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On Principal-Agent Problems, Rogue Agencies, and Systemic Government Failure: A Case Study

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Abstract

Using the concept of global democratic retreat as a background, this article analyses the particular case of abuses committed by intelligence agents working for the US Department of Commerce (DOC) over a 16-year period. Given the complexity of the case, we approach it from different vantage points. Starting with the institutional context, we argue that the issues covered could only occur alongside systemic government failures. We then focus on the agents and argue that they were motivated by white supremacist values and that well-known incentive structures would have deterred them. Finally, we consider the agents' actions and conclude that they were totalitarian in nature. Overall, this article contributes to the understanding of the idiosyncratic aspects of US democratic retreat, which helps with preventing the spread of similar undemocratic modes of operation to other parts of government and highlights issues that need to be addressed to support resilient democratic institutions.

KEYWORDS: Authoritarianism; corruption; asymmetric information (moral hazard, principal agent); government structure; public sector performance.

JEL CODES: D7; D73; D82; H11; and H83.

According to many accounts, democratic institutions worldwide have been under stress since the mid-2000s. Overall metrics capture a downward trend from different aggregate perspectives (EIU 2024; V-Dem 2024; and Freedom House 2024), and numerous regional accounts furnish relevant idiosyncratic details (see Matlosa 2023 for a multiregional overview). If the democratic retreats of the 1960s and 1970s were marked by swift coups, currently, “rather than overnight breakdown, democratic backsliding is a death by a thousand cuts, in which power-hungry executives slice away at fundamental institutional checks and balances in ways that ultimately distort pluralism and political competition” (Cianetti and Hanley 2021). The US is no exception to this global trend (Encarnacion 2023, Grumbach 2023). For example, the Economist Democracy Index (EIU 2024) indicates a slow but steady decline in the US democratic environment for more than a decade across multiple administrations, classifying the country as a “flawed democracy” since 2016. This article analyses a specific blow against US democratic institutions: the case of the Investigations and Threat Management Services (ITMS) of the Department of Commerce (DOC).

At its core, this study is based on the findings of a US Congress investigation on how the ITMS, a small division of the DOC with a focus on basic security issues, evolved into an intelligence agency with police power (S. Rep. 2021²). This evolution occurred outside the

1 The views expressed in this paper are from the author and do not necessarily represent the views of the IMF, its Executive Board, or IMF management. Much of this work was completed when the author was working at the Congressional Budget Office (CBO). The views expressed here should not be interpreted as CBO's.

2 Senate Report. “Abuse and Misconduct at the Commerce Department.” *U.S. Senate Committee on Commerce, Science, and Transportation*. Committee Investigation Report. <http://www.commerce.senate.gov/services/files/C4ABC46A-7CB0-4D51-B855-634C26E7CF70/>.

boundaries of established government operational procedures. Without sufficient oversight, the ITMS scoured the lives of DOC employees, members of Congress, and US citizens. The acts committed by ITMS agents were not restricted to illegitimate investigations but also included the active sabotage of the lives and careers of ordinary citizens who posed no threat to society. For more than a decade, 24 ITMS agents, many of whom suffered retaliation for their actions, reported the division's abusive behavior to a variety of oversight agencies. Despite these efforts, effective actions against the unit were taken only after a Washington Post article (Boburg 2021) was published, culminating with a congressional report that led to the closure of the unit in 2022. The issues raised in S. Rep. (2021) remain concerning because it is unclear whether the mode of operation exhibited by the ITMS might have spread to other parts of the government given the ample support the ITMS received from other agencies. Furthermore, a deep analysis of this case contributes to the prevention of democratic backsliding in the US by covering some of the specific ways in which its fundamental institutional checks and balances are being slowly eroded while highlighting their potential long-term negative consequences for the functioning of a plural democratic society.

Given the complexity of the case, we consider three different levels. At the macro level, we cover the institutional context that enabled the actions on the part of the ITMS. At the micro level, we consider the factors that motivated the rogue agents. Finally, at the atomistic level, we highlight the significance of specific actions. This article employs a pragmatic approach to the study of US government power (see, e.g., Kaushik and Walsh 2019, and Novak 2008). That is, we consider the case of the ITMS to involve a set of problems that can be analyzed most effectively not by resorting to a general theory but rather by conducting a detailed investigation of power-in-action in the context of everyday practices. Furthermore, following Cover (1986), we bear in mind that our legal and political analyses apply to issues that have real consequences. Accordingly, this article addresses ITMS practices in detail and analyzes this complex situation based on concepts drawn from a variety of sources. For example, this article (1) employs the literature on US federal government dismantling and rebalancing toward national security issues to understand institutional shortcomings, (2) uses articles on the incentive problems faced by security agencies and studies covering issues related to white supremacy to place the motivations of rogue agents within a broader context, and (3) reviews works on authoritarian governments to comprehend the very real and cruel consequences of the actions taken by ITMS agents.

At face value, it may seem difficult to argue that there is an ongoing dismantling of the US bureaucracy, a situation in which parts of government become dysfunctional to the extent where basic expected outcomes fail to materialize. Nevertheless, a rich body of literature corroborates this claim. For example, see Favole (2013) regarding the neglect of offices of the inspectors general (OIGs); Eisinger (2017) concerning issues at the DOJ; Lewis (2018) regarding the dismantling of the bureaucracy under Trump; Covid Crisis Group (2023) and Lewis (2021) with respect to various broad failures of the US health system, especially during the COVID crisis; and Farrow (2018) on the case of the State Department. While the dismantling of the bureaucracy can be used to explain why several US government agencies failed to prevent the actions taken by ITMS agents, it cannot fully explain the case addressed by the S. Rep. (2021), which involves a rapidly expanding and overly empowered government unit. Therefore, we focus on the argument that another issue affecting the US government is the ongoing rebalancing of its agencies toward national security issues to the detriment of other valid concerns (see, e.g., Greenberg ed. 2019). This rebalancing results in new forms of government operations that can bypass established systems of checks and balances, potentially leading to a multitude of principal-agent problems pertaining to

situations in which government workers (agents) pursue their interests rather than those of the public (principals).

If the rogue ITMS agents were strongly attuned to the goals of the stakeholders whom they represented, as were the dozens of agents who reported their concerns regarding the ITMS to numerous oversight agencies, the underlying institutional shortcomings would not lead to fringe ITMS actions. This calls into question the actual motivation of the rogue agents. According to S. Rep. (2021), these agents pursued career gains by increasing the scope and scale of their operations as rapidly as possible, often by targeting minorities, environmental scientists, and individuals who voiced concerns that the census was being used to influence elections. In particular, the viciousness with which the rogue agents pursued minorities shows that they were motivated by white supremacist values (Belew and Gutierrez eds. 2021, Section III).

These agents only pursued private goals that went against the public interest because they operated under a faulty incentive structure. A large portion of this article focuses on uncovering aspects of this topic. Although contract theory, the part of economics that studies incentive structures and their principal-agent problems, is a well-established field (see, e.g., Laffont and Martimort 2002), its bulk is mainly concerned with the private sector. Overall, the public sector is more complex, and it is difficult to design robust incentive structures that encourage government workers to align their goals with the public interest because they perform many tasks over a prolonged period and represent multiple stakeholders (Dixit 2002). We argue, however, that basic incentive mechanisms, such as randomly auditing difficult-to-verify work, were not implemented in the ITMS case, leading to situations in which agents were rewarded for “body count,” i.e., the number of self-reported successful outputs in the context of opaque work. The case of intelligence agencies has specific types of principal-agent problems, but only a sparse literature covers them. To further investigate the ITMS case, we adapt incentive structures detailed in case studies of security agencies to our analysis. In summary, we use the idea presented in Acemoglu et al. (2020) that the principal-agent problems of security forces are particularly worrisome because, given their power, they can subvert oversight agencies (which we argue the ITMS did). Furthermore, although it seems implausible that rogue agencies can find ways to incentivize workers to carry out their morally reprehensible work, granting weight to the argument that the ITMS case is of limited concern, we use the mechanism uncovered by Scharpf and Glassel (2020; 2022) to argue otherwise. Namely, we argue that, by selecting underachievers with limited career options and giving them a way to advance, the ITMS had in place a powerful incentive structure that underlined the duration and intensity of their activities.

After addressing the institutional and incentive-related problems that enabled the issues that occurred at the ITMS, the significance of the actions taken by this unit remains to be understood. The ITMS routinely violated privacy rights, added several innocent people to lists of persons of interest, conducted numerous sabotage operations, and relied on faulty accusations in their attempts to send workers at the DOC and the Office of Executive Support (OES) to jail. Given the volume and variety of these actions, we focus on only one case, that of a DOC worker who was spied on at home and at work for years with the goal of collecting information to support a degradation campaign that aimed to force her to quit her job. We focus on this case because it is the hardest to conceptualize among all of the ITMS rogue actions, it has the weakest incentive tools to prevent its occurrence, and it potentially leaves its target without legal recourse³. Similar “zersetzung” tactics were employed by the Secret

3 Based on anecdotal information. In particular, conversations with representatives of the American Civil Liberties Union (ACLU), Amnesty International, Arent Fox Schiff, Citizen Lab, the National Whistle Blower Association, and Sanford Heisler Sharp indicate to the author that these types of agencies could address most of the cases covered in the

Policy of East Germany, the Ministry of Security and State (Stasi 1985⁴, 464; Dennis and Laporte 2011). These tactics are also currently employed in other countries, as shown by the personal account of a correspondent to Russia employed by The Guardian (Harding 2011). We rely on the argument advanced by Arendt (1973, Chapter 13) to conclude that the actions taken by ITMS agents not only sought to isolate the individual target, and were thus authoritarian, but also, by invading the target's privacy and informing her that she was constantly watched, that the ITMS actions were totalitarian since they blurred the distinction between the target's private and public life.

The remainder of this paper is structured as follows. The first section provides a brief description of the relevant government agencies. Subsequently, the paper explains the path by which the ITMS became an intelligence agency with police power, and the ways in which it organized itself and trained its agents to perform its new functions. It then addresses specific cases in which the ITMS exerted its power. The second section covers the broader institutional context, the drivers of the principal-agent problems that impacted the ITMS, and the nature of the actions taken by ITMS agents, in that order. The final section discusses the conclusions of this research.

1 The ITMS Case

This section provides a factual account of the ITMS power-in-action. The facts covered in the first two subsections are later used to delineate the forms of government dismantling and the unchecked expansions of security-related agencies that enabled the ITMS's actions. The third subsection, on how the ITMS trained its agents, is used to analyze principal-agent problems at the unit; in particular, it is used to explain how a powerful disincentive structure was put in place where underachievers were given the opportunity to gain skill and experience to advance in their careers by committing morally reprehensible actions. Finally, the last subsection covers specific ITMS cases that are used in the discussion of the effectiveness of certain incentive structures that actually prevented some extreme ITMS actions, and how the ITMS circumvented them by adopting covert modes of operation. We will use these cases to argue that the ITMS was motivated by white supremacist values and that its covert operations amounted to a totalitarian form of coercion.

1.1 Summary of Agencies and Departments

The issues addressed by the S. Rep. (2021) pertain mainly to the actions taken by three government agencies: the ITMS, which is a unit of the DOC; the US Marshals Services (USMS), which is affiliated with the Justice Department; and the Office of the Director of National Intelligence (ODNI).

The DOC was founded in 1903 with the goal of promoting economic development in the United States. This department currently bears a large set of responsibilities, including conducting a census, generating the most essential macroeconomic and industrial production indicators, providing patent concessions, promoting measurement standards, and analyzing

next section but not cases involving “zersetzung” types of operations. Hence, it is worth considering it in detail to bring awareness of it and to help build institutional capacity to handle similar cases.

4 Stasi (Ministry for Security and State). 1985. *Dictionary of Political and Operational Work*. Second edition. East Germany.

climatic and oceanic conditions. The department employs approximately 45 thousand people and has the lowest budget of the 15 current government departments in the US (USD 8 billion in 2021). The ITMS is a small division of the DOC's Security Department that was created in 2000 with the mandate to protect DOC buildings and directors.

The USMS is a federal policy force associated with the Justice Department that serves the judicial branch. This institution employs approximately 4 thousand people and, among other police force activities, is responsible for safeguarding judiciary buildings and employees as well as arresting criminals at large. Created in 1789, the USMS is the oldest US law enforcement agency.

The IC includes the operations of 16 government agencies, which are distributed across six government departments, in addition to one agency that does not fall under any department (the Central Intelligence Agency [CIA]). These agencies focus on the collection and analysis of information related to national security, and they have unique authorities for intelligence collection. Due to the nature of their work, these agencies operate with higher levels of secrecy than other parts of government. Since the passage of the Intelligence Reform and Terrorism Prevention Act of 2004⁵, IC agencies have been supervised by the ODNI, a role that was previously assigned to the CIA, whose director was, by default, the director of national intelligence (DNI). The budgets and number of workers associated with IC agencies are not made public. However, the number of people with a level of security clearance that grants access to national security-related information is approximately 850 thousand, and according to some estimates, 260 thousand intelligence workers are employed by the US government in some capacity (Priest and Arkin 2010; Light 2018).

1.2 How the ITMS Became an Intelligence Agency with Police Power

Initially, the scope of the ITMS was restricted to the provision of protective services. The division had a specific mandate to protect the DOC director and departmental buildings, and it lacked police enforcement power or the right to perform activities related to national security issues.

To obtain police enforcement power, the ITMS used the USMS. Under specific circumstances, USMS agents can deputize people outside the agency, thereby granting them police power. ITMS members were deputized by the USMS with a mandate to protect the DOC's "critical infrastructure" (S. Rep. 2021, pages 4, 5, 10, and 17)⁶. It remains unclear why the USMS decided to deputize the ITMS agents, and this program granting police power has its own issues (S. Rep. 2021, 14). The vague definition of what constitutes the critical infrastructure of the DOC, alongside the wide variety of activities conducted by this department, allowed the ITMS a broad scope of action. After being deputized, ITMS agents began to conduct criminal investigations, make arrests, and carry weapons in public spaces (including on flights).

To obtain intelligence agency powers, the ITMS initially used the services of the Office of Executive Support (OES) to access the IC, which is the standard way in which a federal agency outside the IC can request its services. However, over time, the ITMS started to view the OES as a roadblock to the division's interactions with IC agencies and acted to obtain direct access to those agencies. Accordingly, the ITMS used its police power to launch

5 Pub. L. No. 108-458, 118 Stat. 3638 (2004).

6 Notably, even the USMS ultimately denounced the actions taken by the ITMS agents to the OIG, claiming that they were biased against minorities (S. Rep. 2021, 35).

security violation investigations of all OES employees. This process included their mass interrogation, and three OES employees were referred to the Department of Justice (DOJ) for potential lawsuits; however, all these cases were later dropped⁷. It is unclear why, but after this investigation, the ITMS received direct access to the IC and began to act as if the division had the authority to perform counterintelligence activities (S. Rep. 2021, pages 4, 14 to 19, 30, 31 and 34). Indeed, a formal complaint submitted by a special agent claimed that the ITMS operated under minimal supervision and as the Federal Bureau of Investigation (FBI), CIA, and National Security Agency (NSA) combined (S. Rep. 2021, 17).

Although the ITMS had only a tenuous mandate to perform police or intelligence agency work, the division cemented its activities in these contexts with ample support from both the legislative and executive branches. The ITMS ended up reporting its actions directly to the ODNI, the office created to supervise the entire IC. An ODNI assessment of ITMS activities concluded that it was important for the ITMS to be involved in counterintelligence operations, that its initiatives were excellent, and that these initiatives had the potential to be extended to other parts of the government (S. Rep. 2021, 16). Congress also supported the ITMS activities; by 2017, it was approving DOC budgets that described the ITMS as a division that fulfilled the national strategic needs of counterintelligence, transnational crime, and counterterrorism by investigating grave national security threats⁸.

1.3 How the ITMS Trained Its Agents

The manner in which the ITMS trained its agents indicated how the division generally operated. Overall, S. Rep. (2021) concluded that ITMS managers were not qualified to establish a police force unit or an intelligence agency and that the training they provided to ITMS employees was focused on how to perform clandestine operations (see, e.g., S. Rep., 25).

Specifically, several agents indicated to the congressional investigation committee that the training they received while working at the ITMS diverged from the expected federal government standards and involved chasing the ITMS director's car at high speeds; placing armed agents in banks and having actors confront them without the agents being aware that the situation was a training exercise; and taking forensic analysis courses led by the ITMS director, who did not have qualifications in the field. The ITMS director himself did not complete the basic training required for criminal investigators and failed to obtain the USMS qualifications required for deputized agents.

The mode of operation exhibited by the ITMS reflected the division's disregard for basic training. In particular, no internal guidelines were established. For instance, although the division conducted police investigations, it either did not document them or did not follow the relevant guidelines concerning how to handle collected evidence (S. Rep. 2021, 22). Furthermore, untrained ITMS agents interviewed and interrogated people without informing them of their constitutional rights. The agency also opened many weak cases which it never closed.

7 See S. Rep. (2021, 15) for the initial interaction between the ITMS and the OES. See page 32 of the same document for the ways in which the ITMS acted against the OES to obtain direct access to the IC.

8 The DOC budget for 2011 already contained a similar description of the function of the ITMS (S. Rep 2021, 15).

1.4 Specific ITMS Actions

By acting as a police force and a national security agency without substantial oversight, the ITMS disrupted the lives of innocent people, sabotaged the careers of DOC workers, invaded the privacy of members of congress and the public, and retaliated against agents who tried to correct the division's mode of operation. The ITMS actions demonstrate the potential destructive power even a small number of poorly trained public servants have when they are granted access to modern surveillance tools and are allowed to use abusive police tactics. Perhaps the most egregious actions carried out by the ITMS were trial cases it attempted to build using faulty evidence. The DOJ regularly declined to bring them forward (S. Rep. 2021, 4), but it accepted the cases against Sherry Chen and Chunzai Wang (S. Rep. 2021, pages 12 and 13).

Sherry Chen is an award-winning hydrologist associated with the National Oceanic and Atmospheric Administration (NOAA) who was investigated and interrogated by the ITMS due to the suspicion that she was a Chinese spy. A case against her was brought to court based on public-domain material that she had forwarded to a foreign acquaintance. In 2014, she was arrested while awaiting trial, but all charges against her were dropped at the beginning of the trial. The defendant referred to potential gross misconduct on part of the ITMS, including the facts that she was pressured by ITMS agents to sign a document stating that she was guilty, and that she was advised by such agents not to seek legal counsel. Chen remains on the DOC's payroll, but she has been placed on administrative leave for an indefinite period since the end of her trial. In 2022, she settled a lawsuit she brought forward against the DOC regarding malicious prosecutions and false arrest (Yam 2022a and 2022b). She is the only target of the ITMS actions that received some form of reparation.

Chunzai Wang is a top scientist researching the impact of climate change on the ocean at the National Oceanic and Atmospheric Administration (NOAA). His participation in a Chinese talent development program triggered an ITMS investigation. Wang was interrogated by the ITMS, his house was searched for evidence, and he spent a day in jail awaiting trial. Initially, prosecutors sought a 5-year jail sentence for him, but all criminal charges against him were subsequently dropped.

The ITMS focused on its acts of sabotage against DOC workers after it became clear that the division was unlikely to win the judicial cases it brought forward. Employing clandestine operation tactics, the ITMS regularly searched the office spaces of DOC workers that it considered suspect (S. Rep. 2021, 12)⁹. These investigations were performed by agents who wore balaclavas and shoe nets and who turned off internal circuit cameras with the goal of leaving no trace and ensuring that the investigations remained off record. The agents searched employees' computers, email accounts, and cell phone data. S. Rep. (2021) notes that the ITMS investigated the lives of many DOC employees thoroughly, including by accessing their information on intelligence agency databases (which include detailed real-time information such as their geolocation, financial transactions, cell phone app usage and communication logs) because their names were not standard white American ones (S. Rep. 2021, pages 18 and 19). A whistleblower noted that xenophobia was the main motivator of the actions taken by the ITMS and that these actions were focused on ethnic minorities, foreign visitors, and individuals with connections to these types of people. The report also indicates that, once a case was opened against a DOC employee, it was unlikely to be closed and that many such cases were classified as "related to terrorist acts."

9 S. Rep. (2021) concludes that many of the ITMS investigations of DOC employees were based on limited evidence.

The extreme surveillance of DOC employees performed by the ITMS was used to inform its acts of sabotage. In one case (S. Rep. 2021, 18), a worker from an ethnic minority group was investigated by the ITMS for more than 4 years, despite the lack of any clear case against her. No supporting evidence of criminal activity was found, although this worker was surveilled both at work and at home. An ITMS agent quoted by S. Rep. (2021) indicated that the aim of this type of surveillance was to isolate employees (to make them “radioactive” in the agent’s words) and force them to quit their jobs due to the enormous pressure they faced.

The ITMS investigated many US citizens and members of Congress. At least one member of Congress was investigated by the ITMS after this member sent a letter to the DOC director asking questions about the US census process. The ITMS used mass surveillance tools to track comments on social media platforms regarding the DOC (S. Rep. 2021, 19). A case covered in S. Rep. (2021) described a situation in which an elderly man with few followers on Facebook was investigated by the ITMS after criticizing the US census on that platform. Alongside a variety of similar cases, this person was referred to the FBI for further investigation. The FBI invariably dropped these criminal investigations, claiming that the people under investigation were exercising their freedom of speech rights in the context of conversations that did not pose a threat to national security. However, the ITMS did not close any of these cases. Another case was opened when a group of middle school students sent a letter to the DOC asking for a whale species to be included on the list of endangered species. This request prompted the ITMS to open a case on these students and to conduct a detailed investigation of the letter’s main author, who was a middle school student (S. Rep. 2021, 33).

The ITMS also routinely retaliated against agents, including decorated soldiers or agents from other agencies, who raised internal or external complaints about the division’s mode of operation. S. Rep. (2021) described several cases in which the ITMS sought to decrease the security clearance of these agents (see, e.g., page 27). Such actions can derail or end the career of a security agent. The courage displayed by these agents was notable. Although they were probably well aware of the retaliation they would face, which could lead to an end of their careers or even jail, they still denounced the ITMS to several government agencies. Their accounts seem to form the core of S. Rep. (2021).

2 Analyzing the ITMS Case

Building upon the facts covered in the previous section, here, we argue in the first three subsections that the ITMS rogue operations occurred because of institutional shortcomings and a faulty internal incentive structure. The final subsection focuses on interpreting the more covert actions of the ITMS since these are the ones that are least countered by legal checks or incentive structures.

2.1 Government Dismantling and Systemic Failure

It could be the case that the idiosyncratic and temporary mismanagement of several US government agencies failed to prevent the abusive behavior of the ITMS; that is, this behavior could have been a tail event, namely, a random, albeit very unlikely, occurrence. S. Rep. (2021, 21) concludes that the ITMS was chronically mismanaged and that it exhibited a culture of rampant disregard for government norms. However, for such extreme abusive

behavior to occur, it was necessary for the mismanagement of the ITMS to be aligned with failures in other parts of government, such as the following:

1. The USMS deputation program (S. Rep. 2021, 14).
2. The DOC upper management, which was informed of the actions taken by ITMS agents, investigated the division and concluded that it did not have the authority to employ broad police power (S. Rep. 2021, pages 20 and 21); nonetheless, the DOC did not act to prevent the division from exercising such power¹⁰. Indeed, it sought to increase the ITMS's budget over the years.
3. The broad network of the offices of inspector general, in particular those of the departments and agencies involved in the ITMS case, that have ample power to investigate and remedy abuses committed by government agencies, but they did nothing to prevent the violations of civil liberties and constitutional rights by the ITMS (S. Rep. 2021, pages 5 and 33 to 36).
4. The DOJ that received many trial cases from the ITMS based on weak evidence, some of which were dropped during the trial, but it did not push for an audit of the ITMS.
5. The ODNI that allowed and encouraged a small division operating outside the IC to act as an intelligence agency under minimal supervision, thus potentially allowing the mode of operation exhibited by the ITMS to spread to other government units (S. Rep. 2021, 16).

If the random alignment of such failures on the part of these US government agencies allowed the ITMS's actions to occur, preventing similar misconduct would involve reducing the probability and duration of such failures. Reinforcing the role of agencies that provide formal means by which government divisions can interact, such as the OES, should decrease the likelihood of collaboration among mismanaged divisions. Strengthening the role of OIGs should not only deter agency misconduct but also quickly end the abusive behavior of an agency because these offices have a mandate to investigate and redress such issues; they can report directly to Congress; and they have the power to conduct audits, inspections, and investigations.

The dismantling of government institutions could provide a more systemic explanation for the failure of several government agencies to prevent misconduct by the ITMS. On the surface, it seems difficult to argue that the US federal government is being dismantled or, even further, that it is "weak" (Novak 2008). First, the scope of government operations (Higgs 1991) underwent a large increase from 1990 to 2017, as argued, for example, by Coyne and Hall (2018, 9). In addition, based on labor data¹¹ drawn from Light (2018) and budget data drawn from the Office of Management and Budget (OMB 2023), little evidence has been found to indicate that the US bureaucracy is under attack in terms of either the number of workers in the bureaucracy or its budget. Indeed, these metrics indicate that the US government is growing in scale.

As Figure 1 illustrates, all departments experienced budget increases from 1990 to 2018, and most departments reported increases that exceeded the growth of real GDP. The

10 Even the DOC upper management was likely powerless against the ITMS. One secretary of commerce built a Faraday cage in his office to prevent eavesdropping. See S. Rep. (2021, 26) for a discussion of how the ITMS lacked an internal supervisor for many years and how it investigated a person hired to oversee the actions of ITMS agents.

11 See Light (2020) for more current labor data. We exclude the years affected by COVID from the analysis to avoid the inclusion of years featuring exceptionally high government expenditures.

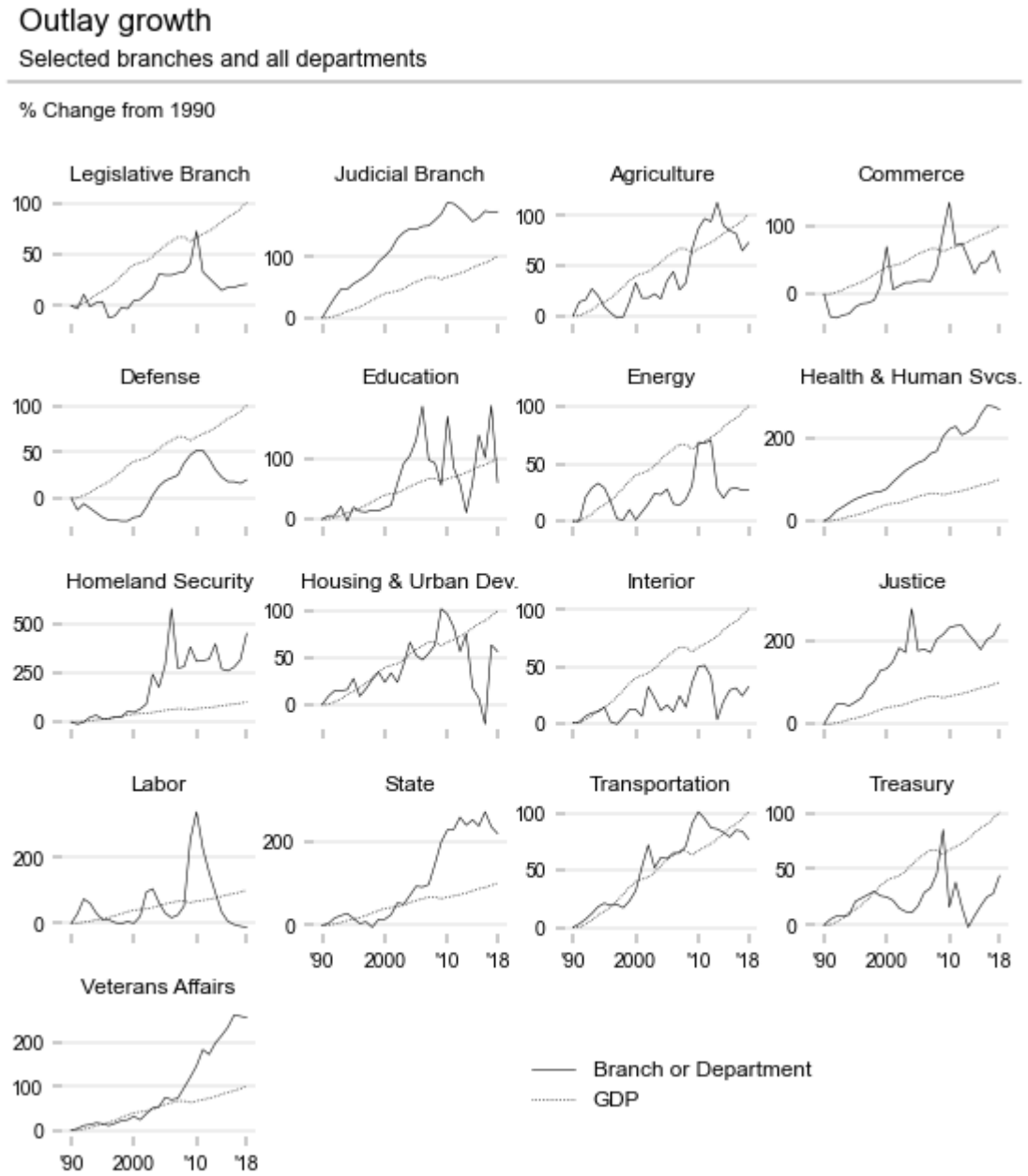
number of federal employees decreased from a peak of approximately 2.1 million workers in 1990 to a minimum of approximately 1.7 million workers in 2002, but this workforce recovered to approximately 2 million workers by 2017. The decrease in workforce size of approximately 5% that occurred from 1990 to 2017 was large, but a more detailed workforce analysis tells a different story.

First, the number of federal workers has historically fluctuated around 2 million workers (a threshold known as “Whitten’s cap”), and since the 1970s, this number decreased to below 2 million only from 1996 to 2006. Second, we should focus on nondefense federal workers in our arguments concerning the dismantling of the bureaucracy, and the number of these workers grew from approximately 1.1 million in 1990 to approximately 1.3 million in 2017 (i.e., a 16% growth rate). Even if we include contract workers in this analysis, which constitute the majority of the people working for the federal government, we still observe a 4% growth in the number of federal workers in this group, which increased from 2.8 million in 1990 to 2.9 million in 2017.

Nevertheless, the robust literature on the dismantling of US bureaucracy has viewed this phenomenon as the main threat to the proper functioning of the US government (see, e.g., Fukuyama 2014 and 2023; Kovacs 2020 and 2021; Freeman and Jacobs 2021; Noll 2022; Moynihan 2023a and 2023b). A great deal of this literature has identified the actions taken by the presidency against the bureaucracy as the mechanism underlying the dismantling of the administrative state; however, the literature has also identified many other mechanisms, such as the neglect of parts of the bureaucracy by presidencies that are focused mainly on their own policy goals (Bednar and Lewis 2023), the contracting out of essential government functionalities, which could erode government capacity (Verkuil 2017, Light 2018), and the accumulation of various layers of managerial bureaucracy that can hinder proper government work (Light 2008). Skowronek, Dearborn, and King (2021) also refer to the dismantling of the bureaucratic state within the broader context of a fight between an entrenched bureaucracy and an overly empowered presidency.

The dismantling of the bureaucratic state likely played a role in facilitating the actions taken by the ITMS. For example, as detailed in the previous section, the position intended to oversee the ITMS directly remained vacant for many years, the ITMS actively eroded the OES, and the OIG failed to act on numerous complaints concerning ITMS actions, including complaints raised by ITMS agents themselves. The dismantling of the bureaucratic state provides an alternative to the theory that tail events explain the coordinated failure of several government units. The ITMS case serves as a warning that the continued dismantling of the bureaucratic state may lead to systemic government failures that are difficult to understand or resolve fully. The literature on this topic has considered many policies that could address this issue, and Light (2008) offers a comprehensive set of proposals in this regard, such as (1) limiting the number of political appointees, (2) reducing the layers of government management, (3) reducing the size of government, (4) revitalizing the federal government career, and (5) reducing the frequent outsourcing of federal work.

Figure 1.



Source: (1) FRED (2024) for GDP and deflator, (2) OMB (2024) for outlay information.

2.2 Principal-Agent Problems and Undemocratic Side Effects of Unrestrained Government Rebalancing Toward National Security Issues

Several agents related to Congress that the main goal of the ITMS was to expand its power as quickly as possible (S. Rep. 2021, 29). Indeed, the ITMS rapidly became an intelligence agency with police power under minimal supervision. Hence, the dismantling of the bureaucratic state alone does not explain the entirety of the ITMS case; we must also consider the ongoing process of rebalancing the US bureaucracy in favor of security issues. Ample evidence of this phenomenon has been reported. On this topic, see, for example:

1. Brooks (2016) regarding the fact that the Department of Defense (DOD) has been taking responsibility for the mandates of other agencies, becoming one of the few efficient departments;
2. Farrow (2018) and Stuart (2009) regarding how the State Department lost ground to the Pentagon and intelligence agencies;
3. Farrell and Newman (2023) for the fact that the Treasury Department has become an agency capable of conducting economic warfare¹²;
4. Balko (2021) regarding the militarization of the police force;
5. Coyne and Hall (2018) and Schrader (2019) for a historical account of the ways in which numerous US-led foreign interventions resulted in the accumulation of knowledge and capital pertaining to social control and surveillance that were later applied inside the US;
6. Golden (2018) concerning the increasing influence of intelligence agencies on academic institutions; and
7. Zuboff (2019; 2022) and Schneier (2015) for a detailed analyses of the profound social transformation associated with the rise of technology companies that operate as mass surveillance agencies.

A large body of literature has investigated the reasons underlying the US government's tendency to rebalance its operations in favor of security issues, usually by focusing either on long-term trends (starting with the US occupation of the Philippines or the Truman administration) or on more recent events in the post-9/11 world (for example, see Coyne and Hall 2018; Glennon 2014; Greenberg ed. 2019; Greenberg 2021; Hogan 2000; and Stuart 2009). In the context of this article, we focus on post-9/11 policies. In particular, we interpret the actions taken by ITMS agents in light of the new government operational procedures, a set of three "subtle tools," as described by Greenberg (2021). Namely, this reference argues that post-9/11 the US federal government has begun to (1) abandon established procedures and act without internal institutional constraints; (2) write new laws in a vague manner, thereby providing the executive branch with an ample field of action; and (3) avoid scrutiny of its actions, including internal scrutiny, such as by establishing new tribunals within the executive branch to avoid oversight from the judiciary branch, or by

12 See also Mulder (2022) for a historical perspective on the tools in use. In summary, following Slobodian (2018, 271) and considering the neoliberal world economy to be centered on institutions, such as the World Trade Organization (WTO), that were built to prevent the interference of states in the (global) economy, then we are transitioning away from this order toward a paradigm in which other national and security interests take precedence over economic issues.

restricting access to information to only a few members of congressional oversight committees.

The case of ITMS is in line with Greenberg's (2021) analysis of new forms of government operations. Overall, the ITMS was a division of the executive branch that dispensed with the established guidelines that govern American intelligence agencies and police forces by obtaining a vague mandate that allowed this division to act without meaningful oversight or public acknowledgment of its actions. Indeed, the general public seems to be unaware of the fact that individual government agencies (e.g., the DOC census in the example previously discussed) can investigate them if they complain about the services provided by those agencies on social media platforms. If Greenberg's (2021) subtle tools facilitated the emergence of the ITMS, it would be difficult to prevent, detect, or fix the recurrence of such problems since they could emerge in situations in which agencies or private firms operate outside the scope of any meaningful oversight, including oversight from the IC. Given the size of the US federal government, it is likely that numerous civil servants and contractors are already operating under vague mandates, in the absence of institutional constraints, and under conditions of little oversight; hence, some of these individuals might already be implementing ITMS-like operations. In this scenario, it is important for the government to proactively identify such cases, and it is necessary for the IC to reassert ownership of its own mandate. Overall, the main issue of concern in this context is the potential for states that overemphasize security concerns to become totalitarian to some extent. According to Arendt (1973, Chapter 13), the aspect that characterizes a totalitarian state is not the fact that it is powerful but rather the fact that it blurs the distinction between public and private lives. The actions taken by ITMS agents clearly blurred that distinction in a variety of ways. Replacing the aforementioned subtle tools with a better-designed institutional mode of operation for security-related agencies and private firms is perhaps the safest way of preserving the ability of the federal government to function appropriately.

2.3 The ITMS Incentive Structure

To fully understand the ITMS case, we must consider the main drivers of the division's managers and the incentive structure under which they operated independent of the institutional shortcomings that facilitated their actions. Anecdotal accounts of faulty incentive structures and related principal-agent problems of situations in which security and intelligence agents seek personal profits from their positions are prevalent, and works of fiction have captured the essence of these accounts well¹³. Unlike most of these accounts, no evidence was found to indicate that the ITMS managers aimed to extract financial rewards or other crude benefits from their victims; rather, these managers were focused on broader career rewards and used ideological biases to justify their actions.

If we follow Belew and Gutierrez eds. (2021, xi) and define white supremacy to mean both the belief in the superiority of white people and the broad systems of inequality that ensure racial disparity, even in the absence of individual belief, then the extreme methods the ITMS agents employed against minority workers were white supremacist in nature. In short, the targeting of minority workers with trial cases based on false accusations, the mass investigation of all workers without "standard white names", and the home surveillance of a minority worker used to inform an intimidation campaign in an attempt to force the person to

¹³ See, for example, Von Trier (2000), *Dancer in the Dark*, and Von Donnersmarck (2006), *The Life of Others*, for works of fiction that depict principal agent problems in which the principal agents rely on authoritarian and totalitarian techniques, respectively.

quit a job indicate that an extreme system of inequality was put in place at the DOC that, on one hand, provided a congenial work environment for white employees and, on the other hand, dispensed an abject treatment to minority workers. White supremacist problems have been previously reported among law enforcement agencies (see, for example, Belew 2019; FBI 2006¹⁴; and Speri 2017). The account of the actions by ITMS agents provides concrete evidence that not even high-level and highly accomplished US government workers are immune to the actions of white supremacists, indicating that these values are pervasive and that intelligence units also face serious white supremacist problems.

The incentive structure of the rogue ITMS agents exhibited basic contract theory problems. Government workers perform several tasks over a prolonged period while representing multiple stakeholders. This situation causes them to respond weakly to incentives. Hence, it is difficult to develop strategies for properly incentivizing and overseeing their activities (Dixit 1997 and 2002). However, in the case of the ITMS, even well-known incentive and oversight structures were not implemented. Some of the actions taken by ITMS agents involved bringing trial cases against DOC and OES workers. In these cases, the quality of the ITMS agents' work was difficult to observe externally, but the quality of their output was still observable by checking whether the cases were accepted by prosecutors or by analyzing the results of the corresponding trials (namely, this situation represents a "moral hazard" problem). The strategy that is usually employed to address a moral hazard problem is to devise a reward structure (a "payment schedule") based on the observable part of the relevant actors' work, i.e., the final outcome of their services. Fortunately, such an incentive structure was implemented in the case of the ITMS. That is, DOC managers could use the trial work performed by the ITMS as a justification for requesting larger budgets or more authority for the ITMS from Congress only if the cases were ultimately successful (in the terminology of contract theory, these managers faced a tight "step function" payment schedule). This approach, however, seems to be the sole appropriate reward structure for incentivizing ITMS agents. This type of incentive may be sufficient for prosecutors since trial results (or at least the use of respectable legal practices) define their career standing; however, it is insufficient for agents who multitask and hence have access to alternative reward structures, which is commonly the case for government workers, since they can shift away from nonprofitable incentives (Dixit 2002). Unfortunately, the ITMS agents could still justify the division's need for more power and a larger budget by performing tasks associated with opaque outputs, as evidenced by the number of cases they opened but never closed or their drive to investigate all DOC workers without standard white names. The basic strategy used to prevent abuse in situations in which outputs are costly to verify is to increase the probability of an audit as the number of claimed successful outputs increases (Dixit 2002). Otherwise, agents are rewarded based on body count, an incentive structure that is widely regarded as flawed.

The previous discussion employed a general theory of the incentive structure of government workers. That theory does not completely cover the ITMS case; we refer to a more specialized literature on the incentive structure of intelligence and security agencies to explain the broader corrupting effects of the ITMS, and the intensity and duration of the ITMS activities.

The adverse effects of the actions of the ITMS agents were not circumspect to the quality of the services they provided. This may be the case for a generic government agency but, as noted in Acemoglu et al. (2020), covering issues of Colombian security forces, given the power that police and intelligence agencies wield, faulty but highly rewarding incentive structures can lead to broader government failures since the relevant agents can use their

14 FBI (Federal Bureau of Investigations) 2006. "White Supremacist Infiltration of Law Enforcement." FBI Intelligence Assessment.

power to intimidate other parts of government, just as the ITMS did to OES workers, internal DOC supervisors, and other ITMS agents who reported on the unit's actions. Hence, the ITMS case furnishes another concrete example of this phenomenon, and stresses the need for a theory addressing the broader corrupting effects of rogue intelligence agencies.

The duration and intensity of the ITMS actions can be explained from an incentive structure perspective. As reported by the S. Rep. (2021), the rogue ITMS agents sought to increase the scope and scale of their unit as quickly as possible. However, they mostly worked on a fabricated caseload, and the training they offered, as well as their overall mode of operation, showed that they were poorly prepared to perform intelligence or police work. As such, it would be better for these individuals to pursue a career in more firmly established parts of the IC with the goal of obtaining proficiency in their chosen field of work. These parts of the IC, however, are hierarchical and meritocratic (see, for example, Figliuzzi 2021 for an internal account of the example of the FBI); thus, the rogue agents would have limited career prospects in that environment. It is easy to regard these individuals as fringe actors or "buffoon agents" who were ultimately bound to fail. The amount of time for which the ITMS operated, which spanned nearly two decades, and the effort needed to stop this institution, however, indicate that these individuals were driven workers. The problem that emerges is that of underachievers who lacked good career prospects in established intelligence agencies and who performed morally reprehensible acts with the goal of acquiring skills and status that would otherwise be inaccessible to them. This is a powerful incentive structure that underpins the more repressive aspects of autocratic governments. Indeed, architects of secret police services in authoritarian regimes, ranging from Nazi Germany to Latin American dictators, have been well aware of the power of this incentive structure, and they have actively selected underachievers to perform morally reprehensible jobs (Scharpf and Glassel 2020 and 2022)¹⁵. The ITMS case not only provides further evidence corroborating the theories of Scharpf and Glassel (2022) but also supports two hypothesis made by these authors regarding repressive structures in democracies. The first one propose that, in democratic countries, security agencies tasked with morally challenging roles, balancing national security against civil liberties, are likely to retain employees who are less inclined to refuse assignments due to limited career alternatives¹⁶. Their second hypothesis posits that democratic institutions can undergo swift autocratic turns without major bureaucratic resistance by relying on the willing work of officials facing career pressures, while their well-placed peers remain silent bystanders. Both predictions can be argued to apply to the ITMS case, offering insight into why this unit's rogue agents were highly motivated, why their operations persisted for an extended period, and why there was no significant institutional opposition to their actions.

2.4 Nature of the Actions Taken by ITMS Agents

After addressing the institutional and incentive structure that enabled the ITMS case, we now provide an interpretation of the nature of their actions. Here, we focus on one particular case, that of an unnamed DOC worker who was spied on at home and at work for years with the goal of giving her the impression that she was under constant surveillance, and to collect

15 As one such architect indicated, "We don't want clever people. We want mediocrities" (Scharpf and Glassel 2020).

16 These employees may approach their tasks with enthusiasm, recognizing that the skills and experiences they acquire could enhance their qualifications for more rewarding positions in the future.

information to support a degradation campaign that aimed to force her to quit her job. This case closely resembles the *zersetzung* operations performed by the Stasi with the goal of isolating and undermining targeted people while preserving a veil of normalcy and avoiding formal judicial procedures, as discussed by Dennis and Laporte (2011). Specifically, the Stasi Manual (MfS 1985, 464) indicated that *zersetzung* involves first acquiring detailed information on a target and then systematically degrading the target's reputation, image, and prestige by engineering social and professional failures with the goal of undermining the individuals' self-confidence, causing them to shut down. Similarly, the ITMS agents mentioned that they spied on the private life of a target of their actions over many years and then proceeded to place an enormous amount of pressure on that individual with the goal of isolating her at work (e.g., making the individual "radioactive," in their own words) and force her to quit her current position. Both the Stasi and the ITMS applied these methods to individuals whom they knew to be innocent but who nevertheless belonged to "undesirable" groups. These actions can lead to lasting changes in the lives of target individuals, as discussed by Funder (2003). See also Harding (2011) for a more current personal account of how the Russian government used *zersetzung* tactics against a foreign correspondent.

We refer to Arendt (1973, Chapter 13), which analyzes in detail the differences between authoritarian and totalitarian forms of government, to obtain a proper perspective on *zersetzung*, interpreting it as a totalitarian form of coercion. Authoritarian actions are based on the isolation of individuals, that is, on the aim of rendering them incapable of pursuing a common concern. Although this approach represents a very aggressive form of coercion, it leaves individuals' private lives intact and thus allows them to retain the ability to enjoy personal life experiences, the option of performing technical work, and the capacity for meaningful thought. To the extent that technical work requires a degree of isolation, as emphasized in the reference cited above, PhD scientists working at technical institutions such as the NOAA who face an aggressive form of isolation may cope with this situation by focusing on the technical parts of their work. Totalitarian forms of control are more aggressive than authoritarian ones since the former go one step further by attacking individuals' private lives, the method of attack of the *zersetzung*-like actions of the ITMS. The aim of such forms of control is to produce loneliness, i.e., a situation where individuals feel that they are superfluous, lack human companionship, and do not belong to society; such a situation was identified by Arendt (1973, 475) as one of the most radical and desperate circumstances that humans can endure. Totalitarian undertones can be detected in other events covered in the previous section. Examples of this include the case when the ITMS started to search the workspaces of DOC employees because they were members of minority groups, or the fact that the DOC decided to retain Sherry Chen on its payroll but refused to reinstate her, thereby making her capacity for work superfluous and causing her to feel that her life efforts were in vain (Yam 2022a).

Zersetzung tactics or other forms of authoritarian attacks on individuals may have broader negative political outcomes, even if the country itself is not under an authoritarian regime. In the past, American intelligence agencies have used underhanded maneuvers to remove numerous progressive workers from the federal government (see, e.g., Storrs 2012) in a manner that drove an even larger number of like-minded people away from government jobs. Similarly, the ITMS used underhanded tactics to remove several minority workers from the government and potentially decreased the desire of such populations to participate in or interact with the government after these stories became public. Ultimately, this curtails the views of a plural society inside the federal government.

3 Conclusion

This article summarizes S. Rep. (2021), a report on abuse and misconduct within the DOC. The report covers the actions taken by a division of the DOC, the ITMS, which evolved from a security group with a mandate to protect the department's buildings and director to an intelligence agency that wielded police power and operated under minimal oversight. This development led to principal agent problems; that is, key division workers acted in accordance with their preferences and interests to the detriment of the public interest that they were hired to represent. The abuse and misconduct exhibited by this division were not limited to the misuse of funds but also included acts of sabotage against people whom the division knew to be innocent as well as clandestine operations that violated fundamental rights, such as the right to privacy. Ultimately, the agents of the division seem to have been motivated by white supremacist values.

The misconduct exhibited by the ITMS was able to occur and last for nearly two decades because the concomitant failures at several government agencies either empowered the rogue agents working for the ITMS or prevented the targets of the ITMS from accessing services that would ensure the preservation of their basic rights. Ultimately, the inaction of several government agencies and the tacit consent granted by the silence of numerous federal government workers normalized the use of degrading practices that are usually associated with authoritarian, or even totalitarian, governments. Whether this large-scale failure of several government agencies represented a systemic failure or a chance occurrence remains unclear. This paper considers various potential mechanisms, such as tail events; the dismantling of federal government agencies; and new government operational procedures, including the "subtle tools" of Greenberg (2021). Proposals to counter these potential underlying issues, especially those of Light (2018), have been considered. Regarding the literature on issues facing the US bureaucracy, we diverge from Fukuyama (2023) and Moynihan (2023a; 2023b), who focused on the dismantling of the bureaucratic state for political reasons, and suggest that strengthening government workers should be the preferred policy. In this paper, we also consider the rebalancing of the federal government toward security issues. This rebalancing leads to new forms of government operations that can bypass established systems of checks and balances, potentially resulting in a multitude of principal-agent problems and the loss of government legitimacy.

Given its general approach, this article may serve as a broad analysis of a concerning problem that can be used to guide more pointed quantitative studies. However, even at a general level, some core issues are missing in this analysis. Unfortunately, S. Rep. (2021) failed to provide sufficient financial details regarding the ITMS, which could reveal further cases of principal-agent problems, especially if private intelligence companies were hired by the ITMS. In addition, the report did not address revolving door issues, which might be relevant to the task of determining whether the rogue agents were ultimately interested in acquiring job experiences that could be relevant to more lucrative private-sector positions. Some evidence suggests that private agencies are employed throughout the government (Light 2018; Priest and Arkin 2010; and Shorrock 2007), that these agencies operate under minimal oversight (Light 2018; and Verkuil 2017) and that they are beginning to grow out of control (Farrow 2020; Priest and Arkin 2010; Richard and Rigaud 2023; and Shorrock 2007). These agencies have strenuously defended objectionable clients, as indicated by the underhanded tactics they have used in defense of sexual predators (Farrow 2020) or the actions they have taken against journalists seeking to report on organized crime (Richard and Rigaud 2023). No issue seems to be too small for their employment; for example, they have been used to influence the election of a small-town hospital board in California to support a

corrupt official (Entous and Farrow 2019). The incentive structure associated with this case is different from the structure applied to the rogue ITMS agents; the cited references have indicated that these private companies hire from leading government intelligence agencies, and that they operate in poorly regulated markets in the absence of meaningful oversight. The incentive operative in this context encourages these companies to act as aggressively as possible to satisfy their clients or to develop a market reputation that can enable them to secure further contracts. Hence, such companies operate in response to an incentive that would encourage them to spread the aggressive ITMS-like practices to other parts of government. One policy proposed by Light (2008), i.e., ending the outsourcing of essential federal work, would resolve this particular threat to proper government functioning, whereas strong market regulation is needed to address the problems these private agencies are causing in society as a whole.

Globally, democratic institutions are being tested. Different regions have their own reasons for this phenomenon. In the US, idiosyncrasies include an ongoing dismantling of the bureaucracy; a rebalancing of the government toward national security issues; and badly designed incentive structures within crucial government units. This article highlights how these shortcomings enable the emergence of principal-agent problems, which may risk pushing the US federal government toward adopting totalitarian tactics rather than leveraging its unparalleled legal and investigative structure. Since it remains unclear whether the rogue mode of operation exhibited by the ITMS was adopted by other government agencies or private companies, the development of policies and guidelines aimed at preventing or mitigating its occurrence is not merely an interesting academic topic but also a timely research agenda that can support the government's functioning. Moreover, if this problem is neglected, it is likely to spread to other countries, many of which possess considerably weaker media institutions and systems of checks and balances compared to the US, potentially steering the world toward greater authoritarianism.

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