

Crony Capitalism: Unhealthy Relations Between Business and Government

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Committee for Economic Development



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Executive Summary

Sustainable Capitalism: Why This Policy Statement?

Capitalism is the economic system, if you will, that underlies all of the economic decisions — big, small, profound, mundane — that we make every day.

But the nature of our economic system is not a question that people necessarily ask every day. Societies do not need a profound philosophy to produce and exchange; the motivation comes from instinct. Adam Smith did not in the 18th century establish the economic system of his time — capitalism; he observed, described, and analyzed what he saw already going on around him.

Pre-Adam Smith, there was less philosophical or analytical underpinning to thought about economic systems. More of the variation in systems came from alternative approaches to ownership. For example, a sovereign might own everything and make the decisions of who gets what, and what they do with it. Alternatively, property (including the individual citizen's own labor) could be owned privately, and all owners could make independent decisions — the system that Adam Smith observed and analyzed. Post-Adam Smith, variations were more self-conscious. Socialism and communism were created, advocated, and put into practice. One might say that they have evolved into “state-owned capitalism,” as it is being practiced today in the formerly communist China and Russia.

But capitalism is our economic system — basically what Adam Smith observed — based on private property, independent choices of work and investment, and free exchange.

The Committee for Economic Development of The Conference Board (CED) judges capitalism according to three basic criteria — the functions we expect an economic system to perform:

- Allocate capital, accurately and efficiently (i.e. to

its best uses, at low transactions cost). If it does, the system will...

- Facilitate the formation of new and innovative businesses, and
- Cause productivity growth, output growth and high employment, and therefore widely shared prosperity (which is CED's stated goal).

By these standards, capitalism has performed spectacularly throughout history. It has supported the development of the greatest economy that the world has known. It has also allowed for the reduction of poverty at home and abroad on an epic scale.

However, in the most recent decade, the U.S. economy has suffered; and some would blame capitalism itself.

- Some would argue that capitalism has imposed a substantial cyclical and perhaps even structural shock on the economy, although of course capitalism's responsibility (as opposed to other forces, such as government policy) is in dispute.
- It arguably has imposed excessive costs of allocating capital (although many dispute that argument).
- It arguably has less accurately allocated capital, judging from very low new business formation (again debated).
- Since the financial crisis, the economy has generated less employment (though again causation is subject to intense debate), and therefore has shared income growth more narrowly than we would want.

The remarkable success of capitalism in the United States has been made possible by widespread public support for that system. Sadly, in recent years, and especially since the September 2008 financial crisis, that support has seriously eroded. Increasingly the public is coming to view the system as unfairly benefitting the few and as favoring Wall Street over Main Street. Moreover, the system is no longer perceived to be producing the same impressive economic results as before.

This apparent recent erosion of consensus about the merits of the U.S. economic system, however well- or ill-founded over the long term, at least reduces the comity of our dialog over public issues, threatens our policymakers' ability to mobilize consensus in any future emergency, and diverts our energy from vital public concerns.

Looking forward, we want to reestablish and fulfill the fundamental objectives of an economic system. But we can't just go back to the "good old days," because the world has changed. We need to adapt capitalism to the changing world — we need to foster "Sustainable Capitalism."

We by no means see fundamental, fatal flaws in our capitalist system. But we do see several respects in which capitalism must change if it is to succeed where it may have stumbled over recent years. This policy statement will address just one of them: the problem of "crony" capitalism.

Crony Capitalism

To some critics, one reason for the perceived recent shortcomings of economic performance — and allegedly capitalism itself — is the rise of so-called "crony capitalism:" deals between some private interests (business, anti-business interests, professions, social groups) and government that "pick winners" and thereby also pick losers, on the basis of political influence rather than merit. Such deals would inhibit the productive reallocation of society's resources, and reduce innovation and economic growth. Examples of such deals include cash subsidies, tax preferences, earmarked appropriations and no-bid contracts, regulatory and trade protection, among other forms of favorable treatment. They can be crafted to benefit virtually any sector of the economy, and though each alleged deal has its defenders — else it would not exist — the list of questionable private sector-government interactions is long.

The term "crony capitalism" has become a part of our vernacular, and so we use it here. However, it also is to some an indictment of all of the business

community, or of capitalism itself; and that is by no means our intent. We emphasize that U.S. business, operating under capitalism, has over the long term produced tremendous improvements in income and living standards for the population at large; and that capitalism must, for that reason, be made sustainable. But we recognize that a small minority in the business community did cause enormous harm in the course of the financial crisis. We also will describe a gradual and perhaps growing tendency of private interests, including but not limited to business, to try to mute or circumvent market competition by influencing the policymaking process in Washington and in state capitals and local governments around the country. Our goal is to raise awareness of this trend, which may have grown so gradually as to attract less attention than its remedy would require. We seek to bring capitalism fully on track, to make it sustainable, and to unite Americans of differing persuasions behind the core principle that our economic system can work for all of us.

Why do such deals happen?

Crony deals predate the identification of capitalism, and capitalism itself; sovereigns have rewarded themselves and their families and friends for eons, and any government could exercise policy in such a way as to misallocate resources. Such opportunities might be thought to recede when markets displace sovereign power in the allocation of resources. But crony deals have been made throughout the history of our Republic.

In practice and for a variety of reasons, government over the past 40 years has become a more important factor in the economy in terms of its share of overall spending, the breadth and influence of that spending across the economy, and its increased regulatory reach. Every increase in the government's reach also increases the number of potential channels of public policy's influence. Every increase in the weight of the government's touch increases its potential leverage in such misallocations. The increased importance of the government has been an incentive for private interests, including but not limited to business, to

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seek competitive advantage from the government. It has also given those who oppose business an opportunity to secure restrictions on business.

How are such deals achieved?

Self-interested private-sector-and-government deals can be achieved in a variety of ways. The simplest nonmonetary deals — as old as elections, and dotting our entire political history — can occur whenever an elected official provides whatever some particular private interest wants, and the private interest provides the elected official with votes and reelection. However, a disturbing trend in recent years has been a growing nexus among crony deals, campaign contributions, and lobbying.

Lobbying is the constitutionally protected petitioning of the government by its citizens. Much of today's lobbying is the non-self-interested communication of important information to busy non-specialist legislators, and argument for what the lobbying organizations deeply believe to be the public interest. Business interests that compete with one another need to express their perspectives, lest only the other side be heard. At the same time, most campaign donors seek to achieve what they wholeheartedly believe to be a better world.

Increasingly, however, to achieve their self-interest, some organizations engage in direct lobbying of politicians, or more commonly they employ professional lobbying firms. For their part, because of the human instinct of reciprocity, politicians faced with ever-more-expensive electoral campaigns inevitably provide more time for the arguments of the lobbyists who have regularly provided financial support than for those who have not provided such support. To be sure, there is no bright line between campaign contributions that are purely support for like-minded elected policymakers, and those contributions that are self-serving. And some of the worst abuses occur when elected officials demand campaign contributions behind veiled threats of retribution through their governmental power. But abuse is possible when incumbent interests, which may align with either

party, have the deep pockets needed to provide campaign finance and engage in sophisticated lobbying, and upstart challengers do not.

This symbiotic and potentially destructive relationship between private interests and government has been evident in basic trends that have characterized the U.S. political economy over the past few decades:

- There has been a sharp increase in the costs of election campaigns for all levels of public office. This has made politicians more dependent on raising campaign financing and less focused on solving the nation's problems. The increase in campaign funding surely has increased the need for campaign funding still further, as electoral opponents have engaged in a veritable arms race — “deterrence,” “mutually assured destruction,” and “overkill” — against one another.
- There has been a marked increase in lobbying by all sectors of our economy. Institutions that can afford lobbyists too often dominate legislative consideration of issues that affect those that cannot afford lobbying (although businesses most subject to government intervention might need to lobby so that their real-world perspectives will be brought into the formulation of public policy). Business interests that are involved in either seeking legislative advantage or opposing contrary legislation are often blamed, sometimes for good reason, for the failure of government; but many other private interests seek their own rewards, sometimes merely opposing business. Because large incumbent firms have the resources to engage in such lobbying, they tend to be over-represented in business-government deals — often for fully legitimate reasons, but sometimes to forestall competition from young and innovative competitors, and sometimes to achieve competitive advantages over one another. Such manifestations of “crony capitalism” — and lobbying by anti-business interests — can have unfortunate consequences for the economy.

Although there are numerous instances of healthy public-private partnerships, the unhealthy interaction between large government and private

interests, when coupled with costly election campaigns and the increased influence of lobbying, has exerted an important toll on the U.S. economy. This has occurred along the following lines:

- It arguably has impeded fundamental economic reforms, which could in principle yield equity and efficiency gains.
- It has reduced the overall degree of competitiveness of the economy by favoring insiders over outsiders.
- It has resulted in the costly introduction of subsidies or tax breaks that benefit vested interests at the expense of the general public.
- It has encouraged rent-seeking rather than economically productive behavior.

If left unchecked, crony capitalism will continue to sap vitality from the economy. It also will continue to undermine public support for the American model of capitalism. This adds urgency to the task of finding solutions to the rise of crony capitalism.

Remedies must touch all parts of this vicious cycle of economic cost and public disillusionment. Reducing the breadth and weight of government's involvement in the economy would reduce and lighten the touch-points through which harmful deals have their impact. Here we recommend changes in every major component part of the federal budget — which are necessary to achieve long-run fiscal sustainability in any event. High on the list of changes that we recommend is the reduction or repeal of many of the subsidies that

could be classified as crony deals — which include appropriated spending, tax subsidies, and even potential manipulation of purchases under some benefit programs. We provide recommendations through which the regulatory process could be streamlined — which would be beneficial in its own right, but also could remove access points where crony deals could interfere in the marketplace. We recommend changes to the legislative process that would reduce the frequency of occasions for the enactment of anticompetitive tax or spending laws.

Although there are strong differences of opinion on these issues — witness the current controversy surrounding campaign finance — we seek policy decisions based more on the merits, and less on the influence of money in politics. Reducing the role of money in politics also would reduce the potentially undue deference that elected policymakers and candidates must show to lobbying interests that are also potential sources of funding in the now apparently endless arms race of political spending.

Finally, fundamental reforms of the policymaking process in Washington — to ensure transparency and both due diligence and ultimate action on our serious public problems — would improve the performance of our economy and renew our people's faith in capitalism.

In short, the nation needs reform to make our capitalism sustainable.

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Introduction

There can be no doubt that America's unique brand of capitalism has served both the United States and the global economy well since the republic's very founding. It has supported the development of the greatest economy that the world has known. It has also allowed for the reduction of poverty at home and abroad, and projection of democracy and freedom around the world, on an epic scale.

The remarkable success of America's exceptional form of capitalism — exceptional in our nation's endowments, its energy, its culture, and its cohesion — has been made possible by widespread public support for that system. Sadly, the system is no longer perceived to be producing the same impressive economic results as before, and so in recent years and especially since the financial crisis that erupted in September 2008, that support has been seriously eroded. Many among the public are coming to believe that the economic success that some enjoy increasingly arises from close relationships between private interests (including businesses, nonprofit institutions, and labor unions) and their lobbyists on the one hand and government officials on the other; and we fear that there is reality behind the troubling and damaging appearance. Reversing these perceptions would seem to be a major long-run challenge if America's brand of capitalism is to be sustained and strengthened.

This report focuses on the growing public perception of a crony form of capitalism in America. The report then considers the underlying reasons for crony capitalism, and highlights a number of ways in which it has reduced economic efficiency. A final section of this report explores some solutions that have been proposed to curb the power of vested interests and to restore the market-driven motivation of American free enterprise that has served the country so well.

The Public View of Crony Capitalism

Although American capitalism enjoyed particularly strong public support in the golden post-war economic growth years from 1945 to the early 1970s, since then that support has been eroding.¹ Three basic reasons might explain that erosion. The first is that American economic growth has not continued at the extraordinary pace of those fortunate early post-War years. The second is that the gains from economic growth are now widely seen to be increasingly unevenly distributed. The third — which many believe is an important cause of the first two — is that policy decisions are coming to be viewed by the public as reflecting the preferences of the connected and organized few rather than those of the general public.² Deterioration of public support for capitalism for all of these reasons contributes to the demoralization of the citizenry and the difficulty of solving America's problems, including increasing economic growth — and so to some extent these problems grow through a vicious cycle and are self-perpetuating. Thus, slowing economic growth and crony capitalism are to some degree mutually reinforcing.

The weakness in the recent performance of the U.S. economy has included slower growth of aggregate output, of labor productivity, and of median household income. And while those adverse trends have worsened the absolute status of typical U.S. households, the conspicuous display of rapidly rising incomes among a small proportion of the well-to-do has compounded the popular frustration.³

In the public mind, these trends seem to be connected.⁴ The standard of living of the typical citizen is advancing slowly by historical standards, while a few are doing well. The game is rigged, people tell opinion researchers, with the results pre-programmed to favor some over others. The perverse system that yields these unfortunate results has come to be known by its critics as “crony capitalism.”

Business-Government Relationships — Good and Bad

The greatly expanded role of government in the U.S. economy, as described more fully below, has substantially increased the number and magnitude of interactions between business and government. Many such interactions are necessary and healthy, and benefit the overall U.S. economy. The broadening interface between government and the economy also has led business legitimately to take action to defend itself against instances of undue government intrusion and regulation.⁵ At the same time, however, it has provided strong incentives for private-sector interests — both business and non-business — to attempt to influence government decisions to their advantage, often at a substantial cost to overall economic efficiency. It is this latter sort of private sector-government activity that has been of particular concern to many of the critics of capitalism from both sides of the political spectrum.

How can we distinguish the harmful government interventions in the economy from the necessary and constructive?

As just noted, some interactions between business and government are necessary and healthy. From the time of Adam Smith, most economists have believed that the market yields the best (indeed, optimal) outcomes. However, markets are not always perfect, and when they are not, public policy must intervene if the economy is to attain — or sometimes just to approach — optimal outcomes. But when government intervenes effectively in such a fashion, we can have good public-private “deals.”

The first textbook example of an imperfection in a market (sometimes called a “market failure”) is monopoly. Markets yield efficient outcomes if there are many producers, so that none has market power. But if there is only one producer (or merely too few to make a competitive market), the seller can restrict supply and extract excess profits from consumers, reducing society’s welfare. Government

would need to restore competition, which inevitably is easier said than done.

There are many other examples. If a producer cannot reap the full reward of its efforts, it will produce too little. Hence, the typical economics textbook says that *basic* research and development (R&D — sometimes “research and experimentation,” or R&E) must be subsidized, or even undertaken directly or indirectly by government, if the nation is to invest enough in vital new ideas.⁶ This is an example of a “public good,” where the benefits of production or consumption “spill over” to the public at large, such that “free riders” can enjoy the benefit without paying. National defense is another clear example of a public good.

A further example of spillovers, bad instead of good, is pollution. A factory that generates dangerous by-products might cheaply dispose of them by dumping them in an adjacent river. Then, they are the problem of the metaphorical town downstream.

The summary, though, is that there is relatively broad acceptance that markets work, and should be allowed to work whenever possible. This can apply even in some instances of market failure, such as the pollution example, where market-oriented solutions might be better than hard-and-fast regulation. Outright regulation that “thou shalt not dump” might require an exceedingly costly alternative disposal system, whereas a market-oriented fee based on the concentrations of harmful pollutants might allow the use of an inexpensive filter that removes such a high percentage of the contaminants that the problem is for all practical purposes solved. In some instances, everyone, including consumers as well as producers, could be better off with a market-based solution to such a market failure.

The concept of market failure is not so much

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controversial on the basis of ideological orientation. (In fact, President George H.W. Bush recognized a market failure and used an auction of permits to limit sulphur dioxide emissions to combat acid rain.) What is controversial, rather, is precisely whether any particular situation constitutes a market failure. Because perfectly competitive markets are extremely rare, we must judge real-world markets based on relative degrees of imperfection, not by clear and absolute standards. Often one might conclude that there is a significant market failure, but that none of society's relatively blunt public-policy instruments would solve the problem without causing even worse collateral damage. And one person's perceived monopoly or oligopoly power, for example, is another person's hard-earned success and profitability in a competitive market. Such judgments are sometimes cut along fairly well-defined partisan lines; so, for example, some might look for monopoly power in our economy first in terms of labor and union organization, rather than few and powerful businesses in a particular industry.

Thus, our crucial issue of "crony capitalism" is, for all of its importance, not clear cut. Just as market failure is to a considerable degree in the eye of the beholder, it follows that "crony capitalism" is a matter of judgment. Because market failure can require government intervention in the economy, "crony capitalism" cannot be defined as *any and every* government intervention. Rather, crony capitalism would constitute government intervention *not* justified by market failure, but rather as part of a pursuit of a *purely private* interest through some subsidy (whether delivered through public spending or as a tax preference) or some regulatory protection against fair competition.

A consequent characteristic of bad public-private deals is that they are negative-sum uses of the nation's resources. A government intervention that effectively addresses a market failure may not make *every* interest in society better off, but it makes society *as a whole* better off. Thus, in the pollution example, creating a deal under which dumping is appropriately reduced in severity creates larger

gains for the heretofore victims than it imposes costs on the polluters. In theory, the victims can compensate the regulated polluters out of those larger gains, and everyone can be better off. Some "crony deals" might be true and precise zero-sum transactions — for example, a dispute over which interest gets to use an economic resource (perhaps which bidder gets a concession to operate a restaurant location on a limited-access public highway), where the economic consequences would be identical whichever bidder wins. However, a truly bad crony deal might prevent an innovator from challenging an incumbent business with a new and superior technology. In that instance, deprived of additional competition and innovation, society as a whole is *worse off* — even though the protected interest may be *better off*. If an incumbent interest can in that fashion protect an inferior way of doing things merely to safeguard its own advantaged position, we have a crony deal at its worst.

Furthermore, even though the concept of crony capitalism cannot properly be extended to all interventions into government policy, it should embrace improper interventions from whatever source. Thus, although interventions by business to pursue the benefits of "corporate welfare" are perhaps raised most commonly, there can be equal ill effects on the performance of the economy from unjustified interventions from any interest — including (among those sometimes mentioned) labor, the tort bar, and particular subgroups of the population. Some improper interventions seek benefits for business, or segments of the business community; some seek to hinder business for the perceived benefit of other groups. Public-private deals cannot be judged by their source, but only by their merit; and judgments inevitably will differ from one observer to the next.

Thus, bad crony deals do not come with indelible bar codes to identify them. If challenged, even a bad crony deal will be defended by the interests that profit from it. However, we can say that under the best unbiased analysis, a bad crony deal will be found *not to address any true market*

failure, and it will *fail a society-wide cost-benefit test*. Unfortunately, this is no easy answer to the problem of combating crony capitalism; it is an endless series of judgment calls and public-policy puzzles. For example, no mere mortal can know precisely the benefits of future competition; and so no one can know the costs of a bad public-private deal that forestalls future competition. Any judgment on this point will be subjective, and will be challenged.

Today, the broader interface between an expanded government and (particularly) large business enterprises encourages many private-sector attempts to influence government policy. These efforts have taken many forms, as have been catalogued in the following list by researchers at George Mason's Mercatus Center (there could be many more):⁷

- Obtaining exemptions from legislation or securing the passage of legislation to provide targeted benefits;
- Effecting regulatory changes, exemptions from regulation, or regulations that discourage new or small competitors;
- Obtaining targeted tax breaks or modification of tax penalties;
- Securing direct or indirect subsidies;
- Obtaining tariff or quota protection from foreign competition;
- Gaining access to bailout funds or loan guarantees;
- Securing benefits from non-competitive bidding.

While no comprehensive studies are available as to the aggregate economic cost of unjustified private-sector and government interaction, the distortionary effect of such public-policy activity might be illustrated by the following oft-cited specific industry examples.

Agricultural Industry Relationships With Government

Among the more studied instances of arguably harmful and costly effects of public-private deals on U.S. economic efficiency and fairness have been that of the agriculture sector in general and of corn and sugar producers in particular. Ever since the New Deal, a highly organized agricultural lobbying effort has succeeded in obtaining a wide array of farm subsidies and import tariffs for agriculture that have distorted markets and that have benefited the agricultural sector at the expense of the general public.

Opponents argue that agricultural deals not only have distorted market functioning, but also have done very little to help the small farmers that purportedly are the principal focus. Indeed, it is estimated that ten percent of the recipients of farm subsidies collect almost three quarters of the subsidies, which in the mid-2000s amounted to around \$90,000 per farm. By contrast, the bottom 80 percent of farmers collected some \$3,000 per farm. Among those receiving large farm subsidies have been a number of Fortune 500 companies, several prominent former and current congressmen, and a number of celebrities.⁸ Research also indicates that the main recipients of farm subsidies have been those companies which spend the most on lobbying and on election campaigns.⁹

The federal government funds programs to market U.S. agriculture products overseas; those programs arguably could be funded privately. The federal government also makes public lands available for grazing (and for mineral exploitation) for what some argue are preferentially low rates in comparison to prices charged by private landowners.

A particularly harmful example of public-private deals in the agricultural sector arises in the sugar industry, which spends a disproportionate amount on lobbying and campaign contributions through political action committees. (See following chart.) The government protects the domestic sugar industry by shielding producers against foreign competitors through import tariffs and quotas. It

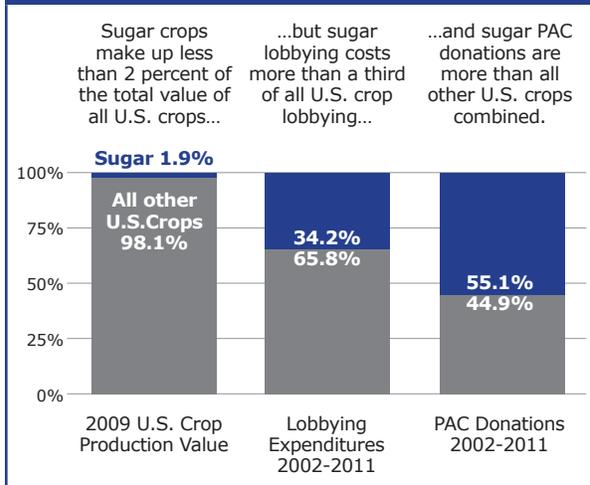
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also shields the industry against low prices through a non-recourse loan program that serves as an effective price floor. A consequence of such policy is the huge disparity in sugar prices that American consumers face compared to the rest of the world. As a result of these government actions, U.S. consumers and businesses have had to pay twice the world price of sugar on average since 1982. Recent estimates put the annual direct cost to consumers at almost \$4 billion per year. But there are further costs imposed on the taxpayers through higher government spending — for subsidized loans to producers, through payments to foreign producers as compensation for import quotas below levels set in trade agreements, and potentially through subsidized sales of excess sugar to motor-fuel producers for use in ethanol production — alleged further instances of favoritism to agriculture. Sugar-using firms, such as producers of finished food products, have opposed these subsidies — but without success. Those firms are estimated to have lost about 20,000 jobs because of the higher cost of sugar.¹⁰ Most of the benefits of protection have accrued to a handful of sugar producing corporations, which have engaged actively in lobbying and in financing political campaigns. This illustrates the potential nexus among the growing influence of government on the economy, political campaign contributions, and lobbying (which will be discussed in more detail below).

Sugar producers, not surprisingly, see this issue differently. They believe that current policy balances supply and demand to keep prices stable, and to avoid the issuance of subsidy payments to U.S. sugar farmers — unlike other agricultural commodity programs. They argue that the routing of imports to the ethanol industry avoids excess supply in domestic markets — which in other commodity programs would trigger direct payments to farmers.¹¹

These differences of opinion illustrate that just about any public-private deal can be viewed in very different ways by different interests. We can state our opinions, but these opinions are definitive only to ourselves. What this statement will do

Figure 1 Sugar Producers' Sweet Deal



Sources: Chart from Heritage Foundation. Crop values: U.S. Department of Agriculture, USDA National Agriculture Statistics Service, Agricultural Statistics 2011 (U.S. Government Printing Office; Washington, D.C.), 2011, http://www.nas.usda.gov/Publications/Ag_Statistics/2011/2011_Final.pdf (accessed April 10, 2012). Lobbying expenditures and PAC donations: Center for Responsive Politics, "Lobbying Spending Database: Crop Production and Basic Processing," <http://www.opensecrets.org/lobby/industryclient.php?id=A01&year=2011> (accessed April 9, 2012); and "PAC Contributions to Federal Candidates," <http://www.opensecrets.org/pacs/industry.php?txt=A01&cycle=2012> (accessed April 9, 2012).

henceforth, however, is to cite a list of public-private arrangements that we believe cry out for impartial review by our elected policymakers. We believe that, with such review, many would be found unjustified and would be repealed.

The Export-Import (Ex-Im) Bank

Another current example of differences of opinion about "corporate welfare" or "crony capitalism" is the *Export-Import (Ex-Im) Bank*. Some see the Ex-Im Bank, which provides financing guarantees for U.S. exporters to risky (according to its stated intent) overseas markets, as a quintessential private-interest deal between government and big business, providing what amounts to an explicit subsidy to its selected beneficiaries.¹² Others counter that all of our major competitor nations have such export-financing facilities, and that Ex-Im is needed to level the playing field; they go further to add that if we hope to negotiate away

such facilities in future trade talks but eliminate our own facility now, this equivalent of “unilateral disarmament” would allow our competitors to refuse to yield in negotiation and to retain a significant competitive advantage. The lineup of U.S. firms on the two sides of this debate is indicative of the difference of point of view. As one example, U.S. aircraft manufacturers support Ex-Im to help them to sell in other markets, and to protect their manufacturing jobs. U.S. airlines oppose Ex-Im on the ground that it allows cheaper acquisition of U.S. aircraft by *their* competitors overseas. The balance is in the eye of the beholder, and the differences of opinion are strongly held.

We do have a concern that the Ex-Im Bank has been cowed by public criticism into abandoning its core mission. If Ex-Im should exist at all, it should finance transactions that the private sector will not — specifically, sales to risky markets, usually in less-developed countries, and sales by smaller companies that are less able to obtain financing. But because of misguided criticism that some of those deals in the end lose money, Ex-Im instead has leaned toward safe deals in safe markets, which the private sector would be more likely to finance. In taking this safer path, Ex-Im has strayed toward the grounds of crony capitalism. Thus, the popular press and unschooled critics actually ask for crony capitalism, and — no surprise — that is what they get. However, this criticism clearly does not address the conundrum of a world in which other nations follow the same ill-advised strategy of subsidizing their exports, leaving the United States to choose whether to compete on that unfavorable ground or to abandon the entire marketplace to our national competitors.

The Defense Establishment

The Department of Defense has an enormous procurement program. Some contend that weapons systems designed for the last war are continued in the interests of the contractors that supply them; this of course is subject to complex judgments. (NASA projects and their contractors sometimes are seen in the same light.)

But the three most recent Secretaries of Defense, whose Administrations admittedly have been faced with the looming budget crisis, have weighed anew the merits of existing defense procurement programs against the new and different security threats that we face as a nation, and have concluded that our scarce national resources could be allocated far more effectively; and that so doing would result in a significantly different hardware portfolio for the various services.

It is important to understand that as large as the Department’s procurement budget is, it understates the true cost of all that hardware. All that the procurement dollar does is to put that hardware on the tarmac. If a weapons system is to be used to provide national security, it must be manned, it must be fueled and armed, it must be maintained, and in some instances it must be transported to the theater of its use. Thus, an investment in a weapons system is a commitment to a much larger stream of funding extending well into the future. If there is any question whether a weapons system is well chosen to address true national security needs for years to come, that case must be given the most careful hearing before such a commitment is made.

DOD procurement projects have been subject to both misstep and scandal in the not-too-distant past. There are allegations of favoritism in contract terms (such as non-competitive contracts), and in one recent instance there was a major scandal in the contracting process.¹³

To combat challenges to existing programs, the defense industry has engaged in what might be called tactical subcontracting. Large projects have been known to spread the construction work all across the country. Therefore, if the project is challenged, the largest possible number of Members of Congress would find their constituencies adversely affected. That ensures the highest probability that the case for the weapons system will receive a sympathetic hearing on Capitol Hill.

Some believe that a quick resolution of defense budget issues could be reached by delegating

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decisions to a commission. But even ignoring constitutional niceties,¹⁴ this phenomenon is a fundamental reason why the sometimes vaunted “base closure commission” model of cutting defense (following on the Base Realignment and Closure (BRAC) Commission) in fact is productive in only a very narrow range of circumstances. Taking account of the co-location of some of the designated facilities, the initial round of recommendations from the BRAC adversely and significantly affected perhaps two dozen congressional districts. That meant that when those recommendations came before the Congress, the other more than 400 House Members had an intense interest in seeing the order take effect, lest a subsequently revised version should turn around and hit facilities in *their* districts. Thus, the BRAC process took advantage of an opportunity to fabricate a large majority for retrenchment. In contrast, enacting any legislation to eliminate a major weapons system that has been or would be built through tactical subcontracting would require that a large majority of Members of Congress vote to terminate jobs among their *own* constituencies, not *others*’.

That is why the BRAC model, however cleverly designed it was for the particular task to which it was applied, is not a generally applicable tool and is unlikely fundamentally to change the dynamic and reduce the difficulty of cutting the overall defense budget, and to rationalize and modernize defense procurement. That model might allow all Members of Congress to disavow responsibility for the formulation of the retrenchment plan, but it would not allow them to deny a role in allowing jobs to be eliminated in their districts.¹⁵ So Members of Congress will have to do their jobs and make the difficult but necessary decisions to allocate our tax dollars.

We believe that the maintenance of outdated or poorly targeted military systems, especially given our overall fiscal struggles, is particularly unwise. Each dollar poorly spent detracts from what could be devoted to our true national security, because it adds to our nation’s public debt. We believe that this issue should be high on the list of priorities for review and reassessment in an effort to reduce or eliminate unwise public-private deals in Washington.

Inappropriate Energy Subsidies and Investments

Policy relating to energy and the environment is subject to varying criticisms from different points of view. Those most concerned about the potential ill effects of climate change decry perceived subsidies for fossil fuels, and want increased support for low- or no-carbon sources. Those who are more skeptical of climate change tend to argue that uneconomic sources of so-called green energy are being kept alive only by costly and wasteful subsidies — which field has had its own scandals of late.¹⁶

Just about anyone might wonder at a system that provides subsidies to both carbon-intensive and carbon-free sources of energy. But recent critics point particularly to failed investments in companies and products, some of which have been alleged to be scandalous favors to political supporters and providers of campaign finance. To be clear, however, we are not troubled that some government-supported investments failed. We are troubled, rather, at the *kinds* of investments that failed.

We noted earlier that a valid — indeed, vital — activity of government is to support basic research — the development of new knowledge that is prior to, and not tied directly to, any particular product. By its very nature, investment in basic research is speculative and highly risky. Some — perhaps many — investments in basic research will have no ultimate commercial payoff. There *will* — with certainty — be some “dry holes” dug. If such investments were “sure things,” the private sector would undertake them. But that reality does not negate the case for government investment in basic research. Rather, it reinforces the need for mature policymakers to accept the reality and make the necessary decisions with their eyes open, and not to use failed projects as opportunities for political gain against some electoral adversaries.

We are troubled, rather, that the federal government would invest in the development or even the production of existing product designs

that should stand in the marketplace on their own two feet. Whether carbon emissions are a concern or not, it makes no sense to subsidize **both** carbon-intensive **and** “green” sources of energy. Likewise, it is economically unwise to favor particular sources of “green” energy over others without a mature market judgment on their relative merits. Thus, the popularly expressed concern that the federal government lost money on its green energy investments is not the point. The private sector will provide the necessary investments in profitable product development and marketing. The point is that the federal government should invest in technology, not products based on that technology.

If carbon emissions truly are a matter of concern, then rational policy might eliminate subsidies, in some way penalize emissions of carbon at a level in keeping with the estimated damage, and allow the market to choose among low-carbon alternatives (and conservation, energy efficiency and research). Potentially productive **basic** research, which in any field would be an appropriate focus of government, should be a key part of that strategy.

Local Benefits From Infrastructure

In infrastructure, the federal government undertakes numerous projects — water projects, including some beach restoration, are prominent — that are argued by some to provide essentially local rather than national benefits, and thus arguably should be funded at the local level. (Local advocates obviously see a greater national benefit, or argue that needs rise to the level of emergencies, or are appropriate transfers from wealthier to poorer parts of the nation.) Some such projects used to be funded by explicit statutory earmarks, which some contended were unfair and opened the door to corruption (such as in a noted scandal regarding defense spending¹⁷); although explicit earmarks are now prohibited, Members arguably can achieve the same effect with simple letters or telephone calls to cooperative executive-branch agencies, which are dependent on the Congress for their funding — if the program administrators are willing to knuckle under to

such pressure. Also, substantial national funding has been offered for high-speed rail projects, which arguably are uneconomic and primarily benefit local communities and those constructing the projects. Subsidies to Amtrak and to regional and local airports also are either uneconomic or not the appropriate responsibility of the federal government; others cite environmental benefits, aid to ailing out-of-the-way communities, or simply jobs. Construction undertaken by the federal government is subject to Davis-Bacon restrictions on wage rates, which some argue increase the costs to excessive levels.

One locus of infrastructure-oriented public-private deals was the American Recovery and Reinvestment Act of 2009, commonly known as the “stimulus bill.” Many economists believed that the economy was in freefall, and that action was needed urgently. However, the form which the bill took — an enormous piece of emergency, must-pass legislation — left the door open to special-interest deals. Some activities that could not move expeditiously in any event were nonetheless called “stimulus” and put into a huge bill where they could not possibly receive appropriate review. In much the same sense, the monetary-policy response to the financial crisis, along with legislation allowing federal government “bailouts,” created a massive and urgent program that was open to miscalculation and abuse — although again the needs of the economic and the financial sector were dire.

We are concerned particularly with the tendency of influential legislators to use their power to provide local benefits at the expense of the Federal Treasury. If the Congress wishes to provide assistance to needy parts of the country, either because of disaster or secularly lagging regional economic growth, it should say and do so explicitly. Instead, under the current scattershot approach with no explicit rationale, many more parts of the country line up to get their “share” of infrastructure spending — with the result that the Treasury is drained to serve influence rather than genuine need.

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Finance and Housing

The federal government has for decades supported the demand for housing through tax and outlay subsidies. In finance and over the same period, the government has supported the mortgage markets through the semi-governmental Fannie Mae and Freddie Mac, which benefited from an “implicit guarantee” of their securities. In the depths of the financial crisis, that implicit guarantee became explicit, and so bondholders were protected (though equity investors suffered large losses). More broadly, the reality that some systemically important financial institutions are “too big to fail” created an incentive to engage in large-scale risky behavior without fear of the consequences if their bets should lose. Some institutions followed that incentive. Again, in the financial crisis, some investors suffered severe losses, but skeptics argue that responsible parties often did not pay for their miscalculations or misdeeds. Banking regulation in the run-up to the crisis was not effective; large volumes of questionable mortgages were issued for years without rebuke, and many critics ask why. Some might claim that regulators were “captured” by the firms that they were charged to regulate, or otherwise lacked the imagination or persistence to see that financial institutions were running enormous levels of undiversified risk.¹⁸ Others argue that the federal government itself pressured financial institutions to make risky mortgage loans — so that the government could claim rising homeownership rates — under threat of being cited for violations of law (such as charges of discrimination under the Community Reinvestment Act) or other regulations.¹⁹ Under whatever combination of influences — there is widespread acknowledgment of multiple instances of incompetence and wrongdoing, with most of the dispute over the causal importance of each particular failure — massive harm was done across the economy, and the regulatory system clearly either caused or failed to prevent it.

More broadly, in finance (and in other industries as well), some would contend that the federal government has fallen down on the job of enforcing

antitrust restrictions, with the result that firms become too large and accumulate unhealthy market power — including becoming “too big to fail;” others would respond that financial firms that are too small would be insufficiently diversified and therefore unstable, and antitrust enforcement is exceedingly difficult and has been pursued to the extent feasible. Many cite in particular the tax advantage (treatment as capital gain, taxed at reduced rates) for income received by hedge-fund managers as “carried interest,” which critics contend is more in the nature of cash compensation than a return to the risk of the managers’ own capital.

Health Care

Many see Medicare as an unimpeachable source of support for elderly persons who could not otherwise afford health insurance or afford medical care (and who themselves paid payroll taxes to provide coverage to preceding generations of elderly). In any event, no political candidate would attack the program outright, though there are sharply differing views on what it means truly to support Medicare. Still, Medicare’s system of administered prices arguably creates the opportunity for favoritism and manipulation. For example, a vigorous debate rages between those who advocate that government demand rebates of part of pharmaceutical prices for low-income beneficiaries, and others who contend either that Medicare is too large a share of the total market to bargain effectively, or that reducing Medicare’s prices will reduce the pool of funds needed to finance research and innovation.

Despite recent hopeful news of slowing cost growth, projected Medicare expenditures still exceed available budgetary resources, and hence drive a projected unsustainable growth of public debt. Thus, principled support for the program in concept still requires intense effort to ensure that the program’s expenditures are as well targeted as possible. Therefore, some would join CED in arguing against the current administered-price system, and for a more-market-oriented program, driven by cost-conscious consumer choice.²⁰

Medicaid spends enormous sums on difficult-to-regulate long-term care for the indigent disabled. That system has been challenged by some as overly favorable to particular industry interests.

Some argue that compensation for medical malpractice is poorly determined and delivered only after excessive delay because of the interest of the tort bar in maintaining traditional adjudication of complex and emotionally charged episodes. CED has recommended reforms to the malpractice system that we believe would reduce the cost of and the delay in reaching decisions without harming the interests of those who are truly harmed.

“Tax Expenditures”

Many families of issues are raised by the preferential provisions in the tax system — sometimes called “tax expenditures,” a term coined by tax-policy attorneys and economists to refer to provisions of law, regulation or custom that amount to “spending through the tax system.”²¹ Although measurement of tax expenditures is difficult, the best evidence is that their cost in terms of revenue forgone is growing faster than is the economy as a whole.

There are at least two reasons why legislators and private interests find tax expenditures more attractive than outlay programs. First, in political optics, a spending program makes government look bigger, and to many constituencies therefore is considered bad; whereas pursuing precisely the same objective with precisely the same resources through preferential treatment in the tax code makes the government appear smaller (revenues are lower rather than outlays higher), is a “tax cut,” and therefore probably to most constituencies looks good. Second, in most instances a tax cut is written into permanent law, and therefore in the environment of recent years is never evaluated or reviewed. In contrast, if the same resources were devoted to the same purpose through an appropriated program, that program would be at risk every year if appropriations were not

passed on time — although again, under current patterns of behavior, Congressional oversight of even annually appropriated programs is next to nonexistent.

The following items are just a small sample of the tax expenditures often cited as constituting crony deals.

Health insurance.

The largest single tax expenditure, costing the Treasury more than \$200 billion per year, is the exclusion from measured income of employer-paid health-insurance premiums. But that allocation of massive resources has left employer coverage stagnant and far short of broad coverage, because the tax expenditure is poorly targeted. Because the subsidy is distributed as an exclusion from measured income, the greatest incentive goes to those with the highest incomes, whose tax savings are determined by the highest tax rates and therefore are the largest. Those with moderate incomes, who need more help and incentive, get less; those with the lowest incomes, who need the most help and incentive, get nothing at all. This “upside-down subsidy” yields the least progress with the greatest cost. Furthermore, making health insurance appear cheaper dulls the incentive of these consumers to try to hold healthcare costs down. Some would argue that the exclusion is supported by unions, which claim that they can provide better health-insurance coverage than unorganized workers can negotiate on their own. Restructuring this provision could save needed revenue while providing more support to those who need it most.

Retirement savings.

The second largest single use of resources (combining five closely related but separately listed tax expenditures), consuming more than \$100 billion of federal tax dollars each year, is household saving for retirement. And yet the majority of U.S. households, overwhelmingly those of modest means, are sorely underprepared for retirement. Poor financial education and an unwillingness to defer gratification surely play a role. But another

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reason why such vast resources fall short of the goal is that the tax expenditure is poorly targeted. Again, the “upside-down subsidy” gives more of the revenue forgone per dollar of pension contribution to the taxpayers with the highest incomes, those who need the incentive and the resources the least. If the current subsidy could be redirected to provide relatively more incentive to those of more-modest means — there is a tax credit in the law, but it has not been sufficiently effective — we could expect increased (though perhaps still not sufficient) retirement security for more Americans. As a nation, we need more savings from whatever source to finance more business investment and thereby increase productivity and incomes. But our total resources are scarce, and so it is preferable to target more of our incentives toward people who would be most likely to increase their savings, rather than those who probably would save even with a lesser inducement.

Other tax expenditures.

Deductions for state and local taxes paid are said by some to provide tax savings for purchases of services (education, infrastructure, etc.) that are no more deserving of subsidy than private purchases. Others argue that the deduction tends to equalize burdens across localities of different levels of wealth, and that it makes it less painful for states and localities to increase revenue when needed. Interest earned through life insurance policies is tax-deferred and in some instances not taxed at all, in contrast to interest earned from many other sources. The federal government provides a tax credit for investment in low-income housing which some would argue is inefficient, and essentially merely increases the income of the developers. The research and experimentation (R&E — sometimes called research and development, or R&D) tax credit receives broad support, but some argue that even it provides a subsidy for activities that firms would undertake in any event. Despite complicated legal drafting, it can be manipulated to reward comparatively steady-as-you-go research spending as much as extraordinary incremental effort. In addition, the R&E credit’s temporary status — it must be re-enacted periodically — subjects businesses to unnecessary uncertainty,

and creates a lobbying free-for-all every time it approaches its expiration date. We believe that the Congress should make up its mind and either make the tax credit permanent or, preferably, repeal it as part of a fundamental tax reform to reduce corporate tax rates and thereby make all U.S. firms more competitive internationally. Firms would then undertake R&E spending according to its value in the marketplace.

Other Tax Issues

The federal government collects excise taxes on alcoholic beverages but has not increased those tax rates in dollar terms for years, such that they have been greatly eroded by general inflation, and arguably do not compensate society for the ill effects of alcohol consumption. With a similar lack of price indexation, the federal government also has allowed gasoline tax collections to fall far short of the cost of needed highway construction and repair, which may gratify many highway users but slows the economy in traffic congestion and costs money and lives through unsafe driving conditions.

Regulation

Misguided regulation can divert economic resources from their best uses and thereby reduce economic growth. As just one example, a 2003 rule issued by the Securities and Exchange Commission had the effect of strongly motivating investment fund managers to hand off the voting of their corporate shares to outside proxy advisers, a class of business that is dominated by just two firms. Investment fund managers were implicitly told that they must vote on every shareholder issue, such that they could not abstain, but also threatened by potential challenges of conflict of interest in the votes that they did cast. They were told that giving their proxies to the outside proxy adviser firms would guarantee safety from conflict-of-interest charges. The result was that the two dominant proxy advisory firms were given the power to influence the vote of vast numbers of corporate shares that they did not own, and to operate essentially as a duopoly in this narrow

segment. The SEC has issued revised guidance, but needs to ensure that shares owned by investment fund managers are voted (or not) according to the interests and preferences of the owners, not by others designated in effect by the SEC itself.

Other Questionable Private-Sector Deals

Labor also can engage in public-private deals. Some argue that antitrust exemptions for unions, and particularly the ability of public-sector unions to collect mandatory dues and then contribute to the political campaigns of the officeholders who will negotiate their pay and benefits, are questionable public-private deals. Others point to the Davis-Bacon Act (which supports wage levels in public projects), the Jones Act (which restricts shipping between U.S. ports to U.S. constructed and flagged vessels using U.S. labor), and state laws that facilitate union organizing (as opposed to “right-to-work” laws, which do not) as restraints on competition that reduce the well-being of citizens at large while providing protection to small classes of the workforce. We believe that the Jones Act has had a particularly perverse effect of increasing costs and inhibiting commerce. Some would also argue that non-for-profit organizations serving particular favored constituencies influence the political process to obtain funding, regardless of the substantive merit of their activities.

Questionable Deals at the State and Local Government Level

Although the focus of this statement is on crony capitalism as practiced at the federal level, other alleged public-private deals are not confined to the federal government, or are exclusively in the domain of state or local government.

State and local governments engage in “economic development,” which often means providing subsidies to businesses as an inducement to locate in the jurisdiction in question. Such subsidies, usually delivered through tax concessions, are highly questionable policy instruments. A tax subsidy might seem an acceptable price to pay

from the point of view of a single community that is suffering a downturn and in desperate need of jobs. But from the perspective of the nation as a whole, dueling subsidies from many such down-on-their-luck communities looks more like a negative-sum race to the bottom. Those communities need jobs in part to generate tax revenue to maintain needed public services, but job-seeking subsidies give those potential revenue gains away, at least in part. Furthermore, if the process devolves into a contest among *all* communities as to which can provide the biggest subsidy, then almost by definition the community most able to pay is the one least in need. And at the end of the agreement that provided the subsidy, the subsidized business would have been shown by example every reason to put its location back up for bid again, including by the current subsidizing community; and likewise, every other business in that community (and every other one) would have been taught to ask for the same kind of subsidy. It is easy to preach from afar, especially to those feeling compelled to sign contracts of desperation, but in the long run it would make much more sense for a locality to market itself with the highest quality workforce, infrastructure and schools rather than to bargain away its tax base.

Some would argue that professional licensing requirements for trades from law to hairdressing merely restrict entry of additional workers, limiting supply and so raising prices.²² Protection of tenure for teachers, in some instances without adequate assessment of performance, is highly controversial. Licenses and concessions to do business in particular fields (gambling licenses, certificates of need for provision of medical care) are sometimes awarded at no cost, even though such rights might have considerable market value. Some might argue that exclusive rights should not be sold if those fees would then be passed on to the public. However, that raises the question of whether such free licenses or rights are given to the most worthy candidate, or rather are handed out at zero or below-market prices as favors to the most politically well-connected — perhaps because of election campaign contributions.

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The Causes And Tools Of Crony Capitalism

Three interconnected trends have increased the potential for public-private deals to benefit narrow interests at the expense of the U.S. economy as a whole. First, dating back to World War II and even before — for a variety of reasons including national defense, a growing public role in retirement, the growing cost of and public role in health care, the complexity of modern transportation and communications, and many other factors — the government has become an increasingly important, some might say even dominant, player in the U.S. economy. It has become so through its increased regulatory reach as well as its taxation and spending policies. This trend has made it increasingly profitable — and in the perceptions of some, apparently necessary — for private interests to attempt to influence the workings of government.

Associated with the growing size and influence of government in the economy, two trends in politics and policymaking have created the tools by which such deals could be struck. For one, a rapid rate of increase in the costs of election campaigns for all levels of public office has made politicians particularly dependent on higher and higher levels of campaign finance.

And in addition, there has been a marked increase in lobbying activity as a channel by which large vested interests and deep pockets can legally influence the legislative process to their advantage.

Neither campaign contributions nor lobbying is by any means reprehensible in and of itself. Lobbying is the constitutionally protected petitioning of the government by its citizens. Much of today's lobbying is the non-self-interested communication of important information to busy non-specialist legislators, and argument for what the lobbying organizations deeply believe to be the public interest. Business interests that compete with one another need to express their perspectives, lest only the other side be heard. At the same time,

most campaign donors seek to achieve what they wholeheartedly believe to be a better world.

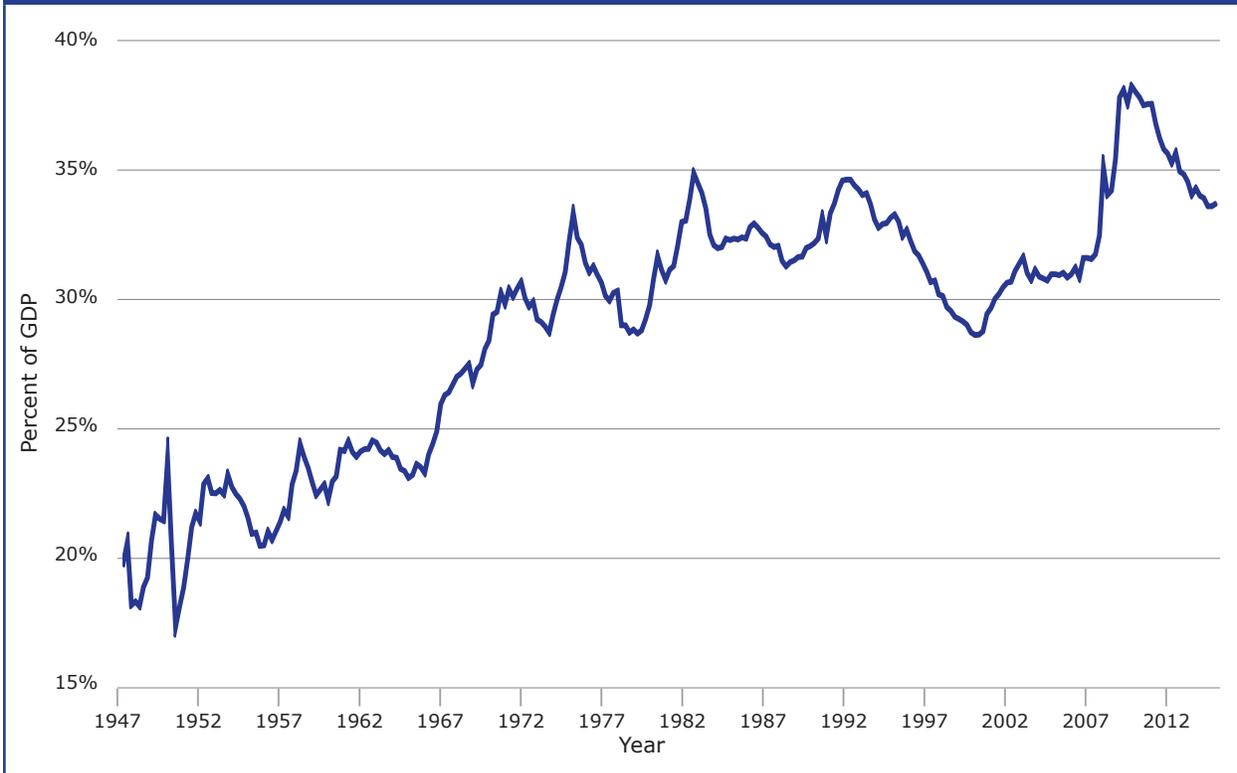
Our concern, however, is that the leverage of government on the economy, pursued through the tools of campaign finance and lobbying — sometimes applied simultaneously — can lead to crony deals that aid a narrow private interest but may hurt others and even the total economy on net.

As noted above, the increased importance of government in the economy has allowed various interest groups, companies, trade associations and labor unions potentially to benefit if they can affect public policies, perhaps even to obtain direct support from the government. This potentially leads to the nexus of manipulation of public policy through the tools of crony capitalism. The worst case is if elected policymakers, in dire perceived need of campaign finance, give undue weight to the lobbying of incumbent interests in preference to less-well-heeled new businesses and innovators, because those established interests are able to provide greater campaign contributions. Such circumstances can play on the natural human impulse of reciprocity: Lawmakers feel an obligation to give a full hearing to those who have supported their election campaigns. Ultimately, however, the fruits of crony capitalism's subsidies can be recycled into campaign finance in a self-perpetuating sclerotic loop that destroys the competition and innovation that American capitalism needs to maintain international leadership, prosperity, and the public trust.

The Motivation for Crony Capitalism: The Pervasive Role of Government

Crony deals between the private sector and government, of course, are as old as the Republic. In fact, they pre-date our Republic, and can be identified back to Rome and beyond. We do not need contemporary mass communications and K

Figure 2 Total Government Spending as a Percent of GDP



Federal Reserve Bank of St. Louis

Street lobbying shops to explain anti-market deals between business and government, nor would somehow eliminating those technologies and institutions somehow render government always pristine and efficiency-enhancing.

However, a striking feature of the U.S. economy over the past several decades has been the growing role of government. This has allowed elected officials the means increasingly to influence economic outcomes in favor of those who can most effectively petition the government. Moreover, as Nobel Laureate Edmund Phelps has observed, while the nexus between the private and public sectors has become stronger, it has become far more invasive in a few particular industries like health care and education.²³

There are multiple ways by which this has become possible.

The most obvious indicator of the government's ever-increasing impact on the U.S. economy has been the substantial *growth in its size*. Total U.S. federal and local government spending rose from less than 25 percent of GDP in the mid-1960s to more than 35 percent today. Mere growth would not necessarily matter, but in fact government has expanded its reach through more of the economy, and given the government substantially increased influence over the allocation of resources in the economy. Some would argue that several important sources of increased spending — for example, retirement and healthcare — are relatively politically neutral or benign. Even those narrow points are arguable — for example, beneficiary populations can seek to reduce their share of costs, even though that level originally was believed to be fair. But still, that argument misses the point that even unimpeachable spending programs can be manipulated to favor unfairly and inefficiently

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some who provide the services. Also, those programs require higher taxes, which themselves increase government's intrusion into the economy and open the door to preferences that can favor one interest over another and distort the economy. (Alternatively, interests that seek spending programs can argue that their programs are so meritorious or beneficial that they should *not* be paid for with higher taxes — which decision would impose its own costs on the economy as a whole.)

The large relative increase in public spending has been accompanied almost directly by an **explosion in government regulation**, which not only channels that government spending but also controls and constrains private-sector behavior in non-governmental activities. To be sure, for the success of capitalism some regulation is absolutely needed to keep markets fair and open, to avoid unnecessary monopolies, and to safeguard public health and safety. However, excessive or poorly drawn regulation can act like sand in the gears of an economy's efficiency. In some circumstances, influencing government regulation — possibly to forestall competition from innovators who threaten to unseat incumbent interests — can be a more profitable use of business funds than cutting costs or developing product. Or regulation can be a stealth tool used to hamstring business for any reason.

The very rapid growth and complexity of government regulation has fed Washington's lobbying machine. Edmund Phelps notes, using data from United Agenda, that regulation has mushroomed. Each year from 1997 to 2006 there were around 80 new "significant" regulations (defined as those costing around \$100 million each).²⁴ Beginning in 2007, there was a sharp increase in even that pace of regulation, reaching 150 significant new regulations a year by 2011. And these figures include only federal, not state and local regulation.

Many observers contend that these regulations are having a perceptible effect on both investment

and innovation. Businesses also have to contend with the uncertainty that a changing regulatory environment engenders. Whereas in 1950 there were fewer than 20,000 pages of federal regulations, today there are in excess of 165,000 pages. These regulations contain rules covering every conceivable aspect of commerce and society. By the regulatory agencies' own estimates, the total cost of complying with their rules amounts to hundreds of billions of dollars, with each year's new rules adding more than \$10 billion to the total²⁵

Another form of public-private "deal" is the expansive use of patents and copyrights to protect an existing enterprise from fair competition, or alternatively to poach on the returns to true innovation with ambitious and speculative claims of intellectual property rights. Edmund Phelps notes that parallel to the increase in regulation there has been an explosion in patent and copyright protection that has stifled both innovation and competition. Phelps contends that in the high-tech industry there is such a thicket of patents in force that a creator of a new method might well require as many lawyers as engineers to move forward with his idea.

A clear indication of the ever-growing trend towards more complex and intrusive government regulation is provided by the passage of the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act. In contrast to the 37-paged 1933 Glass-Steagall Act, which separated investment banking from commercial banking, the Dodd-Frank bill alone ran to more than a staggering 2,300 pages, with more implementing regulations to follow.

Luigi Zingales has observed that, in view of their close contact with the government, industries in which the government has become an important regulator or protector are particularly liable to seek more extensive government aid.²⁶ They take advantage of their close contacts not only to reduce government influence on their activities in some respects, but also to mold it to their advantage in others.

Figure 3 Number of Pages of Regulations Added to the Federal Register Each Year, 1936-2011



Source: <https://www.federalregister.gov/blog/learn/tutorials>

Even though regulators in theory are independent, they can be subject to the influences of money in the political system. Regulators' budgets often come through the appropriations process. Members of Congress can make their preferences known, and regulators can perceive that it is in their long-term interest to give their funders what they want. (Regulators can also be "captured" through intimidation, if aggressive pursuit of their missions would expose them to public attack, or if they could find themselves in court and would lose stature if defeated in a trial.)

The U.S. tax code is yet another area where lawmakers have found the means to favor special interest groups. Since the last major tax reform in 1986, the U.S. tax system incrementally and increasingly has become more complex and riddled with many *tax expenditures and loopholes*. Today the U.S. tax code runs to more than 4 million words and is understood by very few. As a result, a majority

of the U.S. population considers the tax system to be unfair, and both individuals and businesses incur ever-increasing costs just to comply.²⁷

In response to the 2008 financial crisis, the Administration responded with a \$780 billion fiscal stimulus package, which was the largest U.S. peace-time fiscal stimulus on record. It also responded with the introduction of the Troubled Asset Relief Program (TARP) whose purpose was to purchase assets and equity from financial institutions to strengthen the U.S. financial sector. The result was that many *outlay programs and loan guarantees* selected for inclusion in the package benefited particular firms and industries. However necessary those measures might have been in the wake of the financial crisis, both the fiscal stimulus package and TARP are generally perceived to have given the government great discretion to favor special interest groups like the automakers and Wall Street.

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The Federal Reserve's resort to *extraordinary monetary policy measures* in response to the recent recession has added fuel to the public perception that Wall Street is favored at the expense of Main Street. Those aggressive measures have resulted in a dramatic expansion in the size of the Fed's balance sheet to over \$4 trillion. They have also resulted in the repression of long-term interest rates to record low levels that are perceived by many as a tax on savers, especially small savers with limited investment options, and a corresponding subsidy to the equity markets, which have become relatively more attractive as investment vehicles. Supporters of the programs argue that they were essential in light of the extraordinary stress on the financial sector and the economy in general, and that it was impossible to protect the citizenry at large from the fallout without also saving financial institutions that might have played roles in the housing bubble and collapse. Still, the nation struggles with the perception that some individuals and organizations profited unfairly from the response to widespread hardship.

The Tools of Crony Capitalism

The growth of government, and of the regulation to implement that growth, has increased the incentive to engage in public-private deals, and the potential reward from such deals. The private interests that perceive opportunity to pursue their own welfare through the expanding role of government have at least two noteworthy tools to do so. Those two tools have become increasingly prominent — and troubling to many — in recent years. Politicians need money (or believe they do) to run for office, and they are more likely to listen to those who provide it.

a. The exorbitant cost of elections

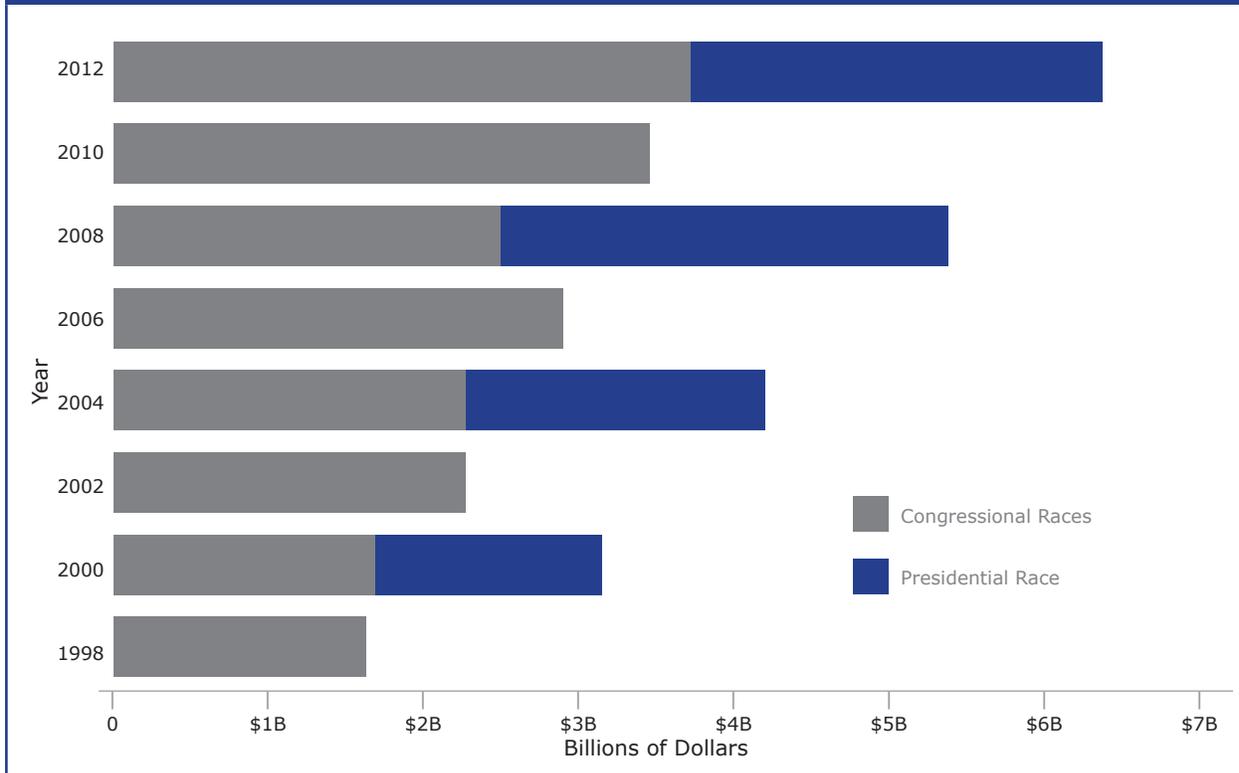
Since the mid-1990s, for a number of reasons, the cost of U.S. political elections has skyrocketed. Whereas in 2000 the total cost of the presidential and congressional campaigns was a little over \$3 billion, by 2012 the total cost had more than doubled to almost \$7 billion. By 2012, the estimated average cost of winning an election to

the House of Representatives had increased to \$1.5 million while the average cost of a successful Senate race had increased to almost \$9 million.²⁸

Political scientists have advanced several plausible reasons as to why U.S. elections costs have escalated:

- The first is that following the Republicans' capture of the House of Representatives in 1994 for the first time in over forty years, control of the Congress was no longer a foregone conclusion.
- A second reason, as Robert Kaiser has noted, is that campaigns dependent on pollsters, consultants, and television commercials were many times more expensive than campaigns in the earlier eras before those inventions took hold.²⁹ So congressman and senators who used (or faced opposition using) those technologies quite suddenly needed — or thought or feared they needed — much more money than ever before to run for re-election. With two candidates using such costly techniques, and with television advertising rates responsive to demand and so total advertising costs potentially without limit, a veritable “arms race” could easily (and often does) ensue. Even early in an election cycle, before an incumbent faces a declared opponent, filling a big war chest can serve as a deterrent to potential challengers. If no challenger appears, the incumbent can redistribute that money to earn gratitude from more vulnerable colleagues and thereby make a case for a position in the party's leadership. And arguably, if petitioners want to ingratiate themselves to elected officeholders, and choose to do so through campaign contributions, then those officeholders will find ways to spend the money, and still further innovations including and beyond polls and television will follow that money inevitably.
- A third reason why campaign costs and the emphasis on fundraising have increased is the rise of the permanent campaign. Campaigns are no longer limited to a few months prior to an election. As the demand for money has grown,

Figure 4 Total Cost of US Elections, 1998-2012



Source: <https://www.opensecrets.org/bigpicture/>

fundraising and politicking have become a continuing necessity, leading candidates to begin their campaigns earlier and earlier, and causing incumbents to maintain their political operations throughout the election cycle.

- Yet a fourth reason which has been advanced to explain the spike in total campaign spending in recent elections has been the massive growth in independent spending, that is, expenditures intended to advance the cause of a particular candidate for election but undertaken by an outside entity nominally without coordination with the candidate's own campaign. From 1992 through 2012, independent expenditures have increased by a factor of 100 — from \$10.9 million in 1992, to \$143.6 million in 2008, to \$1.0 billion in 2012. Corporations and labor unions were allowed to make independent expenditures in 2012 as a result of the Supreme Court's 2010

decision in *Citizens United v. the Federal Election Commission*. While the fear was that these newly empowered entities (especially large corporations) would spend heavily, this has not happened. Instead, wealthy individuals have been the primary source of this substantial increase in independent spending.³⁰ Whether corporate or union contributions to independent committees will increase from that low level in the future is uncertain. A subsequent federal district court ruling based on *Citizens United*, *Speechnow.org v. Federal Election Commission*, fueled the surge in spending by permitting political committees to use unlimited contributions to make unlimited expenditures in support of a candidate, so long as these expenditures were independent of the candidate supported. The Supreme Court has now ruled in *McCutcheon v. Federal Election Commission* that aggregate limits on the total contributions an individual gives to candidates,

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parties, and political action committees (PACs) are unconstitutional under the First Amendment (although the limits on contributions to each individual candidate still stand). This most recent ruling is likely to increase the role of wealthy donors and lobbyists in the financing of federal campaigns — as such individuals, either by choice or because of irresistible demands by candidates, make contributions to increasing numbers of candidates.

Whatever the reason for the escalation in election campaign costs, political candidates have become highly dependent on private sources of funding to secure re-election. As a result, politicians are engaged in what has come to be referred to as a “permanent campaign.”³¹ Indeed, it is estimated that most congressional incumbents spend between one-quarter and one-third of their time in campaign fundraising activities. This makes them increasingly pressured — whether they bend to that pressure or not — to conform their views and their voting patterns to the wishes of major campaign donors. It may mean that candidates who are more willing to accept the requests of donors are more likely to win election. It has also contributed to at least a public perception of politicians “owned” by large donors who ask for favors — “crony capitalism.”

Yet another troubling development is the rise of so-called “independent committees” that can spend money to advance a candidate’s own campaign so long as they do not overtly and precisely coordinate with that campaign. These conditions in practice are so lenient that an ambitious private interest can provide virtually unlimited and undisclosed contributions with the full knowledge of a potentially grateful candidate.

Long-time Congress-watchers like Norman Ornstein and Thomas Mann have observed that the high cost of election campaigns has fundamentally corroded the U.S. political system.³² For example, higher campaign costs have contributed to a steady rise in the number of wealthy men and women sitting in the House and Senate, as “self-

funded” candidates have exploited their natural advantages in electoral politics. This may make those candidates’ funding more transparent, but it also may make it impossible for people of more modest means to compete. More troubling yet, the permanent campaign has turned politics into a relentless struggle for political power rather than an attempt to solve the country’s problems. It also arguably has led to a meaningful deterioration in the quality of service that officeholders provide to their constituents, as they spend more and more of their time raising campaign funds rather than working on the nation’s problems — which is bound to have a bearing on the nation’s ability to solve those problems.

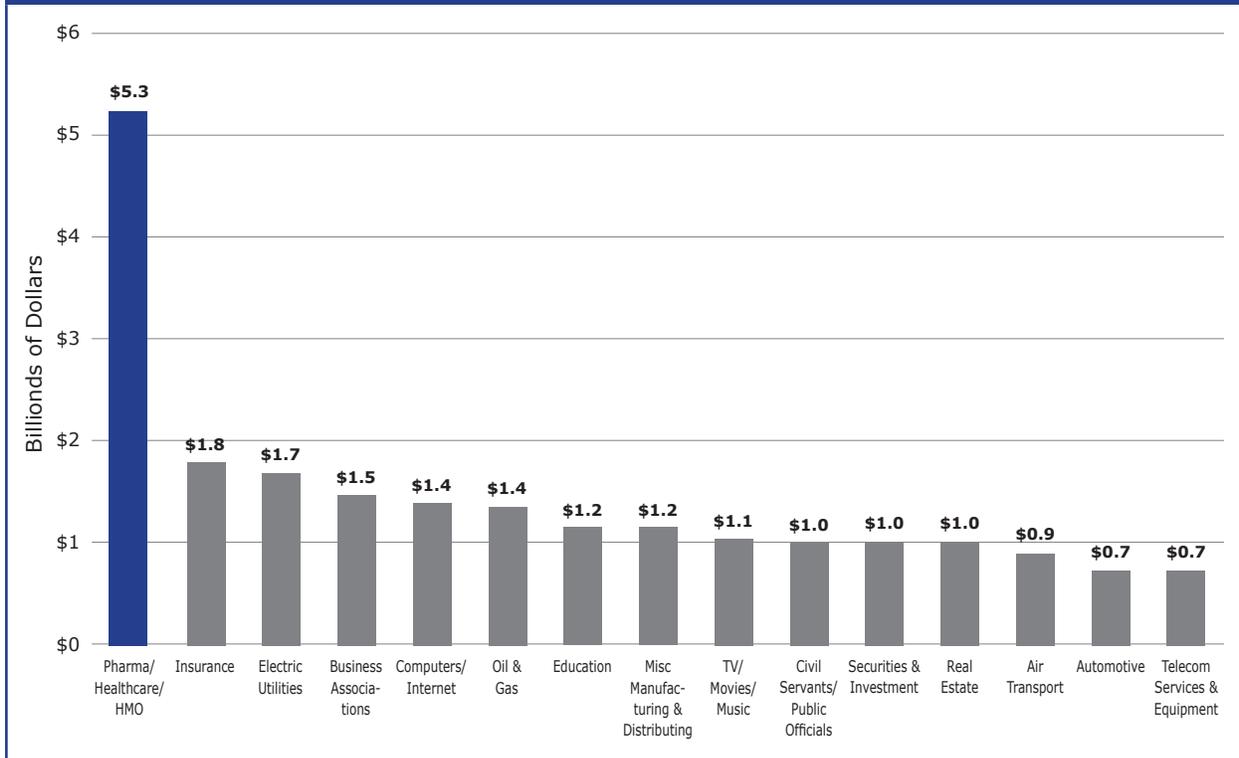
b. Lobbying

Again, the Constitution protects the right of citizens to petition their government, and lobbying can fulfill a legitimate need of lawmakers for information and perspective. Lobbying practiced properly is an honorable profession. Much of lobbying, today as in the past, involves either the communication of necessary, useful information to non-specialist legislators, or the petitioning by individuals and groups that have no self-interest in the issues at hand but merely seek to pursue the public interest as they see it.

Our concern is that legitimate use of lobbying can be subjected to pressure for abuse — by the intersection of lobbying with the growing role of government in the economy, and the growing role of money in elections.

Paralleling the escalation in election costs has been an increase in the amount of money devoted to lobbying. By official estimates, lobbying is the third largest enterprise in our nation’s capital, after government and tourism. There are an estimated 11,781 professional lobbyists registered by Congress representing virtually every type of interest in America; but it has been estimated that the total number of persons employed in Washington who either are lobbyists or are associated with them in some way is well over 100,000. According to the Center for Responsive

Figure 5 Lobby Dollars Spent, 2001-2012 (\$Bn)



Source: Center for Responsive Politics

Politics (CRP), over the past fifteen years the amount of money spent on lobbying has more than doubled to reach its present level of around \$3.2 billion. The CRP has reported also that between 1998 and 2011, the top ten clients of lobbying firms alone spent over \$3.1 billion.³³ But that includes only what is reported by registered lobbyists in public records. It does not include money spent for grassroots organizing; coalition building; issue advertising on television, radio, and in the print media; and advocacy on the Internet, which do not fit the legal definition of lobbying. Some estimate that total spending to influence public policy in Washington is close to four times the officially reported amount.³⁴

Since the mid-1990s, U.S. law has required public disclosure of all lobbying activity. This has allowed a more-informed analysis of the lobbying industry. Recent academic research reveals a number of

regularities in U.S. lobbying activities:³⁵

- First, lobbying expenditure is pervasive in the American political system and it substantially dwarfs interest groups' campaign contributions. In 2012, the amount spent by organized interests on lobbying the federal government amounted to \$3.5 billion. This compares with the approximately \$750 million annual expenditure on campaign contributions in the 2011-2012 election cycle by interest groups' PACs, super-PACs, and 527 organizations.
- Second, expenditures by corporations and trade associations, which comprise the vast majority of lobbying expenditure, account for around 85 percent of total federal and state-level government lobbying. In addition, large organized interest groups and groups that are supported by large corporations are very much

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more likely to lobby on their own behalf than smaller groups (although smaller interests are represented collectively by trade or industry associations).

- Third, the returns from targeted lobbying can be very high, which may be one reason (beyond the increasingly pervasive role of government, discussed above) why lobbying has become so widespread.³⁶ For example, a Sunlight Foundation analysis of 200 corporations found that between 2007 and 2010 companies investing heavily in lobbying paid significantly lower effective federal tax rates than those that did not.³⁷ According to the study, six of the eight companies that invested the most in lobbying between 2007 and 2009 saw effective-tax-rate declines of at least seven percentage points — in contrast to the median tax rate decline among all 200 companies of 0.6 percentage points.³⁸ Meanwhile, recent data assembled by the United Republic, a liberal-leaning campaign reform organization, suggest that lobbying returns have been particularly large for multinational companies and those in the pharmaceutical and oil industries. For their part, a number of lobbying firms themselves advertise that \$1 invested in lobbying can yield as much as \$100 in benefits.
- Fourth, large corporations and well-funded groups are more likely to lobby independently than smaller groups, which are more likely to lobby using trade associations. Lobbying also increases when particular issues are more relevant and salient and when there are big stakes for the organized interest.

With the growth of lobbying, perhaps predictably, has come an increasing recruitment of well-placed policymakers into lobbying as a second career. Whereas prior to 1973 barely 3 percent of former congressmen or senators took up employment as lobbyists upon leaving office, today around 40 percent of former Congressman and 50 percent of

former Senators lobby. The same is true of former senior House and Senate staffers. It is also reported that an increasing number of former (and perhaps also future) lobbyists are to be found in senior congressional staff positions, and senior positions in the Executive Branch (subject to some recent restraints).

In a much cited 2006 study, Richard Hall and Alan Deardorff found that lobbyists tend to concentrate their efforts on politicians who are already most convinced of their positions.³⁹ They argued that lobbying was in effect a matching grant of costly policy information, political intelligence and labor to strategically selected legislators. The proximate objective of this strategy is not so much to change legislators' minds as to assist natural allies in achieving their own coincident objectives. This pattern would suggest that the unimpeachable information function of lobbying, a raising of general knowledge levels among a broad population of policymakers, might have become less common than this boutique support of a narrow group of like minds.

For his part, Lawrence Lessig considers the intersection of lobbying, campaign finance and economically invasive government to be a fundamental part of a "gift economy."⁴⁰ While there might be no formal quid pro quo between Congressmen and lobbyists, Congressmen are under increasing pressure to bend their views to satisfy lobbyists who choose to offer ongoing support and help in raising campaign finance. Several well respected politicians, including John McCain and Chuck Hagel, have described lobbying in less flattering terms. In their words, the confluence of U.S. campaign finance and lobbying has effectively become a system of legalized bribery. We believe that it contributes to an at least perceived unhealthy co-dependence between government and private interest groups, including but not limited to business.

The Economic Cost of Crony Capitalism

Economists dating as far back as Adam Smith have emphasized how costly such crony capitalism can be. They have warned that it can impose an effective tax on the public in that it distorts the proper functioning of the market economy for the benefit of the few.

As Adam Smith famously observed in 1776 in *The Wealth of Nations*:

People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices. It is impossible indeed to prevent such meetings, by any law which either could be executed, or would be consistent with liberty and justice. But though the law cannot hinder people of the same trade from sometimes assembling together, it ought to do nothing to facilitate such assemblies; much less to render them necessary.⁴¹

More recently, this point has been well articulated by Mancur Olson who has argued as follows:

An increase in the payoffs from lobbying and cartel activity as compared with the payoffs from production means that more resources are devoted to politics and cartel activity and fewer resources are devoted to production. This in turn influences the attitudes and culture that evolve in society. Lobbying increases the complexity of regulation and the scope of government. It does so by creating special provisions and exceptions. A lobby that wins a tax reduction for income of a certain source or type makes the tax code longer and more complicated; a lobby that gets a tariff increase for the producers of a

particular commodity makes trade regulation more complex than if there were a uniform tariff on all imports and more complex than it would be if there would be no tariff at all.⁴²

While the costs of crony capitalism on the U.S. economy are intrinsically difficult to measure, there can be little doubt that they are substantial. This becomes all the more clear when one considers the following specific costs:

- a. Crony capitalism **reduces the overall degree of competitiveness** of the U.S. economy. It does so by impeding new entrants through tax exemptions or spending or low-cost credit for established firms, or through a complex regulatory environment. Those measures favor incumbents at the expense of new entrants, and contribute to increased market concentration that makes for a less competitive economy.

To some degree because of crony capitalism, and to some degree reinforcing it, there is strong evidence of a substantial increase in industrial concentration in the American economy over the past six decades. This concentration has been detrimental to both competition and innovation. In the financial sector, big banks have become behemoths while the small banks have disappeared or shrunk. In the non-financial sector too, economic activity has moved dramatically away from small- and medium-sized enterprises to large corporations.⁴³

- b. Crony capitalism results in rent-seeking through **subsidies or taxes** that benefit vested interests at the expense of others, rather than the pursuit of profit through socially and economically productive behavior. It reduces the drive for innovation and for minimizing costs and maximizing consumer benefits. A most notable example of such market-distorting behavior is the subsidies for corn production and the

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taxation of sugar imports. Those policies result in large increases in the prices that the U.S. public has to pay for gasoline, for food sweeteners, and for food in general. Although this is perhaps the most glaring example of an adverse public-private deal, many more were cited earlier.

c. Crony capitalism *impedes fundamental economic reforms* which might be expected to yield substantial efficiency and equity gains to the economy and for which there might be widespread bipartisan public support. An egregious case is tax reform, where special interest groups oppose the simplification of the tax code and the elimination of tax expenditures that might make possible a simpler tax system with substantially lower marginal tax rates on all taxpayers. Other much needed reforms arguably thwarted by special interest groups could benefit policy relating to entitlement spending, tort law, immigration policy, and student loans.

Combating crony capitalism

If left unchecked both in fact and in the court of public opinion, crony capitalism must be expected to continue to sap vitality out of the U.S. economy and to undermine public support for the American model of capitalism. This adds urgency to the task of finding ways to combat crony capitalism. This challenge is considerable. The roots of crony capitalism are deep, and no single silver bullet will solve the problem. Every crony private-sector deal exists because it was appropriated by a majority of legislators and signed by a president, or because it was approved by regulators or contract administrators with independent authority. The forces benefiting from those deals and the present system, including potentially the Congress itself, each have much to gain or lose. They therefore are stronger and more united in defending those deals and the system than is the loose collection of private citizens, each of whom through reform would gain only a small share of the very large cost of the deals and the system.

Policy Options for Combating Crony Capitalism

Thus, the roots of crony capitalism are dug deeply into the U.S. political system. The potential fruits of anticompetitive deals are many, and given that motivation — as in campaign finance, narrowly considered — the availability of money creates a strong predisposition toward its use.

We believe that the business community can help. Business has a special role and responsibility to communicate to both policymakers and the public, and to set standards of discourse and behavior.

By all evidence, including public opinion polls and press accounts, many Americans believe that most or all of the business community is complicit in crony capitalism.⁴⁴ Crony capitalism has given business a bad reputation — and to some degree and in some instances, that bad reputation is deserved.

Thus, the vast majority of business leaders who compete every day to provide jobs to their employees, investment opportunities to pension contributors and retirees, and high-value goods and services to all Americans and persons around the world, need to tell — and often to explain — the complex truth to their fellow citizens and their elected policymakers. We hope that this policy statement contributes to that effort.

And further, business leaders need to practice the gospel of fair competition that they preach. As Alan Greenspan once said, we all want the fruits of vigorous competition among our suppliers and the providers of the goods and services we buy; we just don't want competition to apply to us. But if we all get the latter wish, there will be no competition, and our fate will be much attenuated innovation and productivity and economic growth. There are ill-advised and counterproductive attacks on business, which must be answered. And a complex world does require some government intervention in the workings of the economy. But business leaders must accept the need for competition everywhere in the economy; and when government must intervene,

business leaders must make the case factually and fairly, understanding that deteriorating standards of policymaking will in the end bring low all enterprises — including the apparent early-round winners in the influence game.

Beyond leadership from business, the nation needs leadership in Washington. An example can be found in the elimination of a mass of crony public-private deals — veritable price-fixing — in the transportation industry in the 1970s. President Gerald Ford made a public case to eliminate industry regulation to which the nation had become inured, even though it cost consumers billions of dollars.⁴⁵ Challenging it created a fear of the unknown among many, even as it aroused primal opposition from the interests that it protected and profited. And yet today it is unimaginable that the nation would climb back into such a regulatory straitjacket that we now realize limited innovation in a foundational industry for our entire economy. We need to build on this precedent to weed out old crony deals and avoid new ones.

That requires leadership. Leaders would refuse to accept a campaign-finance money game that forces them to spend more time seeking contributions than solving public problems. Leaders would explain to their contributors that those contributions bought their independent judgment, not their fealty.

The first line of defense, of course, is awareness — and an attitude of “just don't do it.” We need to make the case so strongly that our society builds an ingrained aversion to crony deals. Now that it has become so clear just how riddled with distorting deals public policy has become, our elected policymakers should put a high hurdle in the way of enacting additional deals — and should put a premium on efforts to reverse existing ones.

Each deal has its advocates — else it would not have been enacted in the first place. And

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in the age-old dictum of political science, the “disinterested majority,” there always is a greater reward for policymakers to providing a benefit to a narrow interest than to rejecting it in the interest of the broader public — because the typical citizen is far less aware of any such issue, and would benefit less from the denial of the benefit than would each of the very small group of petitioners from its creation. Such deals quickly can become a snowballing problem, through the widely recognized “logrolling” process: Once one deal is on the table, it can attract support from other policymakers in exchange for support for *their* proposed deals. Thus, it is the responsibility of the informed public, aided by the press, to follow the progress of any deals and to hold the responsible policymakers to account.

Several analysts have emphasized the distinction between “pro-business” and “pro-market” policies.⁴⁶ Supporting *existing* businesses through subsidies and preferential regulation — to the exclusion of *new* businesses and innovators — inhibits the working of the market and does not serve long-term prosperity or economic growth. Truly pro-market policy is pro-*society* policy — which in the long term serves the interest of business and every other segment of our nation — because it allows competition and markets to determine success or failure, and the ultimate allocation of resources.

Again, the inevitable difference of judgment on the merits of any individual public-private deal makes it impossible to create some general rule that automatically will screen out all bad deals (though a sound cost-benefit analysis is the nearest thing to a common denominator). However, the following menu of policy measures might be effective in minimizing the scope of crony capitalism.

Conceptually these solutions fall into four distinct categories: (a) limiting the size and scope of government; (b) reforming campaign financing; (c) reforming the lobbying industry; and (d) reforming the policy-making process.

a. Limiting the size and scope of government.

The smaller the reach of government and the less involved it is in the functioning the economy, the less leverage there is for crony capitalism to undermine the proper functioning of the free market, and the less potential gain from deals between government and private interests. The challenge and the complexity arise because there are market failures that need to be addressed, and so government involvement in the economy at some level is inevitable and necessary. The keys are balance and judgment.

Solutions along these lines might include:

- Limit the size of both public spending and the public deficit (which are most meaningfully measured in relation to gross domestic product). Along these lines, recommendations of the CED, the Bipartisan Policy Center Domenici-Rivlin Debt Reduction Task Force,⁴⁷ and the Bowles-Simpson Commission Report⁴⁸ include the following suggested reforms:
 - Demand additional efficiency from Washington by tightening and strengthening discretionary expenditure caps, rather than imposing further abrupt across-the-board cuts. A rough guideline would be limiting the growth of both defense and non-defense spending to the rate of inflation through 2025.
 - Reform the healthcare system to incorporate competition among private healthcare plans based on cost-conscious consumer choice. Extend this basic system to embrace Medicare and (with modifications appropriate to a low-income population) the non-disabled portion of Medicaid as well.
- Fundamentally reform the tax system. Substantially simplify it and leave few loopholes that can be exploited. In this respect, one could again build on the recommendations of the CED, the Domenici-Rivlin Task Force, and the bipartisan Bowles-Simpson Commission report:

- Eliminate virtually all tax expenditures for both income and payroll taxes. Simplify and streamline other provisions and the system as a whole (see the Domenici-Rivlin report).
 - Use some of the revenue proceeds of the elimination of tax expenditures to reduce and simplify the tax rate schedules. Use the remainder for deficit reduction.
 - Eliminate tax preferences to reduce the corporate tax rate to a level that would restore U.S. international competitiveness.
 - As a part of tax reform, eliminate the complex and economically distorting alternative minimum taxes on individuals and corporations.
- Subject all existing tax and spending deals to review.
 - Schedule all existing tax and mandatory spending deals to an objective review, including a cost-benefit analysis. In general, tax and entitlement spending programs remain in effect until the law is changed. In practical terms and in recent years, this has meant that past deals have been continued without question or evaluation. That is clearly unacceptable, because the world changes, and even a fully justified provision today might not be five years from now. One issue is which legal provisions would be made subject to review; we believe that the list should be expansive. One option would be to subject all such provisions to expiration (commonly called a “sunset”) when they are selected for review. We would not choose to do so lightly, because as noted above (in the discussion of temporary tax law provisions) the periodic expiration of such provisions can occasion considerable mischief each time — including the loss of predictability that is essential to business planning and investment. Others believe, however, that without a hard sunset provision reviews will not be undertaken at all.⁴⁹
- Germany has an interesting practice under which its federal government periodically engages two reputable private research institutions to evaluate separately every preferential tax law. Having two separate reviews motivates each reviewer to be thorough and unbiased, because if one reviewer submits poor work, the other will take advantage by doing better work and will solicit additional future government business on that basis. In addition, the contract researchers would be less likely to submit an apologist evaluation that merely protects the position of one political side or the other, because the disagreeing side will be more than happy to point that out, to the detriment of the reputation of the reporting institution. Private institutions would also be less likely than governmental bodies to make their own calculation that policy action would be unlikely, and that the evaluations do not merit any serious effort. Private institutions would want to fulfill all obligations under their terms of engagement, so that they would be paid for their work. Subjecting existing provisions to a “sunset” — a scheduled expiration at some point in the future — may or may not force serious review, and may create a “must pass” legislative vehicle upon which undeserving deals can ride (see the frequent discussion of the “tax extenders” in the current law).⁵⁰
- Substantially streamline regulatory policy and make such policy more transparent and accountable. Some ideas include:
 - Amend the Administrative Procedure Act to make cost-benefit analysis of regulatory measures as applied by the White House review programs since 1981 a matter of statutory law subject to judicial review. Under this proposal, a regulatory rule could be challenged in court, not only as “arbitrary, capricious or an abuse of discretion” but also based on whether the agency in question had made a reasonable demonstration that the

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rule met the cost-benefit standard.⁵¹

- Maintain a “regulatory budget” to highlight trade-offs among the seemingly limitless regulatory proposals that keep surfacing and that overburden businesses and the economy. Some would create a hard-and-fast ceiling on the total estimated cost of regulations, perhaps as a percentage of the GDP, with a kind of “pay-as-you-go” provision whereby enactment of a new rule would require repeal of another. However, if regulations are subject to a rigorous and fair cost-benefit test, then rejection of a proposed regulation to avoid its cost would deny the public its greater benefit. Furthermore, a percentage-of-GDP limit would suggest that regulations could be expanded when the economy grows, and then somehow must be cut back when the economy is beset with a recession. We believe that the key is cost-benefit analysis, rather than any rule based solely on cost.
- Create a systematic process for the review of existing regulations, with the aim of repeal of obsolete regulations and the simplification of those that are excessively complex. This will be a massive, multi-year task. However, the very mass of regulation, even if some are obsolete, creates cost for the economy. Repeals and simplifications will make the entire body of regulation easier to comprehend, improve compliance, and reemphasize the legitimacy of the rule of law.
- Require that new major regulatory rules be approved by a joint resolution of Congress and signed by the president before taking effect. Under this proposal, if the Environmental Protection Agency or the Securities and Exchange Commission issued a costly new corporate reporting rule, the rule would in effect be a legislative proposal. This reform would require Congress to approve directly all decisions that could cost more than some minimum threshold.

- Per the recommendation of the National Commission on the Public Service (the “Volcker Commission”), recognize and accept the importance of skilled and experienced regulators, and pay them market-based salaries.⁵² In fields where private-sector pay far exceeds civil-service salary caps, incentives drive regulators to consider their public service as mere training for moves into more-lucrative private employment with the very firms they are charged to regulate. Even assuming that such regulators behave with the utmost integrity in their public positions — and the incentive could be very much to the contrary — the best and the brightest civil servants will have every reason to move on at the first opportunity. And good regulation, as practiced by those with the best judgment, will not be excessive or counterproductive regulation. (The same principle would apply to, for example, contracting officers at the Department of Defense — who might negotiate and administer multi-billion-dollar programs against industry personnel hand-picked from among the public servants’ more-experienced predecessors.)

While such reforms would go a long way to curbing crony capitalism, they are more than likely to meet with fierce opposition from the powerful interest groups that benefit from the present system. They will also be subject to the strong spirit of partisanship that currently characterizes Washington politics and that impedes serious economic or political reform. However, the alternative to taking on these forces is to do nothing — and that course is unacceptable.

b. Reforming the system of campaign financing

Campaign finance reform could free elected officials from their dependence on private campaign funding. Such funding is seen as an important reason why elected officials might bend their views on policy issues away from the public interest.

- The Committee for Economic Development's proposed reform for national elections would aim at leveling the playing field between small and large campaign contributions through a system of matching funds. Government might match the first \$250 of every campaign donation, perhaps by a multiple of as much as four to one. This would have the effect of making small donations more valuable to a campaign, which might induce candidates to put more effort into pursuing small donations. It might also allow a candidate to achieve a competitive level of finance solely through benign small contributions.
- An alternative proposal is a "voting with dollars" plan which was first proposed by Yale law professors Bruce Ackerman and Ian Ayres in 2002.⁵³ The plan includes two components. The first would give each voter a \$50 voucher each four years, which they could donate to the federal campaigns of their choice. The second would require that all donations, including those through vouchers and additional private campaign contributions, must be made anonymously through the Federal Election Commission. Yet another approach, which supporters refer to as a "clean money-clean elections" proposal, would involve giving each candidate who chooses to participate in the scheme a certain set amount of campaign finance money. Those candidates accepting public funding would not be allowed to accept private contributions (beyond some minimal amount of seed money or qualifying funds) or use their own personal money. Candidates who face privately funded candidates who exceed public funding spending limits or are forced to compete against spending by independent groups would be allowed to raise additional amounts of money from small private donations.

c. Reforming the lobbying system

As a complement to electoral campaign finance reforms, the lobbying system itself might be reformed to reduce the use of lobbying along with campaign finance to exert leverage over the

legislative process. These reforms might include any of the following:

- Very much stricter prohibitions on Members of Congress and their staffs from seeking employment in lobbying firms upon leaving the Hill. This might lengthen to two years the cooling-off period between the time someone leaves the House and the time that they may engage in any form of lobbying (which has been the rule in the Senate). The same restrictions could apply to employees of government agencies or regulatory authorities.
- Congress could ban any registered lobbyist and any institution that hires registered lobbyists from raising or soliciting contributions for federal candidates and officeholders, or from serving as treasurers of Leadership PACs and other campaign fundraising organizations. Substantially reduced limits to a nominal amount could also be placed on the amount that a lobbyist might give personally for any campaign to a federal office.
- The loophole that allows congressional travel on non-commercial, company- and individually owned aircraft for purposes of campaign fundraising events should be closed.
- Lobbying reform should strengthen the enforcement of laws and ethics rules that cover Members of Congress, staff and lobbyists. The Committees that currently are assigned the responsibility for ethics (the House Committee on Standards of Official Conduct, and the Senate Select Committee on Ethics) have not fulfilled their responsibilities. Some would argue that Congress needs a strong and independent enforcement authority to help it to punish and deter ethical violations by lobbyists and Members, and that the Congress is not capable of policing itself. They believe that a nonpartisan ethics enforcement authority, of a stature equivalent to the Congressional Budget Office or the Government Accountability Office, could be led by persons of distinction such

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as former Members of Congress and retired judges, insulated from political pressure. It should have a professional and independent staff, and adequate funding. It should be free to initiate its own investigations, and empowered to receive complaints from Members and from the general public. It should see its investigations through to completion, not merely pass non-frivolous complaints on to the Congress itself. Its conclusions should go to the Ethics Committees of the Congress or to the Department of Justice as befits the findings. It should be empowered to dismiss frivolous complaints, to bar subsequent filings by those who submitted them, and to charge the filers of frivolous complaints for the cost of their investigation. The Ethics Committees should make financial disclosures by Members, staff and lobbyists easily accessible to the public. Others would contend that such an authority would be fundamentally unaccountable and could do considerable harm in pursuing its own politically partisan agenda. A decision would hinge on the degree of confidence in the ultimate integrity of such an independent organization.

- Stricter limits might be placed on the number of political appointees that each successive administration can make in favor of a strengthened civil service (understanding that potential appointees with necessary experience will sometimes have backgrounds in the private sector, and that such individuals can truly aspire to pursuing the public interest). In addition, a longer cooling-off period could be placed on the revolving door between government and the private sector.

d. Improve and Comply with the Rules of the Legislative Process

Many of crony capitalism's deals are created in law. Improving the legislative process could minimize the creation of new crony deals.

- Create and follow pay-as-you-go standards in the budget process. If deals are to be enacted — through either spending or tax preferences — at

least make their cost be paid through other spending reductions or tax increases. Ideally, the requirement to reduce other justified programs or to increase revenues will deter proposals for special-interest deals.

- Follow the regular order. Provide adequate time for consideration and review of legislation. Avoid omnibus “must-pass” bills, which provide the greatest opportunity for special-interest deals to ride unseen into law.
- Revive the concept of “scope” in conference committees. The best way for the Congress to evaluate the merit of potential public-private relationships is through hearings. The easiest way to slide a public-private deal into law without proper review is to add it not to a House or a Senate bill, but in a conference committee reconciling a bill already passed in differing versions by the House and the Senate. Such a conference amendment would go with the reconciled version of the House and Senate bills directly to the floors of the two chambers, and would not be subject to hearings. Some years ago, there was an informal rule that every provision of a conference committee bill must relate to a provision in either the House bill or the Senate bill — that is, it must be “in scope.” But in recent years, some of the most alarming stories about enacted legislation have arisen because a totally new provision was inserted into the conference committee report without any serious review — and on a few occasions apparently inserted by staff, without any Member of Congress acknowledging responsibility for the provision. The Congress should return to the sound practice that every provision in a conference committee report must be within the scope of the House and Senate bills.
- Make true “oversight” a legislative priority again. As was noted earlier, one of the most painful ill effects of the campaign-finance “arms race” is the amount of time that Members of Congress feel compelled to spend on fundraising. Those Members cannot engage in the (sadly) thankless task of review of existing programs and tax-

law provisions when they are on the telephone “dialing for dollars.” Some believe that “biennial budgeting” will free time for program oversight, but a two-year budget cycle will not free Members to spend all of their time raising funds for the “permanent campaign” only every other year. If the nation should succeed in reforming campaign finance, it should take the next logical step and demand that its elected policymakers use their new-found time to review all of the entitlement and tax programs that are written in permanent law, to exercise due diligence when other programs come up for multi-year reauthorization, and to write serious annual appropriations bills with program reforms rather than punting from year to year through omnibus continuing resolutions that simply fund all programs at the previous year’s level (or some fraction or multiple thereof). Limiting the size of government should not mean government without change (which would therefore be government without improvement, designed to address yesterday’s challenges).

- Enact any new public-private interventions that might be questionable as annually appropriated spending programs, rather than as tax expenditures or entitlement programs. Annually appropriated programs are subject to annual review, if the Congress deigns to do its job. In contrast, tax provisions or entitlement (mandatory) spending programs are generally

written into permanent law, and therefore generally are less likely to receive oversight and review (although again the Congress unquestionably should do its job). An alternative would be to write explicit sunset provisions into every new potentially questionable piece of legislation. But such sunsets, again, come at a price, because they can become periodic must-pass legislation that provides a vehicle for still more questionable deals. Better would be a new consciousness and mindset under which the Congress passes no new crony deals, and reviews all past deals periodically to be sure that they remain justified as circumstances change.

- Consider funding of regulation through fees rather than discretionary appropriations. There is a downside to providing agencies with their own independent sources of funds, in that they can become sloppy and inefficient, and might appear immune to congressional oversight and review. On the other hand, making funding dependent upon pleasing elected representatives can pass the influence of money through the electoral process and into regulation, as appropriators communicate their wishes to the agencies that they fund. Ultimately, there is no substitute for honest and dedicated elected policymakers and regulators, but institutional processes can make a difference.

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Notes

¹ See, for example, Globescan, “Sharp Drop in American Enthusiasm for Free Market, Poll Shows,” April 6, 2011 (<http://www.globescan.com/news-and-analysis/press-releases/press-releases-2011/94-press-releases-2011/150-sharp-drop-in-american-enthusiasm-for-free-market-poll-shows.html>); Pew Research Center, “Pervasive Gloom About the World Economy,” July 12, 2012 (<http://www.pewglobal.org/2012/07/12/pervasive-gloom-about-the-world-economy/>).

² Pew Research Center, *ibid*; Andrew Ross Sorkin and Megan Thee-Brenan, “Many Feel American Dream Is Out of Reach, Poll Shows,” *New York Times*, December 11, 2014, p. B1 (http://dealbook.nytimes.com/2014/12/10/many-feel-the-american-dream-is-out-of-reach-poll-shows/?ref=business&_r=0).

³ CED will issue a policy statement on rising income inequality.

⁴ Andrew Ross Sorkin and Megan Thee-Brenan, “Many Feel American Dream Is Out of Reach, Poll Shows,” *op.cit.*

⁵ Department of the Treasury Office of Economic Policy, Council of Economic Advisers, and Department of Labor, “Occupational Licensing: A Framework For Policymakers,” July 2015 (https://www.whitehouse.gov/sites/default/files/docs/licensing_report_final_nonembargo.pdf).

⁶ “Basic,” as opposed to “applied,” research does not provide short-term payback and is not “appropriable” by any one organization. That is, its outcome is uncertain and some distance in the future, and it has broad application rather than contributing to taking a specific product to market. Basic research sometimes is so expensive that it is out of the financial reach of the private sector. The classic reference on this subject is Richard R. Nelson, “The Simple Economics of Basic Scientific Research,” *Journal of Political Economy* 67 (1959), 297-306. See also Committee for Economic Development, *America’s Basic Research: Prosperity Through Discovery* (Washington, D.C., 1998), especially pages 1-5 and 12-13. Kenneth W. Dam, *The Rules of the Global Game: A New Look at US International Economic Policymaking* (University of Chicago Press, 2004), p. 256, documents that this understanding is accepted throughout the developed world. However, some economists fear that the policymaking focus has shifted away from basic research to product development, yielding waste and inefficiency; see the discussion of energy policy below, and Sam Shapiro, “Federal R&D: Analyzing the Shift From

Basic and Applied Research Toward Development,” <http://economics.stanford.edu/files/Theses/SamShapiro-HonorsThesis-May2013.pdf>.

⁷ Matthew Mitchell, “*The Pathology of Privilege—The Economic Consequences of Government Favoritism*,” Mercatus Center, 2012.

⁸ See Lawrence Lessig, *Republic Lost, How Money Corrupts Congress And A Plan To Stop It*, 2011.

⁹ See the following chart with respect to the sugar industry.

¹⁰ John Beghin and Amani Elbeid, “The Impact of the U.S. Sugar Program,” November 17, 2011. Cameron Stokes, “Artificial Sweetness: A Survey of the Harmful Effects Caused by the U.S. Sugar Program and Possibilities for Reform,” cites an estimate from the National Confectioners Association of 112,000 jobs lost in sugar-using industries between 1997 and 2009.

¹¹ “U.S. Sugar Policy,” American Sugar Alliance, <http://www.sugaralliance.org/us-sugar-policy/>.

¹² Sallie James, “Time to X Out the Ex-Im Bank,” Cato Institute, July 6, 2011 (<http://object.cato.org/sites/cato.org/files/pubs/pdf/tpa-047.pdf>)

¹³ U.S. Department of Justice, “Boeing to Pay United States Record \$615 Million to Resolve Fraud Allegations,” http://www.justice.gov/archive/opa/pr/2006/June/06_civ_412.html; New York Times, “Ex-Pentagon Official Gets 9 Months for Conspiring to Favor Boeing,” <http://www.nytimes.com/2004/10/02/business/02boeing.html>.

¹⁴ Article 1 of the Constitution requires that all expenditures must be appropriated by the Congress. Note that this requirement possibly could be finessed with decisions by a commission subject to congressional veto.

¹⁵ A side issue is worth mention. The U.S. defense program often is cited by our foreign competitors in markets for civil aircraft as a gigantic R&D and manufacturing subsidy. Of course, U.S. taxpayers pay through the defense program for the protection of these competitors and their countrymen, who get their national security for free, or at least at a steep discount.

¹⁶ “Solar Firm Aided by Federal Loans Shuts Doors.” *New York Times* (<http://www.nytimes.com/2011/09/01/business/energy-environment/solyndra-solar-firm-aided-by-federal-loans-shuts-doors.html>); “F.B.I. Raids So-

lar Firm That Got U.S. Loans,” *New York Times* (<http://www.nytimes.com/2011/09/09/business/solar-company-is-searched-by-fbi.html>); “Solyndra Scandal Timeline,” *Washington Post* (<http://www.washingtonpost.com/wp-srv/special/politics/solyndra-scandal-timeline/#document/p1/>).

¹⁷ “Congressman Admits Taking Bribes, Resigns,” *Washington Post* (<http://www.washingtonpost.com/wp-dyn/content/article/2005/11/28/AR2005112801827.html>).

¹⁸ Alan S. Blinder, *After The Music Stopped*, New York: Penguin Press, 2013.

¹⁹ Peter J. Wallison, “Dissenting Statement,” *The Financial Crisis Inquiry Report: Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States*, U.S. Government Printing Office, <http://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf>.

²⁰ Alain C. Enthoven, *To Reform Medicare, Reform Incentives and Organization*, Committee for Economic Development, 2011.

²¹ Martin S. Feldstein, Chair of the Council of Economic Advisers under President Ronald Reagan, defines “tax expenditures” as “those features of the tax code that are a substitute for direct government spending.” See Feldstein, “A Simple Route to Major Deficit Reduction,” *Wall Street Journal*, February 20, 2013 (<http://www.wsj.com/articles/SB10001424127887324880504578296920278921676>), and “Raise Taxes, but Not Tax Rates,” *New York Times*, May 5, 2011 (http://www.nytimes.com/2011/05/05/opinion/05feldstein.html?_r=0).

²² Department of the Treasury Office of Economic Policy, Council of Economic Advisers, and Department of Labor, op.cit.

²³ In a recent paper, “The New Commanding Heights,” Arnold King and Nick Schulz observe that health care and education have become increasingly government-dominated industries. They also note that this domination has produced two ill effects that have exacerbated the changes that these sectors are already undergoing: Government influence has (a) artificially increased the demand for both health care and education, and (b) made these sectors less efficient than they would otherwise have been by shielding them from market forces.

²⁴ Edmund Phelps, “Mass Flourishing,” 2013. “Significant” here is defined in Executive Order 12866, issued September 30, 1993, which was intended to streamline the regulatory process.

²⁵ Christopher De Muth, “The Regulatory State,” National Affairs, 2012. De Muth makes the important point that the modern regulatory state is a bipartisan enterprise. He argues that during the half century before President Obama’s election, the greatest growth in regulation came under Presidents Richard Nixon and George W. Bush, and that the latter set the stage for many of the subsequent Obama Administration regulatory initiatives.

²⁶ Luigi Zingales, *A Capitalism for the People*, Basic Books, 2012.

²⁷ A Pew Research Center for the People & the Press Political Survey (December 2011), found that 3 percent of respondents said that the tax system was “very fair” and 40 percent said “moderately fair,” against 24 percent who said it was “not fair at all” and 31 percent “not too fair” (<http://www.people-press.org/2011/12/20/tax-system-seen-as-unfair-in-need-of-overhaul/>). In answer to a Tax Foundation 2009 survey, only 2 percent said that the federal income tax is “fine as it is” and 12 percent said “it needs minor changes,” while 40 percent said it “needs major changes” and 42 percent said it “should be completely overhauled” (<http://taxfoundation.org/article/topline-results-tax-foundations-2009-survey-us-attitudes-taxes-government-spending-and-wealth>).

²⁸ Expressed as a percentage of GDP, some historical elections – in the economic crises of 1896 and 1932, and during the Vietnam war in 1968 – have elicited extraordinary levels of campaign spending. Matthew O’Brien, “The Most Expensive Election Ever: ...1896?” *Atlantic*, November 6, 2012 (<http://www.theatlantic.com/business/archive/2012/11/the-most-expensive-election-ever-1896/264649/>). However, there has been a consistent upward trend even using this metric since 1996 (when spending was only slightly below 1992). Over those 16 years (five presidential election cycles inclusive), spending as a percentage of GDP has about tripled, and in 2012 was not far short of the post-World War II peak at the height of the Vietnam engagement in 1968. Measured in constant dollars rather than as a percentage of GDP, campaign spending has increased even more markedly.

²⁹ Robert Kaiser, *So Damn Much Money*, Vintage, 2010.

³⁰ Scott Blackburn, “Dire predictions about Citizens United prove false,” *Washington Times*, January 29, 2015 (<http://www.washingtontimes.com/news/2015/jan/29/scott-blackburn-dire-predictions-about-citizens-un/#ix-zz3SKTv0XPZ>).

³¹ The term “permanent campaign” was coined in 1980 by the journalist Sydney Blumenthal in his book *The Permanent Campaign*. He contended that the perma-

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ment campaign had become the political ideology of our age and that it made government into an instrument designed to sustain an elected official's popularity.

³² See Norman Ornstein and Thomas Mann, *The Broken Branch: How Congress Is Failing America and How to Get It Back on Track*, 2006.

³³ This list was led by the Chamber of Commerce and was followed by the American Medical Association, General Electric, the American Hospital Association, the Pharmaceutical Research and Manufacturers of America, the AARP, Blue Cross/ Blue Shield, the national Association of Realtors, Northrop Grumman, and Exxon Mobil.

³⁴ <https://www.opensecrets.org/lobby/top.php?show-Year=a&indexType=s..>

³⁵ See John Figueiredo and Brian Richter, "Advancing the Empirical Research on Lobbying," National Bureau of Economic Research.

³⁶ However, lobbying may be "defensive" rather than "offensive." That is, rather than pursuing preferential deals, firms may need to explain market conditions to policymakers or regulators to avoid bad public policy, or to protect themselves from ideologically or competitively driven challenges from government or from other private entities.

³⁷ "Lobbying and declining corporate tax burdens," by Lee Drutman, March 2013.

³⁸ Similarly, Richter, Samphantharak, and Timmons, found in their 2008 study on "Lobbying and Taxes" that firms that spend more on lobbying in a given year pay lower effective tax rates in the next year. According to their study, increasing registered lobbying expenditures by 1 percent appears to lower effective tax rates by somewhere in the range of 0.5 to 1.6 percentage points for the average firm that lobbies.

³⁹ Richard Hall and Alan Deardoff, "Lobbying as legislative subsidy," *American Political Science Review*, 2006.

⁴⁰ Lawrence Lessig, *Republic, Lost*, 2011.

⁴¹ Adam Smith, *The Wealth of Nations*, 1776.

⁴² Mancur Olson, *The Rise and Decline of Nations: Economic Growth, Stagflation, and Social Rigidities*, 1984.

⁴³ See John Foster, Robert McChesney, and Jamil Jona, "Monopoly and Competition in Twenty First Century Capitalism."

⁴⁴ Andrew Ross Sorkin and Megan Thee-Brenan, "Many Feel American Dream Is Out of Reach, Poll Shows," op.cit.

⁴⁵ Roderick M. Hills, obituary of President Gerald R. Ford, *Fortune* magazine.

⁴⁶ Luigi Zingales, *A Capitalism For The People*.

⁴⁷ Senator Pete Domenici and Alice Rivlin, *Restoring America's Future: Reviving the Economy, Cutting Spending and Debt, and Creating a Simple Pro-growth Tax System*, November 2010.

⁴⁸ *Report of the National Commission on Fiscal Responsibility and Reform*, December 2010.

⁴⁹ Timothy P. Carney, "Corporate welfare takes a blow," *Washington Examiner*, July 1, 2015 (<http://www.aei.org/publication/corporate-welfare-takes-a-blow/>)

⁵⁰ Joseph J. Minarik, "Tax Expenditures in OECD Countries," Organisation for Economic Cooperation and Development, June, 2008.

⁵¹ See Christopher de Muth, "The Regulatory State," *National Affairs*, 2012. Note that regulators can face a "Catch-22" dilemma if they are required by one law to subject all regulations to a cost-benefit test and are required by another law to create and issue a specific regulation, but that regulation cannot be made to pass the cost-benefit test. Legal clarity will be essential.

⁵² *Urgent Business for America: Revitalizing the Federal Government for the 21st Century*, Report of the National Commission on the Public Service, January, 2003, Recommendation 13, pages 30-31.

⁵³ Bruce Ackerman and Ian Ayres, "Voting with dollars: A new paradigm for campaign finance," 2002.

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