

INSIDE JOB

National decline is typically blamed on special interests from the demand side of politics corrupting a country's institutions. The usual demand-side suspects include crony capitalists, consumer activists, economic elites, and labor unions. Less attention is given to government insiders on the supply side of politics – rulers, elected officials, bureaucrats, and public employees. In autocracies and democracies, government insiders have the motive, means, and opportunity to co-opt political power for their benefit and at the expense of national well-being. Many storied empires have succumbed to such inside jobs. Today, they imperil countries as different as China and the United States. Democracy, government by the people, does not ensure government for the people. Understanding how government insiders use their power to subvert the public interest – and how these negative consequences can be mitigated – is the topic of this book by Mark A. Zupan.

Mark A. Zupan is President of Alfred University, New York. He holds a B.A. from Harvard University and a Ph.D. in economics from the Massachusetts Institute of Technology (MIT) and has won several teaching awards. He has served on the boards of several for-profit companies, including Constellation Brands, PAETEC Holdings, Northern Trust, HNP Capital, iVEDiX, and Stocker Yale, as well as nonprofits such as the United Way, the Harley School, GMAC, and AACSB. His previous book, *Microeconomics: Theory and Applications*, co-authored with Edgar Browning, is currently in its twelfth edition. Zupan has published in the *Wall Street Journal*, *New York Times*, *LA Times*, *Bloomberg Businessweek*, *Huffington Post*, *Kiplingers*, and *Financial Times*.

Inside Job

How Government Insiders Subvert the Public Interest

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Preface

The book is targeted, first and foremost, at scholars and students of political economy. While the economic model of politics that has been developed over the last fifty years has helped us to better explain and predict policy outcomes, the model has even greater potency than has been realized. By “economic model of politics,” I mean the market-based framework wherein public officials are the sellers of wealth transfers through their policy actions so that interest groups must compete for favorable wealth transfers by offering support to public officials in return. The expanded potency of the model comes through relying on insights from disciplines such as history, political science, sociology, and psychology while applying the model broadly over time and across autocracies and democracies. Along the way, I pry open what has typically been treated, at least by most economists, as a black box on the supply side of politics. By doing so, a key insight that emerges is the extent to which government insiders can subvert the public interest. Taking this insight and coupling it with lessons from historical or present-day cases of the political system being captured by government insiders allows us to better conceptualize what can be done to mitigate the potential of such capture.

Too little attention has been paid to the supply side of political markets populated by rulers, elected officials, bureaucrats, and public employees and the extent to which such government insiders can profit at the expense of the public interest. Existing explanations for national decline focus on capture of the state by special interests operating on the demand side of politics, such as businesses, consumer activists, crony capitalists, trade unions, industry cartels, economic elites, and so on. Government insiders have the motive, means, and opportunity that investigators focus on when seeking to identify the perpetrator of a crime.

Looking across the broad expanse of time and around the globe, inside jobs have led to the decline of both autocracies and democracies. At the present time, they threaten both the world's largest democratic economy, the United States, and the world's largest autocracy, China. In the United States, the danger from inside jobs is posed by congressional representatives who have grown increasingly insulated from electoral competition; a K-12 public education sector whose supply side has become increasingly monopolized over the past fifty years; and rising public sector unionization. The last of these trends has resulted in mushrooming unfunded pension and health care liabilities for public workers that now represent the second-largest fiscal challenge for the country (larger than Social Security but not as large as Medicare/Medicaid/ObamaCare) and have produced budgetary crises in locations such as Detroit, Puerto Rico, Chicago, Philadelphia, Illinois, and Rhode Island. In China, inside jobs and the extent to which the ruling class has a vested interest in preserving its wealth and political power threaten to diminish the high GDP growth rates resulting from Deng Xiaoping's economic reforms.

Historical cases of inside jobs bringing down nations include the New Kingdom of Egypt, the Ottoman Empire, France under the Bourbon kings Louis XIV through Louis XVI, and China under certain emperors of the Ming dynasty. Modern examples of government insiders subverting the public interest can be found in the news on a daily basis and range from autocracies such as Venezuela, North Korea, Cuba, Russia, Zaire, and Iran to democracies such as Brazil, Turkey, Argentina, India, Malaysia, Greece, Italy, and the European Union. Inside jobs diminish a nation's prosperity, curtail citizens' political rights and civil liberties, erode citizens' trust in their government, dissipate resources through efforts to capture the rents associated with political power, and promote conflict both within a nation and between nations.

Particularly in democracies that provide more opportunity for demand-side interests to operate, capture of the state often involves a symbiotic relationship between demand-side and supply-side interests. This symbiotic capture is akin to how cancer, a leading cause of death in humans, involves a defect in the genetic code that leads to over-replication of cells to the detriment of the host organism. In our genetic code, the nucleotide base guanine, in one strand of DNA's double helix, always bonds with cytosine in the other strand, while adenine always bonds with thymine. Thus, whenever there is an incorrect nucleotide base on one strand of our DNA, it is also paired with an incorrect base on the other strand. This serves to amplify the damage done to the human body through cellular

over-replication, or cancer. Analogously, any co-opting of the state by demand-side special interests is likely to be associated with government insiders who simultaneously benefit and thus serve to encrust the political outcome. Such symbiotic capture of the political process underscores why, according to Milton and Rose Friedman, “there is nothing so permanent as a temporary government program.”

The book provides a simple equation ($P = G \times S \times I$) explaining how the magnitude by which government insiders profit at the expense of the public interest (P) is determined by three factors: the prospective gains from such capture (G), which depend in a positive fashion on the size of government in a society; the slack between citizens and their public officials (S); and the interest of public officials in exploiting any such slack for their benefit (I). Various chapters explore the determinants of these factors and how they either increase or diminish the possibility of inside jobs and the damage to a nation from government self-capture.

The book helps to explain the movement toward democracy and away from autocracy over the last two centuries through the operation of a quasi-market in politics. Such a market responds to changes in the costs associated with autocracy, albeit often accompanied by violence in the course of changes in political power. The costs associated with autocracy have grown over the last two centuries on account of factors such as specialization, education, and trade.

Relying on Transparency International measures of public sector integrity, this book is the first to show that democracy represents an improvement, on average, over autocracies. This is presumably due to the lower slack (S) between citizens and their public officials in democracies versus autocracies. While there are some notable exceptions such as Singapore, the UAE, and Botswana, the public sector tends to be more corrupt in autocracies than in democracies. That said, democracy, or government *by* the people, is not sufficient to ensure government *for* the people. Over a quarter of the world’s democracies, for example, have a lower Transparency International rating for public sector integrity than does the average autocracy. And fewer than half of the world’s democracies score higher than 50, the midpoint of the 0–100 Transparency International scale for public sector integrity, where 100 represents a perfectly clean public sector.

The book perhaps helps to explain the success of certain US presidential candidates such as Donald Trump and Bernie Sanders in the 2016 electoral season. Both Trump and Sanders railed against the extent to which government insiders have co-opted the political system to their benefit and at the expense of our nation’s citizens.

The book's insights also are germane to broader audiences interested in what determines organizational success – whether such organizations are for-profit firms or nonprofit churches, hospitals, and universities. While there are more ample curbs against inside jobs in nonpolitical settings, the restraints are imperfect. So long as there are prospective gains to be realized (*G*), slack between managers and owners (*S*), and interest on the part of managers to co-opt the organization for their benefit (*I*), there is the possibility of an inside job and its associated destructive consequences. Witness the shenanigans at FIFA, soccer's international governing body, or the damage done during the Middle Ages by corruption within the Catholic Church's ecclesiastical ranks all the way up, at times, to the Pope. Or recall how the vested film interests within Kodak impeded the move toward digital products and thus ultimately resulted in that iconic firm's bankruptcy.

While this book has only one figure, one equation, and two tables, it is my fond hope that, through illustrating the importance of the supply side of the political marketplace, it will add to our understanding of why nations succeed or fail – whether the nations are autocracies or democracies. Government *by* the people, that is, is not sufficient to ensure government *for* the people. Democracy by itself cannot be the socioeconomic terminus if we seek to promote national well-being. Further attention has to be given to the supply side of political markets and how we can better ensure the accountability of rulers, elected officials, bureaucrats, and public employees to the public interest.

Acknowledgments

Paul Kalnithi's poignant recent memoir, *When Breath Becomes Air*, reminds us of the brevity of each of our individual interludes on this earth. In light of the brevity, one can question the wisdom of devoting a year or more of one's existence to writing a book. Yet, as Matt Ridley so eloquently notes in *The Rational Optimist: How Prosperity Evolves*, the defining and ennobling characteristic of the human species is our capacity to promote the "sex of ideas." Through language, stories, and scholarship we have developed the capacity to retain and build upon the knowledge that we have collectively accumulated in the past and thereby to create a better future for our species. The ability of universities to foster such a capacity for retaining and building upon knowledge helps explain the durability of our institutions of higher education. Whereas only one of the twelve companies comprising the initial Dow Jones Industrial Average in 1896 survives to this day (General Electric), virtually all of the top universities in existence 120 years ago continue to flourish and contribute to our nation's socioeconomic development.

In writing this book, I have benefited from the wisdom and insights of numerous historians, sociologists, psychologists, political scientists, philosophers, and economists. Many have educated me through their writings – Robert Caro, Francis Fukuyama, Paul Kennedy, Ibn Khaldun, and Max Weber, to name but a few. I have been privileged to meet and directly learn from others such as Tom Borcherding, Edgar Browning, Ronald Coase, Carolyn Minter Hoxby, Paul Joskow, Gary Libecap, Deirdre McCloskey, Terry Moe, Robert Nozick, Sam Peltzman, Richard Schmalensee, Robert Solow, George Stigler, Stephan Thernstrom, Gordon Tullock, and James Q. Wilson. Among those who comprise the latter category, I owe the deepest debt to Joe Kalt. As a freshly hired professor at Harvard, Joe first inspired me to study economics and then taught me how to do scholarship in the field of political economy.

The two papers that I was fortunate enough to co-author with Joe Kalt roughly three decades ago on the determinants of legislator voting behavior in representative democracies planted the seeds for this book. In effect, the papers showed, contrary to our own priors going into the research endeavor, that there was considerable slack between citizens and their public officials in a representative democracy such as the United States. On account of the slack, senators had latitude to pursue their worldviews or ideologies when casting roll-call votes. Contrary to the emerging economic model of politics, in other words, elected public officials in democracies did not appear to be perfectly accountable to their citizens and to how the interests of those citizens were manifest on the demand side of the political marketplace. The interests of the public officials operating on the supply side of politics mattered when it came to explaining and predicting political outcomes.

I am grateful to the University of Rochester's Simon Business School for providing a sabbatical that gave me the gift of time to write this book. The administrative experiences as a dean at Simon and prior to that as a dean at the University of Arizona's Eller College of Management and associate dean at USC's Marshall School of Business also afforded valuable insights as to how the central arguments of this book also can be applied to organizational settings outside of the political arena.

During my sabbatical, Jim Dorn generously provided an office at the Cato Institute in Washington, D.C., where I could reflect and write. He regularly pointed me to books and articles that were instrumental to sharpening my thinking. Colleagues and/or alums at the University of Rochester, such as Mark Ain, Jim Brickley, Richard Couch, Ray Dorsey, Chris Dunstan, Ron Hansen, Dennis Kessler, David Primo, Eric Rubin, Mike Ryan, Alex Sukhoy, Janice Willett, and Jerry Zimmerman, offered constructive suggestions and valued encouragement. So did seminar participants at the Cato Institute, CEMA, Clemson, Florida Atlantic, George Mason, Georgia Tech, and Johns Hopkins.

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This book is dedicated in memory of my younger brother, Andy, who positively impacted so many of us through his wide-ranging intellect, good cheer, committed service as a pediatrician, love for his family, and noble spirit. With each passing day, I treasure his example while wishing that I still had the opportunity to discuss the ideas that follow with him.