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The Real Takers

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Asian visitors often remark on America's crumbling infrastructure, as they leave shiny new airports in Beijing or Singapore and touch down in the dilapidated terminals of New York or Boston. Roads into town are pot-holed and the public transport shabby. Even the traffic tends to be worse. Compared to the best of the developing world, the United States often looks disturbingly like an emerging economy.

Sometimes this comparison is made flippantly, but it has bite when critics turn to broader institutions. From the dysfunction of Congress to the polarization of political culture, America appears unable to invest sensibly for the future or even remedy grave social threats. Driven by the opioid crisis, U.S. life expectancy declined for the second year in a row during 2016, an indicator of the kind of social collapse more common in countries like Argentina or Greece, during their respective spells of financial crisis.

President Trump provides particular focus for this unhappy comparison. The narrative of his presidency—a charismatic populist running a family fiefdom constrained only by a handful of good generals—is more often associated with nations like Turkey or the Philippines. Yet while Trump has clearly harmed America's institutions, their problems preceded him, with a system that over recent decades has delivered policies which appear designed to serve a powerful few rather than the common good.

In *The Captured Economy*, Brink Lindsey and Steven Teles suggest that the anger of Trump supporters about all this was, therefore, justified. "The economic game has been rigged in favor of people at the top," they write. From laws defending financiers and software mavens to rules cosseting high-status professions, swathes of regulations now redistribute "income and wealth upwards to elites," rather than downwards towards the less fortunate. Core to the authors' argument is an idea that also happens to be central to understanding the inner-workings of many emerging economies: rent-seeking, or the ways in which politics can hand profits to businesses beyond what they should earn in a competitive market. "The opportunistic parasitism of regressive rent-seeking has hit the twenty-first-century American economy at its most vulnerable points—namely its twin susceptibility to slowing growth and rising inequality," they say.

Rent seeking alone did not cause these vulnerabilities, but it has exacerbated them. Without concerted action, the problems that flow from "captured" policymaking processes are likely to worsen. This is especially so under a President as favorable to established interests as Trump. In response, Lindsey and Teles argue for a mixture of policy ideas, from curbing the size of systemically important banks to ripping up zoning regulations. The question that remains is whether even measures like these, were they to be tried, would be radical enough given the severity of the problems.

The authors' arguments are interesting at least in part because of who they are. Lindsey is an ex-Cato Institute employee and reformed libertarian, now working at the Niskanen Center, a non-partisan think tank filled with recovering hardline free-marketeers. Teles, meanwhile, is a political scientist at Johns Hopkins University with broadly progressive views, but also a curiosity for conservative ideas.

The Captured Economy marks the first time the duo have written together, but both have examined the flaws in U.S. governance in earlier works. Lindsey's Human Capitalism from 2009, for instance, looked at the ways in which an increasingly highly educated social elite has pulled up the ladder of social advancement behind it. Teles's most recent book told the story of how conservatives challenged liberal domination of the legal system, but he is also well known for coining the term "kludgeocracy," to describe an American political system hobbled by short-term, inefficient legislative fixes.

Given the current divisiveness in Washington, their partnership is refreshing, as is the broad thrust of their thinking, to which they give the tongue-in-cheek label "liberaltarian." This theory is fleshed out with unsatisfying brevity toward the conclusion, although the basic idea runs through the argument, as the authors repeatedly find fault both with doctrinaire libertarians and big-government liberals. In general, though, their book is persuasive and carefully argued, as it moves though four main case studies of rising rent seeking—finance, intellectual property (IP), professional licenses, and land regulation—and toward what ought to be done to reverse them. "Bit by bit, day after day, countless thousands of individual, small-bore policy choices aggregate up into regressive social outcomes," they write, arguing that the same gradual creep of "upward redistribution" could now be put into reverse.

Yet Lindsey and Teles's claims are interesting for a second reason, namely that they add a new dimension to existing analysis of what ails the United States in the aftermath of the 2008 financial crisis. This story typically begins with the changes brought by globalization and technological change, which combine to hand "winner-take-all" returns to the already highly skilled, exacerbating inequality. Many thinkers on the left—from economists like Joseph Stiglitz, Dean Baker, and Robert Frank—have then pointed to other ways in which the economic game has tilted in favor of the powerful, from declines in union membership to changes in taxation and competition law. Yet while Lindsey and Teles are not alone in suggesting that rent-seeking is a growing part of America's problems, they are unusual in putting it at the heart of their account.

Finance is the most egregious example. Indeed, this is one area where the United States looks very little like an emerging market, where finance tends to make up a much smaller proportion of the economy. Most evidence suggests that growth in sectors like banking and insurance is beneficial only up to a point, after which it becomes at best “socially useless,” in the words of British regulator Adair Turner, and at worst makes the economy more prone to bubbles and financial instability. Yet the size of the U.S. financial sector has grown rapidly over recent decades, as has the pay of its workers. Even after the crisis, the largest banks are bigger than ever, while the financial sector is barely smaller as a proportion of gross domestic product than it was in the mid-2000s, which were comparative go-go years. All this points to a regulatory system that is captured by those it is in fact meant to control.

Yet the problem areas don’t stop there. This past year has seen a widespread reaction against the sweeping powers enjoyed by big tech companies like Google and Facebook. But Lindsey and Teles are more worried by recent moves to strengthen copyright and intellectual property protection, from the powerful Digital Millennium Copyright Act passed in 1998 under President Bill Clinton to a rapid expansion in patent and trademark protection over recent decades covering everything from pharmaceutical inventions to software code.

Although such protections are often defended as midwives to invention, there is actually surprisingly little academic evidence that tighter IP laws boost innovation or economic growth more broadly. What is clear is that that they do hand windfall gains to IP owners, most obviously larger companies from Disney and Sony to Apple and Microsoft, and the senior executives who work for them.

A broadly similar trend is unfolding in urban policy, where zoning rules protect homeowners by limiting new building, bumping up the value of residences in elite coastal cities in particular. Complex “occupational licensing” limits entry into white-collar professions: “While the average American may think of Warren Buffet and Mark Zuckerberg when they envision the top 1 percent, it is actually the surgeon who replaced their hip, the dentist who performed their last root canal or the lawyer who handled their divorce.” Much of this story will be familiar to observers of emerging markets, where weak institutions have historically been easier to capture by political insiders. In 2009, not long after the post-crisis bank bailouts, economist Simon Johnson wrote an essay in The Atlantic entitled “The Quiet Coup.” “Emerging-market governments and their private-sector allies commonly form a tight-knit—and, most of the time, genteel—oligarchy, running the country rather like a profit-seeking company in which they are the controlling shareholders,” he wrote. Now the same seemed true in America, most obviously in the banking and financial services industries, in which financiers, regulators and politicians—many of them supposedly on left—pushed through far-reaching deregulation in the decades prior to the credit crunch, and organized equally extensive bailouts in its aftermath. In earlier eras, U.S. rent seeking was at least more even-handed, with policies pushed by labor unions and other similar interests balancing out those that favored the wealthy.

In developing economies, it is true that rent seeking sometimes involves outright corruption. But more often, it stems from what political scientist Minxin Pei describes as “collusion between elites,” in other words processes in which powerful interests benefit from favorable regulation, or otherwise win scarce public resources, monopolies or licenses. In some developing nations, rent seeking has been a deliberate and successful strategy for development. Governments in South

Korea and Taiwan, for instance, offered rents as bait to favored businesses, so long as they invested in things that encouraged growth, like basic infrastructure and education. Yet neither does this more benign form of rent seeking seem to be happening in the United States, nor would it be terribly effective in an advanced industrial economy, where growth rests on more complex processes of technological innovation and higher productivity.

The authors admit that definitive evidence for recent increases in rent-seeking levels is hard to pin down—after all, surgeons, dentists, and lawyers had occupational licenses in the 1950s, too. It is also true that, for all of its recent growth, the U.S. lobbying industry remains small relative to the value of the changes its activity can bring about. The transparency group Open Secrets suggests that spending on corporate lobbying has more than doubled to $3.3 billion over the last two decades. Yet looked at another way $3.3 billion is actually surprisingly small—a phenomenon sometimes called "Tulloch's Paradox," after economist Gordon Tulloch, who first pondered why lobbying wasn't a far larger industry. Apple might have spent $7 million on lobbying during 2017, but that remains minuscule next to the estimated $47 billion the company will reportedly save following Trump's recent tax cut.

Yet even if Lindsey and Teles can't nail the exact extent of rent seeking's rise, they provide compelling circumstantial evidence in their four case studies, as well as from indications of falling U.S. economic dynamism more generally, such as declines in firm creation and drops in the geographic mobility of workers. They draw, too, on an influential 2015 paper from economists Jason Furman and Peter Orszag, who suggested that increasing numbers of larger American companies earn the kind "supernormal" returns associated with regulatory favoritism. The paper's most striking finding, however, was that the top 10 percent of America's most profitable listed companies, excluding those in financial services, have seen dramatic increases in their returns on capital invested, shooting up from roughly 30 per cent in the mid-1990s to 100 per cent in 201 —a finding that mirrors the equally dramatic increases in wealth grabbed by already wealthy individuals.

Toward the end of the book, Lindsey and Teles lay out a handful of ideas to roll back rent seeking. A few are technical yet still potentially radical, notably because of their desire to create a new cadre of well-paid expert congressional staffers: "[W]e should double committee staff and triple the money available for salaries," they write. The hope is that better resourced, technically competent public servants would be better able to resist the entreaties of interest groups and develop policies based on evidence rather than self-interest. Other ideas seem more half-hearted and improbable, however, notably the authors' hope that that generous and public-spirited philanthropists might begin to support a wave of new anti-rent-seeking policies to reverse many of the gains won over the last few decades by everyone from bankers to record industry executives.

At times, the authors' "liberaltarian" ideas lead them to be excessively even-handed, as they seek to lay blame equally with distortions in markets and misguided state action. They begin their section on the failings of finance with a lengthy section on "colossal failures in the public sector" in the run-in to 2008, highlighting the many problems caused by well-meaning state subsidies for mortgages, as well as policies that helped to support the extension of credit to households and provided unwise guarantees to big banks and insurers.

This is not entirely wrongheaded. In general, progressives could arm themselves with a sharper criticism of the failings of the state. More than many on the left would care to admit, the 2008 meltdown was indeed partly a crisis of misguided government intervention, most importantly in the way in which implicit guarantees encouraged excessive risk taking by banks. The book covers other areas in which the state could draw back, for instance by scrapping some generous IP protections, including via their incorporation in trade agreements.

Yet the logic of *The Captured Economy* still suggests a larger and more powerful state, although this is an answer its authors often appear to shy away from for ideological reasons. Lindsey and Teles are clear on the fact that America's financial services sector remains too large, for instance, and no safer today than it was before the crisis. Fixing this will require a range of new measures to reduce the size of banks and curb their ability to introduce new financial innovations, including a few the authors support, including forcing lenders to hold far higher levels of capital, even if this came at the cost of short-term economic growth. But at a deeper level, it still seems misguided to lay equal blame at the feet of the government and the market, either when trying to understand the specific reasons for the 2008 crisis or when weighing up the way in which finance itself has contributed to rising social inequalities. In truth, a fairer financial system is far more likely to emerge from a more traditional social-democratic approach, which favors intrusive intervention to correct market failures, than an even-handed "liberaltarian" approach.

There is a similar conundrum lurking behind their contention that deregulation of various sorts could help to create a more vibrant U.S. economy. This may turn out to be true, although the case for it is by no means clear. If it was, however, an economy that is more competitive—meaning one in which more companies are starting up and shutting down, and more workers are losing and finding jobs—is also likely to create more of the kind of social and economic anxiety that lay behind Trump's victory. Preventing this, in turn, would require a far larger state offering the kind of social bargain that is often dubbed "flexicurity" in Scandinavia, in which flexible labor market laws and competitive markets are paired with much more generous social insurance schemes and support for retraining, to help those affected by economic changes.

A larger state would probably help the narrow task of reducing rent seeking. Lindsey and Teles cite academic evidence suggesting that countries with bigger governments also tend to have lower levels of corruption, in part because citizens in high-tax nations are more demanding about getting good government in return for their investment. But it is also true more generally, in that any sensible approach to the broader problems of reducing inequality and increasing opportunity for the middle classes seems likely to require larger state transfers and higher public investment as well.

In other words, what Linsdey and Teles have written is a pre-Trump book, in the sense that they describe a system that is being warped subtly by established interests. Trump's craven Administration clearly changes this equation. All the problems a book like The Captured Economy identifies will be immeasurably worse by the time Trump is gone. Yet in a sense this only makes the ideas the authors suggest that much more important, because cracking down on rent seeking and rebuilding political institutions will be central to any post-Trump agenda for the Democratic Party.

Here again, the United States now shares more in common with emerging markets than it would like to admit. Policymakers in countries like Argentina and the Philippines have become wearily used to cycles of institutional degradation and renovation, as their leadership swaps back and forth between illiberal leaders and able technocrats. At one point, Lindsey and Teles reference Why Nations Fail, the influential 2013 book by Daron Acemoglu and James Robinson, which argues that weak economic development is typically a problem of institutions that are unable to avoid capture by well-established rentiers.

Progressive politics in emerging markets therefore often revolves around attempts to renew those same institutions during those moments when they have managed to rid themselves of the scoundrel at the top. After Trump, that will be America’s task, too.