Chapter 4

Economic Freedom and Economic Privilege

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Since at least the days of Adam Smith, economists have suspected that economic freedom was a necessary, if not sufficient, condition for human prosperity. Smith wrote of freedom as a "system of natural liberty" and declared that "Little else is requisite to carry a state to the highest degree of opulence from the lowest barbarism but peace, easy taxes, and a tolerable administration of justice."[1]

For most of the two centuries since Smith wrote and lectured about freedom, however, economists have had few tools to systematically test his claim. Now, with the advent of objective measures of "natural liberty" such as the *Index of Economic Freedom*, we have those tools, and scores of economists have employed them to test the relationship between freedom and prosperity.

Overwhelmingly, these researchers have reached the same conclusion: Economic freedom is indeed positively associated with economic prosperity. Consider, for example, a recent survey of the literature by Chris Doucouliagos and Mehmet Ali Ulubasoglu. After reviewing 45 separate peer-reviewed academic studies, the authors concluded that, "regardless of the sample of countries, the measure of economic freedom and the level of aggregation, there is a solid finding of a direct positive association between economic freedom and economic growth."[2]

Despite the manifest evidence that freedom and prosperity are linked, an appallingly large number of people lack basic economic freedoms. In the latest edition of the *Index*, for example, 92 countries—home to nearly 70 percent of all of humanity—were listed as "mostly unfree" or "repressed." Even among the freer nations such as the United States, economic freedom in recent years has been declining.

Why is this so? One answer is that ideas matter and that in many places throughout the world, the right ideas are simply not prevailing.[3] This answer is the raison d'être of organizations like The Heritage Foundation and the Mercatus Center at George Mason University. These groups exist—as the Mercatus mission puts it—to bridge the gap between academic ideas and real-world problems. I get up and go to work every day because I believe that there is at least some truth to this.

But there is another, far more difficult explanation for why so many humans lack economic freedom. Put simply, some entrenched interests benefit from the current lack of economic freedom and are prepared to go to great lengths to maintain the unfree status quo.

If this is not immediately obvious, it may be because the advocates of economic freedom often fail to emphasize it. Too often, those of us who argue for freedom highlight the fact that taxes are crushing, that regulations are burdensome, and that government involvement in the economy is an impediment to progress. While this is typically true, it is also true that tax dollars line the pockets of some well-connected companies, that regulations often allow some firms to profit at the expense of customers and competitors, and that almost every intervention in the market creates both losers *and winners*.

If we are to advance economic freedom, I believe it is imperative that we understand how special interests benefit from its absence. In the pages that follow, I will talk about the winners—those firms that are inevitably privileged when economic freedom is curtailed.

TYPES OF PRIVILEGE

Governments dispense privileges to particular firms and particular industries in both obvious and not-so-obvious ways.[4]

- Direct subsidies, bailouts, protection from foreign competition, and grants of monopoly status are among the most conspicuous of privileges. What is less obvious is that even the *expectation* of a bailout can be a privilege if it allows the expectant firms to obtain credit at more-favorable terms.
- Loan guarantees are another form of privilege. These tend to escape taxpayer notice unless the loan falls through.
- Tax subsidies are quite common, in part because they are hard to trace. They offer politicians a tool to dispense privilege without having to take responsibility for a line-item in the budget.
- Private contracting presents another source of privilege if the contracting process is non-competitive.
- Finally, regulations can be a lucrative and inconspicuous source of privilege. While we tend to think of regulations as burdensome, it can be a privilege to be regulated if the regulations somehow limit competition or disproportionately raise the costs of rival firms.[5]

THE COSTS OF PRIVILEGE

Whatever its guise, government-granted privilege is an extraordinarily destructive force. It undermines competition, misdirects resources, impedes genuine economic progress, breeds corruption, and undermines the legitimacy of both the government and the private sector.

The "Deadweight Loss" of Anti-Competitive Privileges. At the heart of modern economics is the notion that free and voluntary exchange is mutually beneficial.[6] In fact, a national economy, with all its sophistication and complexity, is simply a very large number of mutually beneficial trades.

The number of such trades—and therefore the gains from exchange—are maximized when markets are competitive, and the key to competition is open entry and exit. New firms must be allowed to enter the industry and compete, while old ones that fail to innovate and provide value to customers must be forced to shutter their doors. In this way, open entry and exit discipline an industry to focus on maximizing consumer benefits while minimizing production costs, and this tends to push competitive industries toward maximal gains from exchange.

When governments bestow privileges on particular firms, however, competitive forces are weakened, and this discipline goes away. Privileged firms possess pricing power that competitive firms lack and need not accept the price that would emerge in a competitive market. This means that privileged firms gain more from exchange than they would were they competitive. It also means that while consumers still gain from exchange, they gain less than they would were the market competitive.

Would-be producers—those not blessed with privilege—also lose out on the opportunity to gain from exchange. Total sales in non-competitive industries tend to be less than total sales under competition because the higher price drives some customers out of the market. What's more, the gains of privileged firms are less than the losses of consumers and would-be producers. Hence, society as a whole is worse off.

Economists refer to these social costs as "deadweight loss." They represent the fact that there are mutually beneficial trades that *could* occur but do not. It is estimated that each year, monopolies cost Americans between $60 billion and $240 billion in deadweight losses.[7]

The "*X*-Inefficiencies" of Privilege. Deadweight losses are not the only costs associated with a government-granted privilege. Shielded from the discipline of a competitive market, managers and workers at privileged firms may exert less effort and may be less efficient than they would be under competitive circumstances. This insight was first developed by economist Harvey Leibenstein. To distinguish this type of inefficiency from other types, such as traditional deadweight loss, he called it "*X*-inefficiency."[8]

Leibenstein noted that in most circumstances, individuals and firms are not as efficient as economists' models assume. There is always room for "slack," and when firms are protected from competition, there will tend to be more slack. "For a variety of reasons," he argued, "people and organizations normally work neither as hard nor as effectively as they could. In situations where competitive pressure is light, many people will trade the disutility of greater effort, or search for the utility of feeling less pressure and of better interpersonal relations."[9]

Thus, due to workers' diminished efforts, marginal production costs in an *X*-inefficient firm will be greater than those of a competitive firm. The firm will also sell less, consumers will gain less from exchange, and the deadweight loss of monopoly will be larger.

The U.S. Postal Service (USPS) is a classic example of *X*-inefficiency. While most goods tend to get cheaper in inflation-adjusted terms over time, the price of a first-class stamp rose by twice the rate of inflation from 1970 to 2010.[10]

The Lower-Quality Products of Privileged Firms. Protected firms are not only unlikely to minimize costs; they are also apt to be less attentive to consumer desires and tend to produce lower-quality products. Thus, *X*-inefficiency may result in both increased marginal costs *and* decreased consumer benefits.[11] Because consumers will derive less value from each unit they buy, they will not demand as much of the product, and the firm will sell less than it otherwise would.

Here, again, the USPS is illustrative. Not only does the firm have trouble containing costs; it also has trouble maintaining quality. Packages shipped via USPS are more likely to break than those shipped via the United Parcel Service (UPS).[12] And when Hurricane Katrina struck, the private shippers UPS, FedEx, and DHL all restored service to New Orleans within weeks, while the USPS took seven months to reopen its processing and distribution center.[13]

The Rent-Seeking Costs of Privilege. As we have seen, privilege is costly for society at large, but (at least for a time) it can be quite lucrative for those fortunate enough to obtain government favors. Economists refer to the above-normal profits of a privileged firm as "rent,"[14] and because rents can be substantial, firms are willing to go to some effort to obtain and maintain them. Firms will donate to political campaigns and political action committees, sponsor advertisements designed to sway public policy, maintain expensive lobbying operations in state and national capitols, and go to great lengths to curry favor with politicians. Even those firms that do not seek their own privileges may invest heavily in political activities in order to fend off attempts by competitors to obtain their own privileges.

Economists refer to these activities as "rent-seeking."[15] Because rent-seeking requires resources—time, money, and effort—and because it creates no value for consumers, it is another social cost of government-granted privilege. The amount of money wasted in rent-seeking depends on the value of the rent. The more valuable the privilege, the more resources will be wasted in rent-seeking.

The amount lost also depends on the returns to political activity. For example, it may be the case that the more a firm plays politics, the better it gets at the game. In this case, economists have shown that the total cost of all efforts to obtain rent, maintain rent, or fend off a competitor's attempts to rent-seek can exceed the total value of the rent itself.[16] Though no one firm would rationally spend more to obtain a privilege than the privilege is worth, the sum of all firms' efforts may be greater than the value of the privilege.

There have been a number of attempts to measure the aggregate social cost of rent-seeking. These studies suggest that the annual cost is somewhere between 7 percent and 22.6 percent of gross national output.[17] This means that rent seeking may cost the U.S. economy between $1 trillion and $3.5 trillion every year.

The Distributional Effects of Privilege. Before discussing some of the other implications of privilege, it is important to emphasize the characteristics of winners and losers. The owners and operators of privileged firms, of course, win. They capture large shares of the market and charge it a high price. Those who help monopolists obtain rent also win: Lobbyists and political consultants can command lucrative salaries because their connections are worth it.

Consumers and would-be competitors lose out. Consumers pay higher prices for low-quality goods, and would-be competitors fail to reap any gains from exchange. Economists often emphasize that the losers lose more than the winners win, which is why they consider monopoly to be inefficient. But for many people, it may be just as important to note that the winners are more likely to be wealthy and well-connected than the losers are. This disparity may explain why both the Tea Party and the Occupy Wall Street movements opposed the Wall Street bailouts.[18]

Unproductive Entrepreneurship. Joseph Schumpeter is credited with highlighting the key role of entrepreneurship in economics. The entrepreneur's function, he wrote, is to "reform or revolutionize the pattern of production."[19] The entrepreneur does this by developing new goods and new production methods, by opening new markets and exploiting previously unused resources, and by developing new ways to organize firms.[20]

More recently, however, economists have come to realize that entrepreneurs may innovate in socially unproductive ways as well. New York University economist William Baumol is credited with this insight. According to Baumol, there is such a thing as unproductive entrepreneurship. "Schumpeter's list of entrepreneurial activities," Baumol writes, "can usefully be expanded to include such items as innovations in rent-seeking procedures, for example, discovery of a previously unused legal gambit that is effective in diverting rents to those who are first in exploiting it."[21] Baumol hypothesizes that when governments hand out rents, talented people will be less likely to engage in productive entrepreneurism and more likely to engage in unproductive or even destructive entrepreneurism that results in the destruction of wealth.

Similarly, economists Kevin Murphy, Andrei Shleifer, and Robert Vishny note that a country's "most talented people" can organize production in two different ways.[22] On the one hand, they may "start [or improve] firms," in which case they will "innovate and foster growth." On the other hand, they may "become rent seekers," in which case "they only redistribute wealth and reduce growth."[23]

Think of the thousands of talented lawyers, lobbyists, and strategic thinkers who occupy the expensive office buildings lining K Street in Washington, D.C. All of this talent might be employed in the discovery of new ways to bring value to consumers and to expand the gains from exchange. Instead, many of these smart and hardworking people spend their time convincing politicians to hand out privileges to their own firms or fending off attempts to hand out privileges to their competitors.

Empirical tests support the theory of unproductive entrepreneurship. Economists Russell Sobel and Thomas Garrett have developed a number of measures of unproductive entrepreneurial activity based on the concentration of political and lobbying organizations in state capitals.[24] Using these measures, Sobel has found that those states in which privileges are more likely to be dispensed (as indicated by a low level of economic freedom) tend to have higher levels of unproductive entrepreneurship and lower levels of productive entrepreneurship.[25]

Other research suggests that unproductive entrepreneurship is associated with slower economic growth. Murphy, Shleifer, and Vishny, for example, studied this question using data from 55 countries. As a proxy for productive entrepreneurism, they used the proportion of college students majoring in engineering, and as a proxy for unproductive entrepreneurism, they used the proportion of students concentrating in law. Up to a certain point, lawyers are theoretically good for growth; they help delineate and define property rights, and they help maintain the rule of law. But beyond some minimum point, more lawyers may lead to more rent-seeking. Even if lawyers themselves are not the cause of rent-seeking, they may be an indication of it. In the same way that a large number of police per capita may be an indication of a city's inherent violence, a large number of lawyers per capita may be an indication of a nation's tendency to rent-seek.

In their analysis of the data, the authors found that a 10 percentage point increase in the share of students concentrating in law was associated with 0.78 percentage point slower annual growth in output per worker as measured by per capita GDP.[26] This can add up over time. In 2011, U.S. per capita GDP was about $43,000. But if, since 1980, per capita GDP had grown 0.78 percentage point faster than it actually did, then 2011 per capita production would have been over $54,000 rather than $43,000.[27]

Loss of Innovation. Privilege can also have a profoundly negative effect on innovation, and a lack of innovation, in turn, can disadvantage an entire society. For example, economist Chun-Lei Yang has shown that as rent-seeking activities grow more prevalent, firms have less of an incentive to invest in productivity-enhancing research and development. Thus, privileged firms are less likely to innovate.[28]

Empirical research supports this claim. For example, economists Stefanie Lenway, Randall Morck, and Bernard Yeung studied a decade's worth of data from 130 steel firms to look for differences between firms that lobby heavily and those that do not. They found that the most active lobbyers "tend to be larger, older, less diversified, and less profitable than non-lobbyers" and concluded that protection "appears to reward less innovative firms."[29]

International evidence supports the claim that firms that are more likely to ask for privilege tend to be less profitable. In a survey of 450 politically connected firms from 35 countries, Mara Faccio, Ronald Masulis, and John McConnell concluded that "among bailed-out firms, those that are politically connected exhibit significantly worse financial performance than their nonconnected peers at the time of and following the bailout."[30]

Slower Growth. As protected firms become less innovative, a country's overall economic growth may suffer. This is because, as Schumpeter emphasized nearly a century ago, economic growth thrives on "creative destruction." In a healthy economy, new firms constantly arise to challenge older, less-innovative behemoths.[31]

One of the leading experts on entrepreneurship, Amar Bhidé of the Columbia Business School, has argued that big firms, encumbered by larger internal bureaucracies, are virtually incapable of capitalizing on radical ideas.[32] Indeed, research finds that new firms are more likely than existing firms to license novel technology.[33] And compared with larger firms, smaller firms are about twice as likely to file "high-impact" patents.[34]

For these reasons, turnover among a nation's largest firms is a sign of vitality. The list of U.S. *Fortune* 500 companies is illustrative: Only 13.4 percent of those companies on the *Fortune* 500 list in 1955 were still there in 2010.[35] But not all nations experience the same sort of "churn" among their top firms.

To test Schumpeter's theory, Kathy Fogel, Randall Morck, and Bernard Yeung recently examined the link between turnover among nations' top firms and economic growth.[36] They looked at the lists of top firms in 44 countries in 1975 and again in 1996. After controlling for other factors, they found that those nations with more turnover among their top firms tended to experience faster per capita economic growth, greater productivity growth, and faster capital growth. Looking at the factors that correlate with faster firm turnover, they found that "big business turnover also correlates with smaller government, common law, less bank-dependence, stronger shareholder rights, and greater openness [to trade]."[37] Thus, turnover is more likely when there is economic freedom.

The Decline of Nations. In a classic, sweeping study, economist Mancur Olson went so far as to claim that special-interest privilege can account for the "rise and decline of nations."[38] As societies grow wealthy and stable, he argued, the seeds of their own destruction are sown. Stable societies are fertile ground for special interests. These interest groups grow in power and influence over time and, once entrenched, rarely disappear. "On balance," they "reduce efficiency and aggregate income in the societies in which they operate and make political life more divisive." Eventually, "The accumulation of distributional coalitions [those that seek rents] increases the complexity of regulation, the role of government, and the complexity of understandings, and changes the direction of social evolution."[39]

Olson used his theory to explain the relative decline of the United Kingdom throughout the 20th century. As a remarkably stable society, by 1982, the U.K. had accumulated large numbers of powerful, entrenched interest groups. These groups obtained various government privileges, which, in turn, slowed the U.K.'s economic growth compared to that of other large industrialized nations. In contrast, World War II and postwar reconstruction swept away the entrenched interests in Germany and Japan, allowing these countries to grow much faster than the U.K. (In the 30 years since Olson's study, one might argue that powerful interest groups have again begun to ensnare Germany and Japan.)

Similarly, Olson found that the economies of those U.S. states that had been settled the longest tended to grow more slowly, presumably because they had accumulated a greater number of powerful special-interest groups.[40]

MACROECONOMIC INSTABILITY

In the previous section, I discussed the ways in which government-granted privilege can undermine long-run economic growth. For a number of reasons, privilege may also undermine short-run macroeconomic stability. For one thing, government privilege often encourages undue risk-taking. The problem is especially acute when gains are privatized while losses are socialized (for example, through a bailout or the promise of a bailout). The economic term for this behavior is "moral hazard." It refers to the tendency for individuals to take on undue risk when they know they will not bear the full costs of failure.

A group of economists at the International Monetary Fund (IMF) recently studied this problem and its contribution to the 2008 financial crisis.[41] They looked at data from nearly 9,000 lenders in 378 U.S. metropolitan areas spanning the years 1999 to 2007. They found that those lenders that lobbied more intensively tended to take on more risk as characterized by higher loan-to-income ratios, more securitization, and faster credit expansion. When the crisis hit, delinquency rates were higher in those areas where lobbying lenders aggressively expanded their lending practices, causing these lenders to suffer abnormally large losses during the crisis.

The implication is clear: Those lenders that lobbied more intensely (other things being equal) were more likely to be bailed out than their counterparts. As a result, the heavy lobbyers took on more undue risk. Thus, the true cost of a bailout encompasses more than the opportunity cost of taxpayer money paid to the failing company. It also includes the cost of the moral hazard it induces.

Even when privilege does not lead to excessive, undue risk-taking, it can still lead to instability by misallocating resources. When governments dispense privileges, the basic building blocks of growth—labor and capital—tend to be allocated on the basis of political considerations rather than on the basis of fundamental costs and benefits. This misallocation can lead to large and painful adjustments when the political considerations fail to coincide with market fundamentals.

A number of economists have argued that political cronyism caused or at least exacerbated the financial crisis that rippled through many Asian economies in 1997. Indeed, the term "crony capitalism" was first popularized during this crisis.[42] In a study measuring the value of political connections in Indonesia, for example, Raymond Fisman of Columbia University stated a well-known hypothesis for the 1997 crisis: "The claim was that in Southeast Asia, political connectedness, rather than fundamentals such as productivity, was the primary determinant of profitability and that this had led to distorted investment decisions."[43] Fisman's analysis confirms that politically connected firms were particularly sensitive to changes in the health of their benefactor, President Suharto, and when the crisis hit, these firms suffered more than their unconnected counterparts.

William Baumol, Robert Litan, and Carl Schramm of the Kauffman Foundation describe a similar dynamic in South Korea:

> Long accustomed to directing its banks to provide loans to the larger South Korean conglomerates ("chaebols"), South Korea's government induced too many banks to invest excessively in the expansion of the semiconductor, steel, and chemicals industries. When the financial crisis that began in Southeast Asia during the summer of 1997 spread to South Korea, the country's banks and, more important, the companies that had borrowed to expand were so overextended that the South Korean economy came close to collapse.[44]

As often happens with privilege, the "solution" to this problem involved more privilege: South Korea was rescued by a U.S.-led effort to prop up South Korean financial institutions.[45] Baumol, Litan, and Schramm document similar problems in China and Japan.[46]

CRONYISM

Privilege entails cultural as well as economic costs. When governments dispense privileges, concerns of fairness and impartiality almost always arise. These concerns can undermine the legitimacy of both government and business.

Objective criteria for dispensing privilege are hard to come by. Without objective standards, politicians may end up picking winners and losers on the basis of personal connections and political expediency. When they do, their reputations and those of the firms they favor suffer.

Indeed, research suggests that connections matter. Economists Jordi Blanes i Vidal, Mirko Draca, and Christian Fons-Rosen examined the political connections of over 7,000 firms. To isolate the influence of political connections on earnings, they looked at the change in lobbyists' revenue after the departure of Senators with whom they were connected. They found, "Lobbyists with experience in the office of a US Senator suffer a 24% drop in generated revenue when that Senator leaves office."[47]

Similarly, a study by economists at MIT, Yale, and Brigham Young University looked at the value of political connections to Treasury Secretary Timothy Geithner. After controlling for other factors, they found, "The announcement of Timothy Geithner as President Barack Obama's nominee for Treasury Secretary in November 2008 produced a cumulative abnormal return for Geithner-connected financial firms of around 15 percent from day 0 (when the announcement was first leaked) to day 10."[48]

University of Chicago economist Luigi Zingales argues that privileges sully the reputations of businesses and business leaders.[49] "The larger the share of capitalists who acquire their wealth thanks to their political connections," he avers, "the greater the perception that capitalism is unfair and corrupt."[50]

CONCLUSION

Government-granted privileges are pathological. Privileges limit the prospects for mutually beneficial exchange—the very essence of economic activity. They raise prices, lower quality, and discourage innovation. They pad the pockets of the wealthy and well-connected at the expense of the poor and unknown.

When governments dispense privileges, smart, hardworking, and creative people are encouraged to spend their time devising new ways to obtain favors instead of new ways to create value for customers. Over the long run, privileges depress economic growth, and in the short run, they threaten macroeconomic stability. Privileges even undermine cultural mores, fostering cronyism, blurring the distinction between productive and unproductive entrepreneurship, and eroding people's trust in both business and government.

For all the social problems they create, government-granted privileges can be extraordinarily valuable to the individual firms that receive them. That, unfortunately, can make these firms powerful opponents of economic liberalization.

This chapter has been adapted from Matthew Mitchell, The Pathology of Privilege: The Economic Consequences of Government Favoritism *(Arlington, Va.: Mercatus Center at George Mason University, 2012).*

Endnotes

1 On "natural liberty," see Book IV, Chapter IX of Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (London: Methuen & Co., Ltd., [1776] 1904). Smith's assertion about peace, taxes, and justice was made nearly a quarter-century before *The Wealth of Nations*. See Edwin Cannon's introduction to *The Wealth of Nations*.

2 Chris Doucouliagos and Mehmet Ali Ulubasoglu, "Economic Freedom and Economic Growth: Does Specification Make a Difference?" *European Journal of Political Economy*, Vol. 22 (2006), pp. 60–81.

3 On the importance of ideas, see F. A. Hayek, "The Intellectuals and Socialism," *The University of Chicago Law Review*, Spring 1949, pp. 417–433.

4 For more details, see Mitchell, *The Pathology of Privilege*.

5 On regulations limiting competition, see George Stigler, "The Theory of Economic Regulation," *Bell Journal of Economics and Management Science*, Vol. 2 (1971), pp. 3–21. On the "raising rivals' costs" model of regulation, see Fred S. McChesney, *Money for Nothing: Politicians, Rent Extraction, and Political Extortion* (Cambridge, Mass.: Harvard University Press, 1997).

6 This point is not disputed by economists. See, for example, the microeconomic textbooks by Paul Krugman (of the left) and Gregory Mankiw (of the right). Paul Krugman and Robin Wells, *Microeconomics*, 2nd ed. (New York: Worth Publishers, 2009); Gregory Mankiw, *Principles of Microeconomics*, 6th ed. (Mason, Oh.: South-Western Cengage Learning, 2012).

7 John Taylor and Akila Weerapana, *Principles of Microeconomics: Global Financial Crisis Edition* (Mason, Oh.: South-Western Cengage Learning, 2010), pp. 285–286.

8 Harvey Leibenstein, "Allocative Efficiency vs. 'X-Efficiency,'" *American Economic Review*, Vol. 56, No. 3 (June 1966), pp. 392–415.

9 Ibid, p. 413.

10 William McEachern, *Microeconomics: A Contemporary Introduction*, 9th ed. (Mason, Oh.: South-Western Cengage Learning, 2012), p. 217.

11 In an influential paper, Michael Mussa and Sherwin Rosen show that a "monopolist almost always reduces the quality sold to any customer compared with what would be purchased under competition." See Michael Mussa and Sherwin Rosen, "Monopoly and Product Quality, *Journal of Economic Theory*, Vol. 18 (1978), pp. 301–317, esp. p. 301. To my knowledge, however, no one has explored the link between X-inefficiency and decreased consumer benefits.

12 McEachern, *Microeconomics*, p. 217.

13 Ibid.

14 Classical economist David Ricardo was the first to introduce the term. It has little to do with the word "rent" as it is normally used in English.

15 Gordon Tullock developed the concept in 1967, and Anne Krueger introduced the term in 1974. See Gordon Tullock, "The Welfare Costs of Tariffs, Monopolies and Theft," *Western Economic Journal*, Vol. 5 (1967), pp. 224– 232; Anne Krueger, "The Political Economy of the Rent-Seeking Society," *American Economic Review*, Vol. 64 (1974), pp. 291–303.

16 "Overdissipation" is the term for this scenario. For details, see Dennis Mueller, *Public Choice III* (New York: Cambridge University Press, 2003), pp. 336–337. On the possibility of increasing returns to rent-seeking, see Kevin Murphy, Andrei Shleifer, and Robert Vishny, "Why Is Rent-Seeking So Costly to Growth?" *American Economic Review Papers and Proceedings*, Vol. 83, No. 2 (1993), pp. 409–414.

17 Keith Cowling and Dennis Mueller, "The Social Costs of Monopoly Power," *Economic Journal*, Vol. 88 (1978), pp. 727–748; Richard Posner, "The Social Cost of Monopoly and Regulation," *Journal of Political Economy*, Vol. 83 (1975), pp. 807–827; Krueger, "The Political Economy of the Rent-Seeking Society"; and David Laband and John Sophocleus, "The Social Cost of Rent-Seeking: First Estimates," *Public Choice*, Vol. 58 (1988), pp. 269–275.

18 According to Occupy Wall Street activists, "Corporations…run our governments…have taken bailouts from taxpayers with impunity, and continue to give Executives exorbitant bonuses." New York City General Assembly, "Declaration of the Occupation of New York City," http://www.nycga.net/resources/declaration/ (accessed April 30, 2012). And according to the Tea Party Patriots, "The Tea Party movement spontaneously formed in 2009 from the reaction of the American people to fiscally irresponsible actions of the federal government, misguided 'stimulus' spending, bailouts, and takeovers of private industry." Tea Party Patriots, "About Tea Party Patriots," http://www.teapartypatriots.org/about/ (accessed April 30, 2012).

19 Joseph Schumpeter, *Capitalism, Socialism, and Democracy* (New York: Harper & Brothers, [1942] 1950), p. 132.

20 Joseph Schumpeter, *The Theory of Economic Development* (Leipzig: Duncker and Humblot, [1912] 1934), p. 66.

21 William Baumol, "Entrepreneurship: Productive, Unproductive, and Destructive," *The Journal of Political Economy*, Vol. 98, No. 5, Part 1 (October 1990), pp. 893–921, 897.

22 Kevin Murphy, Andrei Shleifer, and Robert Vishny, "The Allocation of Talent: Implications for Growth," *Quarterly Journal of Economics*, Vol. 106, No. 2 (May 1991), pp. 503–530.

23 Ibid.

24 Russell Sobel and Thomas Garrett, "On the Measurement of Rent Seeking and Its Social Opportunity Cost," *Public Choice*, Vol. 112 (2002), pp. 115–136.

25 Russell Sobel, "Testing Baumol: Institutional Quality and the Productivity of Entrepreneurship," *Journal of Business Venturing*, Vol. 23 (2008), pp. 641–655.

26 Murphy, Shleifer, and Vishny, "The Allocation of Talent," p. 526.

27 Matthew Mitchell, "The Cost of Rent-Seeking: Actual and Potential Economic Growth," Mercatus Center at George Mason University, 2012.

28 Chung-Lei Yang, "Rent Seeking, Technology Commitment, and Economic Development," *Journal of Institutional and Theoretical Economics*, Vol. 154, No. 4 (December 1998), pp. 640–658.

29 Stefanie Lenway, Randall Morck, and Bernard Yeung, "Rent Seeking, Protectionism and Innovation in the American Steel Industry," *The Economic Journal*, Vol. 106 (March 1996), pp. 410–421, esp. p. 410.

30 Mara Faccio, Ronald Masulis, and John McConnell, "Political Connections and Corporate Bailouts," *Journal of Finance*, Vol. 61, No. 6 (December 2006), pp. 2597–2635, esp. p. 2597.

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36 Kathy Fogel, Randall Morck, and Bernard Yeung, "Big Business Stability and Economic Growth: Is What's Good for General Motors Good for America?" *Journal of Financial Economics*, Vol. 89 (2008), pp. 83–108.

37 Ibid., p. 83.

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39 Ibid., p. 74.

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47 Jordi Blanes i Vidal, Mirko Draca, and Christian Fons-Rosen, "Revolving Door Lobbyists," London School of Economics and Political Science, Centre for Economic Performance *Discussion Paper* No. 993, 2010, forthcoming, *American Economic Review*.

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