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The Rules of the Game*

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Abstract: The success or failure of economic actors depends on a variety of factors, which I sort into three groups: attitudes and values, endowments, and rules. Of these three, we only fully control for factors in the first group. Factors in the other two groups are determined by luck, though through individual effort we may enhance them, particularly endowments such as talent or inherited resources. As individuals, most of us have no or very little influence on rules. Rules depend on power, and most people exercise power only indirectly as members of a group or groups. In this address, I focus on the rules, which also means that I focus on power, a neglected topic in economic development, and in modern economics in general.

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JEL Codes: A13, D02, D30, D40, D63

1. INTRODUCTION

Whenever people come together in organized activities, they develop informal and formal rules. We observe this even among groups of children at play and, of course, in families, schools, businesses, and governments and administrations. In this article, we use "rules" as a summary term that includes laws, regulations, standards and codes of conduct, customs, etc. We are so accustomed to established rules that we rarely challenge them or ask "Who makes the rules?", though asking this question would lead to follow-up questions about the rule-making and rule-approval processes. One does not have to be cynical to believe that those who get to make and/or approve rules stand a better chance of having their interests represented, recognized, and protected than those left out of the process (Rothstein, 2017).

A major part of the policy research we conduct deals with economic development. Some forty years ago, Molotch (1976) in "The City as a Growth Machine" described local development efforts as serving economic interests of a land-based elite. Compatible with Molotch's hypothesis, Swindell and Rosentraub (1998) find that the benefits of public investments into professional sports facilities accrue to team owners, professional athletes, and fans, but not the public. They

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conclude that if local governments invest in such facilities at all, funding should come from special user fees or tax districts, and not from general revenue sources (see also Noll and Zimbalist (2011)). Although sports facilities are usually local, special interests are equally likely to influence policy-making at the regional, state, and even national levels.

The questions about rule-making are questions about the distribution of costs and benefits of public decisions, which are ethical issues. Unfortunately, modern economics, which influences much of our thinking about economic policy, has neglected ethics. A prominent critic writes: "I would argue that the nature of modern economics has been substantially impoverished by the distance that has grown between economics and ethics" (Sen, 1987, p. 7). In this address, I explain why I believe that we should pay more attention to ethical issues in regional economic development research than is currently the case, and I focus on rules broadly understood. Before we engage in this discussion, however, we need to briefly examine determinants of success or failure.

2. DETERMINANTS OF SUCCESS OR FAILURE

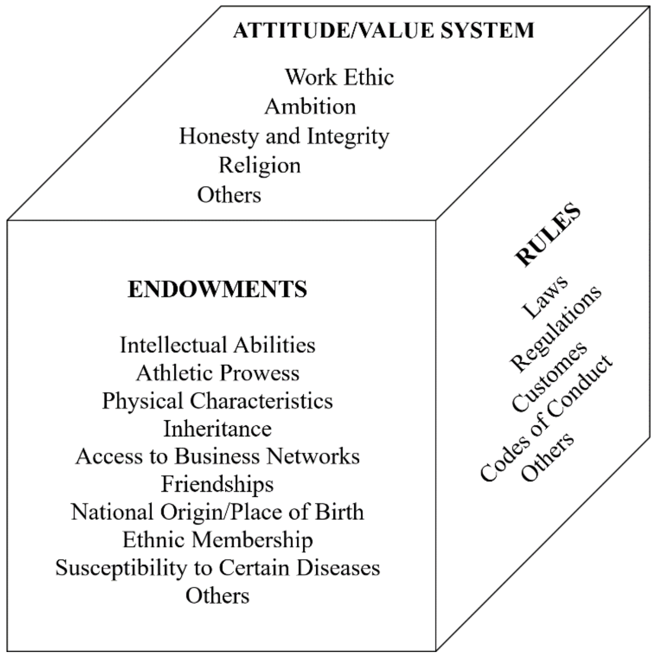
There are several explanations for the success of some and the failure of others. Talent is a widely acknowledged factor that is particularly obvious in elite sports, but applies to other activities, as well. Talent is an endowment. Other examples of endowments that we receive without working for them are financial assets and access to social and business networks owed to family or friends. I also include place of birth because it can determine what opportunities are readily available. The point is that endowments make for uneven starting conditions for individuals.

However, endowments do not guarantee success, they only create more or less favorable conditions. Even the talented must develop and hone their skills through education and practice to capitalize on their endowments, and a person who inherits great wealth can lose it through poor decisions. These latter types of success factors are usually referred to as attitudes and values. Among them, ambition and work ethic are particularly important for achieving success.

Endowments are a matter of luck, rather than merit. On the other hand, attitudes instilled in us by family, schools, church, and others involved in our upbringing (and, therefore, in a way "inherited," too), are, nevertheless, ours to maintain and develop further. Attitudes and endowments can work together. For example, a good work ethic may allow an individual to develop the potential of favorable endowments. In fact, it is not always clear what is more important: endowments or attitudes and values, and it is not even clear that all endowments are nature and not nurture. Since, for my purposes, in this address, the distinction between nature and nurture does not matter, I will not refer to it again.

Housing and Urban Development Secretary Ben Carson points to attitudes as the most relevant factor determining success or failure: "You take somebody that has the right mindset, you can take everything from them and put them on the street, and I guarantee in a little while they'll be right back up there…. You take somebody with the wrong mindset, you can give them everything in the world—they'll work their way right back down to the bottom" (Bridges, 2017). However, it was only in 1966 that the first African American physician was granted admitting privileges at Johns Hopkins Hospital (John Hopkins University, 2004), the place where Dr. Carson (born in 1951) started his outstanding career as a surgeon a few years later. Had he been born only a few decades earlier, not even the right mindset might have overcome the limitations then imposed on African Americans. Because historically African Americans had minimal influence on the

Figure 1: Determinants of Success



rule-making process, legislation and regulations were often biased against them. This is why knowing who is part of making and enforcing rules so often explains who benefits and who is harmed. Figure 1 summarizes the three categories of determinants of success we have identified.

3. THE RULES OF THE GAME

Many factors determine a person's level of success, including luck, but Dr. Ben Carson is also right; attitude can also explain differences in outcomes. However, rarely does one factor alone determine everything. The purpose of this address is to highlight the role of rules by which, as already mentioned, we mean laws, regulations, customs, codes of conduct, habits, standards, and anything else that influences behaviors by providing incentives and sanctions.

It takes power to make rules that are accepted and followed. The necessary power can come from a variety of sources. In the case of governments, they have police and enforcement powers. Employers have economic power, and some individuals have the power of prestige based on their accomplishments, wealth, or ability to persuade. The majority of people, however, have too little power individually to make or shape rules and enforce them beyond immediate family and friends. They only have such power through collective action, for example as members of interest groups.

Economists do not very often talk comprehensively about power and its sources and then mostly in narrow contexts, such as when they discuss monopoly power or market power in general. Political science, which overlaps with economics, has made the study of political institutions and their power its focus, and there are a few well-known economists who work in both disciplines. When political power is stable, a narrow focus is not a problem, but in our times of the erosion of the power of unions and labor, ignoring power results in incomplete analyses and understanding.

Olson (1971) understood that large groups find it more challenging to consistently rally their members behind common goals and strategies than small groups. The probability of the discovery of violations by members of agreed upon norms and behaviors declines with membership size. In the case of diverse and geographically large groups, cheating is even less likely to be detected. There is, therefore, a potential imbalance of power in favor of small and well-funded special interest groups relative to large groups representing the interests of many. In the case of labor, right-to-work laws that are now in force in more than half of all U.S. states add an additional burden to organizing employees. When unions cannot exclude non-members from benefitting from their efforts and are not allowed to charge them anything, dues-paying members get the same benefits as free-riders, which is a disincentive to paid membership (Feigenbaum, Hertel-Fernandez, and Williamson, 2018).

My concern that employees have little influence on policy-making started early in my career. In Schaeffer (1987), I commented on the importance of including labor – by which I mean individuals who are not in top management, self-employed, or members of the armed forces – in economic development policy decisions. When the voice of labor is absent when laws are drafted and important decisions prepared, their interests are unlikely to receive a fair hearing. Since the 1980s, labor representatives have lost ground, while corporations have benefitted from several U.S. Supreme Court decisions, for example with respect to campaign contributions, and several important industries have become more concentrated (Krueger and Posner, 2018; Posner and Weyl, 2018; Shambaugh, et al., 2018). It is worth noting that the last time a labor representative held the position of Secretary of Labor was during President Ford's administration, which ended in January 1977. The lack of employee representatives in the administration is glaring in comparison with the many business executives serving in important positions. Therefore, the most serious concern related to the decline of unions is not stagnant wages but loss of political power, which diminishes not only the ability to negotiate wages but other labor conditions as well, and the content of trade agreements.

There are a number of changes that demonstrate the shift of power away from labor to corporate interests. One very recent change is the May 2018 Supreme Court decision that allows employers to impose mandatory arbitration on their labor force. This can be viewed as privatizing part of the justice system for employees and favors corporations as employees under such an agreement cannot bring class action suits (Stohr, 2018). The use of non-poaching agreements has also received attention when the Justice Department settled with several high-tech corporations, including Google, Apple, and Intuit, who had colluded not to compete for highly skilled employees already employed by one of these companies (U.S. Department of Justice, 2010). What is also noteworthy in this case is the lack of accountability of the individuals who initiated the non-compete agreements.

Nondisclosure agreements, which are legal, are another tool for establishing "rules of the game" that work to the disadvantage of employees. Such agreements have the potential of perpetuating hostile work conditions (Chen, 2017). Furthermore, they are an obstacle to job and employment mobility as similar jobs within commuting distance of a worker's present job may be off-limits for several years. This can depress wage rates and slow down career advancement (Dougherty, 2017).

4. SUMMARY AND DISCUSSION

The point of my comments is to remind us that the economic system is not natural but a human creation. The rules are made by the participants, but not all of them have the same power to make and enforce rules. When power shifts in favor of a particular group, rules that favor that group will follow. As long as no single interest group becomes dominant, this poses no or only minor problems. Over the last few decades, however, the power of labor interests has diminished to the point where they are no longer – in the language of J.K. Galbraith – an effective "countervailing power," and Kesting (2005) comments on the absence of a discussion of power in economics in recent decades.

The neglect of power in economics has consequences. What we do not study and analyze does not enter into our policy recommendations. Instead, many economists warn of government intervention into the economy, which is taught to students as perfect and resulting in Pareto optimal outcomes. Even if this were so, there is still the question of how the starting distribution underlying the outcome was obtained, but more importantly, the system is not perfect (Schaeffer, 2009). It has always puzzled me how many of my fellow economists are confident that natural systems are resilient enough to deal with often dramatic interventions but see the man-made economy as relatively fragile and unable to fully recover from government interventions.

To counter such an attitude, let us acknowledge that imperfections are the norm (Schaeffer, 2009). In fact, one imperfection is widely acknowledged as important to the success of modern economies. This imperfection is the limit of the amount of the shareholders' liability if a corporation fails. If the corporation's assets are smaller than its liabilities, creditors and others who had no role in managing the corporation nonetheless have to absorb some of the costs its actions caused. This is the classical definition of a negative externality, which is supposed to harm the economy, but there is no call for abolishing provisions in corporate law that limit liability, in spite of a few critical voices (Ireland, 2010).

Our success owes much to our efforts and our failure often reflects lack of effort and determination. However, success also owes much to luck, namely that of the family we are born into, the country, or even region within a country, where we are born, and the rules of the game which may favor or disfavor us.

A society where many are diligent and work hard, but cannot succeed, will experience stress and discord. A just society need not guarantee success, much less equal outcomes, but hard work must have a high probability of resulting in a good life. If we need to intervene in the economy to change the rules to make this possible, we have no reason to feel defensive about it. There are no "natural" rules, but someone introduced and began enforcing them in the past, and there is nothing that says that we should not change them or introduce new rules, if we deem them necessary.

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