



THE FIFTH ANNUAL
FRIEDRICH A. VON HAYEK LECTURE

TRANSITIONS INTO — AND OUT OF —
LIBERAL DEMOCRACY

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INTRODUCTION

I feel extremely honored to have the opportunity to deliver a talk named for Friedrich Hayek. His rival Keynes famously said:

The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else. Practical men, who believe themselves to be quite exempt from any intellectual influence, are usually the slaves of some defunct economist. Madmen

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in authority, who hear voices in the air, are distilling their frenzy from some academic scribbler of a few years back.¹

Although Hayek is certainly not the likely font for the frenzies of “madmen in authority” (how would a Hayekian acquire authority?), and whether you see him as right or wrong, he is plainly one of the handful whose ideas lay claim to rule the modern world.

Once you have read his 1945 article on “The Use of Knowledge in Society” you cannot get it out of your mind.² It will forever affect what you think of free market pricing as an information-generating system. Indeed, when you grasp Hayek’s argument on free market pricing, you wonder that we can casually speak of the Fed as “setting interest rates.” Of course that phrase grossly oversimplifies the process. But you still are left puzzling at why we treat it so casually.

But my theme today is not market pricing, nor its opposite, central planning—at least not directly. My general argument takes a number of twists, so let me set it out now in three sentences. I believe a society can be expected to evolve into a liberal democracy, including private property and the rule of law, only if producer groups can organize and exert enough influence to prevent government predation. But groups strong enough to resist predation are likely to be strong enough to mobilize government for predation against others. The resultant rent-seeking society may hollow out liberal democracy to a barely recognizable shell.

After I started mapping out the talk, I learned of a new book, *Violence and Social Orders*, by Douglass North, John Joseph Wallis and Barry Weingast.³ It seemed to fit my ideas, but to add a lot of interesting arguments and observations. So my talk will in some ways be a book review of NWW. But I’ll start by laying out some basic thoughts I’d reached before.

People generally want more rather than less of various good things, and the ways they can get them can be divided, very

¹ JOHN MAYNARD KEYNES, *THE GENERAL THEORY OF EMPLOYMENT, INTEREST, AND MONEY* 351 (Atlantic 2006) (1936).

² F.A. Hayek, *The Use of Knowledge in Society*, 35 AM. ECON. REV. 519 (1945).

³ DOUGLASS NORTH, JOHN JOSEPH WALLIS & BARRY WEINGAST, *VIOLENCE AND SOCIAL ORDERS* (2009).

broadly, into two categories. The first is by exchange in a market subject to competition—either conventional competition or the Schumpeterian variety.⁴ Neither side participates in the exchange unless he thinks it makes him better off. The second broad category includes all the rest of the ways people acquire things. The most obvious is to take things, either by force, by stealth, or by fraud.⁵ These are all rather wasteful. Thus Hobbes’s canonical formulation: that life in a state of nature is solitary, poor, nasty, brutish and short.

So the institution of government offers enormous gains over a state of nature. With government, the *threat* of force is usually enough, and rule by the threat of force is obviously much less wasteful than rule by actual violence. But the gains are only on average; in transition from a state of nature to any sort of government, many may lose drastically—most obviously a defeated warlord and his vassals. Warlords do not go gently into the night.

More important, the transition to a state is far from the equivalent of transition to the world of exchange. Government itself sometimes operates by force and, the rest of the time, usually by the threat of force. Even what may seem like pure government benefits rest on the threat of force. It is, after all, not merely citizens’ public spirit that persuades them to pay the taxes that fund such benefits, but the threat of government force.

The extremes—competitive exchange, and force or the threat of force—naturally never exist in a pure form. In virtually all societies, both are at work; and even in a domain dominated by one or the other, the alternative type is present. And in both types there is plenty of room for complex personal relationships, which I will loosely call patron-client relations, or patrimonialism. While patrimonialism operates in both, I’ll argue in a minute that its character in the world of exchange is radically different from its character in the world of force.

⁴ See generally JOSEPH A. SCHUMPETER, *CAPITALISM, SOCIALISM AND DEMOCRACY* 81–90 (Harper Perennial 1976) (1942).

⁵ There are some intermediate institutions, such as the sort of bottom-up solutions to common pool problems analyzed by Elinor Ostrom, 2009 Nobel laureate in economics. But these seem to apply only to a rather small fraction of the world economy as a whole.

Within the world of competitive exchange, for example, we know from Coase that firms locate activities within the firm to the extent that the transaction costs of exchange exceed the costs involved in having the activity integrated within the firm (typically agency and information costs).⁶ A firm doesn't continuously seek to replace its current employees with new ones found in a purely competitive labor market, much less farm its work out on an hourly basis. And associated with the long-term contractual arrangements constituting a firm are an array of complex personal relationships between high- and low-level employees, between peers, between shareholders, between shareholders and management, etc.

On the other side, even in the most monstrous tyrannies, where the threat of force—or death—hangs over every citizen's head, there are patron-client links that channel the threat. I use the word "channel" advisedly. I'm not saying that these links necessarily mitigate or deflect the threat of force. Far from it: they may aggravate the system's menace, as when someone mobilizes the state's force to do in an adversary.

At the same time, even in a state dominated by the threat of force and by patrimonial links, an element of exchange applies. A client may advance in a network by performing services needed by his patron, or, more interestingly, his patron's patron, thus leap-frogging up the hierarchy. But the patron and client have been engaged in an exchange—services in exchange for advancement.

Liberal democracy, particularly the "liberalism" element, provides the institutional basis for a society dominated by competitive exchange, as opposed to one dominated by force or the threat of force. A vital question, then, is how societies make a transition to liberal democracy. I would posit as central to that transition the development of producer groups that are cohesive and powerful enough, in concert with others, to avert government predation, such as confiscations of wealth and unjustifiable limits on productive activity. I am far from alone in this argument. In a somewhat different form, it's the core of Douglass North's analysis of Britain's economic development, with the barons at Runnymede bargaining with King John for a formal say in the imposition of taxes, through

⁶ See generally R.H. Coase, *The Nature of the Firm*, 4 *ECONOMICA* (NEW SERIES) 371, 386-405 (1937).

parliament, and for protection against arbitrary criminal proceedings.⁷ In North's analysis, it was perhaps more the barons' powers as resource holders than as producers that motivated and enabled them to constrain royal predation; but with resources came opportunities to be productive, and the rules bargained for, the building blocks of property rights and the rule of law, enabled the productivity of people with few resources other than their talent and energy. Perhaps surprisingly, we find a similar argument in Marx. He predicts that peasants will be victims as long as they are isolated in pre-market economies, and that once embarked on production for markets they will forge links enabling them to resist predation:

The smallholding peasants form a vast mass, the members of which live in similar conditions but without entering into manifold relations with one another. Their mode of production isolates them from one another instead of bringing them into a mutual intercourse. . . . Each family is almost self-sufficient; it itself directly produces the major part of its consumption and thus acquires its means of life more through exchange with nature than in intercourse with society. . . . In so far as there is merely a local interconnection among these smallholding peasants, and the identity of their interests begets no community, no national bond and no political organization among them, they do not form a class. They are consequently incapable of enforcing their class interests in their own name, whether through a parliament or through a convention.⁸

⁷ DOUGLASS C. NORTH, INSTITUTIONS, INSTITUTIONAL CHANGE AND ECONOMIC PERFORMANCE 50, 113–17, 138–40 (1990).

⁸ Karl Marx, *The Eighteenth Brumaire of Louis Bonaparte*, in KARL MARX & FREDERICK ENGELS, SELECTED WORKS IN ONE VOLUME 170–71 (1968), cited in Moeletsi Mbeki, *Underdevelopment in Sub-Saharan Africa: The Role of the Private Sector and Political Elites*, 85 CATO FOREIGN POLICY BRIEFING at n.5 (April 15, 2005). Marx is in part comparing peasants with proletarian workers, but his insight into peasant vulnerability also works as a contrast with farm producers operating in a market environment and able to evolve into a bourgeoisie, whose ability to protect its class interests, of course, Marx never doubted.

Although Marx seems to assume that a group can protect its interests only through a parliament or convention, and such an institution is obviously helpful, in fact groups can also exert pressure to protect their interests in societies without them.⁹

But the *kind* of protection interest groups seek is critical. When a producer group seeks protection from government predation, its chances of success seem likely to increase if it works in concert with other groups with diverse interests. And when multiple diverse producer groups act in concert, and secure broadly acceptable compromises, they seem likely to be driven to seek property rights and the rule of law, for only those can protect *all*. Property rights and the rule of law, then, are not necessarily any group's first preference, but emerge by default.¹⁰

I mentioned earlier that there was considerable overlap between liberal democracy and strictly hierarchical societies: patron-client relations play a role in both. Now let me turn to some differences.

First, companies operating in competitive product, employment and capital markets are all under pressure to rein in patrimonialism's ill effects (and perhaps to exploit its good qualities). Even monopolies are under pressure in capital and employment markets. But in a regime thoroughly dominated

⁹ Pre-Meiji Japan provides one example. Powelson describes ways in which, for centuries before the Meiji restoration, peasants, merchants, financiers and other groups, acting in multiple-interest alliances, jostled against emperor and shogun, and sometimes against each other, to forge protections for their interests and for the rights necessary for a market economy. See JOHN POWELSON, CENTURIES OF ECONOMIC ENDEAVOR 14-38 (1994).

¹⁰ Powelson's *Centuries of Economic Endeavor* is perhaps the most emphatic proponent of this view. See *id.* If, as Powelson argues, a shift to exchange and the rule of law is driven by the collective action of formerly powerless groups, a related issue is the extent to which a reform government can force feed this process. (A preliminary question, of course, is whether government would ever want to reform in this fashion, which after all restricts the government's freedom of maneuver. I put that aside.) The issue is important, because there is a tendency in the United States to assume, when we see autocracy and illiberalism abroad, that we must keep an eye primarily (a) on the electoral process, and (b) on whether the government conducts reform. If you are skeptical of the very idea of government-generated reform, you'll suspect that this focus is at least partially misplaced. The question is whether interest groups are forming that have a capacity for mobilizing pressure in favor of property rights and the rule of law, and have (at least collectively) an interest in doing so.

by patrimonialism, there is little competitive constraint—at least short of international competition, which I’ll come to in a bit.

More broadly, I think, the key difference lies in what guides investment choices. In an exchange economy, investment is guided (in general) by the entrepreneurs’ beliefs about what people are willing to pay for the goods or services, and about the expected costs of the inputs.

In contrast, in a hierarchical or patrimonial regime, the problem for those making investment choices is to ascertain what those at the top of the hierarchy want, and to meet, or at least to appear to meet, those desires. Thus, in tsarist Russia a high proportion of investment was by firms aiming simply at the government market.¹¹ The firms commonly found they did a lot better if their directors and officers included a good sprinkling of nobles well connected at court, regardless of their business skills.¹² And I’m told that firms in today’s China find it a good idea for the board to include a retired general or a retired party or government official.

Recently scholars have developed “forensic economics” to explore the value of this sort of connection, looking at how the stock market responds to abrupt news about the health of high-level patrons. They have found, for example, that when the Indonesian government released news in 1996 that President Suharto was going out of the country for a health check-up, the Jakarta Composite Index fell about 2 percent; but the stock of a company run by his son Tommy fell 10%.¹³ Forensic economics may thus turn the word “cronyism” from an epithet into a discrete, measurable fact.

Notice that I’m not depicting a contrast in either the sheer quantity of investment or in the security of investments once made. In a hierarchical regime, investment may be plentiful and well protected. In the Soviet Union, for example, investment was frequently

¹¹ See, e.g., THOMAS C. OWEN, *RUSSIAN CORPORATE CAPITALISM FROM PETER THE GREAT TO PERESTROIKA* 40, 50–84 (1995); LAUNCELOT A. OWEN, *THE RUSSIAN PEASANT MOVEMENT, 1906–1917*, 72 (1937).

¹² See THOMAS C. OWEN, *supra* note 11, at 40.

¹³ *Id.* Raymond Fisman & Edward Miguel, *Economic Gangsters: Corruption, Violence and the Poverty of Nations*, 33–35 (Princeton 2008). See also Raymond Fisman & Edward Miguel, *How Economics Can Defeat Corruption*, *Foreign Pol’y*, Sept.–Oct. 2008, at 66.

a huge percent of GDP (around 25%), and it was quite safe.¹⁴ In a highly competitive exchange economy, by contrast, investments may be quite *unsafe*; in the most innovative sector, they are not safe at all. But what makes them unsafe is the risk that others may provide the good or service more efficiently, or that the innovators may have completely misjudged the market, or, in the case of Schumpeterian competition, the risk that others will do something radically different that will completely supplant demand for the entrepreneur's output.

It seems obvious that an exchange society is likely to generate far more wealth than a hierarchical or patrimonial regime. But I would like to suggest that there is also a moral dimension. Consider some of the words that we associate with patron-client relations: backstabbing, back-biting, intrigue, personal agendas, flattery, undermining, suck-up, nepotism, currying favor, climbing the greasy pole. All have dismal connotations. Think Malvolio, or, even at the more positive end of the spectrum, think Castiglione's Courtier.¹⁵ As to the patron's side of the relation, consider Dr. Johnson's definition of a patron (a literary patron in his case) as "commonly a wretch who supports with insolence, and is paid with flattery."¹⁶

Here I want to introduce NWW. The basic divide that they draw is between what they call either "limited access orders" or the

¹⁴ ANGUS MADDISON, ECONOMIC GROWTH IN JAPAN AND THE USSR 119 (George Allen and Unwin 1969). ("As there are no official Soviet national accounts which are comparable with those for Western countries, our estimates of Soviet investment rates cannot be very exact. However, Mooresteen and Powell have made a massive effort to calculate the Soviet capital stock, and they estimated gross fixed investment to be 23.2 per cent of G.N.P. at factor cost for 1953-61. For the whole period 1953-65 investment was probably about 24 percent of G.N.P. at factor cost.") (footnotes omitted). *See also id.* at 116 ("After the constant emphasis in the Stalin period on the need for faster growth of the heavy industry (capital goods) sector as a basic law of development, it would seem that the Soviet rate of fixed investment has now leveled out at a rate around a quarter of G.N.P.") Of course particular individuals *responsible* for an investment decision were at risk, especially under Stalin.

¹⁵ There are, of course, degrees in the repugnancy of patrimonialism. My youngest son, an expert on Chinese literature, tells me that in China (never, of course, a liberal democracy) the roles of eunuchs and "consort clans" related to imperial concubines tended to proliferate just before the fall of a dynasty.

¹⁶ 2 SAMUEL JOHNSON, A DICTIONARY OF THE ENGLISH LANGUAGE (1st ed. 1755) *microformed on* The Making of the Modern World: Goldsmiths'-Kress Library of Economic Literature, Gale Doc. No. U109813490 at 309 (Gale, Cengage Learning 2010).

“natural state,” and what they call “open access orders.”¹⁷ The two concepts roughly parallel what I have spoken of as patrimonial societies and societies dominated by free exchange. Both types, as they see it, share the necessity of having to address the problem of violence, and both use “rents” – an excess of returns over cost (including the cost of capital) – as the solution. In the limited access order, the dominant coalition provides rents by creating privileged positions – government posts, special licenses, opportunities for return without effort, or at least returns far in excess of effort. It uses them to buy off persons who might otherwise turn to violence against the ruling elite.

An example NWW offer is the feudal incident known as “wardship,” the right of the king to the revenues of an estate before an underage heir reaches his or her majority. But it turns out that the king, after acquiring a wardship, would usually transfer it to a noble at a heavy discount; in fact on average he retained only about one quarter of the full value. In NWW’s account, the king’s purpose was to appease ambitious barons and keep them safely within the dominant coalition.¹⁸ In later stages, the dominant coalition in Britain used other forms of rents to keep its members attached – for example, the profits enjoyed by privileged corporations such as the South Sea Company and the East Indies Company.

So much for the limited access order. In the open access order, by contrast, the energies of dynamic and ambitious people are directed to a different kind of rent – the rent that flows from innovation, rent that, because it rests on innovation and efficiency, is exposed to erosion by competition, either of the garden-variety or the Schumpeterian sort. Think Steve Jobs.

NWW see the critical move toward open access societies as occurring when corporations cease to be the product of specific legislation and arise instead from citizens’ exercise of universal rights under general incorporation statutes. Until then, Whig theorists, and kindred spirits such as the American framers,¹⁹ saw the corporation as a device

¹⁷ See generally NORTH, WALLIS, & WEINGAST, *supra* note 3.

¹⁸ *Id.* at 18, 103.

¹⁹ *Id.* at 199–202. Note confusion between Whig theorists (who included the Tory Bolingbroke) and the Whig party, which manifested the very problem they attacked. *Id.* at 200.

by which individuals with influence on government doled out selective benefits and thereby perpetuated their political power. Created by special legislation and used for these purposes, corporations plainly facilitated the triumph of “faction,” which the framers famously sought to curb.²⁰ After the adoption of general incorporation statutes, the corporation becomes instead a vehicle for opening up competition, for eroding existing rents through innovation. This change, they argue, occurs in Britain, the United States and France just as the electoral franchise is opened up to substantially universal manhood suffrage.²¹ Access in politics, and access in economics, open up together.

Without attempting to sketch any kind of “natural evolution,” NWW do identify three so-called “doorstep” conditions, which they say a limited access society must achieve before it can make the passage to open access. They are: (1) the rule of law for elites; (2) consolidated control of the military; (3) perpetually-lived organizations in the public and private spheres, organizations that in the nature of things will have a somewhat impersonal character.

While all three are important in NWW’s analysis, impersonal, perpetually-lived organizations deserve special attention here because they play a role in the rather sanguine view NWW take of current conditions. They tell us, for example, that at the start of the 19th century, in most states of the U.S., the state treasurer was, in the period between collection of taxes and payment over to the state, the *owner* of the tax receipts.²² Such a role appears a way-station between an individual monarch who cannot be differentiated from the state and a state conceived as an abstract entity largely independent of particular individuals. More telling is their account of changes in provisioning of the British Navy over the course of the 18th century. At the century’s start a network of elite suppliers met the government’s needs, but received neither cash

²⁰ THE FEDERALIST NO. 10 (James Madison).

²¹ NORTH, WALLIS, & WEINGAST, *supra* note 3, at 191, 216–34. In *Citizens United v. Federal Election Commission*, 558 U.S. 50 (2010), Justices Scalia and Stevens sparred over the framers’ views of corporations at the time of the Bill of Rights’ ratification. Both justices, however, appear to agree that many of the framers regarded monopolies granted by the state to individually chartered corporations—the only kind extant at the time—as dangerous for the sort of polity they hoped to establish. See *id.* at 925–26 (Scalia, J., concurring), 949 (Stevens, J., dissenting).

²² NORTH, WALLIS, & WEINGAST, *supra* note 3, at 166–67.

nor the credit of the British government—only payment obligations of specific individuals in government service (like the American state treasurers, but with the money and obligations flowing in the reverse direction). Over the course of the century Britain developed a system by which suppliers were paid in government bills that were negotiable on the secondary market and whose discount reflected the navy's creditworthiness. NWW argue that this shift to institutional obligations enabled Britain to provision the navy for its six-months blockade of France in The Seven Years War, and thus to prevent the French from supplying their forces in Canada.²³

Another example is the change of political parties from groups serving simply as vehicles for individual advancement to today's more abstract and generalized institutions. On a less earth-shaking note, we see the shift from personal to impersonal relationships at work in the oath that federal judges take—to “administer justice without respect to persons.”²⁴

NWW are quite specific that achievement of the doorstep conditions doesn't mean that a society will go through the doorway. Their achievement means only that it could—if the right things happened.²⁵ More broadly, they make no claim that limited access societies have an inherent tendency to evolve into open access ones.

Is there a driver, however, that tends to take a society through the doorway? I don't see NWW explicitly identifying one. While they certainly recognize the importance of a dense fabric of associations, including associations of producers,²⁶ they don't appear to assign those associations a leading role in bringing on the ultimate shift to an open society. This is perhaps a little surprising, in light of North's earlier work, which assigns a critical role to successively broader groups' mobilization of power to constrain the monarch. NWW in fact modify North, perhaps obliquely, by arguing that a model of ruler against interest groups simplifies matters unduly; in the natural state, as they view it, there is not really a single ruler but

²³ *Id.* at 181–85.

²⁴ 28 U.S.C. § 453.

²⁵ NORTH, WALLIS, & WEINGAST, *supra* note 3, at 26, 161, 189.

²⁶ *Id.* at 111

a dominant coalition composed of multiple actors whose loyalty is secured by a strategic allocation of rents.²⁷

One of NWW's most interesting moves is to find a place for governmental redistribution. For them, open access must include politically open access. And implicit in politically open access, they believe, is a need for redistribution. The need, if I read them correctly, is largely just political reality. If the non-elite have a vote, they will demand a degree of redistribution. And the elites should just accept that as part of the price paid for the benefits of open access. And of course redistribution, if well handled, can do a lot to make marketization acceptable to short-term losers, as it has in the more successfully liberalizing economies of East Asia.²⁸ NWW also see the shift to impersonal rules as facilitating redistribution politically, by giving credibility to promises of broad social programs based on general criteria.²⁹

Now I want to turn to the gloomy side of this talk—transitions *out of* liberal democracy. NWW seem to think such transitions theoretically possible but highly improbable.³⁰ I'm not so sure.

The first step is to point out the overlap (I would almost say the identity) between rent-seeking (here I use the term in the conventional sense, *not* NWW's alternative vision of rents obtained through innovation), on the one hand, and the basic functioning, the *modus operandi*, of a limited access society, on the other. Recall that such societies are dominated by hierarchical organizations, marked by patron-client links from top to bottom, in which persons advance by satisfying those above them in the hierarchy. Of course that process is "competitive," but the competition is within a rather narrow channel, and consumers' wishes are not a concern—except to the extent that those at the top of the hierarchy may see consumer interests as being of political advantage and are able to pressure lower echelons into satisfying them. Even then, standard agency problems, so well captured in Hayek's article on "The Use of

²⁷ *Id.* at 31, 169–70.

²⁸ See ROBERT COOTER & HANS BERND SCHAEFER, HOW MANY OVERCOME FEW, SOLOMON'S KNOT: HOW LAW CAN END THE POVERTY OF NATIONS (forthcoming 2011).

²⁹ NORTH, WALLIS, & WEINGAST, *supra* note 3, at 122–25

³⁰ See *id.* at 133.

Knowledge in Society,” are likely to prevent the top of the hierarchy from effectively monitoring performance.

Rent-seeking appears to comfortably match the characteristics of patrimonial relations. The rent-seekers try to gain an exclusive advantage—a subsidy for themselves or a restriction on their competitors (foreign or domestic). Each increment of successful rent-seeking, then, is a step away from open access, a step *back* toward limited access. If we hope for the survival of the open access society and liberal democracy (which I will treat as substantially interchangeable), we must see each rent-seeking advance as an encroachment on open access. At some point, with enough rent-seeking encroachments—draining the pool of available capital, necessitating taxes to back up subsidies for the rent seekers, rendering unsubsidized innovation competitively impossible, legally restricting the offer of goods or services that might jeopardize the rent seekers’ interests—it would be silly to say we still had an open access society.

Further, this brings us up against the conundrum I set out at the start: the phenomenon that (in my view) drove change toward an open access society may have the power to drive change backward. Groups that have the power to constrain government predation are likely to have the power to mobilize predation against others. The power to protect enterprise may be the power to destroy.

But we perhaps can refine our thinking on this. Mancur Olson drew a distinction between roving and stationary bandits.³¹ The roving bandit has no concern for the prosperity of his victims; he makes a hit and moves on. The stationary bandit looks to a whole society as a long-term source of wealth. The more prosperous the realm, the better it is to exploit. In another of Olson’s phrases, the least dangerous of rent-extractors would be an “encompassing” coalition, one that depends to a high degree on society’s overall prosperity.³² Such a coalition would likely have concern for the rule of law and property rights, whereas a group representing a very narrow sector would not have those as its highest priority.³³

³¹ See MANCUR OLSON, *POWER AND PROSPERITY* 9–13 (2000).

³² See *id.* at 20–22.

³³ A narrow group, might, of course, assign priority to the rule of law and property rights as a point around which it could rally with other interest groups; if such a

Thus, we should hope for broadly encompassing interest groups. We should prefer the Chamber of Commerce to the ethanol alliance, the AFL-CIO to the UAW. Of course for the most part we don't choose; in a free society interests organize themselves, whether broad or narrow. In one area, interestingly, we do put our thumb on the scale—campaign finance. There we systematically *disadvantage* the political parties, which at least aspire to be encompassing coalitions, as against all other supporters of candidates. In imposing “soft money” limits on parties, Congress relied on evidence that some people had admitted “donating substantial sums of soft money to national committees not on ideological grounds, but for the express purpose of securing influence over federal officials.”³⁴ Neither Congress nor the Court, evidently, was interested in whether the parties' ability to channel and aggregate interests might make their influence more beneficent, or at least less harmful, than that of unchanneled interests.

NWW of course recognize rent-seeking as a menace, and inevitable, but they think it unlikely ever to be fatal once an open access society is born. They appear to endorse a version of Gary Becker's argument that competitive political forces, and the openness of access in general, will drive the costs of rent-seeking down to some acceptable level. Let me deal first with Gary Becker's argument, then with the NWW variant.

Becker published a paper in 1983 arguing that competition between interest groups (including taxpayers) creates a pressure toward efficiency in the market for government transfers just as competition does in purely economic markets.³⁵ Transfer recipients do not have unlimited resources for exerting political influence, so they prefer the largest net transfer for the least effort. Taxpayers, a stand-in for all who directly or indirectly finance transfers, similarly wish to economize on their efforts at resistance. Efficient methods of transfer thus arouse less opposition than inefficient ones, everything else being equal. So it is in

rallying occurs, the groups that rally around these values would collectively *become* an encompassing interest group.

³⁴ *McConnell v. Fed. Election Comm'n*, 540 U.S. 93, 147 (2003).

³⁵ Gary Becker, *A Theory of Competition Among Interest Groups for Political Influence*, 98 Q.J. ECON. 371, 371–400 (1983).

the interest of both those seeking favors, and those who will pay, to work out deals implementing relatively efficient transfer devices.

Careful economist that he is, Becker notes that he has made various simplifying assumptions. Among these are “a neglect of voting, bureaucrats, politicians, and political parties.”³⁶ Nestled in those omissions is the fact that successful rent-seeking requires a cover story. If the owners of land suitable for growing corn simply came to Congress and said, “We’d like \$40 billion, please cut us checks,” Congress would point out that voters would find such a naked transfer intolerable; members of Congress who voted for it would lose their seats. But such a solution would give the claimants money without distorting land markets or food markets, or requiring a large tariff on Brazilian ethanol. Instead, of course, the owners of corn land must say that ethanol subsidies will reduce greenhouse gases and other externalities from the production and use of gasoline, and that exclusion of Brazilian ethanol is imperative for energy “independence.” So the justification for the transfer requires a series of complicating and socially costly rules.

Of course the outright \$40 billion grant would have its distortions too: the effects of the taxes or borrowing necessary to supply the money, plus the complications of drafting restrictions assuring that the corn land owners would not be back the next year with a similar demand. But the grant alternative doesn’t lose because it is less efficient (though it may be); it isn’t even on the table, because the political market simply won’t produce rents without a cover story.

Further, Becker gives us no reason to think that, even if all possible methods were on the table, the most efficient method of effecting a transfer would not be *very costly*, both in deadweight loss and in diversion of resources into rent-seeking activity. In reality those costs appear high; estimates seem mainly to run between five and 12% of GDP a year.³⁷ And the activity involved is akin to what repels us in a patrimonial society – the activity of the courtier, not the entrepreneur, Malvolio, not Steve Jobs.

³⁶ *Id.* at 396.

³⁷ JONATHAN RAUCH, *GOVERNMENT’S END: WHY WASHINGTON STOPPED WORKING* 119 (1999).

NWW make either a slightly different argument, or express Becker's argument in a slightly different form. When rent seekers and the politicians they've enlisted go too far, they say, competing politicians will sense an opportunity and seek support as anti-rent-seekers.³⁸ An example along these lines that *works* is the 1986 tax reform. Politicians recognized that the tax code had become of grab bag of special favors, and that if they could scrap some of them, they could lower the rates overall. The insight succeeded. But only for a time.

In the long run, it is hard to see why there should not be a more-or-less steady snowballing of rent transfers.³⁹ When rent seekers pull off a success, they don't go out of business. They set up an association in Washington to lobby for continuation—and often for expansion—of the existing rent transfers.⁴⁰

Not only do the groups continue, but when their competitors secure a benefit, they will usually find it easier to match it with an offsetting intervention than with repeal of the competitors' move. Such a repeal almost never happens. So, rather than seek repeal of tax benefits for oil and gas, for example, it's simpler for their competitors to win new ones for alternative energy sources. And sugar producers, rather than fight the legislative advantages of corn fructose, have sought their own benefits—for example, by persuading the Food Nutrition Board, part of the Institute of Medicine of the National Academy of Sciences, to raise the recommended daily allowance for added sugar to 25% of a person's caloric intake.⁴¹ The "Sweetener Caucus" in the Senate evidently played a forceful role in securing this scientific development. Those of you who are worried about undue partisanship in the District will be relieved to hear that the Sweetener Caucus is completely bi-partisan.⁴² There are evidently some things our two great parties can agree on.

But, you might say, isn't the current public loathing of lobbyists evidence of revulsion against rent-seeking? The loathing is apparently

³⁸ NORTH, WALLIS, & WEINGAST, *supra* note 3, at 129.

³⁹ See generally MANCUR OLSON, *THE RISE AND DECLINE OF NATIONS* (1982).

⁴⁰ See generally JEFFREY M. BERRY & CLYDE WILCOX, *THE INTEREST GROUP SOCIETY*, Ch. 2 (2007) (showing steady increase in most measures of interest-group activity).

⁴¹ See Lawrence Lessig, *A Declaration for Independence*, <http://lessig.org/blog/d4i-levine.html>.

⁴² *Id.*

so strong that in the last election campaign both leading candidates frequently expressed their disdain for lobbyists and desire to banish them from their administrations. But at the same time both proposed legislative initiatives that were guaranteed to generate new waves of lobbying – and *not* purely defensive lobbying.

The public disdain for lobbyists is in fact very crude. In the first place, it seems odd to focus on the agents and not on their principals. If lobbying is repellent, why aren't those who send them forth to lobby just as guilty, perhaps more so?

A more fundamental problem is that the popular attitude toward lobbyists draws no distinction between ones engaged in purely defensive activity – which I'll define loosely as either support for pie-expanding rules or resistance to others' rent-seeking – and those engaged in rent-seeking aggression. At least in terms of protecting the open access society, these are radically different. Pie-expanding government activities are ones a government would conduct in a world where transactions costs were zero, i.e., interventions that would at least increase the well-being of the beneficiaries enough so that they could compensate the losers. Rent-seeking activities, as I am using the term, generate interventions that could not meet that test (and in that light resisters of rent-seeking aggression are simply defending against a pie contraction). Yet the popular condemnation lumps them together. As I'm about to describe, distinguishing between the two is not always easy.

An unfortunate reality underlies both the above points – my critique of Becker and my failure to find solace in the public hatred for lobbyists. Rent seekers can almost always make *some* claim of public benefit, a claim that will seem especially strong if people don't ask about second- and third-order effects. That reality is what makes Professor Becker sound like a Pollyanna, and it is also what makes the populist disdain for lobbyists useless in the struggle against rent-seeking. And it is, of course, part of the reason for the widespread failure even to try to distinguish defensive moves from rent-seeking aggression.

The indivisibility of rent-seeking and policy also tends to rule out the judiciary as a remedy. As an individual, I like to think that I can make a reasonable judgment as to whether a specific legislative or executive choice reflects rent-seeking. And I can imagine a doctrine to the effect that pure rent-seeking is beyond the authority of the legislature or executive. Indeed, we once had such a doctrine,

commonly framed as a rule against “partial legislation” but better known nowadays as “substantive due process.” The leading commentator on those cases, Howard Gillman, having plowed through hundreds of them, says that:

most of these cases demonstrated a superior judicial commitment to the familiar Jacksonian preoccupation with political equality or government neutrality, the belief that government power could not be used by particular groups to gain special privileges or to impose special burdens on competing groups.⁴³

That sounds very much like the Whig tradition, with its hostility to “faction.”

But despite the doctrine’s honorable lineage, it seems to me judicially unworkable. I find it hard to imagine standards for distinguishing rent-seeking from permissible legislation that would be clear enough to yield much uniformity of decision. And without a good deal of uniformity, I think the doctrine would be publicly unacceptable—as substantive due process proved, at least in its historic form.

There is still another solution that is undermined by the indissolubility of policy and rent-seeking—a solution proposed by Hayek himself.⁴⁴ Offering the proposal was rather in conflict with his much repeated insistence that humans aren’t capable of designing an efficient system; they only stumble on them, and inter-society competition sorts it out. His solution was to divide what we think of as legislative tasks between two entities, a “government assembly” and a “legislative assembly.” The first would be constituted along the lines of a modern legislature. The second would be elected by citizens 45 years of age or older, voting for representatives meeting the same age criterion, and serving for one 15-year term; the delegates would be assured decent livings after the end of

⁴³ HOWARD GILLMAN, *THE CONSTITUTION BESIEGED* 12 (1993).

⁴⁴ See 3 FRIEDRICH A. HAYEK, *LAW LEGISLATION & LIBERTY*, 109–11 (1979) (reprinting a 1978 lecture presented at the London School of Economics and Political Science and originally published as *The Three Sources of Human Values*). See generally *id.* at 105–27.

their terms. Their key task would involve defining rules to limit the means that the government assembly could employ. Their popular election would give them a democratic legitimacy that judges do not enjoy. But in the end, I fear, the entanglement of policy and rent-seeking would make them ineffective.

NWW's comparatively relaxed view of rent-seeking may depend in part on the way they see "impersonal" rules as a key contribution to development of an open access society. We saw an example of this in the changes in supply of the British Navy. They say of open access governments that they "can systematically provide services and benefits on an impersonal basis; that is without reference to the social standing of the citizens or the identity and political connections of an organization's principals."⁴⁵ They compare systems where "food subsidies go to those individuals meeting the relevant characteristics rather than, as in the case of ration cards in India, being sold by corrupt bureaucrats to the highest bidder."⁴⁶ That seems rather a low benchmark!

How far does impersonality of this sort get us? To be sure, legislation establishing generic criteria for a benefit seems, superficially, to smack less of crude patrimonialism than do the special monopoly-granting corporate charters that alarmed the Whig theorists and our framers. *And* such legislation *can* implement the sort of redistributive moves that appeal to the Robin Hood in all of us, redistribution genuinely aimed at those who, through bad luck of one kind or another, find it difficult or impossible to eke out a decent living.

But does generically worded legislation inherently ward off the sins of patrimonialism? Or does it, rather, simply substitute a more sophisticated form? Suppose Congress authorizes the Secretary of the Treasury to purchase "troubled assets from any financial institution, on such terms and conditions as are determined by the Secretary,"⁴⁷ and the Secretary uses the authority to help fund a new automobile company that assumes a debtor's unsecured obligations to its pensioners, and that, thanks to government funding, has a chance of actually meeting the obligations; suppose, meanwhile,

⁴⁵ NORTH, WALLIS, & WEINGAST, *supra* note 3, at 113.

⁴⁶ *Id.*

⁴⁷ 12 U.S.C. § 5211.

that the debtor's secured obligations to other creditors are paid off for a few cents on the dollar. I know the argument is made that these pension debts were entirely in the interest of the new company, enabling it to secure necessary labor. And perhaps that is true. But indulge for a moment the possibility that Treasury's move was driven more by a desire for the future political support of the UAW. If that was actually the driving force, is the result less destructive of the principles and operation of an open access society, or less akin to the operations of a patrimonial regime, than if Congress and the executive had specifically named the beneficiaries? Perhaps a practice of legislating in generic terms nudges lawmakers toward a focus on the public interest, but it hardly stands in the way of using taxpayer revenue, legislative prohibitions, and grants of private right to make bloc pay-offs. Thus the practice moves us toward a world where rewards are produced by connections and influence (even though, in a vast democracy, the connections and influence may link millions) rather than the willingness and ability to meet individual needs through goods and services offered for voluntary exchange. And each encroachment of rent-seeking *closes off* access to a degree: it drains away otherwise available capital or throws prohibitory or competitive roadblocks in the path of true innovators.

I want to add that despite my favorable mention of "encompassing interests," a group can be very large and apparently public-spirited without its influence *genuinely* reflecting very broad interests. At work here is Robert Michels's intuition about the inevitability of oligarchy.⁴⁸ For an organization with many members, or purporting to represent many citizens, rational ignorance will lead most of the members and contributors⁴⁹ to refrain from carefully assessing the leaders' policy decisions. There is, as a result, an agency problem that parallels the problem between citizens as a whole and their representatives. The members' rational ignorance enables the leaders to deploy highly selective and tendentious rhetoric. Jonathan Rauch quotes Senator Alan Simpson, in turn quoting a veterans' lobbyist,

⁴⁸ See Robert Michels, *Oligarchy*, in THE SOCIOLOGY OF ORGANIZATIONS: BASIC STUDIES, 25-43 (Oscar Grusky & George A. Miller eds., 1970).

⁴⁹ Or, more broadly, people purportedly represented by the entity.

who spoke of “juicing of the troops,” and doing so with “raw fear.”⁵⁰ Certainly I receive plenty of communications calling on me to pony up \$25 or \$100 to protect the country from some outrage – an outrage that may or may not really be imminent, and may not even be outrageous.

Similarly, I sometimes wonder whether those who contribute to “green” organizations, which often demand expenditure of virtually unlimited funds on various types of clean-up, would themselves pay \$1000 to avert a loss that has an expected value of \$10.⁵¹ I suspect not.

So, because of agency problems *within* citizens’ groups, even groups that appear to be public-regarding may themselves manifest rent-seeking in another guise. Thus I’m not as ready as NWW to think that legislation by general category is much of a barrier against rent-seeking or a protection of open access.

NWW also invoke international competition as a ground for optimism, pointing to some minor cutbacks in the welfare state in western Europe.⁵² This is similar to Hayek’s broader argument that international or inter-society competition will cause regimes to evolve for the better through natural selection. Here is Hayek himself: “Most of the[] steps in the evolution of culture were made possible by some individuals breaking some traditional rules and practicing new forms of conduct – not because they understood them to be better, but because the groups which acted on them prospered more than others and grew.”⁵³ Thus, when one or a few societies stumble on sound rules, their accidental find may spread by competitive selection.

One difficulty with the analysis is that although there is some overlap between what is good for a nation’s competitive position and what is good for its citizens, the two are hardly identical. This was most obvious in the Cold War. It seemed to many of us that the United States was an overwhelmingly better society for the people who lived there, but the rulers of the Soviet Union could

⁵⁰ RAUCH, *supra* note 37, at 7.

⁵¹ See *Illinois Dunesland Preservation Society v. Illinois Department of Natural Resources*, 584 F.3d 719 (7th Cir. 2009), for a wonderful account of an organization stirring up what appears to be rather extravagant alarm.

⁵² NORTH, WALLIS, & WEINGAST, *supra* note 3, at 130–31.

⁵³ See HAYEK, *supra* note 44, at 153.

devote 25% or more of GDP to arms, so the ultimate outcome was not so obvious. In the end, of course, a combination of factors—regime fatigue, the extraordinary sacrifices of dissidents, moral revulsion within the Soviet elite, shifts in the world price of Soviet exports—brought the system down. But that seems more a testimony to its extreme dysfunctionality than to any general assurance that open access regimes will win the competitive race.

That said, of course, international competition takes non-military forms. One is the competition for migration, for intelligent and dynamic individuals; the open access society is well positioned for that competition. It seems likely that that was at least in part what Hayek had in mind in his reference to the growth of groups that accidentally happen on sound governance. But Americans seem to be at best ambivalent about our country's drawing power in the migration sweepstakes, so it isn't obvious that this competition acts as a real constraint on rent-seeking, at least in the U.S.

Of course American ambivalence about immigrants is not inconsistent with Hayek's claim. It would thoroughly vindicate his claim if *other* countries were to seize on the potential advantage of immigrants. Countries that did so, and established open access, would presumably tend to flourish. But it would be a pity, for us, if they did not include the United States.

Before leaving Hayek's argument about the growth and prospering of groups that stumble on sound governance I should explain the context. He was trying to reconcile his extreme skepticism about the ability of humans to design sound governance with the fact that societies have grown up that permit efficient activity to go on. So his argument isn't that international competitive selection *will* lead to the best of humanly possible worlds, only that it explains why productive social systems exist at all. And, of course, international competitive selection may continue to exert force in favor of open access.

By now I've thrown cold water on several arguments aimed at reassuring us that interest groups will not drag us back to the limited-access world. In closing I'd like to offer a minor step towards a solution.

Although I don't see resurrection of the rule against "partial legislation" as feasible, courts might implement a far less intrusive doctrine. In reviewing agency decisions, we of course set aside action that violates the clearly expressed intent of Congress. But in

the range where the congressional meaning isn't clear, courts might apply a mild presumption that Congress would not have intended to encourage rent-seeking. Suppose Congress authorizes an agency to impose some sort of restriction, apparently for standard environmental purposes. But the language does not obviously bar the agency from taking into consideration the fact that one possible restriction (as opposed to an alternative that is equally or even more effective environmentally) would tend to boost a particular industry. If the agency, in choosing among plausible restrictions, chose one in part on the ground that it would help the X industry (perhaps one popularly thought to be "green"), the court under my mild presumption would find the agency interpretation unreasonable.⁵⁴

This may seem inconsistent with my rejection of a constitutional rule against "partial" legislation. The same fuzziness applies as in that context, and thus there will be splits among judges. But the stakes are lower. All Congress need do, to reverse the judicial intervention, is to define agency authority in a way that clearly permits rent-seeking purposes. Granted, to affect the congressional agenda is not a trivial imposition, but it's far less than a constitutional ban. Indeed, courts have applied kindred doctrines, I think with some success. For example, even where Congress has vested an agency with authority to regulate an industry generally thought to be a natural monopoly, courts have pushed the agency to allow competition where it might be useful, refusing to permit the agency to exclude a new service provider simply on the ground that it would compete with the existing provider.⁵⁵ The results have seemed generally acceptable and perhaps beneficent. And the interpretive gloss that I'm suggesting is akin to that ruling: both build on a preference for competitive open access.

I should add that I don't contemplate anything so formal as a "clear statement" doctrine. Rather, I picture opinions observing

⁵⁴ A case that comes fairly close to this model is *American Petroleum Institute v. EPA*, 52 F.3d 1113 (D.C. Cir. 1995). The court did not invoke any such presumption, but rather found the limitation in the plain words of the statute. Agencies, of course, could often defeat the proposed principle by stealth—as indeed they can defeat many principles of administrative law.

⁵⁵ See, e.g., *MCI Telecomms. Corp. v. FCC*, 561 F.2d 365 (D.C. Cir. 1977).

something like, "We are reluctant to impute to Congress an intention to authorize provision of naked subsidies to a particular industry."⁵⁶

In the end, changes in legal doctrine seem to me unlikely to be more than trivially effective. Either the public will develop a nose to sniff out rent-seeking, or it will not. If it does develop such a nose, it will probably do so only because *elites* start to take the problem seriously. One place to start might be journalistic coverage of policy arguments. The media, who like a horse race, will often identify the groups on various sides of an issue. So far so good. But they will rarely discuss second- and third-order consequences. They even seem to revel in ignorance. Not long ago, a news column in *The Washington Post*, reporting on a policy conflict, mentioned that one side had raised the issue of "moral hazard"; the reporter even gave the gist of what the phrase meant. But he then treated the argument as a great joke, as if it were arcane gibberish, which a congressman could not possibly be expected to understand. If economics were made a compulsory part of the high school curriculum, perhaps reporters would be better able to handle "moral hazard," etc., and could expect their readers, and members of Congress, to grasp routine economic arguments.

Another source of hope may be the curious habits ingrained in the American people through generations of experience of an open access society. Along with that experience—who is to say what is cause and effect?—have come entrepreneurialism, faith in experiment, readiness to take chances that seem objectively crazy, and willingness to invest in research and development and in innovative business strategies. Perhaps these will create pressures strong enough to hold at bay the forces that seek to allocate wealth by connections and fiat.

If I leave one thought with you today it is that we should not see rent-seeking as a mere wart on the body politic. It is a fundamental and perhaps fatal disease. Its characteristics are those of hierarchical patrimonialism, mobilizing the force of the state for private ends, and not those of an open access society. It has the

⁵⁶ Compare some interpretive solutions proposed by Jonathan R. Macey in *Promoting Public-Regarding Legislation Through Statutory Interpretation: An Interest Group Model*, 86 COLUM. L. REV. 223 (1986), and existing solutions noted by Cass R. Sunstein in *Nondelegation Canons*, 67 U. CHI. L. REV. 315 (2000).

potential to undo developments that over the last two hundred years have yielded unimaginable prosperity, reaching hundreds of millions of people (and, in a lesser degree, billions). So far as I can see there is no magic bullet, no simple institutional tweak, that can constrain it. Only awareness and determined struggle.

In sustaining that awareness, we might all bear in mind a remark of Calvin Coolidge, in advice to his successor:

You have to stand, every day, three or four hours of visitors. Nine-tenths of them want something they ought not to have. If you keep dead still, they will run down in three or four minutes. If you even cough or smile, they will start up all over again.⁵⁷

⁵⁷ RAUCH *supra* note 37, at 2.