranties add complexity and cost, and these may be worthwhile only for relatively durable products. A small piece of this is that even where services are long-lived and expensive, the buyer can terminate the relationship in mid-course. The product market counterpart is one where the customer can choose to buy or rent the product, and here we ex-

14. See L.L. Bean Guarantee, at <http://www.llbean.com/customerService/aboutLLBean/guarantee.html> (last visited Oct. 2, 2003).

15. U.C.C. § 2-314.1 (2003) (stating that with the sale of all goods there is an implied warranty of merchantability).

pect warranties to be associated with the purchased product and not the rented one. Indeed, the rental is itself a kind of service.¹⁶

The market for services is also competitive. This alone does not explain the absence of warranties, inasmuch as the market for products is of course also often competitive (though perhaps less so because of entry barriers, including economies of scale, in manufacturing and distribution). But the point is that services are often associated not only with repeat play and reputation but also with market alternatives for the consumer. Competitive service providers will advertise their own strengths, and customers can easily experience a variety of providers.

It goes almost without saying that when the government provides services, it is rarely in a competitive market. Many students and their families are unable to move back and forth between public and private schools, and the same is true for virtually all citizens when it comes to welfare services, postal services, crime fighting, national defense, and much more. The best explanation for the product-service distinction in the private sector does not therefore carry over to the public sector, and I think we can be comfortable imagining and experimenting with public sector warranties for services. The argument is strongest with respect to services regarding which there is a 60/40 problem so that the political market is unreliable as well. It is for this reason that the idea advanced here is limited to circumstances where the 60/40 problem seems plausible.

There is of course some competition *among* government units, even if a government itself seems to be a monopolistic provider. An argument for maintaining the product-service distinction in the public sector is, therefore, that the market disciplines governments, for a poor provider of education or safety will lose taxpayers (from the losing 40%, perhaps) to other jurisdictions. One reaction to this is defensive and progressive, and it is to point to citizens who are less mobile than others or who will simply lose wealth when they sell property to buyers who will pay less because of the poor government services. Indeed, the 60/40 problem may be built around the fact that politicians sometimes serve best those who are in danger of exiting or those who have been induced through government's promises to move into a jurisdiction.

Another reaction is to use intergovernmental competition in structuring warranties. A state might set up a citizen warranty that took resources from underperforming jurisdictions and moved these

16. The state of Texas is the only state to provide for a limited implied warranty for services as well as goods. It does so for many of the same reasons mentioned here. *Melody Home Mfg. Co. v. Barnes*, 741 S.W.2d 349 (Tex. 1987) (implying warranty for home repair services).

resources to high-performance jurisdictions, both by way of reward and by way of compensating the successful jurisdictions for the influx of needy citizens. Imagine, for example, an educational warranty plan that moved students from failing schools to successful ones nearby (in the same local jurisdiction or not) and along with each re-assigned student moved more money than necessary to compensate the expanding school. The idea is to make the failing school wish it had not lost the student, and the successful school pleased that it earned the premium associated with educating one new student.

Similarly, a local police force associated with unusually high crime rates could lose funds in favor of the state police or county police who would take on some responsibility for crime fighting in the underserved area. The idea is to use competition among governments to make these warranty programs more successful and politically attractive. Put differently, an objection to citizen warranties will be that poorly served citizens will simply be worse off if money is drawn away from their jurisdictions. I have already suggested that one solution to this problem, if it is that, is to structure the payments so that they go to a third party that has bid for the right to receive these payments. There need not be a net outflow in such a scheme. A different solution is to funnel the payments to alternative providers of services.

V. CONCLUSION

The school voucher movement may be an unfortunate way to introduce many citizens and politicians to the idea that markets can improve governmental performance, because voucher plans invite the rhetoric and reality associated with the problem of students who are “left behind” in failing schools.¹⁷ Serious competition among public schools, or third party payments of the kind introduced here, might fare better.

More generally, it may be useful to see that in modern times we have experienced increased governmental liability in the form of civil rights suits, the decline of sovereign immunity, and a variety of legislated government payments, and at the same time we properly credit our governments for major accomplishments. But such accomplishments as fighting some wars well, exploring space, developing the common law, curing diseases, and so forth are more often than not achievements that benefit all citizens, or at least are not susceptible to differential delivery of services across the citizenry. Where partial

17. Senator Edward Kennedy (D-MA) has stated that vouchers would be “a death sentence for public schools struggling to serve disadvantaged students, draining all good students out of poor schools.” Casey Lartigue Jr., *Helping Kids Succeed in School Is Not “Creaming”* (Feb. 19, 2002), at <http://www.cato.org/dailys/02-19-02.html>.

public service can be associated with great success, as in the case of public universities in the U.S., there is vigorous competition among providers—as there is not for much of lower school education, crime fighting, and the like. The ideas advanced here have been applied in situations where majorities may receive services at the expense of minorities, and it is in just such situations that warranties may be most useful. These warranties might empower citizens to understand just what it is that the government promises to do, and payments to third parties (who might or might not pay for the right to receive warranty payments) might eliminate the moral hazard that makes most government warranty schemes seem foolish.