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# Review Essay

## The Petty Larceny of the Police Power

MONEY FOR NOTHING: POLITICIANS, RENT EXTRACTION,  
AND POLITICAL EXTORTION. By Fred S. McChesney.†  
Cambridge: Harvard University Press, 1997.  
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*Reviewed by J. Gregory Sidak‡*

The biggest theoretical insights seem obvious in retrospect. So it is in law and economics with Coase's nature of the firm<sup>1</sup> and social cost,<sup>2</sup> Alchian's definition of cost,<sup>3</sup> Baumol's contestable markets,<sup>4</sup> Williamson's opportunism,<sup>5</sup> and Landes and Posner's market power.<sup>6</sup> The list could go on, but those are my personal favorites. All are insights that could be made comprehensible to a first-year economics student and garner near consensus that, indeed, such is the way the world works.

Fred McChesney's theory of rent extraction is a similar insight. "The overriding lesson of the rent-extraction process," he writes, "is that politicians are interested in any stock of immobile capital or wealth from which they can extract a share."<sup>7</sup> Hyperbole comes cheap, of course, in book reviews, and only time will tell whether McChesney's scholarly contribution will enable him to attain *posnervana*. Even a quick inspection of *Money for Nothing* reveals that the implications of this compact book are broad and profound—not only for the

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1. See generally R.H. Coase, *The Nature of the Firm*, 4 *ECONOMICA* 386 (1937).

2. See generally R.H. Coase, *The Problem of Social Cost*, 3 *J.L. & ECON.* 1 (1960).

3. See generally Armen A. Alchian, *Cost*, in 3 *INTERNATIONAL ENCYCLOPEDIA OF THE SOCIAL SCIENCES* 404 (David L. Sills ed., 1968).

4. See generally WILLIAM J. BAUMOL ET AL., *CONTESTABLE MARKETS AND THE THEORY OF INDUSTRY STRUCTURE* (rev. ed. 1988).

5. See generally OLIVER E. WILLIAMSON, *THE ECONOMIC INSTITUTIONS OF CAPITALISM* 47 (1985); OLIVER E. WILLIAMSON, *MARKETS AND HIERARCHIES* 26 (1975).

6. See generally William M. Landes & Richard A. Posner, *Market Power in Antitrust Cases*, 94 *HARV. L. REV.* 937 (1981).

7. FRED S. MCCHESENEY, *MONEY FOR NOTHING: POLITICIANS, RENT EXTRACTION, AND POLITICAL EXTORTION* 122 (1997).

development of positive theories of regulation and public choice, but also for far-flung issues in administrative and constitutional law.

McChesney's central argument is that, to make accurate predictions of the actions of legislators and regulators, one must model those actors as self-interested parties who maximize their personal welfare by extracting from private citizens a portion of the wealth that those government officials forbear from expropriating altogether. In McChesney's model, the government is a ubiquitous pickpocket who perpetrates its larceny through the powers to tax and to regulate. But, as Posner noted long ago in a famous harbinger of McChesney's thesis, taxation by regulation is rampant, and may be the single most important attribute of regulation.<sup>8</sup> Viewed in the broad sweep of history—during which, it has been argued, invading armies invented taxation not as a means of supporting public works but as a more efficient alternative to the nasty business of repeatedly pillaging their conquered subjects<sup>9</sup>—rent extraction might be regarded as the ultimate refinement of the Genghis Khan school of public administration.

I wish to address the similarly rapacious use of the police power. For that reason, I take as the title of this Essay one of the most famous phrases ever deleted from a draft Supreme Court opinion—"the petty larceny of the police power"—a phrase coined by Justice Oliver Wendell Holmes in a 1922 takings case that offended his colleague on the Court.<sup>10</sup> In Part I of this Essay, I discuss McChesney's theory of rent extraction, note one disagreement that I have with his analysis, and suggest possible answers to several enigmas that he identifies. Part II applies McChesney's model of rent extraction to one current debate concerning the structure of government: the statutory line-item veto. Part III provides a glimpse of the potentially profound implication of McChesney's analysis for judicial review.

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8. See Richard A. Posner, *Taxation by Regulation*, 2 BELL J. ECON. & MGMT. SCI. 22 (1971).

9. See WILLIAM H. MCNEILL, *THE PURSUIT OF POWER* 106 (1982) ("[R]ulers and ruled had a common interest in substituting regular taxation for irregular plundering.").

10. See Letter from Oliver Wendell Holmes to Harold Laski (Oct. 22, 1922), in 1 HOLMES-LASKI LETTERS 457 (Mark DeWolfe Howe ed., 1953) ("[M]y brethren, as usual and as I expected, corrected my taste when I spoke of relying upon the petty larceny of the police power, dele[te] 'the petty larceny of.' It is done—our effort is to please."). Justice Holmes deleted the phrase from *Jackman v. Rosenbaum Co.*, 260 U.S. 22 (1922). See *id.* at 456. For an incisive discussion of Justice Holmes' analysis of takings at the time of his "petty larceny" remark, see Robert Brauneis, "The Foundation of Our 'Regulatory Takings' Jurisprudence": *The Myth and Meaning of Justice Holmes' Opinion in Pennsylvania Coal Co. v. Mahon*, 106 YALE L.J. 613 (1996).

## I

## MCCHESNEY'S THEORY OF RENT EXTRACTION

McChesney's book germinated from his classic article on rent extraction published in the *Journal of Legal Studies* in 1987,<sup>11</sup> one of the most influential articles in law and economics of the last decade. McChesney's book is a more explicitly economic companion to Richard Epstein's influential book on takings.<sup>12</sup> It is similarly ambitious in scope and similarly persuasive in its reasoning and explanatory power.

A. *McChesney's Basic Argument*

By the early 1970s, legal and economic scholars at the University of Chicago challenged the public interest theory of regulation, traceable to the Progressive Movement and the New Deal, which posited that regulation served the interests of consumers. According to Stigler, Becker, Peltzman, Posner, and other Chicagoans, regulation served the private interests of regulated firms by effecting a form of government-sponsored cartelization.<sup>13</sup> The function of regulation was to create economic rents (supracompetitive returns) that could not be earned in the absence of government-imposed restrictions on market entry. The modern theory of economic regulation asserted that government does not regulate platonically "in the public interest" but supplies regulation to interest groups who demand it and pay for it with political currency of one sort or another—be it votes, contributions, or public accolades. To the Chicago School, *rent creation* was thus the function of regulation. Within the Chicago School analysis of regulation, as well as in the Virginia School of public choice theory, *rent-seeking behavior* connotes the various activities that interest groups undertake to receive such income transfers through the legislative or regulatory process.<sup>14</sup>

Governmental rent creation has social costs. Creating or perpetuating economic rents by means of government intervention increases costs for those who buy the goods or services of the party earning the rents.

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11. See Fred S. McChesney, *Rent Extraction and Rent Creation in the Economic Theory of Regulation*, 16 J. LEGAL STUD. 101 (1987); see also Richard L. Doernberg & Fred S. McChesney, *On the Accelerating Rate and Decreasing Durability of Tax Reform*, 71 MINN. L. REV. 913, 926-27 (1987).

12. RICHARD A. EPSTEIN, *TAKINGS* (1985).

13. See Gary S. Becker, *A Theory of Competition Among Pressure Groups for Political Influence*, 98 Q.J. ECON. 371 (1983); Sam Peltzman, *Toward a More General Theory of Regulation*, 19 J.L. & ECON. 211 (1976); Richard A. Posner, *Theories of Economic Regulation*, 5 BELL J. ECON. & MGMT. SCI. 335 (1974); George J. Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MGMT. SCI. 3 (1971).

14. See generally JAMES M. BUCHANAN & GORDON TULLOCK, *THE CALCULUS OF CONSENT* (1962); DENNIS C. MUELLER, *PUBLIC CHOICE II* (1989); MANCUR OLSON, *THE LOGIC OF COLLECTIVE ACTION* (1965).

Thus, rent creation represents an implicit redistribution of income. It also entails a deadweight loss in allocative efficiency, which accrues to no one's benefit. Posner and others asked whether the potential beneficiaries of rent creation would, in their competition to receive government largess, spend so much on lobbying, litigation, and related activities that the transaction costs of rent seeking would dissipate the entire expected value of their rents. This would dramatically increase the social cost of monopoly beyond the conventional deadweight loss triangle that price theorists had long recognized.<sup>15</sup>

McChesney gives this body of scholarship a cold blast of fresh air. Regulation, he notes, can do more than create rents through an extra-legal form of exchange between the state and a private interest group. Regulation can also *extract* rents—either rents created through such government largess or rents created privately (such as through innovation).<sup>16</sup> McChesney writes:

In his pathbreaking article on rent creation via regulation, Stigler opined that creating new rents was the primary regulatory activity of politicians. That is, of course, an empirical claim for which no supporting evidence has been presented. Nor do I have any compelling evidence to the contrary. Yet despite the centrality of rent creation in the economic literature, there is good reason to think that selling wealth protection explains more of what is going on in the United States.<sup>17</sup>

Viewed in those terms, a major consequence of regulation may be to extract private rents. Typical forms of rent extraction are political threats to reduce prices or raise costs. The private firm that is the target of the threatened rent extraction faces an incentive to pay some form of consideration to politicians to prevent the imposition of the new regulatory regime. Political contributions are a principal way by which rents can be extracted, but other means include honoraria and in-kind gifts. A recent, vivid example is the proposal in Congress to require broadcasters to offer "free" air time to political candidates.<sup>18</sup> Although private threats to expropriate rents would likely be considered extortion, the government's threats to do so are not prohibited by law (save perhaps by the Takings Clause, discussed more below).

McChesney does not stop at theory. He surveys the scant empirical research on rent extraction and conducts his own econometric tests on

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15. See Richard A. Posner, *The Social Costs of Monopoly and Regulation*, 83 J. POL. ECON. 807 (1975); Gordon Tullock, *The Welfare Costs of Tariffs, Monopolies, and Theft*, 5 W. ECON. J. 224 (1967).

16. See McCHESNEY, *supra* note 7, at 23-32.

17. *Id.* at 164.

18. See LILLIAN R. BEVIER, *IS FREE TV FOR FEDERAL CANDIDATES CONSTITUTIONAL?* (1998).

the Clinton administration's unsuccessful health care initiative, which would have regulated pharmaceutical prices.<sup>19</sup> Using event-study methodology, he tests the hypothesis that the abnormal decline in a company's stock price upon the announcement of a policy to expropriate rents is not reversed, or not fully reversed, when the threat of expropriation subsides. That empirical result is consistent with the hypothesis that the company has experienced an extraction of some portion of its rents by politicians in return for their removal of the threat of full expropriation. McChesney concludes that, in the case of the Clinton health care initiative, rent extraction did occur:

The losses were incurred [by pharmaceutical companies] between the time of President Clinton's election and the Democrats' announcement in September 1994 that plans for health-care legislation were being dropped for the moment. It is particularly interesting that the November 1994 Republican electoral victory did not restore to pharmaceutical firms the wealth they had lost. In the end, the threatened firms had paid good money for nothing: their wealth was diminished, and no legislation was passed.<sup>20</sup>

A ripe topic for empirical research would be to apply McChesney's same event-study methodology to other instances in which legislative or regulatory bluster is followed by apparent inaction.

### *B. Is It Efficient to Contract with Legislators for Rent Preservation?*

McChesney's model of rent extraction is less satisfying when he argues that it is efficient, in terms of minimizing the private party's extraction of private rents, to have durability of contract with the legislators doing the extracting.<sup>21</sup> Such durability may permit "greater certainty about the future [that] facilitates private planning" and "reduce[] deadweight transaction costs of dickering between politicians and private parties."<sup>22</sup> But McChesney's conjecture on contract durability and rent preservation invites two responses.

First, the conjecture is consistent with the criticism that the current regulation of campaign spending promotes incumbents.<sup>23</sup> This point is not, strictly speaking, a rebuttal of McChesney's argument that it is wealth-maximizing for a private firm to achieve a long-term equilibrium level of rent extraction with politicians that it can trust. Rather, it is an argument that a private firm's rational wealth-preservation response to

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19. See McCHESNEY, *supra* note 7, at 69-85.

20. *Id.* at 78.

21. See *id.* at 86-106.

22. *Id.* at 88.

23. See Michael W. McConnell, *A Constitutional Campaign Finance Plan*, WALL ST. J., Dec. 11, 1997, at A22.

rent extraction might have the external effect of making elected offices less contestable. Whether one regards that state of affairs as a positive or negative externality will likely depend, in turn, on how one views term limits, recall votes, impeachment, and other devices for encouraging turnover of elected officials.

Second, and more directly responsive to McChesney's conjecture on durability of contract, the prisoners' dilemma that he uses to model the firm's optimal response to rent extraction may not be representative of important categories of cases.<sup>24</sup> Why, for example, would it not be a superior strategy for a firm to "just say no" to politicians' demands for rent extraction? Is it really so clear that, if their bluff were called, politicians or regulators could succeed in responding with full expropriation? The Federal Communications Commission (FCC), for example, issued rules following enactment of the Telecommunications Act of 1996<sup>25</sup> that attempted to set prices for unbundled access to the networks of incumbent local exchange carriers (ILECs).<sup>26</sup> The ILECs believed that the prices were confiscatory, both as a matter of economic theory and as a matter of takings jurisprudence. They convinced the U.S. Court of Appeals for the Eighth Circuit to stay,<sup>27</sup> and ultimately vacate,<sup>28</sup> the FCC's pricing rules on jurisdictional grounds.

The experience of the FCC's pricing rules on unbundled access to the ILEC network underscores an important point that affects the relative magnitudes of the payoff matrix that McChesney uses to describe the private firm's choice between submitting to the payment of rent extraction or defending itself against the threat of full-scale rent expropriation. The latter threat must be discounted by its probability of withstanding judicial scrutiny. The availability of judicial review (under any standard of scrutiny) reduces the probability that a politician's threat of expropriation will succeed. For purposes of the prisoners' dilemma matrix that McChesney presents, judicial review reduces the expected cost to the private firm of the expropriation threat. At some point, the expected cost of expropriation falls to the expected cost of extraction. Of course, for the private firm to reduce, through litigation, the probability that a threat of expropriation will succeed is not costless. The

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24. See McCHESNEY, *supra* note 7, at 38-39, 97-100.

25. Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56.

26. See Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, 11 F.C.C.R. 15,499 (1996) (first report and order); see also J. Gregory Sidak & Daniel F. Spulber, *Givings, Takings, and the Fallacy of Forward-Looking Costs*, 72 N.Y.U. L. REV. 1068 (1997); J. Gregory Sidak & Daniel F. Spulber, *The Tragedy of the Telecommons: Government Pricing of Unbundled Network Elements Under the Telecommunications Act of 1996*, 97 COLUM. L. REV. 1081 (1997).

27. See *Iowa Utils. Bd. v. FCC*, 109 F.3d 418 (8th Cir. 1996).

28. See *Iowa Utils. Bd. v. FCC*, 120 F.3d 753 (8th Cir. 1997), *cert. granted sub nom. AT&T v. Iowa Utils. Bd.*, 118 S. Ct. 879 (1998).

relevant comparison becomes one between the expected cost of extraction and the expected *net* cost of expropriation.

As these comments suggest, my own predilection is that strategic use of litigation is more likely to protect private property from rent extraction than is capitulation aimed at producing a seemingly durable contract with politicians. The efficacy of litigation will depend, of course, on the scope and content of judicial review, which Part III will discuss.

### *C. Answering the Enigmas of Rent Extraction*

McChesney's final chapter explores a series of questions concerning rent extraction that he concedes his model does not answer. They are good questions, worthy of serious research. I offer here some conjectures on possible answers to those enigmas.

#### *1. The Victims of Rent Extraction*

McChesney says that the rent extraction model does not explain "why some groups' rent gets extracted while others do not."<sup>29</sup> This observation seems less puzzling than McChesney suggests. If the poor, by definition, had no money, theorizing why Robin Hood stole from the rich is not difficult. Similarly, the state cannot credibly threaten to expropriate economic rents that do not exist. As McChesney notes, the suitability of a firm for politicians' rent-extraction purposes depends on the relevant elasticities of demand and supply.<sup>30</sup> And so, in a perverse sense, one might at least say that, in static terms, the targeting of rent extraction tends to minimize its deadweight loss by simulating the Ramsey pricing or inverse-elasticity pricing of a multi-product firm (or a multi-tax jurisdiction).

How do these observations translate into actual predictions? "New industries (firms) have relatively little capital; therefore, little extraction is to be expected, since there is little to extract."<sup>31</sup> But a firm such as Microsoft has created substantial private rents. Those rents have become a target for antitrust prosecutions that have been based on novel (and nonfalsifiable) economic theories and urged upon the Department of Justice by Microsoft's competitors, at least some of which actively supported the election and re-election of the nation's highest law enforcement officer, President Clinton.<sup>32</sup> One possible predictor of the victims

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29. McCHESNEY, *supra* note 7, at 159.

30. *See id.* at 160.

31. *Id.*

32. In December 1997, one columnist speculated on how Richard Nixon would have terminated the Clinton administration's prosecution of Microsoft:

Nature had admirably outfitted Mr. Nixon with a suspicious and distrusting mind, which would have alerted him to a bureaucracy run amok on the personal agendas of its



of rent extraction, therefore, is success in an innovative industry. Rent extractors are drawn to the private creation of wealth like iron filings to a magnet.

## 2. *Why Auction Losers Pay*

McChesney wonders "why is it routinely observed that both sides to a political (rent-transfer) issue pay, when only one will win?"<sup>33</sup> Citing the example of federal product-liability legislation, McChesney observes that "every year the debate—and the payments from both sides—begins anew."<sup>34</sup> Then, he asks, "Why is the issue simply not resolved once and for all, and why are both sides paying when only one side is winning (no legislation has ever been passed)?"<sup>35</sup>

One possible explanation relates to intermediation and agency costs. Companies that would be affected by federal product-liability legislation or similar initiatives typically retain outside law firms and lobbyists. Agency costs may arise. An established Washington law firm or lobbying firm has substantial investments in its relationships with members of Congress, their staffs, and regulators. In a sense, Washington lawyers and lobbyists are intermediaries who simultaneously serve two clients: the firm that retained them and the government officials before whom those lawyers and lobbyists repeatedly appear. The desire of the lawyer or lobbyist to push hard for her formal client is thus compromised by the desire to stay in the good graces of government officials before whom the lawyer or lobbyist will appear again on another day for another client. In addition, the demand for the services of these intermediaries diminishes sharply if the policy debate is ever finally resolved, as do the fund-raising opportunities for politicians.

## 3. *The Returns from Rent Extraction*

McChesney is puzzled why the returns from rent extraction appear to be so small relative to the amount of economic rent that politicians threaten with expropriation. If one thinks of rent extraction as an ad valorem tax, and expropriation as a one hundred percent ad valorem

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functionaries. With a few well chosen expletives over the phone he would have called off an adventure as speculative and irresponsible as the assault on Microsoft. In doing so he would have earned the gratitude of his nation and all the campaign contributions that Microsoft's lobbyists could stuff into his pockets. He would have understood exactly what the assault is really all about.

Holman W. Jenkins, Jr., *At Least at Microsoft, Someone's in Charge*, WALL ST. J., Dec. 24, 1997, at A11. For a critical assessment of the economic reasoning supposedly propelling the government's Microsoft prosecutions, see J. Gregory Sidak, *Antitrust and the Federal Software Commission*, JOBS & CAPITAL, Winter 1997, at 18.

33. McCHESNEY, *supra* note 7, at 162.

34. *Id.*

35. *Id.*

tax, why do politicians settle for such low tax rates when extracting rents? There are at least three possible answers.

First, politicians may, in fact, be receiving a higher ad valorem tax than initially appears. Again, McChesney does not consider the role of intermediaries, such as lawyers and lobbyists, in the rent extraction game. A powerful member of Congress may receive contributions not only from the political action committee of a corporation threatened with rent expropriation, but also from partners in the law firms and lobbying firms that represent that corporation before Congress and regulatory bodies. This possibility suggested itself to me in 1997, when a Washington lobbyist representing a foreign company (which cannot make political contributions of any magnitude to members of Congress) told me that he personally was one of Senator X's biggest fund-raisers. The lobbyist's clients that *were* American companies made sure to contribute generously to Senator X, even if the foreign company could not. Thus, the presence of intermediation in the market for political favors creates the potential for a wide range of side agreements that can boost the actual returns to politicians from rent extraction.

The second possibility is that the optimal tax rate for rent extraction is an interior solution rather than a corner solution. Rent extraction works best if it is not widely detected. The magnitude of the extraction tax rate, however, may increase the probability of detection; and detection may carry with it substantial private costs to the rent extractor.<sup>36</sup> A rent extractor maximizes his returns by constraining his piggish propensities below their full porcine potential.<sup>37</sup> In late 1997, for example, a subsidy to wire schools and libraries to the Internet that had been slipped into the Telecommunications Act of 1996<sup>38</sup> was revealed by a *Washington Post* columnist to be a hidden tax (on telecommunications carriers) sponsored by Senator Stevens of Alaska, a tax running into the billions of dollars.<sup>39</sup> Rush Limbaugh picked up the story and relayed it to millions listening to talk radio.<sup>40</sup> The controversy forced Congress to

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36. For an analogous model that specifies the probability of detection of price fixing to be an increasing function of the percentage markup over marginal cost, see Michael Kent Block et al., *The Deterrent Effect of Antitrust Enforcement*, 89 J. POL. ECON. 429 (1981).

37. This point is analogous to my conjecture with Thomas A. Smith that politicians seek to maximize *unaccountable* power. See J. Gregory Sidak & Thomas A. Smith, *Why Did President Bush Repudiate the "Inherent" Line-Item Veto?*, 9 J.L. & POL. 39 (1992); see also J. Gregory Sidak & Thomas A. Smith, *Four Faces of the Item Veto: A Reply to Tribe and Kurland*, 84 Nw. U. L. REV. 437 (1990).

38. Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56.

39. See James K. Glassman, *A New Tax for the New Year*, WASH. POST, Dec. 2, 1997, at A27.

40. See Interview with James K. Glassman, Columnist, *Wash. Post*, in Washington, D.C. (Dec. 12, 1997).

hold hearings, and it even provided a campaign issue for a candidate challenging an incumbent senator who had supported the tax.<sup>41</sup>

Third, the expected value associated with the cost of expropriation (net of litigation costs) caps the amount that politicians can extract from a private firm. As noted above, although expropriation is a dire outcome, the probability of its surviving judicial review, or of its being politically feasible to impose, may be low. Thus, the low extraction tax rate that McChesney discusses may simply reflect the low ceiling imposed by a not-very-credible threat that politicians could succeed in expropriating the private rents at issue.

## II

### THE LINE-ITEM VETO

The ability to extract rent with impunity is a valuable privilege. One would predict that rent extractors would jealously defend that privilege against potential usurpers. Viewed in such terms, many controversies in constitutional law that traditionally play out as arid debates over the separation of power or federal preemption of state authority have direct implications for a model of rent extraction. The manner in which Congress and the President jockey for the privilege to create and extract rents comes into sharp relief with the Line Item Veto Act,<sup>42</sup> which President Clinton has used repeatedly since August 1997.<sup>43</sup> Rent creation and rent extraction may thus give rise to separation-of-powers disputes that will doubtless be argued before the Supreme Court with greater solemnity than McChesney's theory might suggest is justified.

The line-item veto can affect rent extraction in at least two ways, both of which dilute the ability of members of Congress to extract rent. First, the line-item veto enables the President to protect citizens from congressional threats to expropriate private rents. To the extent that such threats are contained in severable provisions that can be vetoed in

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41. See Interview with James K. Glassman, Columnist, *Wash. Post*, in Washington, D.C. (Feb. 24, 1998).

42. 2 U.S.C. § 691 (1997); see also *Raines v. Byrd*, 117 S. Ct. 2312 (1997). The Line Item Veto Act was declared unconstitutional in *City of New York v. Clinton*, 985 F. Supp. 168 (D.D.C. 1998), cert. granted, 66 U.S.L.W. 3571 (U.S. Mar. 3, 1998) (No. 97-1374).

43. See Statement on Line Item Vetoes of the Energy and Water Development Appropriations Act, 1998, 33 WEEKLY COMP. PRES. DOC. 1607 (Oct. 17, 1997) ("Today marks the sixth time I have used my line item veto authority to save the taxpayers money by canceling unjustified, special interest provisions."); Statement on a Line Item Veto of the Treasury and General Government Appropriations Act, 1998, 33 WEEKLY COMP. PRES. DOC. 1593 (Oct. 16, 1997); Statement on Line Item Vetoes of the Department of Defense Appropriations Act, 1998, 33 WEEKLY COMP. PRES. DOC. 1582 (Oct. 14, 1997); Remarks on Signing Line Item Vetoes of the Military Construction Appropriations Act, 1998, and an Exchange With Reporters, 33 WEEKLY COMP. PRES. DOC. 1501 (Oct. 6, 1997); Remarks on Line Item Vetoes of the Balanced Budget Act of 1997 and the Taxpayer Relief Act of 1997 and an Exchange With Reporters, 33 WEEKLY COMP. PRES. DOC. 1225 (Aug. 11, 1997).

an itemized fashion, the President can preserve private rents that Congress would have expropriated. The President and his political party, of course, are presumably amenable to accepting political contributions from grateful citizens whose private rents have been rescued through the exercise of a line-item veto. In such a situation, the locus of rent extraction shifts from Congress to the White House.

The locus may even shift to private individuals who have influence with the President. In a January 1998 article on Washington's most influential lobbyists, *Washingtonian* magazine wrote about Vernon Jordan of Akin, Gump, Strauss, Hauer & Field:

The line-item veto has changed everything in Washington. And one thing is for sure: It has made presidential buddy Vernon Jordan more powerful than ever. Now, you won't find Jordan's name on any lobby registrations of the kind most lobbyists have to file under the Lobbying Disclosure Act of 1995. Jordan doesn't even acknowledge that he is a lobbyist. Colleagues aren't exactly sure what it is that Jordan does to bring in the hundreds of thousands of dollars in corporate retainers he draws for the firm, but they suspect that the long hours he spends in the presidential golf cart don't count against him. Beyond that, Jordan sits on more corporate boards, which ordinarily pay about \$20,000 to \$25,000 per meeting—and meet as often as four times a year—than any other private attorney in America. He helps direct JC Penney, Union Carbide, Sara Lee, Ryder Systems, and Xerox; earlier this year he joined the board of Callaway Golf, making him truly the Big Bertha of Washington lobbyists.<sup>44</sup>

Again, this passage suggests the importance of intermediaries, such as Washington lawyers and lobbyists, in the rent extraction process.

Second, the line-item veto gives the President the ability to extract a portion of *public* rents created by Congress. On October 6, 1997, President Clinton used the line-item veto to kill thirty-eight projects in a military construction bill.<sup>45</sup> He characterized the vetoed projects as pork barrel spending. Yet, in his remarks upon exercising his item veto that day, President Clinton indicated that the vetoed projects were not necessarily dead forever:

I want to stress that I have retained most of the projects that were added by Congress to my own spending request. Congress plays a vital role in this process, and its judgment is entitled to respect and deference. Many of the projects I have chosen to cancel

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44. Kim I. Eisler, *Show Me the Money*, WASHINGTONIAN, Jan. 1998, at 78, 170.

45. See James Bennet, *Clinton Vetoes Construction Items in Military Bill*, N.Y. TIMES, Oct. 7, 1997, at A1.

have merit, but should be considered in the future. This is simply the wrong time.<sup>46</sup>

President Clinton's statement could be interpreted as an offer to approve the very same items of pork barrel spending in the future.<sup>47</sup> If so interpreted, his remarks would signal that recipients of public rents created through pork barrel spending must apportion some share of those rents to the President as well as to the responsible members of Congress. Because any government policy can create only a finite amount of economic rent, the practical effect of the line-item veto is to force Congress to share the proceeds of rent extraction with the President.

Why would Congress do such a thing? The answer may lie in party politics. A Republican Congress might enact such legislation in the belief that, if the past forty years are any indication of the future, Republicans are more likely to hold the presidency and less likely to hold Congress. Thus, on balance, the line-item veto would shift rent-extraction proceeds from Democrats to Republicans.

Do these conjectures, if correct, imply that the line-item veto is bad? Not necessarily. Rather, they suggest that the line-item veto, like any form of government action, cannot be viewed through rose-colored glasses. Even this element of fiscal "reform" is susceptible to being used to advance an agenda of extraction of economic rents created by either public or private means. In short, the overlay of rent extraction provides a new insight into the debate over whether a statute or constitutional amendment is the preferable means to confer a line-item veto power on the President.<sup>48</sup> If the line-item veto is strictly a creature of statute, then Congress can deny the President that prerogative in any given case. In that respect, Congress can increase the credibility of any given political deal for the public creation of rents or the threatened expropriation of privately created rents. Thus, it may be that opposition to the line-item veto, particularly opposition to proposals to confer it on the President by constitutional amendment, results as much from the desire to continue a McChesnian process of political extortion as the desire to continue doling out pork-barrel spending.

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46. Remarks on Signing Line Item Vetoes of the Military Construction Appropriations Act, 1998, and an Exchange With Reporters, *supra* note 43.

47. On December 19, 1997, President Clinton announced that he lacked legal authority when he used his line-item veto power on a provision that would enable government workers to switch their pension systems in a manner that could increase their retirement incomes. See Stephen Barr & Joan Biskupic, *Clinton Recants on Item Veto of Pension Switch*, WASH. POST, Dec. 20, 1997, at A1.

48. See J. Gregory Sidak, *The Line-Item Veto Amendment*, 80 CORNELL L. REV. 1498 (1995).

### III JUDICIAL REVIEW

McChesney concludes that "recognition of the ubiquity of rent extraction (over time and over space) should also begin to raise questions outside the confines of what is traditionally thought of as 'regulation.'"<sup>49</sup> He cites as examples the state's interest in the continuing illegality of victimless crime (particularly with respect to the boon to law enforcement budgets from seized assets), the relationship between enforcement of laws against theft and the ability of politicians to extract wealth, and the relationship between politicians' behavior and their special interest constituencies.<sup>50</sup>

To that list, one can add a topic having monumental implications. If one accepts McChesney's thesis that rent extraction is endemic to the legislative and regulatory processes, then the Supreme Court must reconsider the function and scope of judicial review from the ground up. If the extraction of privately created rent is an illegitimate purpose of legislation or regulation, then, as applied, any statute or regulation that produces such extraction should evoke the most demanding level of judicial scrutiny under the Due Process and Takings Clauses—if, indeed, the statute or regulation is not presumed to be unconstitutional *ab initio*.

Needless to say, such a reorientation of judicial review would fundamentally change the way the judiciary and constitutional scholars view the role of courts. Conservatives would holler about judicial activism; liberals would holler about the reincarnation of substantive due process. For those who would favor such a revision in judicial review, it is discouraging that the Court has repeatedly countenanced public rent creation—as long as it was properly dressed in the formal attire of state action. Since the notorious case of the California raisin cartel given state-action immunity from the federal antitrust laws in *Parker v. Brown*,<sup>51</sup> the state or federal government has been permitted to confer a statutory gratuity on a firm. In the half century since *Parker*, the Court has repeatedly permitted a governmental body to use its regulatory prerogatives to cartelize an industry and shield private firms from the antitrust liability that would otherwise arise from such horizontal coordination on decisions concerning pricing and output.<sup>52</sup> In 1991, the Court was asked to remove antitrust immunity from state-managed

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49. McCHESNEY, *supra* note 7, at 165.

50. *See id.* at 165-68.

51. 317 U.S. 341 (1943).

52. *See, e.g.*, *FTC v. Ticor Title Ins. Co.*, 504 U.S. 621 (1992); *City of Columbia v. Omni Outdoor Adver., Inc.*, 499 U.S. 365 (1991); *324 Liquor Corp. v. Duffy*, 479 U.S. 335 (1987); *Southern Motor Carriers Rate Conf. v. United States*, 471 U.S. 48 (1985); *Hoover v. Ronwin*, 466 U.S. 558 (1984); *California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc.*, 445 U.S. 97 (1980); *Bates v. State Bar of Ariz.*, 433 U.S. 350 (1977).

restraints of trade in cases in which the state action creating those restraints resulted from a conspiracy against consumers or competitors into which public officials and private actors had entered. Justice Antonin Scalia, writing for the Court in *City of Columbia v. Omni Outdoor Advertising, Inc.*, refused to extend the antitrust laws to reach such conduct:

Few governmental actions are immune from the charge that they are "not in the public interest" or in some sense "corrupt." The California marketing scheme at issue in *Parker* itself, for example, can readily be viewed as the result of a "conspiracy" to put the "private" interest of the State's raisin growers above the "public" interest of the State's consumers. The fact is that virtually all regulation benefits some segments of the society and harms others; and that it is not universally considered contrary to the public good if the net economic loss to the losers exceeds the net economic gain to the winners.<sup>53</sup>

In Justice Scalia's view, pork is as American as apple pie. But would this judicial refusal to upset rent creation legislation extend to political extortion of privately created rents? McChesney's model makes clear the illegitimacy of that legislative purpose, and the political extortion of private rents may offend the sensibilities even of those who do not find the public creation of rents objectionable. But it is anyone's guess whether the Court will ever muster the courage and candor to face down the political extortion that McChesney theorizes is ubiquitous.

McChesney's notion of rent extraction dovetails with the idea, rooted in Holmes' opinion in *Pennsylvania Coal Co. v. Mahon*,<sup>54</sup> issued two months after his "petty larceny of the police power" faux pas, that little takings should go uncompensated. "Government hardly could go on," wrote Holmes, "if to some extent values incident to property could not be diminished without paying for every such change in the general law."<sup>55</sup> This principle may be simply an unprincipled "gimme"—a mulligan elevated to constitutional dignity on the verdant fairway of political economy. Or one can construct a transactions cost rationale, as Daniel Spulber and I have done, that the cost of compensating property owners for the state's lesser transgressions is prohibitively high relative to the compensation that would be forthcoming.<sup>56</sup>

McChesney's theory provides yet another rationale for this rule of no compensation, one less innocuous than the transactions-cost rationale: If the legislature is immune under takings jurisprudence for little

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53. *Omni Outdoor Adver., Inc.*, 499 U.S. at 377.

54. 260 U.S. 393 (1922).

55. *Id.* at 413.

56. See J. GREGORY SIDAK & DANIEL F. SPULBER, DEREGULATORY TAKINGS AND THE REGULATORY CONTRACT 217, 223 (1997).

acts of larceny, then the market for rent extraction payments becomes, as they say at the Pentagon, a target-rich environment. The laxity of takings jurisprudence thus would make the judiciary complicit in the extraction of rents effected by legislators or regulators. What presumably makes Holmes' petty larceny of the police power petty rather than grand is that its perpetrator is satisfied with absconding with only a slice of the pie rather than the whole dish. But in McChesney's model of rent extraction the rent extractor is a repeat offender who absconds with a modest slice of *many* pies, such that the cumulative disincentive to investment in specialized assets vulnerable to rent extraction could be substantial. That concern should find some traction even in the *least* protective category of takings decisions, which turn on the analysis of "investment-backed expectations."<sup>57</sup>

As suggested earlier, what is needed is an approach to judicial review that dissolves the credibility of the politician's threat to expropriate. As McChesney observes, however, there may be no more effective legal constraint on Congress when it threatens expropriation through its exercise of the taxing power than when it threatens to do so through the exercise of the police power.<sup>58</sup> Nonetheless, the popular political constraint may be effective: Politicians may threaten to tax away privately created rents, but to do so, they must be willing to enact new taxes or raise existing ones. Such actions would increase their chances of being defeated for reelection by a challenger who promised instead to vote for tax cuts.

There is, of course, a certain problem of justiciability. As Richard Epstein notes in his dust-jacket commentary on *Money for Nothing*, McChesney's episodes of rent extraction are the dogs that didn't bark in the night. By definition, they are the instances in which the private firm capitulated to demands for the payment of tribute. In those cases, a court has nothing to review. An agreement exists (albeit one procured under duress), but no lawsuit. Rather, in the rarer cases of challenges to outright expropriation, courts would be asked to review the action of legislators and regulators. This selection bias suggests that a worldly-wise jurist, such as Justice Scalia speaking for the Court in the passage from *Omni Outdoor Advertising* quoted above, should approach an allegation of expropriation with the presumption that it was the outcome of a political process in which the private firm rejected the alternative course of submitting to rent extraction.

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57. See *id.* at 219, 224-26.

58. See McCHESNEY, *supra* note 7, at 86-87.



## CONCLUSION

McChesney's *Money for Nothing* is a provocative, important book. It is an unflattering portrayal of the sophisticated regulatory state and a model for analyzing regulation and taxation that greatly extends the explanatory power of its predecessors. If McChesney's theory of rent extraction can be substantiated, as anecdotal experience and early empirical research suggest that it can, it should require the courts to reexamine the appropriate scrutiny for them to bring to cases in which private parties claim that the regulatory state has extracted or expropriated private wealth.