



RENT-SEEKING ON THE SUPPLY SIDE OF POLITICS¹

MARK A. ZUPAN²

In studying how rent-seeking diminishes a nation's well-being, the focus typically is on the demand side of the policymaking process: crony capitalists, economic elites, labor unions, industrial cartels, consumer activists, and/or environmentalists seeking favorable policies to promote their own economic rents at the expense of the general public. Precious little attention, however, is devoted to a potentially far more dangerous and pervasive form of political capture by government insiders who operate on the supply side of the policymaking process – rulers, elected officials, policymakers, and public employees. Government insiders have the motive, means, and opportunity to co-opt the machinery of the state to promote their monetary and ideological interests at the expense of the general citizenry. This malignancy operates akin to how cancer hijacks the body's own reproductive machinery to grow at its expense.

Politics can be defined as “Who Gets What, How, Why, When, and Where.” It is helpful to keep this definition in mind when thinking about government self-capture: who and what it involves; how it grows both in autocracies as well as in democracies; why it is so difficult to counteract and thus was a core concern of the Founders when constructing the constitutional foundations of the American Republic; and the numerous settings when and where it has accounted for national decline and failure.

The list of storied civilizations succumbing on account of government self-capture is lengthy. It includes Egypt's New Kingdom; China's Han Dynasty; the Roman Empire; the Republic of Venice; the Mamluk

sultanate; France's Ancien Regime; and the Ottoman Empire.

The lessons to be learned from these historical failures are manifold. While difficult to counteract, government self-capture is not inevitable and there are some important curbs with which it can be combated. Moreover, the current importance of understanding the affliction of government self-capture and its debilitating consequences cannot be overstated.

In today's developed nations, total government outlays average more than 50 percent of GDP, while public sector employment averages over 28 percent. Public sector employment exceeds 50 percent in some developing countries such as China (OECD 2015). In the United States, the unfunded pension and health care liabilities of state and local government workers and K-12 public education provide two compelling examples of the negative effect of government self-capture. If not addressed, the magnitude of these negative effects will continue to grow and threaten the viability of the American Republic.

Government self-capture: who and why?

Government self-capture involves self-enrichment by government insiders at the expense of the overall body politic. Rulers, political leaders, and public employees can benefit from their positions on the supply side of the policymaking process. The perks or economic rents that they derive on account of imperfect accountability on the supply side of the policymaking process may be material (kleptocratic) or ideological.

In building an effective state, one must overcome an important conundrum. Specifically, while political order provides important benefits for a society and its citizens, such monopolization of power also contains the seeds of political decay. This resembles the natural monopoly problem: economies of scale militate toward a sole supplier of the entire market, but the resulting monopoly position affords, if unchecked, the sole supplier the means and opportunity to extract rents at the broader public's expense. The rents derived by government in-

¹ This paper is based on a forthcoming book by the author titled “Co-opting the State from Within: How Government Insiders Subvert the Public Interest” and slated to be published by Cambridge University Press.

² Simon Business School, University of Rochester.

siders on account of their roles on the imperfectly accountable supply side of the policymaking process impose an efficiency cost on society and thereby diminish national well-being.

How does government self-capture work?

Government insiders capture rents when the supply side of the policymaking process is imperfectly accountable. Financial rents can be secured openly or in secret and can accrue from the diversion of public funds or from payments received from other sources (legal as well as illegal) on account of politicians' visibility, status, and/or ability to influence policy outcomes. The various potential channels for material remuneration include campaign contributions, honoraria, in-kind gifts, revolving-door positions in industry, and payments to family members and family businesses. The rents may be derived from relevant interest groups in return for promoting particular policies. They also may accrue on account of politicians' threatening to undertake activities that will make an interest group worse off.

Recent examples of kleptocratic leaders and the estimated amounts, in today's dollars, that they amassed include: Indonesian President Suharto, USD 15–35 billion; Philippine President and First Lady Marcos, USD five to ten billion; Congolese dictator Mobuto, USD five billion; Egyptian President Mubarak, USD 70 billion; Generalissimo Franco of Spain, USD 2.2–3.5 billion; and Libyan dictator Gaddafi, USD 200 billion. Russian President Putin's private wealth has been estimated to be as high as USD 40 billion. Putin heads a ruling clan, moreover, whose assets total over USD 200 billion (Dawisha 2014).

In China, 203 of the 1,271 richest people in the country, or more than one in seven, are delegates to the nation's Parliament or its advisory body according to the Shanghai-based Hurun Report. The delegates' combined net worth is nearly USD 500 billion. 18 of them have assets exceeding the combined wealth of all 535 members of the US Congress, President Obama's cabinet, and all nine members of the Supreme Court (Forsythe 2015).

Historical cases of kleptocracy also abound and include names such as Croesus, King Solomon, Henshen, Tsar Nicholas II, Mir Osman, Ali Khan, Mansa Musa of Mali, Mausolus, Trujillo, and the Perons. At the end of Trujillo's regime in the Dominican Republic his family's fortune equaled 100 percent of the country's GDP

and 60 percent of the country's labor force owed their living, either directly or indirectly, to him (Acemoglu, Robinson and Verdier 2004).

It has been estimated that fully 87 percent of humanity presently lives under a corrupt government (McCloskey 2015). Although kleptocracy is more common in developing countries with less democratic political institutions, democracies are not immune to the phenomenon. Winners of Indian state elections realize annual growth in assets three to five percent higher than for runners-up. Asset appreciation, furthermore, is greater for electoral winners in more corrupt states, those holding ministerial positions, and those with greater incumbency (Fisman, Schulz and Vig 2014). In the United States, the common stock investments made by members of the US Senate and House between 1985 and 2001 generated significant above-market returns: 12.3 percent per year in excess of the market for members of the Senate and six percent for members of the House (Schweizer 2011; Ziobrowski, Boyd, Cheng and Ziobrowski 2004, 2011).

While the pecuniary returns pale relative to those generated by a Marcos or Mubarak in a developing-country setting, some notable First World democratic leaders have profited from political power. Lyndon Johnson amassed a personal fortune of USD 100 million. Bill and Hillary Clinton have surpassed such a total net worth recently through a variety of means such as consulting, giving speeches, and writing books. From modest roots, Newt Gingrich has used similar means to secure as much as USD 31 million in private wealth. Former British Prime Minister Tony Blair is estimated to be worth over USD 150 million on account of the extensive consulting that he has done on behalf of ruling elites in Azerbaijan, Kazakhstan, Kuwait, Qatar, Saudi Arabia, and the UAE, as well as to companies such as British Petroleum and JPMorgan Chase (Caro 2012; Ellison 2015; Schweizer 2015).

Public employees are lower in the pecking order than elected or non-elected political leaders and thus have less apparent capacity to earn rents. That said, public sector positions tend to be insulated from competitive market forces. This is because the government is often the sole supplier or has some effective monopoly power with respect to the provision of a good or a service. In addition, public employees effectively get "two bites at the apple" versus the one available to their private sector counterparts. Not only can they organize themselves to collectively bargain with their managers, as can private sector employees, they also have the ability to elect

and/or otherwise manage the people who are supposed to be managing them (for the sake of ordinary citizens). Governor Scott Walker of Wisconsin recently learned how challenging it can be to stand up to the collective political power of state employees.

Historical examples of government employees benefiting financially from their insider status include: the barons, nobles, and knights in service of feudal European kingdoms; ancient China's Shi warrior-scholar-bureaucratic class; and Janissaries, the elite infantry force created by the Ottoman Sultan Murad I in 1383. Janissary recruits came from lands conquered by the Ottomans and consisted primarily of young Christian boys. Known for their cohesion and discipline, the Janissary ranks swelled from 20,000 in 1575 to 135,000 in 1823. Generously rewarded with salaries, pensions, education-based advancement opportunities, and benefits for their children, Janissaries became an ever more significant political force in the Ottoman Empire.

While initially integral to the Empire's advancement, Janissaries became an important impediment to reform over time, especially after they successfully lobbied in the late 16th century to have their positions become hereditary as opposed to merit-based. They countered efforts to limit their power and perquisites and murdered two reform-minded Sultans (Osman II in 1622 and Selim III in 1807). In such a way, they mimicked the effects of the Praetorians, the vaunted bodyguards relied upon by ancient Roman emperors, who often represented the greatest threat to those same emperors, and the Streltsy, elite troops of Russia's Tsar Peter who strenuously resisted any diminishment of their influence and perks. Not until the Janissary corps was abolished in 1826 by Sultan Mahmud II and over 6,000 of them were executed in a single night was their chokehold on the Empire curtailed.

Government insiders also have the leeway to promote particular ideologies or policy ideas. Consider the world views that individuals such as Atatürk, Gandhi, Gorbachev, Hitler, Lenin, Mao, Mandela, Napoleon, Tsar Peter the Great, Roosevelt, and Thatcher were able to advance through their positions of power, often in the face of well-established traditions and the associated resistance from fellow citizens.

Although it is easier to conceive of autocrats having the means to advance their ideological interests, democratically-elected representatives also have considerable leeway to pursue their world views at the expense of con-

stituent interests. Such leeway is the result of imperfect competition on the supply side of policymaking and the resulting imperfect policing of politician-agents by their constituent-principals (Diermeier, Keane and Merlo 2005; Kalt and Zupan 1984, 1990; Kau and Rubin 1979; Levitt 1996).

Because government, moreover, affords relatively unusual opportunities to impose ideologies on the population at large, politics attracts individuals with relatively intense demands for promoting their particular world views. After all, it is much harder to promote one's ideology through private firms than through the unique coercive powers available through government.

Whether the perks of political power are ideological or material, an added consideration involves the extent to which government insiders dissipate resources to acquire or preserve them. Any resources devoted to such rent-seeking activities, albeit on the supply side of the policymaking process, must be added to the total cost imposed on a society by government self-capture. In early 2015, for example, Freedom Partners, the political organization funded by brothers Charles and David Koch, announced that it is budgeting USD 889 million toward the 2016 US presidential contest (versus USD 240 million in 2012). Ross Perot spent over USD 100 million (in today's dollars) of his own money when pursuing the US presidency in 1992 (Encyclopedia Britannica 2015). While these amounts are still small relative to the impact that the exercise of presidential power can have on US wealth and its distribution, they indicate that rent-seeking costs on the supply side of policymaking are non-zero.

What increases the likelihood of government self-capture?

Seven factors work to increase government size and thereby the means and opportunity for government insiders to co-opt the apparatus of the state for their own benefit. These factors, present in both autocracies and democracies are the perks of power; patronage and other political advantages associated with public provision; bureaucratic growth incentives; the transaction costs associated with government programs; special-interest groups; the common-pool problem; and the political clout of public goods.

For example, consider public goods that are most regularly cited by economists as justifying state intervention.

Once state intervention is justified, account must also be taken of public choice considerations and the logic of collective action to understand why public goods are likely to be over-provided. Whereas public goods provide non-rival benefits to many individuals, these individuals, as a group, are likely to be more concentrated and have more political clout than general taxpayers. Furthermore, public good suppliers, whether public or private, also will be more concentrated than taxpayers. Witness the enduring potency of the military-industrial complex noted by President Eisenhower in the United States and the difficulty of terminating existing weapons systems and military bases. Due to greater political clout on both the demand and supply side of politics, we thus can expect public goods to be overprovided and the potential for government self-capture to grow accordingly.

While some of the factors behind government growth originate from the demand side of the policymaking process (e.g., domestic producers seeking government protection from foreign competitors), all are relevant to the supply side populated by government insiders. By driving growth of the supply side of the political market, all of the identified factors increase the potential for government self-capture and national decline.

The symbiotic relationship between supply- and demand-side interests when it comes to appropriating the rents associated with policymaking helps explain the tyranny of the political status quo. When government insiders have “skin in the game”, important added resistance to policy change is introduced, especially since the restraints on government self-capture are imperfect. In contrast to demand-side interests, supply-side interests have the power to write and enforce the rules. This power (the means and opportunity), when linked with the rents government insiders can appropriate (the motive), helps ossify political outcomes. As Milton and Rose Friedman once observed: “Nothing is so permanent as a temporary government program” (Friedman and Friedman 1984).

The symbiotic coupling of supply- and demand-side capture can be likened to what happens to an individual’s DNA when cancerous gene mutation leads to cell over-replication. In the case of DNA and its four component nucleobases, guanine (G) always pairs with cytosine (C) while adenine (A) always couples with thymine (T). Thus, when cancer leads to an improper sequence on one of the two strands of DNA’s double helix it also is associated with an incorrect nucleobase

on the other strand. Analogously, we can expect any demand-side capture of the body politic to be intertwined with supply-side capture thereby further locking in a political outcome while amplifying the overall damage done to the body politic by demand-side special interests.

What factors constrain government self-capture, albeit imperfectly?

Although not without drawbacks, there are six potential curbs on government growth and self-capture. These include the negative impact of government growth on a nation’s productivity; the ability of constituents to vote with their feet; constitutional, legal, institutional, and/or cultural restraints; electoral competition; a market for political control; and benchmarking across polities. That these curbs only imperfectly limit government growth and the risk of government self-capture is suggested by a series of studies suggesting that the overall productivity of developed nations would be maximized if government spending was limited to 15 to 22 percent of GDP (Niskanen 2008).

Due to the perks of power, government insiders have an incentive to hang on to power. Because of the political power that government insiders possess, moreover, they have some unique means and opportunities to hang on to the perks.

Unlike in the corporate world, buy-out packages in politics are rare. The difficulties to be surmounted by those attempting to buy-out government insiders include the collective action problem and risks inherent in organizing an opposing faction (jail or death are possible outcomes). In addition, politicians contemplating relinquishing power confront risks and negative consequences. It is difficult to fully specify beforehand all the parameters of an arrangement for public officials and their associates once they are out of office. Political positions also provide unique opportunities to promote one’s world views. Furthermore, the attractiveness of any promised arrangement must be discounted due to the fact that one’s successor has both an interest in and the means to break the promise. Can government insiders put credence in the value of any promised arrangements in return for ceding power when in doing so they surrender the right to enforce the promises? Rulers such as Charles I of England, Czar Nicholas II, and Louis XVI and Marie Antoinette all ended up paying with their

lives after ceding power, even though they had assurances of safety beforehand.

While the examples cited above point to the untoward consequences that can befall rulers who lose power, they also highlight how a market for political control may still operate, albeit not exactly in the manner of the market for corporate control. Specifically, part of the reason why monarchies have become less common likely is due to the fact that their associated economic cost, at least relative to democracy, increases as a society becomes more productive through factors such as specialization, education, and trade. A higher opportunity cost creates greater incentive for change in governance form. Any change in governance form, however, is likely to require a resort to violence given rulers' vested interest in retaining power and their inability to rely on the non-violent buyout options available to corporate raiders.

In short, the operation of a Coase theorem in the political arena and a (non-violence-based) market for political control is impeded by monitoring costs and the associated slack in the relationship between constituent-principals and their political-agents on the supply side of politics; the instability of property rights owing to the ability of those in political power to redefine those property rights coupled with the associated tendency of those in power to hang on to it; and collective action considerations (Coase 1960). On account of such factors, we cannot expect competition between interest groups on the demand side of politics for economic rents to result in policies that maximize national economic well-being.

A systematic statistical examination of tenure across national leaders provides evidence of the incentive that political leaders have to hang on to power when they have the means to secure perks through their positions (Zupan 2016). Such congealing of political power exacerbates the negative impact government self-capture has on the wealth of nations.

It is worth noting that this congealing of power is the exact opposite of what we expect in market settings where competition promotes consumer welfare: firms and their managers have longer tenures the *better* they serve consumer interests. In the political arena, by contrast, leader tenure is longer in countries with extractive political-economic institutions that benefit government insiders at the expense of national well-being.

Where and when has government self-capture led to national decline?

When government insiders profit from power either in autocracies or democracies, the adverse consequences include declines in prosperity, restrictions of citizens' liberties, erosion of trust in government, violence within and between nations, and the dissipative use of resources to acquire or maintain power. Argentina, Cuba, Syria, Iraq, Greece, Venezuela, Japan, and North Korea, offer telling case studies of the consequences of government self-capture. Argentina, for example, has gone from being one of the world's most prosperous countries as of the 1920s to an economic laggard due to the sustained dominance of the political party created by the Perons interspersed with several, largely military, dictatorships.

South Koreans now earn more than 15 times per capita and live an average ten years longer than their North Korean counterparts (Ridley 2010). No such differences existed prior to the communists coming to power in the North in 1947 and three generations of autocratic rule by the Kim family.

Historical examples of the adverse consequence associated with government growth and self-capture include: the Ming and Qing Dynasties of China; Castilian and Hapsburg Spain; Tsarist Russia; the Philippines under Marcos; the Dominican Republic under Trujillo; and the Congo under Mobutu.

Why worry? The European Union and unfunded state and local government liabilities in the United States

Government self-capture is not just a clear and present danger associated with autocracies. It can affect the viability of well-established democracies. Witness some of the effects of the Treaty of Maastricht of 1992 that established the European Union (EU) and led to a common currency, the euro. As documented by economist Hans-Werner Sinn, the steps taken by EU policymakers induced huge capital flows from the euro-zone core to the periphery, triggering an inflationary bubble in the latter. The bubble, fueled by certain banking provisions and expectations promoted by policymakers, led to excessive private debt in countries such as Ireland and Spain while relaxing the constraint on interest payments on outstanding government debt in most EU periphery countries. The latter, in turn, freed up funds for expand-

ing government payrolls, an expansion that negatively impacted the long-run competitive positions of these nations. Between 2000 and 2008, for example, public employee salaries increased by 80 percent in Greece and 30 percent in Portugal versus ten percent in Germany and relative to a cumulative inflation rate of 15 percent. In addition, public employment increased by 16 percent in Greece and six percent in Portugal versus a decline of seven percent in Germany over the same time period (Sinn 2014).

Across the Pond, one in six workers in the United States is currently employed by state or local government and the unfunded pension and health care liabilities associated with such public workers have been estimated to be USD 5 trillion. Unfunded state and local pension liabilities are the country's second largest fiscal problem – larger than Social Security, but not as significant as Medicare/Medicaid/Obamacare. In contrast to Paul Krugman's argument that the bankruptcy of Detroit is an anomaly that should not give cause for concern, the Motor City instead epitomizes the fiscal challenge of government self-capture that is increasingly constraining the quality of services provided by state and municipal governments (DiSalvo 2015; Novy-Marx and Rauh 2014).

Why worry? K-12 public education in the United States

K-12 education, so critical to the development of human capital and thus to any nation's future, also suffers from government self-capture in the United States. Notwithstanding the significant increases in real per-student spending over the past half century that have been documented by economist Caroline Minter Hoxby (1996) of Stanford, high school graduation rates continue to decline, as does the preparedness of high school graduates for college studies and professional responsibilities. Until government self-capture in this vital sphere of American society is addressed, there will be important limits on the country's ability to promote broad-based educational opportunity; foster equality; revitalize its cities; and spur entrepreneurial activity and macro-economic growth. Indeed, Stanford political scientist Terry Moe (2011) argues that public sector unionization has been the principal impediment to educational innovation and betterment over the last half century in the United States.

How can we form a more perfect union?

James Madison in *The Federalist Papers* noted that “the great difficulty is this: you must first enable the government to control the governed; and in the next place oblige it to control itself” (Library of Congress 2015). As the role of the state in developed countries has grown over the past century and thereby the risk of government self-capture, what factors can we keep in mind to limit the undesirable consequences of such co-opting of political power at the expense of the general public?

The first factor is restraints on the power of public unions to organize and lobby. The provision of government goods and services is characterized by imperfect competition. Public employees, furthermore, have the ability to manage their managers through their influence on the electoral process. Consequently, policy changes such as those enacted in the US over the last few decades allowing public employees to engage in collective bargaining do not serve the public interest. Much as antitrust laws are enacted to limit the monopoly power that private sector firms exercise to the detriment of consumers, so too can legislative limits be placed on the monopoly power that public employees exert, at the expense of the public interest, through collective bargaining and lobbying.

President Grover Cleveland observed that “a public office is a public trust.” While “trust” referred to the fiduciary responsibility of government insiders, the growth of public union power has diametrically altered the manner in which Cleveland's statement can be interpreted. If anything, we now have to fear the heightened power of public trusts, or combinations in restraints of trade, analogous to the worries that their private-sector counterparts generated over a century ago. The ability of such public trusts to organize and sustain themselves, either directly or through facilitating practices such as requiring all public employees to pay “agency fees” for collective bargaining whether they belong to the union or not, merit close questioning if not outright restrictions.

Second, the public interest can be advanced by incorporating political-economy considerations when determining how much competition to promote in the supply of government goods and services. Much as we are averse to a single firm providing all of our military goods, so too should we be wary of the state being the sole or predominant supplier of K-12 education, medical services for veterans, and postal delivery. Options such as vouchers, charter schools, and competitive outsourc-

ing and franchise bidding all diminish reliance on a sole public provider; and thereby the likelihood of capture by government insiders.

Rethinking the conventional wisdom of ever-larger school districts and municipal service territories is also the order of the day. The trend toward monopolization, often pursued for well-intentioned moral and economic reasons (for example, desegregation and achieving economies of scale and scope), has resulted in some unfortunate consequences by diminishing competition on the supply side of politics. We cannot be driven solely by narrow economies of scale and scope factors when evaluating policies. Public choice considerations – the interests of government insiders as well as those groups on the demand side of politics – must also be incorporated into the policymaking calculus.

Third, America’s Founders realized that competition for office is a primary means of controlling government. Over time, Americans and citizens of many other countries have also come to appreciate term limits as a means of curbing political power ossification. In too many nations, however, the possibility of being president (or holding another government position) for life persists due to a lack of sufficient legitimacy or competitiveness when it comes to the ballot box.

The adverse consequences of inadequate competition for public positions are significant. Robert Mugabe’s iron-fisted rule over Zimbabwe since 1980 provides a compelling example. While his country’s social well-being indicators have regressed to their 1960 levels, Mugabe’s cronies organized a 91st birthday bash in 2015 for the president for life. Held at the Elephant Hills golf course at Victoria Falls, the guest list included 20,000 of Mugabe’s closest friends and the menu featured two elephants, two buffaloes, two sable antelopes, five impalas, and a lion donated by a local farmer. In addition to the USD one million raised by his cronies for the feast, every teacher in the country was forced to contribute up to USD 10.

While term limits can curb political power ossification, they are not without weaknesses. For example, term limits applied to legislators may impede their ability to acquire experience and govern effectively, including exercising oversight over the executive branch. Government insiders are also creative at finding ways to evade the intent of term limits – as shown in Russia by Putin and in Turkey by Erdogan, two nations with term limits on their political chief executive.

A smaller, but significant example of how inadequate competition for government positions subverts the public interest, notably in democracies, involves provisions that strengthen the grip of public employees on their jobs. Some of these provisions were instituted for well-intentioned reasons, such as the desire to discourage patronage and party machines through civil service reforms including competitive exams, qualifications, and regular schedules for advancement and pay raises.

An unintended and adverse consequence has been greater job security for public employees. Most K-12 public school teachers in the US are granted tenure after only two or three years on the job. They are automatically paid for earning a master’s degree and must have a state teaching license. Yet research indicates that none of these features increase teacher effectiveness in the classroom. Furthermore, by diminishing the emphasis placed on teaching quality, the ossifying tenure and dismissal systems employed by K-12 public systems disproportionately disadvantage the prospects of minority and low-income students.

The fourth mechanism of restraint builds on the research of Persson and Tabellini (2003) examining the extent to which government constitutions provide sufficient checks and balances on the supply side of politics. In the case of democracies, for example, proportional electoral rules enhance the hold-out or monopoly power of minority interest groups. This greater power, which operates both through the demand and supply sides of politics, increases government spending, welfare spending, and public budget deficits relative to democracies with majoritarian voting. Furthermore, presidential systems reduce the size of government by at least as much as majoritarian elections. Relative to parliamentary countries with fewer checks and balances between the executive and legislative branches, presidential systems promote greater overall accountability of the supply side of politics, at least as far as accountability is reflected by fiscal performance.

Fifth, improvements in communication, transportation, information, and productivity enhance constituent mobility and knowledge of the impact of government actions, while making it costlier for government insiders to hijack the state for their benefit. Anything that can be done to promote such factors and their salutary impacts is to be championed. A free press plays a key role along these lines. Technological innovations that increase “reporting” by a broader public while better disseminating information to that public, moreover, are bound to foster

government transparency while boosting the effectiveness with which the public can police its public servants.

Finally, when it comes to collective action, general taxpayers are the most widely diffused interest group. Future taxpayers are even more poorly represented politically. These factors enhance the ability of government insiders, as well as interest groups from the demand side of politics, to co-opt political power for their benefit.

Deficit spending makes the present-day cost of government actions less transparent. Moreover, compared to future taxpayers, government insiders are more focused on the near term and the payoffs that they can secure from their power. In light of such considerations, constitutionally-mandated speed bumps that curtail the ability of politicians to over-spend or otherwise slough off obligations to future generations merit consideration. Examples of such speed bumps include balanced-budget rules requiring two-thirds legislative approval to circumvent; and a “debt brake” rule such as that approved in 2001 by 85 percent of Swiss voters.

The Swiss debt brake rule caps any increases in central government spending to average tax revenue increases over a multi-year period. Reliance on debt has to be approved by both chambers of parliament. Furthermore, any increased spending through increased taxes requires a double-majority referendum, meaning a majority of voters in a majority of cantons have to approve. This is unlikely based on the extent to which Swiss voters historically have favored tax cuts over tax increases.

Prior to the implementation of the debt brake rule in 2003, Swiss federal spending was increasing by 4.3 percent per year. Since then, spending has increased by 2.6 percent annually. In addition, while the average debt-to-GDP ratio for euro-zone nations has risen from 70 percent in 2005 to 92 percent in 2014, Switzerland’s ratio has declined from 53 percent to 35 percent.

In short, the foregoing factors offer some hope for optimism regarding the potential to mitigate the extent to which government insiders subvert the public interest. Like Dorothy and her red slippers in the movie *The Wizard of Oz*, we, the people, have (to an ever increasing extent) the ability to form a more perfect union. While the historical, global trend toward democracy, and thereby more government by the people, is to be applauded, we must remain mindful that government must also operate for the people.

A broader perspective on institutional self-capture

As long as the supply side of an institution lacks perfect accountability, there is the potential for damaging self-capture by insiders. The insights cited above regarding government self-capture thus have some broader applicability to other non-profit settings ranging from churches to universities, as well as to for-profit firms. While there are additional restraints on corrupt insider behavior in such settings versus the political arena, the curbs are not always perfect. The damage done at various points in time by insiders to organizations such as FIFA, Kodak, Volkswagen, Enron, Satyam, Bernie L. Madoff Investment Securities, and the Catholic Church attests to the consequences of imperfect accountability.

In non-political settings, self-capture is most commonly termed the “principal-agent problem”. Due to monitoring costs, imperfectly policed agents-managers will not act in complete consonance with the interests of the organization’s principals-owners.

The bottom line

In most legal systems, motive, means, and opportunity are the three key aspects that must be established to determine guilt in a criminal proceeding. Contrary to the existing literature that largely has sought to convict demand-side rent-seekers (capitalists, labor unions, one-percenters, the bourgeoisie, special interests, and so on) for the capture of the state and the untoward demise of nations, government insiders on the supply side of politics merit closer scrutiny regarding culpability. Government insiders have all three key aspects that prosecutors seek to establish in criminal proceedings. They have the motive – political power provides significant pecuniary and non-pecuniary benefits. They have the means – those who operate the apparatus of the state are uniquely and favorably positioned to use it to secure economic rents. Finally, they have the opportunity, which widens as the state’s role in a society increases.

The existing literature often assumes that government insiders strive to serve the public interest or act, in a dis-interested manner, to weigh the demands of competing interest groups when it comes to supplying policy-making services and thereby determining the associated wealth transfers. Non-self-interest is inconsistent with the assumption made by economists, as well as most other social scientists, about what motivates human behavior. The assumption that the preferences of gov-

ernment insiders do not have to be taken into account, furthermore, flies in the face of evidence regarding imperfect competition on the supply side of politics – in autocracies as well as democracies. Such imperfect accountability provides latitude to those within government to promote their own interests.

Prying open the black box on the supply side of politics allows us to better understand why the decline of nations may be, more than anything else, internally determined instead of imposed by external factors. Much as a leading cause of human death is cancer, so too may one of the most prevalent explanations for the demise of the body politic be ultimately linked to the co-opting of the apparatus of the state by government insiders.

Over the centuries, there have been occasional suspicions that those within the black box on the supply side of politics might play influential roles. For example, the Great Man theory fashionable in the 19th and early 20th centuries, posited that history is shaped by heroes possessing superior attributes. While falling out of favor after World War II, the converse side of the theory, that individual leaders can lead nations to ruin, received less attention, even though we can readily identify people who have done so (Bloody Mary, Idi Amin, Nero, and Pol Pot, to name but a few). Even less attention has been paid to the damage that can be done by those inside government below the top leader level, although these ranks are populated by individuals from the same genus and species as their bosses. Cases can also be readily identified of the apparent negative impact that the so-called cogs in the state machine have had on their countries (Himmler, Mladic, Rasputin, and Torquemada).

Suffice it to say, there appears to be a lot in what we have heretofore largely treated as a black box on the supply side of the politics. Prying open the lid to that box is worthwhile if we seek to deepen our understanding of the well-being of nations.

References

- Acemoglu, D., J. Robinson and T. Verdier (2004), “Kleptocracy and Divide-and-Rule: A Model of Personal Rule”, *Journal of the European Economic Association* 2 (2-3), 162–92.
- Caro, R. A. (2012), *The Passage of Power*, Alfred A. Knopf Inc., New York, NY.
- Coase, R. H. (1960), “The Problem of Social Cost”, *Journal of Law and Economics* 3 (1), 1–44.
- Dawisha, K. (2014), *Putin’s Kleptocracy*, Simon & Schuster, New York, NY.
- Diermeier D., M. P. Keane and A. Merlo (2005), “A Political Economy Model of Congressional Careers”, *American Economic Review* 95 (1), 347–73.
- DiSalvo, D. (2015), *Government Against Itself: Public Union Power and Its Consequences*, Oxford University Press, Oxford.
- Ellison, S. (2015), “Which Blair Project,” *Vanity Fair*, January 2015.
- Encyclopedia Britannica (2015), <https://www.britanica.com/biography/Ross-Perot>.
- Fisman, R., F. Schulz and V. Vig (2014), “The Private Returns to Public Office”, *Journal of Political Economy* 122 (4), 806–62.
- Forsythe, M. (2015), “Billionaire Lawmakers Ensure the Rich Are Represented in China’s Legislature”, *New York Times*, 3 March, p. A4.
- Friedman, M. and R. D. Friedman (1984), *Tyranny of the Status Quo*, Houghton Mifflin Harcourt, New York, NY.
- Hoxby, C. M. (1996), “How Teachers’ Unions Affect Education Production”, *Quarterly Journal of Economics* 111 (3), 671–718.
- Kalt, J. P. and M. A. Zupan (1984), “Capture and Ideology in the Economic Theory of Politics”, *American Economic Review* 74 (3), 279–300.
- Kalt, J. P. and M. A. Zupan (1990), “The Apparent Ideological Behavior of Legislators: Testing for Principal-Agent Slack in Political Institutions”, *Journal of Law and Economics* 33 (1), 103–31.
- Kau, J. B. and P. H. Rubin (1979), “Self-Interest, Ideology, and Log-Rolling in Congressional Voting”, *Journal of Law and Economics* 22 (2), 365–84.
- Levitt, S. D. (1996), “How Do Senators Vote? Disentangling the Role of Voter Preferences, Party Affiliation, and Senator Ideology”, *American Economic Review* 86 (3), 425–41.
- Library of Congress (2015), The Federalist Papers, The Federalist no. 51: The Structure of the Government Must Furnish the Proper Checks and Balances Between the Different Departments (8 February 1788), <https://www.congress.gov/resources/display/content/The+Federalist+Papers#TheFederalistPapers-51>.
- McCloskey D. M. (2015), “Two Cheers for Corruption”, *Wall Street Journal*, 28 February – 1 March, p. C5.
- Moe, T. M. (2011), *Special Interest: Teachers Unions and America’s Public Schools*, Brookings Institution, Washington, DC.
- Niskanen (Jr.), W. A. (2008), *Reflections of a Political Economist: Selected Articles on Government Policies and Political Processes*, Cato Institute, Washington, DC.
- Novy-Marx, R. and J. D. Rauh (2014), “Revenue Demands of Public Employee Pension Promises”, *American Economic Journal: Economic Policy* 6 (1), 193–229.
- OECD (2015), General Government Spending (Indicator). doi: 10.1787/a31cbf4d-en (accessed on 29 September 2015).
- Persson, T. and G. Tabellini (2003), *The Economic Effect of Constitutions*, MIT Press, Cambridge, MA.
- Ridley, M.W. (1010), *The Rational Optimist: How Prosperity Evolves*, Harper Collins, New York, NY.
- Schweizer, P. F. (2011), *Throw Them All Out: How Politicians and Their Friends Get Rich Off Insider Stock Tips, Land Deals, and Cronyism That Would Send the Rest of Us to Prison*, Houghton Mifflin Harcourt, New York, NY.
- Schweizer, P. F. (2015), *Clinton Cash: The Untold Story of How and Why Foreign Governments and Businesses Helped Make Bill and Hillary Rich*, Harper Collins, New York, NY.
- Sinn, H.-W. (2014), *The Euro-Trap: On Bursting Bubbles, Budgets, and Beliefs*, Oxford University Press, Oxford.
- Ziobrowski, A. J., J. W. Boyd, P. X. Cheng and B. J. Ziobrowski (2004), “Abnormal Returns from the Common Stock Investments of Members of the United States Senate”, *Journal of Financial and Quantitative Analysis* 39 (4), 661–76.
- Ziobrowski, A. J., J. W. Boyd, P. X. Cheng, and B. J. Ziobrowski (2011), “Abnormal Returns from the Common Stock Investments of Members of the U.S. House of Representatives”, *Business and Politics* 13 (1), 1–24.
- Zupan, M. (forthcoming 2016), *Co-Opting the State From Within: How Government Insiders Subvert the Public Interest*, Cambridge University Press, New York, NY.