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# On Rent Thinking and the Corruption of Republican Government

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**E**conomic rents—essentially, an excess economic return derived from consumer surplus (rent) and capital (quasi-rent)—lie at the core of public-choice analysis, which models public decision making in economic terms.

The theory of *rent seeking* pioneered by Gordon Tullock (1967) demonstrates that monopoly and other market imperfections created by state action for private benefit entail more than deadweight losses and economically neutral wealth transfers. Also entailed is the social cost of nonproductive activities undertaken to influence government decision making—the cost of bribing public officials, lobbying, legislating, litigating, and regulating that surrounds political rent creation. Tullock’s insight is a powerful, positive construct for exploring a wide range of interactions between private factions and public decision makers (Buchanan, Tollison, and Tullock 1980; Rowley, Tollison, and Tullock 1988). Rent seeking has become a euphemism for describing a society in which government is “the chief weapon in a political war of all against all” (Yeager 2001, 249, emphasis omitted).

The theory of *rent extraction* that Fred McChesney (1987, 1997, 2002) introduced more recently demonstrates theoretically and anecdotally, although not yet empirically to any appreciable extent (McChesney 1997, 69–85), that public decision makers themselves are rent seekers with a vengeance rather than impartial spectators. The formal theory of rent extraction concerns “ways *other than* rent creation that a politician can obtain benefits from private individuals” (McChesney 1997, 18, emphasis added). The process entails politicians’ threats to unleash the investigatory,

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legislative, taxing, and other compulsive powers of the state to harass and impose losses on individuals and firms unless the politicians are compensated to refrain from doing so. Compensation arrangements, as with rent seeking, take many forms, ranging from outright bribes and gifts to campaign contributions, in-kind electoral support, and prospective private-sector employment. Rent extraction is a positive theory of political extortion, pure and simple.

The picture thus painted by public choice is one of political corruption. It differs only in subtlety and complexity from the more familiar picture drawn by political scientists and journalists, who like Machiavelli (1513) characterize politics as a process “where integrity has become a handicap” (Sabato and Simpson 1996, 25). Despite the elegance of its theories, however, public choice neither provides a comprehensive theory of “corruption” nor identifies the quantity that is corrupted when a society pursues rents systematically through political means. The political actions at issue typically are not illegal, leaving scholars and others to judge corruption in the same way that courts once judged obscenity—by presuming to know it when they see it. Uncertainty has produced reforms that further impair the democratic process (B. Smith 2001).

Adding to the confusion is the inability of public choice to explain fully the relationship between rent seeking and rent extraction in the political production function (McChesney 1997, 156–70). If politicians can use the state’s coercive power to extract rents for their own account, then why do they bother selling rent-creating services? Why not simply extract rents directly by selling promises of political forbearance and be done with it? Further, given that “[t]he state can now rise above the rights of the persons whom it represents” (Epstein 1985, x), why do politicians engage in extralegal rent activities at all? Why not expropriate directly?

These questions persist in part because economists have difficulty distinguishing empirically between rent-seeking and rent-extracting activities. McChesney notes that “much of what is popularly perceived as rent seeking by private interests is actually rent extraction by politicians” (2002, 346) and that “despite the centrality of rent creation in the economic literature, there is good reason to think that selling wealth protection [rent extraction] explains more of what is going on in the United States [than does rent seeking]” (1997, 164). The empirical evidence needed to establish a strong conclusion along these lines remains elusive.

The inability to distinguish between rent seeking and rent extraction springs in part from their complementarity. Every rent created by state action is an expropriation from one group or faction for the benefit of another, and every successful rent-seeking episode creates an opportunity for future rent extraction. Accordingly, politicians routinely attract compensation from predator and prey alike (McChesney 1997, 161), even as policy choices ultimately depend on politicians’ incentive to maximize political capital (Peltzman 1976, 1980). The total amount of compensation collected over time cannot be allocated meaningfully between rent-seeking and rent-extracting activities. Furthermore, it may be impossible to distinguish between legislation intro-

duced simply to extract rents and legislation introduced for the purpose of maximizing political capital by other means. Elected officials also have an affirmative duty to represent their constituents' interests and an incentive to pad their own utility by pursuing private notions of the right and the good. The upshot is that even robust correlations between side payments and public policies are more likely to reflect coincidence than to reveal causation. As McChesney notes, "[m]ere observation of payments does not permit one to infer that the famous 'special interests' are subverting democracy" (2002, 355).

Channeling rent thinking into formal games of rent seeking and rent extraction reduces the whole of politics and economic regulation to positive theories of bribery and threat: "payments for political favors and payments to avoid political disfavors" (McChesney 2002, 355). It also has the unintended consequence of obscuring the overarching political game in which rent seeking and rent extraction are embedded—the cooperative, positive-sum game of maximizing political capital. This game arises from the jointly recognized interdependence between the private and public sectors and is played despite overt appearances of sector rivalry. Cooperation integrates and harmonizes the substance of rent seeking and rent extraction, making each element more efficient (perhaps to the detriment of the general welfare) and characteristically leaving behind no discrete evidence of quid pro quo political deals. Given that cooperation is a dominant force of nature, it is reasonable to suspect that this supergame has greater effect than rent seeking and rent extraction considered separately.

I proceed by defining *corruption* in the context of republican government and by arguing that today's rent games are *artifacts* of corruption so defined rather than a cause of it. I then expand on contemporary rent thinking by introducing the positive-sum cooperative game into a discussion that presently dwells on zero- and negative-sum outcomes. I describe and illustrate a theory that explains the mechanism of cooperation, and I argue that the appearance of discrete rent-seeking and rent-extracting activities can indicate either an initial absence of or a temporary failure of cooperative behavior. I identify several reasons why empirical studies may be unable to identify individual aggressors and otherwise to account fully for observed political behavior. I consider some implications in the concluding section.

## **Corruption and Rents in the Theory of Republican Government**

James Madison described the virtues of republican government and the indications of its corruption in *The Federalist No. 10*:

The effect . . . is, on the one hand, to refine and enlarge the public views by passing them through the medium of a chosen body of citizens, whose wisdom may best discern the true interest of their country and whose patriotism and love of justice will be least likely to sacrifice it to temporary

or partial considerations. Under such a regulation it may well happen that the public voice, pronounced by the representatives of the people, will be more consonant to the public good than if pronounced by the people themselves, convened for the purpose. On the other hand, the effect may be inverted. Men of factious tempers, of local prejudices, or of sinister designs, may, by intrigue, by corruption, or by other means, first obtain the suffrages, and then betray the interests of the people. (Hamilton, Madison, and Jay [1788] 1961, 82)

The systematic pursuit of rents through political means is a defining characteristic of corrupted republican government. The existence of rent seeking and rent extraction indicates that successive tyrannies of temporary voting majorities who rule according to private interests have replaced republicanism. Corruption reduces the aggregate welfare of society by surrendering the collective pursuit of wealth and utility to the self-interest of politicians (and through them to client factions) whose private incentive is reelection to office. Once that surrender has occurred, the notion of *corruption* has no further meaning and properly is replaced with concepts of *illegality* that pertain to the violation of the laws enacted to maximize political capital.

### *The Corruption of Republican Government*

Imagine two contrasting societies. One is organized along the lines Madison championed. It is strictly rule utilitarian in that government's enumerated powers are limited by constitutional rule to the protection of life, liberty, and property and to the provision of wealth-enhancing public goods. It admits no possibility for political rent creation, rent seeking, or rent extraction. Any appearance of these activities indicates a corruption.

The other society to imagine is one that more closely approximates modern reality. This society, founded on the ideals of republican government, has become weakly rule utilitarian. Its constitution changes daily when court is in session (Berger 1977). A tangle of arbitrary and capricious laws covering most aspects of public and private activity govern it. This society is strongly act utilitarian despite lacking the omniscience necessary to ensure that its ad hoc policies produce only beneficial and intended outcomes (Yeager 2001). Through a process of gradual accretion punctuated by "crisis" events (Higgs 1987), its public sector has acquired the arbitrary power to "do good," which subsequently has become a plenary power to do anything at all. The incentive of individuals acting in a governmental capacity is to maximize the political capital that facilitates reelection and reappointment to office. The political process increases aggregate wealth and utility only by coincidence. There are no persistently "mistaken" public policies, only policies with which some (perhaps many) voters disagree. Although policies occasionally may be adopted in error, "it is fruitful to assume that the real effects [of persistently mistaken policies] were known and desired" (Stigler 1975, 140).

The public sector in this second society is aptly modeled as a Coasean firm (McChesney 1997, 143–53). That is, the magnitude of transaction costs and the sector’s ability to manage information efficiently determine its equilibrium size and scope dynamically. Unlike the size of a Coasean firm, however, its size also is a function of a monopoly over the lawful use of coercion and of rules requiring decision makers to stand periodically for reelection and reappointment to office. The sector grows and contracts as it “responds to the articulated interests of those who stand to gain or lose from politicization of the allocation of resources” (Peltzman 1980, 287). That is, it grows by harvesting pecuniary and in-kind rents and by redistributing them in ways that maximize political capital. All public choices are by-products of the political production function. All takings and redistributions, whether through direct taxation, rent creation, rent extraction, confiscation, or political extortion serve this end. Attempting to decide, on theoretical and empirical grounds, whether a particular choice represents legitimate politics or constitutes an abuse of the political process is a normative exercise that ends in ambiguity and misapprehension. Analytical baselines grounded on constructs of benchmark republican government have little relevance in a society in which political capital is the chosen maximand. In this context, the questions for economic theory concern the shape of the political production function and the marginal contribution that each public choice makes to the maximization of political capital.

Republican government in the second society has been “corrupted” to the point of being unrecognizable. The society can remain in this state so long as it generates sufficient rents to support itself and produces acceptable political ideologies—such as the Rawlsian “difference principle” (Rawls 1971)—to justify the expropriation and redistribution of rents.

### *The Causes of Corruption*

Alexander Hamilton argued in *The Federalist No. 84* that the scope of the public sector depends “on public opinion, and on the general spirit of the people and of the government” (Hamilton, Madison, and Jay [1788] 1961, 514). Hamilton was talking about press freedom, but his point is valid across the breadth of constitutional government. The courts have followed a similar vision of political process, permitting society to squander the essence of the republican heritage promised in perpetuity by Article IV, Section 4, of the U.S. Constitution. The courts’ approach reflects, among other things, the lack of a consistent theory of constitutional interpretation, “a lack which is manifest not merely in the work of courts but in the public, professional and even scholarly discussion of the topic” (Bork 1971, 1; Farber and Sherry 2002). Justice Oliver Wendell Holmes represented this tradition candidly, believing that the job of the constitutional court is to respect “the dominant forces of the community even if it will take us to hell” (qtd. in Alschuler 2000, 59) and personally viewing every piece of enacted legislation as presumptively constitutional unless it made him want to

“puke” (qtd. in Posner 1993, 192). Few justices have acknowledged allegiance to Holmes’s stark view. Nevertheless, the Supreme Court over time has favored popular sovereignty over constitutional principles, granting legislatures considerable freedom to “to adopt whatever economic policy may reasonably be deemed to promote public welfare” so long as the resulting policies are not utterly capricious (*Nebbia v. New York*, 291 U.S. 502, 536 [1934]). This tendency has led some constitutional scholars to conclude that even “vigorous judicial review does not make much difference one way or the other” (Tushnet 1999, 174). The message, at bottom, is that contentious social issues built on false philanthropy and something-for-nothing political promises are more likely to be resolved satisfactorily at the polls than in the courts.

This philosophy of government bothers economists, who complain that it lowers the aggregate wealth of society by misallocating resources and by dulling and distorting individuals’ incentives to produce and conserve wealth. In rebuttal, it might be observed—only half facetiously in the light of social realities—that Adam Smith knew of little public good being done by those individuals “who affected to trade for the public good” ([1776] 1976, 478). Given that politicians have no privileged knowledge of “the public good,” they too are likely to promote it most effectively when pursuing self-interest, which for them consists primarily of reelection and reappointment to office. The serious criticism that the pursuit of political self-interest corrupts republican government by surrendering public decision making to the tyranny of temporary voting majorities is rarely considered outside of constitutional economics.

That society regards these concerns as both valid and largely irrelevant and that it declines to find corruption in the ebb and flow of Holmes’s “forces of the community” raise scant concern in other scholarly domains. Bradley Smith, a legal scholar and present Federal Election Commission member, typifies the view that political “corruption” has become an essentially empty concept:

We must remember that what [editorialists and campaign reform advocates] mean by “corruption” is not that officials are taking bribes or lining their own pockets. That type of behavior, once again, is illegal under other laws having nothing to do with campaign finance. . . . Rather, by corruption they mean that legislators are voting or acting in ways that the legislators themselves believe are bad for the country, and are opposed by their constituencies, in exchange for contributions to their campaigns. When stated this way, the proposition that a large number of lawmakers is corrupt seems highly improbable. Do we really believe that large numbers of elected officials vote against both their own consciences and the wishes of voters in their districts? If so, why aren’t they voted out of office? (B. Smith 2001, 217)

One answer to Smith’s rhetorical flourish stems from the inability of lawyers, economists, and others to produce hard evidence (or even firm statistical inferences) of the

quid pro quo dealings predicted by public-choice theory. Another answer stems from the prevailing antibusiness bias and the private envy of successful business entrepreneurship that encourage and legitimize certain corrupting political practices. Yet another answer stems from the strong and growing sense of individual entitlement to privately produced goods and services, ranging from health care to premium cable programming—a sentiment easily transformed into political capital by coercively altering the terms of trade and therefore the distribution of rents within society.

## **A Theory of Cooperation and Rents**

Where the public sector is constrained only weakly by constitutional rule, consumer surplus (rent) and capital (quasi-rent) are exposed fully and everywhere to expropriation by the state. Much of this wealth must be left undisturbed because taking it would destroy the investment and incentives needed to generate social wealth and political capital. Pure rent, however, is a renewable social surplus that can be harvested and redistributed continuously through the political process without distorting private incentives to produce. A comparison can be drawn to harvesting sheep for their wool (rent) and harvesting them for their meat (quasi-rent). The verb *to fleece* is as descriptive in politics as it is in ranching.

Efficient rent-harvesting techniques become codified over time in tax rules and other regulations as the state assimilates knowledge about the pattern and scope of rents. In the interim, and indefinitely in special cases, harvesting proceeds on a negotiated basis. Negotiations take the form of bilateral monopoly bargaining, the outcomes of which are unknowable *ex ante*. This “indeterminacy with a vengeance” (Scherer 1980, 299) contributes to the empirical problem of analyzing rent games.

The private sector faces two options: either it can seek to bargain continuously for a share of the rent that it controls, or it can act cooperatively, joining with the public sector in an informal but objectively real partnership. As the power and scope of the public sector expand and as the ability to compile and assimilate information about rents grows, cooperative behavior becomes the more-attractive option. Cooperation may appear to make the private sector complicit in its own victimization, but it also produces economic outcomes superior to coerced alternatives.

### *The Origin and Mechanisms of Cooperation*

The extensive game theory, sociobiology, law, economics, and philosophy literatures demonstrate, each in its own way, that cooperation is a dominant strategy of nature. Cooperative behavior is selected for by evolution and is highly developed in humans (Ridley 1996). Individual tastes and preferences are affectations that signal our willingness and desire to cooperate with specific others (E. Posner 2000). Cooperation lies at the core of conventional morality and ethics (Nozick 2001). In other words,

cooperation is the cornerstone of social organization and is so highly integrated into human nature that individuals need not be mathematicians, economists, or game theorists to benefit by it. They need only be rational maximizers of self-interest.

Cooperating partners work toward maximizing the value of collective outcomes over time and in a variety of incompletely defined contexts. These relationships require trust, which arises both from utilitarian self-interest where each side can predict (within limits) the actions of the other and from a moral commitment to “do the right thing” even when that goes against narrow self-interest (Seligman 1997). Cooperation based on utilitarian trust is commonplace. Cooperation based on moral trust is more difficult to achieve but also more valuable. Successful public- and private-sector participants play the cooperation game successfully on both fronts.

Cooperation in politics reduces to an overarching game of strategic calculation. Economist Thomas Schelling (1960), who studied strategies for managing Cold War nuclear threats (the movie *Dr. Strangelove* [1964] was inspired by his work), did pioneering work in this area. To develop an extended theory of positive- and variable-sum games, Schelling built on the zero-sum games of pure conflict introduced by John von Neumann and Oskar Morgenstern (1953). Schelling’s games described cases in which “traditional game theory has not yielded comparable insight or advice”—that is, the “strategy of action where conflict is mixed with mutual dependence,” where “secrecy may play a strategic role,” and where “there is some essential need for signaling of intentions and the meeting of minds” (Schelling 1960, 83).

Schelling described cooperative games as involving “[t]he dependence of the two players . . . conveying their intentions to each other and perceiving the intentions of each, of behaving in predictable patterns and acquiescing in rules or limits” (1960, 105). He focused “on the interdependence of the adversaries’ decisions and on their expectations about each other’s behavior” (3). His theory was not concerned with the use of force per se, “but with the *exploitation of potential force* . . . the employment of threats, or of threats and promises, or more generally of the conditioning of one’s own behavior on the behavior of others” (5 and 15, emphasis in original). Schelling examined situations that entail neither pure conflict nor pure cooperation but rather “an ‘imperfect-correlation-of-preferences’ game; a mixture of conflict and mutual dependence that epitomizes bargaining situations” (87); games characterized by “the ambivalence of [each party’s] relation to the other player—the mixture of mutual dependence and conflict, of partnership and competition” (89); games in which “illicit bargaining, or diplomatic bargaining . . . would be embarrassing to both sides if overheard” (101); “a modus vivendi when one or both parties either cannot or will not negotiate explicitly or when neither would trust the other with respect to any agreement explicitly reached” (53); and games in which “speech may be part of the bargaining process, [but] actions are also part of it, and the game is one of ‘maneuver’ rather than just talk” (101).



Schelling's theory accurately describes the conditions underlying the politics of rent manipulation, yet references to his work seldom appear in the public-choice literature.

Direct discussion within cooperative political relationships is awkward because cooperation itself smacks of collusion in a conspiracy against the public. Players can only hint at their desire to cooperate. They do so through the medium of pecuniary and in-kind political contributions whose value signals both eagerness and breadth of desire. Contributions serve only as signals; they are not part of a discernable quid pro quo political deal, nor do they represent a "commitment" to surrender future discretionary actions "by constraining one's own behavior" (Schelling 1960, 160). Political contributions of this sort, like advertising expenditures, become sunk costs once they are given, so they are irrelevant to future decisions.

Cooperative processes do not lend themselves to empirical investigation. As Schelling explains,

*Taking a hint* is fundamentally different from deciphering a formal communication or solving a mathematical problem; it involves discovering a message that has been planted within a context by someone who thinks he shares with the recipient certain impressions or associations. One cannot, without empirical evidence, deduce what understandings can be perceived in a nonzero-sum game of maneuver any more that one can prove, by purely formal deduction, that a particular joke is bound to be funny. (1960, 163–64).

The identification problem is exemplified by the inability to distinguish between rent seeking and rent extraction even in the presence of empirical evidence. Cooperative dealings can be indecipherable to outsiders, and their political purpose is dismissed easily, as when Senator Ernest Hollings (D-S.C.) memorably described as an "insult" the \$3,500 in payments he received over ten years from Enron Corporation (Opper and Labaton 2002, C4).

Cooperation efficiently reduces the need for bargaining and threats, reduces the need for intermediaries, characteristically leaves no trail of quids (payments) and quos (favors), reduces periodic lurches in the political process, and generally smoothes the process of maximizing political capital. It also grounds the assertion that contributions buy, at most, *access* to the political process, allowing players to be heard against the background noise of deliberative democracy and providing public decision makers with the information needed to maximize political capital. Public choice gives short shrift to this aspect of economic behavior, even though the technical conditions for cooperation in political markets are the same as those for coordination in oligopoly product markets (Scherer 1980, 163).

### *Cooperation and Economic Regulation*

Adam Smith recognized the basic cooperative rent game, which he described as follows:

It is to prevent [the] reduction of price, and consequently of wages and profit, by restraining that free competition which would most certainly occasion it, that all corporations, and the greater part of corporation laws, have been established. In order to erect a corporation . . . a charter from the king was likewise necessary. But this prerogative of the crown seems to have been reserved rather for extorting money from the subject, than for the defence of the common liberty against such oppressive monopolies. ([1776] 1976, 138)

Commercial activities that might be conducted as competitive endeavors could exist instead (if the sovereign desired it) in “regulated” corporate form. Incorporation transformed private consumer surplus into rents by engaging the Crown’s coercive power to establish monopolies and manage cartels. The firm and the Crown shared to mutual advantage the rent stream created by this arrangement. Firms earned a bit more than they otherwise would have, and the Crown benefited from a voluntary and efficient expropriation process that preserved political capital.

Incorporation exemplifies cooperative behavior arranged through economic regulation of the private sector. The principal purpose of regulation, then as now, is taxation and redistribution rather than the advancement of consumer welfare through administrative perfection of the market process (R. Posner 1971, 1999). The alternative to economic regulation is reliance on a less-efficient combination of licensing fees, tariffs, and fines and on a variety of taxes on income, earnings, sales, and “sin.”

Firms probably pocketed little of the rent stream created through incorporation. A firm’s marginal productive effort was limited to tax collection and remittance. Barring some special relationship with the Crown (kinship, friendship, celebrity, charm, and old school ties, for example), these services would be compensated in proportion to their marginal value. In a world of perfect information and zero transaction costs, the Crown could capture the entire rent, less only the compensation paid for collection services. In an imperfect world, the Crown could maximize its share of the rent either by auctioning monopoly franchises among competing bidders or by selling franchises at negotiated prices. Incorporated firms realized scant windfall apart from the absence of meaningful competition.

Smith’s example reflects the benefit of specialization and comparative advantage. The private and public sectors in Smith’s society have a plain incentive to become expert at the tasks they naturally perform best. The private sector has a comparative advantage at harvesting rents through the price system, and the public sector has a comparative advantage at creating rents through coercion. Each side benefits at the margin from a trade in services.

The rules and privileges of incorporation have changed since Adam Smith's time, but the advantages of cooperative economic regulation remain. Accordingly,

No industry offered the opportunity to be regulated should decline it. Few industries have done so. Railroads, airlines, telephone companies, radio stations, and most other industries have warmly embraced regulation when it was offered and have strenuously resisted efforts to remove it. . . . Regulation protects . . . industries against competition from outsiders and from within the industry. It provides protection from antitrust attack. It provides a degree of protection from congressional investigation. Regulation greatly reduces the risk of bankruptcy from causes other than competition. And, while regulation may make very high rates of return difficult to achieve, it does virtually guarantee a steady stream of adequate profits. (Owen and Braeutigan 1978, 2)

The literature of political economy and industrial organization is thick with case studies of private benefits flowing from public regulation. Administrative law casebooks, by comparison, are thick with examples of rents being drained and channeled by regulation to create political capital. Relatively little scholarly effort has been directed toward discovering how these two processes net out over time.

It can be argued that "regulation is proof of failure in the market for political contracts" and that "in the absence of transaction costs, all regulatory activity would be rent extraction" (McChesney 1997, 155, emphasis omitted). However, economic regulation also indicates cooperative behavior. The recent tip toward "deregulation" shows only that traditional forms of cooperation no longer maximize political capital.

### Establishing and Disciplining Cooperative Behavior

Cooperation in a more general form is always available. It arises spontaneously wherever the private sector can earn compensation for helping politicians to produce political capital efficiently.

In considering the organizing principle of cooperative behavior, philosopher Robert Nozick says that "The norm we are proposing is that of *voluntary cooperation*, the norm of unforced cooperation. We might appropriately term this *the core principle of ethics*" (2001, 263, emphasis in the original). Ethical principles arise within both the utilitarian and the moral models of cooperation. They are the mechanisms that preserve order and discipline among parties by "the protecting, fostering, or maintaining of cooperative activities for mutual benefit; the guiding of such activity (as with principles for dividing benefits); mandating behavior for response to deviations from the first two goals listed; and fostering virtues and dispositions that maintain patterns of cooperative behavior" (290).

The task of “responding to deviations”—that is, of punishing defections from a cooperative game—has particular relevance to public-choice analysis. Behaviors that might be characterized as rent extraction also represent both the means by which the state signals its desire to establish cooperation where it is initially absent and a means of “tit-for-tat” discipline for punishing defections where cooperation has failed (Axelrod 1984). Persuasion and punishment in the political context assume a variety of forms, ranging from legislative hearings designed to unsettle and embarrass private-sector decision makers, to predatory “settlements” that expropriate millions and sometimes billions of dollars, to legislation that withdraws or forecloses rent opportunities, to politicians’ subtle refusals to intervene on behalf of constituents who face adverse administrative actions. Repeated instances of rent-extracting behavior indicate a failure to signal and discipline cooperation effectively.

Signaling and punishing within a cooperative framework further complicate empirical testing of theories of rent seeking and rent extraction.

The extralegal “contracts” entailed by cooperative games (and by rent extraction) are not judicially enforceable (McChesney 1997, 86–109). They are unlike legislation and regulatory decisions that are tantamount to enforceable contracts between factions and the state (Landes and Posner 1975). The binding force in extralegal arrangements is the ability of the parties to signal credible threats. As Schelling explains,

The key to these threats is that, though one may or may not carry them out if the threatened party fails to comply, *the final decision is not altogether under the threatener’s control*. The threat is not quite of the form “I may or may not, according as I choose,” but, has an element of, “I may or may not, and even I can’t be altogether sure. . . . The idea is simply that a limited war can get out of hand by degrees. (1960, 188, 193, emphasis in original)

In the theater of domestic politics, any piece of legislation that is broad, vague, and ambiguous is a potential vehicle for signaling and punishing. Some laws are clearly superior in this regard, and the antitrust laws in particular rank among the best. Antitrust theory has lost its intellectual respectability (Bork 1978, 418). Antitrust prosecution has become little more than a rent game wrapped in the jargon of law and economics and driven by arbitrary and ad hoc notions of market fairness (Bork 1978; Kopel 2001; McChesney and Shugart 1995; McKenzie 2000). Antitrust law, like constitutional law, follows no consistent legal or economic interpretation. Although notions of economic efficiency provide a uniquely rational basis for antitrust adjudication, the courts have held that less-objective considerations are entitled to equal if not greater weight, such as Progressives’ goal “to perpetuate and preserve, for its own sake and in spite of possible cost, an organization of industry in small units which can effectively compete with each other” (*United States v. Aluminum Corporation of America*, 148 F.2d 416, 428-9 [2d Cir. 1945]). The lack of objective standards allows

courts to defer to the state's normative vision of industrial organization so long as prosecutors present a minimally coherent argument.

### Some Anecdotal Evidence

The recent federal antitrust action against Microsoft arguably is an example of the government's use of antitrust law to establish cooperative behavior within a rapidly evolving high-tech industry. Microsoft, from its inception, remained conspicuously aloof from national politics, content with its private ability to generate rents by producing highly valued information-technology products. The magnitude of these rents, coupled with the envy and enmity engendered by the company's success and aloofness, and the compelling assertion that Microsoft's Windows screen was "the most valuable piece of real estate on earth" made the firm an attractive target for prosecution. Microsoft remained aloof even as the Federal Trade Commission and the Department of Justice pressed antitrust procedures. The result was a long, costly, embarrassing, and damaging law suit prosecuted without valid regard for either the market process or consumer welfare (Gordon 2002; Kopel 2001; Liebowitz and Margolis 1999; McKenzie 2000). The case was pursued, moreover, with the encouragement and cooperation of Microsoft's competitors, whose incentive was to disrupt the firm's organizational structure and otherwise to raise its cost of doing business. Two of these competitors, Oracle and Cisco, held dominant market positions that also could have made them targets for antitrust action, but conspicuously they were not prosecuted (Kopel 2001).

Microsoft resisted playing the cooperation game until the consequences of that position became unsustainable. Capitulating to political reality, the company signaled contrition by quickly becoming the country's third-largest corporate contributor (Kopel 2001, 154).

Compare the Microsoft case with another recent and highly visible episode, this one involving experienced cooperative players. Time Warner, a media-content producer, and America on Line (AOL), a content distributor and Internet service provider, agreed in January 2000 to merge their businesses, ostensibly to reap anticipated economies and "synergies." The merger required government antitrust approval even though the two firms operated in different markets and neither was dominant in any significant line of business. The merger announcement precipitated a predictable wave of political engagement by telephone and cable television carriers, television networks, and Internet service providers. These parties' economic objective was to handicap prospectively the combined content/distribution company's efficacy as a competitor and to ransom the merger for in-kind rents consisting of preferential access to Time Warner's cable television and Internet distribution facilities and to AOL's proprietary "instant messaging" Internet service. Approval of the merger fell to the Federal Trade Commission and the Federal Communications Commission, which threatened to withhold their sanction until the merging firms offered popular

“concessions.” Failure to gain antitrust approval would have sent the matter to federal court, where prospects for relief were uncertain. The concessions demanded bore little relevance to “perfecting” the market process. Rather, they were geared for creating political capital, at the expense of the merging firms’ stockholders, by bargaining visibly for shares of prospective merger rents. AOL and Time Warner negotiated a deal with regulators after playing a brief and ineffective (and possibly counterproductive) political strategy that included \$1.7 million in political contributions during the 1999–2000 election cycle, up from \$149,500 during the 1997–98 cycle (Schmidt 2001, 127). The negotiation occurred as follows:

AOL and Time Warner don’t apologize for what they call their tough negotiating tactics. Indeed, some FTC staffers said that although the negotiations were difficult, AOL and Time Warner conducted themselves professionally. “I don’t agree that they made missteps. I think it was a tough negotiation with talented lawyers,” said Richard Parker, who at the time was director of the FTC’s Bureau of Competition. For their part, AOL and Time Warner contend that they always were willing to make concessions. Once FTC Chairman Pitofsky had articulated his demands, an AOL Time Warner executive noted, the companies quickly negotiated the deal. (Schmidt 2001, 75)

The Microsoft and AOL Time Warner episodes exhibit aspects of conventional rent seeking and rent extraction, but they also illustrate the role of the antitrust laws for signaling and disciplining cooperation in the cause of building political capital. Microsoft learned the hard way the importance of cooperation, a lesson that AOL and Time Warner already knew. The AOL episode involved both rent redistributions and contemporaneous campaign contributions, but it produced no discernable quid pro quo political deals. Both firms were fleeced in the end—forced to negotiate for a share of what was theirs by property right (Epstein 1993; McChesney 1997)—but an uncooperative Microsoft clearly suffered a proportionately greater loss.

## Conclusion

Rent seeking and rent extraction are aspects of cooperative behavior between the public and private sectors. They serve not only to harvest and redistribute rent but also to signal and discipline cooperation. Their discrete appearance indicates either the initial absence or temporary failure of cooperation.

One characteristic of cooperative behavior in this context is that it produces no evidence of quids and quos that might be interpreted unambiguously as evidence of “corruption” within an already corrupted system of republican government. Cooperative political relationships may be indecipherable to outsiders. Disentangling the

separate effects of rent seeking and rent extraction against this background is a daunting task.

Rent games are not the corrupting force of republican government. Rather, their appearance indicates that society has lost the will to defend its republican heritage. As a society drifts away from rule-based republicanism and toward ad hoc act utilitarianism, political capital becomes the social maximand. Rent seeking, rent extraction, and cooperative rent games are aspects of the political production function.

Government by political capital corrupts republicanism by surrendering the decision-making functions of society to the tyranny of temporary voting majorities, which then rule according to private interests and at the expense of society (except by coincidence). Majority tyranny constitutes an unambiguous “corruption” of republican government. Its appearance is attributable both to the lack of a constraining standard of constitutional interpretation and to supportive “public opinion, and the general spirit of the people,” as Hamilton put it.

Attributing the corruption of republican government to political campaign financing is a mistake, as is the belief that perceived corruption can be eradicated by revising campaign finance rules. The reforms undertaken to date overlook the cause of the political activities at issue. Consequently, they have redirected normatively undesirable activities into less-visible channels and otherwise have harmed the democratic process further. Increasing the transparency of campaign finance, as some reformers have urged, would cause no particular harm. Conversely, it will produce little benefit where the political behavior at issue creates no discernable trail of quids and quos. Establishing a correlation between campaign contributions and public decision making is insufficient to establish causation, although doing so might satisfy the gossamer “appearance of corruption” standard established by the Supreme Court in *Buckley v. Valeo* (424 U.S. 1 [1976]).

A return to the purity of benchmark republican government cannot occur unless society chooses such a return. Despite cries for “reform,” there is no evident desire to abandon the present system of redistributive government. The political conditions about which we complain are direct and unavoidable consequences of the sort of society that we have chosen to be. The cost of these choices can be minimized but never eliminated.

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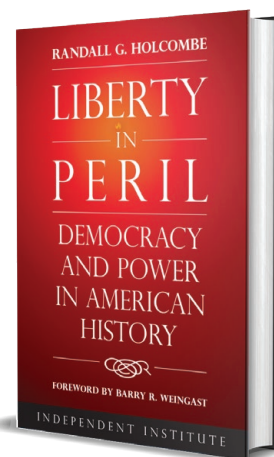
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