EXECUTIVE SUMMARY
On its surface, this paper is about rent-seeking—private parties’ use of government to secure special favors. In today’s political environment, the question to ask is not why there is so much rent-seeking, but why so little? The federal government spends about $100 billion per year on corporate welfare, yet lobbying is only a $3 billion per year industry. Given rent-seeking’s incredible returns on investment, why is the lobbying figure not higher?

Public choice theorists call this question the Tullock Paradox, in honor of the late economist Gordon Tullock, who is widely credited with developing the modern concept of rent-seeking. Tullock’s economic analysis offers several convincing answers for why there is so little rent-seeking. Those answers are valid as far as they go, but in explaining capitalist vice, they do not go far enough in accounting for another important factor in play: virtue. The purpose of this essay is to convince social scientists to consider ways to incorporate morality and virtue in their analysis of *Homo economicus*.

*Homo economicus* is only one part of human nature. We urge social scientists to study the whole human being as best they can. While we confine our analysis to rent-seeking, our larger point—that morality and virtue deserve a place in economic analysis—has much broader implications.

We begin by analyzing Tullock’s “big four” economic explanations for why there is less rent-seeking than one would expect. His first theory is the lottery model of rent-seeking. If the government offers a million-dollar subsidy, a company could potentially spend nearly that much to secure it. But if 10 companies chase that subsidy by spending $100,000 each on lobbying, the winner reaps an astronomical profit. But the nine losers’
combined losses strongly diminish the total returns on rent-seeking as an investment.

Tullock’s second theory involves vote-trading, also known as log-rolling. If a Member of Congress wants to do a favor for a rent-seeking constituent, he must negotiate support for that favor from other politicians, who will ask for their own favors. Since each negotiation eats away at the return on rent-seeking investment, rendering the favor—or “rent”—far less lucrative by the time the Congressman buys majority support for his proposal.

Tullock’s third theory concerns the need to build cover stories. Most people view naked cash grabs like bailouts and subsidies as unseemly. Therefore, companies construct cover stories to make their cash grabs look like something else. Cover stories are not free, and reduce rent-seeking returns. Cover stories can range from multi-million-dollar national advertising campaigns to hiring lobbyists and public relations professionals. General Motors draped itself in Old Glory when it was bailed out by taxpayers, appealing to patriotic nostalgia about American manufacturing. Renewable energy companies paint their considerable rent-seeking activities in environmentalist green. Established companies often also seek non-cash rents such as barriers to entry, licensing requirements, and other preferential regulations. These are harder to trace than simple cash transfers, hence their ubiquity, but they have much the same effect.

Tullock called his fourth theory the transitional gains trap. Existing rents often require upkeep, which over the long run reduces the rate of return. For example, New York City taxicab medallions secured very nice rents for their owners for a long time, but now that they face viable competition in the form of ride-share services like Uber and Lyft, those rents are going away. Medallion owners are fighting reform because even though they
could thrive on a level competitive playing field, giving up their rents would require a very large upfront cost. They are trapped in a bad place, and will continue to waste resources seeking ever-lessening rents.

Having gone through traditional economic explanations for low rent-seeking, we conclude with morality-based explanations, and present several ideas for further research.

Most—but not all!—businessmen, we argue, have a sense of decency or an implicit code of honor that causes them to refrain from rent-seeking behavior, or at least do less of it than one would expect. This virtue defies quantification, which may be why many economists defy incorporating it into their analysis. We seek to encourage public choice economists and other social scientists to gain a fuller picture of humanity than they do now.

A second point we wish to make is that entrepreneurs deserve praise, not just criticism, where due. Economists are quick to condemn unethical behavior like rent-seeking, and rightly so. But they rarely take the time to praise virtue or to recognize the value of cultural restraints on unethical behavior. If abstention from rent-seeking were more widely praised, there might be more of it. To the extent economists focus on rent-seeking while paying little attention to virtuous behavior, they tell only half of the full human story.

We invite academics, students, think tank analysts, and educated lay readers to join this conversation.
INTRODUCTION

Economics can explain a lot, but it cannot explain everything. For example, at the height of the Troubled Assets and Relief Program (TARP) cash-grab frenzy in 2008, General Motors (GM) spent about $13 million on lobbying.\(^1\) Its return on investment was a bailout worth as much as $50 billion — nearly a 4,000-fold return on investment—far more lucrative than the stock market’s 8 percent average annual return.\(^2\)

The GM bailout is just one example of many—from Enron\(^3\) to Boeing\(^4\), to Solyndra\(^5\), to much of Wall Street.\(^6\) In today’s political environment, the question to ask is not why there is so much rent-seeking, but why so little? The federal government spends about $100 billion per year on corporate welfare.\(^7\) And yet, lobbying is only a $3.5 billion per year industry,\(^8\) making for a roughly 30-fold difference. Why aren’t both of those numbers even higher?

Public choice theorists call this the “Tullock Paradox,” after the late Gordon Tullock, who is largely responsible for the modern understanding of rent-seeking.\(^9\) He used economic reasoning to advance several plausible explanations for why there is much less rent-seeking than one would expect. This paper will briefly sketch out four of them.

But something else is in play, and it is largely missing from the literature: virtue. This sense of virtue is as important to solving the Tullock Paradox as are the many explanations advanced in Tullock’s own research. We think Tullock would agree with our two main points: 1) human behavior is multi-faceted; and 2) our quest to understand that behavior must also be multi-faceted.
A major reason for the surprisingly low levels of observed rent-seeking is that most—but not all—businessmen have a sense of decency or an implicit code of honor that causes them to refrain from rent-seeking behavior, or at least engage in less of it than one would expect from a rational actor. This virtue defies quantification, which may be why many economists defy incorporating it into their understanding of the world. *Homo economicus* is a useful and interesting species to study, but social scientists’ ultimate focus must always be *Homo sapiens*.

Most of the scholarly literature on rent-seeking focuses exclusively on vice and ignores virtue. More scholarship needs to focus on virtue in the economy, and how increasing virtue in the business community can reduce rent-seeking and cause other beneficial effects. Just as rent-seekers deserve opprobrium, entrepreneurs who abstain from rent-seeking and behave virtuously deserve praise. For economists and policy makers, the goal is to seek ways to encourage more virtuous behavior.

We suspect that *Homo economicus* and *Homo sapiens* have different views on rent-seeking. Finding out if this is actually the case, and if so how strongly, may prove very useful information for reformers who hope to reduce rent-seeking still further.
We do not dispute the standard economic explanations for low levels of rent-seeking. We merely add that there is more to the story. To summarize some of those economic explanations: In some cases, such as grant programs, rent-seeking can work like a winner-take-all lottery, where not all the players win and some players lose. This limits how much companies are willing to invest in seeking rents. Successful rent-seeking often requires costly coalition-building and vote-trading negotiations, which limits how much rent-seeking companies and vote-seeking politicians can extract. Voters’ distaste for naked transfers requires rent-seekers and their political allies to devise “cover stories” that paint their activities as being in the public interest. These cover stories can come at considerable cost. Much rent-seeking activity is spent not on new rents, but on preserving established ones—including some that might not even be profitable anymore.

The standard models do not fully solve the Tullock Paradox. As F.A. Hayek famously (and correctly) said, “[N]obody can be a great economist who is only an economist.” Solving the Tullock Paradox requires more than economics. It requires integrating psychology, sociology, history, anthropology, and evolutionary biology, for starters.

There are many unexplored questions that require such an interdisciplinary approach to get us closer to an answer. Rent-seeking reflects the belief that investments in seeking political favors are more profitable than wealth creation. But is this true? As noted earlier, rent-seeking entails incurring some rather high costs, and its gains are often limited to the short term. At the economy-wide level, rent-seekers are engaged in a zero-sum—
Some forms of rent-seeking are similar to a lottery, in that not everyone who plays wins. and sometimes even negative-sum—game. Does rent-seeking have increasing marginal costs, giving it an upper boundary as its costs start to exceed its benefits?

This paper analyzes four of the traditional public choice economic explanations for why there is less rent-seeking than one would expect, then builds a case for the role virtue plays in limiting rent-seeking, and the need for economists to account for its existence. This fuller approach, inspired by Tullock’s “Economics without Frontiers” methodological approach, would go a long way towards more fully solving the Tullock Paradox.10

THE LOTTERY MODEL OF RENT-SEEKING

Some forms of rent-seeking are similar to a lottery, in that not everyone who plays wins.11 Suppose you own a renewable energy company, and the government offers you a $1 million grant for research and promotion in your field. You would be willing to spend anything short of $1 million to obtain the subsidy. But if nine other companies are also angling for the same subsidy, then your company only has a one-in-10 chance of getting it. With those odds—assuming equal odds for each company—you would be willing to spend up to $100,000 on rent-seeking. If you succeed, you get a nine-fold return on your investment, while the nine losers each take up to a $100,000 loss, with nothing to show for it.
While the winner gets an outsize profit, the return on the total amount spent by all parties on rent-seeking lotteries can be right in line with normal business activity. The profits are merely distributed less equally. Yet, rent-seeking also imposes a social cost that regular business activity does not. The $1 million subsidy is extracted from taxpayers who might have had some other preferred use for that money. This is in addition to the deadweight loss of up to $900,000 that was spent on failed rent-seeking instead of creating value for consumers.

Given that people tend to be overly confident of their odds of success in lottery situations, the problem is likely worse than the model above would suggest. Even so, companies almost certainly temper their rent-seeking activities when they know their odds of success are less than 100 percent.

LOGROLLING AND COALITION-BUILDING

Another factor restraining rent-seeking is the frequent need for coalition-building and log-rolling—economists’ term for vote trading.

A simple model can illustrate how this works. Suppose a Representative from Arizona wants to build a $10 billion deepwater port in Tucson. (Gordon Tullock would often use humorous examples in his work as a way to leaven the discussion, as well as to make a point about the merits of many real-world government projects. We honor that spirit here, and reuse other Tullockian examples below.) The proposal is popular with his constituents, and passing it would improve his reelection odds. But another Congressman, from Missouri, would likely vote against it, as
his constituents would be unwilling to foot part of the bill, while receiving none of the benefits. However, the Missouri Representative has a project of his own that could benefit him politically, a $10 billion canal running through his district parallel to the Mississippi River. As a federal project, it would be partially funded at the Arizona district’s expense, meaning the Arizona representative would likely vote against the canal.

This loggerheads situation gives both congressmen an incentive to make a deal. The Arizona Representative is willing to eat into a small part of his district’s returns if it increases the odds of funding the Tuscon deepwater port. And the Missouri Representative is willing to eat into a small part of his returns to increase support for his canal project. The Arizona Representative offers to vote for the Mississippi River canal, on the condition that his colleague votes in favor of the Tuscon deepwater port. They agree and shake hands.

The deal makes a lot of sense for both Representatives. Both districts gain a $10 billion project, with nearly all the costs paid by other districts’ constituents. This means the Missouri and Arizona districts each pay about $46 million (a 1/435th share for two projects), and each receives $10 billion. This is a very good deal for both Congressmen, though not for the nation’s taxpayers, who lose $20 billion.

However, there are 435 House members, and a majority of them need to vote in favor of both projects for them to happen, so both the Arizona and Missouri Congressmen will almost certainly have to buy further votes in a similar way to secure the Tucson port’s funding. Since 218 votes is a majority in the House, he will need 217 votes in addition to
his own. If he makes 217 deals similar to the $10 billion Mississippi River canal deal, his constituents will have to pay just less than $5 billion to get their $10 billion Tucson port. This worst-case scenario still nets a profit of just more than 100 percent—far lower than if he did not have to negotiate, but far higher than anything the stock market can offer.

As this example shows, a simple majority vote is rarely enough to stop rent-seeking behavior. Imagine how much rent-seeking there would be if a single vote was enough to pass a spending project! Members of Congress could unilaterally grant nearly unlimited favors to rent-seekers. On the other hand, a requirement for unanimity would block almost all spending bills. Every Congressman could unilaterally veto a bill he doesn’t like.¹²

**COVER STORIES**

In his paper, “Rents, Ignorance, and Ideology,” Gordon Tullock proposes the Tullock Economic Development Program:

This involves placing a dollar of additional tax on each income tax form in the United States and paying the resulting funds to Tullock, whose economy would develop rapidly.¹³

The point of this tongue-in-cheek proposal is to show what rent-seeking looks like without a cover story. It also shows that the most efficient type of rent-seeking is straight cash. The Tullock Economic Development Program’s transaction costs are near-zero—just add one dollar to everyone’s tax bill, cut one check, and mail it to Tullock. Of course, this
type of direct cash transfer strikes most people as unseemly. That is why successful rent-seekers need to adopt cover stories that voters and legislators will find acceptable. For example, GM advocated for its bailout claiming that it was crucial to saving America’s car industry.

This cover story was not truthful, given the presence of Chrysler and Ford, as well as Toyota, Nissan, Honda, BMW, and other manufacturers who make American cars in American factories using American workers.\textsuperscript{14} Nor did this cover story convince everyone. Bailouts are not popular, as President Obama acknowledged in his 2010 State of the Union speech.\textsuperscript{15} But cover stories need not be true to work. They only need to convince enough people, or the right people, to get a policy enacted. GM framed the bailout as a public interest issue in a way that resonated with many voters’ and legislators’ sense of nostalgia and national pride. Successful cover stories often appeal more to the heart than the head.

Cover stories cause economic inefficiencies. Devising and promoting the cover story entails a number of costs, ranging from lobbying to public relations and advertising campaigns. In GM’s case, this involved advertisements on national television. Those bailout dollars could have created more value had they been used elsewhere instead. Conditions placed on the bailouts, such as greater government control to the point of allowing the President to fire GM’s CEO, caused further inefficiencies.

The opportunity costs of rent-seeking are impossible to quantify precisely, but they do exist, and are significant.\textsuperscript{16} Cash transfers \textit{a la} the Tullock Economic Development Program have none of these costs.
Opportunity costs also lower the long-run return to rent-seeking. By lowering the rent-seeker’s efficiency both in obtaining the rent and in using it, cover stories prevent rent-seekers from creating the most wealth using the fewest inputs. This cost is ultimately borne by consumers, who are given fewer and poorer choices.\textsuperscript{17}

Because straight cash transfers are so politically unappealing, rent-seekers often turn instead to non-cash favors, such as favorable regulations. Non-cash rents are easier to fit inside cover stories. These can include import restrictions, licensing requirements, rules that increase start-up costs for new competitors, and other barriers to entry. Like straight cash, non-cash rents fatten the rent-seekers’ bottom lines, but without a signed check, it is harder for the public to realize they are being had. Competition-limiting regulations are an especially harmful form of rent-seeking. They have many secondary effects, including higher prices, lower quantity supplied, slower innovation, and fewer consumer choices.

One of the most compelling illustrations of how rent-seeking cover stories work is Clemson University economist Bruce Yandle’s Baptists and Bootleggers parable.\textsuperscript{18} Baptists favor blue laws requiring liquor stores to close on Sundays for moral reasons—they do not want people drinking

\textit{Like straight cash, non-cash rents fatten the rent-seekers’ bottom lines, but without a signed check, it is harder for the public to realize they are being had.}
The Bootleggers have no need for their own cover story because the Baptists provide one for them. The Bootleggers have no need for their own cover story because the Baptists provide one for them. And because most Baptists are independent from most Bootleggers, their cover stories have more credibility with the public and politicians.

The Baptist-Bootlegger dynamic plays out all over the economy. Health insurance Bootleggers benefited from Baptist politicians’ and public health activists’ successful advocacy for the Affordable Care Act, which requires everyone in the country to purchase their product or pay a fine. Renewable energy and ethanol Bootleggers take advantage of Baptist environmentalists’ issue advocacy to secure subsidies, mandates, tax breaks, and other favorable treatment.

Without Baptists and the credible cover they can provide, Bootleggers find rent-seeking far more difficult. The need for cover stories, whether provided by Baptists or not, reduces the amount of rent-seeking below what we would expect to see, given its often-outsized returns on investment.
THE TRANSITIONAL GAINS TRAP

Not all rent-seeking expenditures are for new rents. Existing rents often require upkeep, which over the long run reduces the rate of return. Gordon Tullock named a particularly pernicious form of rent maintenance the transitional gains trap.19

Suppose a city decides to establish a taxi medallion system similar to the one in New York City. The incumbent taxi drivers no longer have to worry about increasing competition, and they collect a nice rent. Fast forward several years, and the market will have adjusted so that those rents will have dissipated. Depending on the exact mix of prices, customers will substitute traditional taxi service for alternate forms of transportation, including mass transit, unlicensed cab rides, and ride sharing services like Uber and Lyft—all of which eat away at medallion owners’ artificial rents.

Many medallion drivers now actually make less than they would have under free competition. For example, Gene Friedman, who owns more than 900 of New York City’s taxi medallions, is now apparently in debt because competition from Uber has eroded the value of his medallions.20 Yet medallion owners still spend time, effort, and money to keep their medallions, because getting rid of them and opening the taxi industry to open competition comes at enormous short-term cost. Some owners and drivers will have to step up their game, while others might find themselves out of work altogether.

This is why it is called the transitional gains trap. Transitioning to the medallions was good for medallion owners in the short run, but harmful
in the long run. But getting out of the medallion scheme also hurts. There is no profitable short-term option for many medallion owners once they are in the trap. Industries caught in the transitional gains trap spend money convincing politicians to keep policies in place that might hurt them because might reform hurt, too, at least in the short term.

MORALITY

So far, public choice researchers have mostly focused on low-hanging fruit in explaining the limits on rent-seeking. But there is higher fruit to be picked. We encourage public choice researchers to take on more difficult, more complex questions, especially on the roles of virtue and cultural norms in tempering rent-seeking and other economic vices.

Much economic research focuses on the negative aspects of human nature. Its diagnoses have been largely correct, but also incomplete. We urge today’s researchers to complete the picture by also focusing on the positive. Good people do exist. What makes them good? What institutional arrangements are conducive to virtuous behavior? The potential for reform is boundless. Praise, not just criticism, where due.

Virtue and norms matter for any economic analysis that aims to capture the full human condition. Traditional economic models predict that businessmen will pursue rent-seeking whenever a rational opportunity for it arises. But this is not empirically true. There is far less rent-seeking activity than one would expect, given the potential returns, even after
accounting for the many valid economic explanations summarized earlier in this essay.

Consider two individual businessmen’s actions and opinions on rent-seeking.

General Electric, under CEO Jeffrey Immelt, has benefited from a federal near-ban on incandescent light bulbs, which has steered consumers toward the company’s compact fluorescent light bulbs. At the other end of the spectrum, Cypress Semiconductor founder T.J. Rodgers once authored a pamphlet titled, “Why Silicon Valley Should Not Normalize Relations with Washington, D.C.,” and has stayed true to that credo. Rodgers not only explicitly rejects special government favors, he wants nothing to do with the political game.

Immelt and Rodgers are two atypical examples. But what is the median businessman’s attitude? Is Rodgers’s or Immelt’s approach more common in the business world? By how much? And to what degree? This is some unusually low-hanging research fruit that, to our knowledge, has yet to be picked.

Another avenue for future research would concentrate on how businessmen view the general public and their shareholders when government gets in the way. While the principal-agent problem in economic theory can present itself almost anywhere, it does so with increased intensity when the state becomes a stakeholder.
How do businessmen in practice view people to whom they are politically accountable, as opposed to people to whom they are economically accountable? As Ludwig von Mises argued, non-rent-seeking businesses are accountable to the general public on literally life-or-death terms.\textsuperscript{22} When governments give out privileges to businesses, it weakens that accountability.

Much of today’s \textit{Homo economicus} model comes from Adam Smith.\textsuperscript{23} While his treatment of \textit{Homo Economicus} in \textit{An Inquiry into the Nature and Causes of the Wealth of Nations} is a well-known foundation of modern economics, his “other” book, \textit{The Theory of Moral Sentiments}, offers an equally incisive analysis of \textit{Homo sapiens}. Smith argues that happiness, at least in the Aristotelian sense,\textsuperscript{24} comes from being both “loved and lovely”—that is, worthy of being loved:

\begin{quote}
What so great happiness as to be beloved, and to know that we deserve to be beloved? What so great misery as to be hated, and to know that we deserve to be hated?\textsuperscript{25}
\end{quote}

How “lovely,” in the Aristotelian-Smithian sense, are real-life businessmen?

People who appear lovely but actually are not tend to know this about themselves—for example, someone who makes a public show of giving to charity but then secretly embezzles the funds. Even if this person’s public image is spotless, he knows in his heart that he is a bad person. This prevents him from ever being truly happy. All the praise other
people lavish on him is hollow, and he knows this, even if they do not. True happiness eludes him.

If a businessman enjoys success through rent-seeking instead of market competition, would he feel the same way? To some people, rent-seeking is simply how the game is played, just one hand to play among many. And if he does feel guilty about rent-seeking, would he divulge his secret feelings to a survey taker? This is extremely valuable information, though enterprising scholars should keep these caveats in mind.

As economist Deirdre McCloskey and others point out, a society’s economic success often depends on its level of trust among strangers and whether success is the product of either merit or luck. Researchers might find interesting insights on rent-seeking from these observations. It seems likely that low-trust societies, where the prevailing belief is that success is more lucky than earned, will have more rent-seeking than societies with higher levels of trust, where success is more often attributed to merit rather than luck.

Researchers such as the psychologist Michael Tomasello have found empirical evidence supporting these theories. In fact, he argues that “the main function of reasoning is to convince others.” Success at gaining others’ trust “is good for individual fitness, and so humans evolved reasoning abilities not for getting at the truth but for convincing others of their views.” Economists might find much of value in Tomasello’s work, as well as that of similar researchers in other fields.
Another valuable contribution is *Moral Markets*, an essay collection with contributors from a variety of disciplines, edited by neuroeconomist Paul Zak. The essays have a common theme of challenging the traditional Gordon Gekko/*Homo economicus* view of businessmen. Other scholars, especially the very economists most prone to *Homo economicus* reductionism, should continue the project and directly research how businessmen view rent-seeking.

The late University of Texas philosopher Robert C. Solomon develops this theme in “Free Enterprise, Sympathy, and Virtue,” his essay in *Moral Markets*, by arguing that the desire to lead a virtuous life extends into the marketplace.28 His arguments stem in part from Adam Smith’s view that sympathy—what he called “fellow-feeling”—is a natural human attribute. We sympathize with others because we instinctively envision how we would feel in similar circumstances. How does a typical real-life businessman consider how other people view his relative prosperity? Are businessmen more inclined to defend honest profits or ill-gotten gains? Are internal guilt and external shame more common among rent-seekers than among honest entrepreneurs? Do prosperous rent-seeking businessmen feel guiltier than prosperous non-rent-seeking businessmen?

Shame is an underappreciated check on rent-seeking. Businessmen may refrain from such activities because they fear negative press and peer condemnation. Zak notes that we know little about market participant attitudes toward cronyism, rent-seeking, or subsidies. Research on this topic would be worthwhile.
CONCLUSION

Our goal with this paper is to start a conversation. We invite the public choice community to put some of its formidable intellectual resources to use in joining us in seeking to understand not just *Homo economicus*, but *Homo sapiens*. Given the potential returns to rent-seeking, it is a minor miracle there is not more of it. The public choice literature has many plausible explanations for low rent-seeking, but that literature too often ignores virtue, which deserves to figure prominently on the list.

Economists are quick to condemn unethical behavior like rent-seeking, but they rarely take the time to praise virtue or to recognize the value of cultural restraints on unethical behavior. In this sense, they tell only half of the full human story. Economists rarely seek to understand why most businessmen might have evolved, through emergent order processes, a sense of decency that limits their rent-seeking activities, in addition to traditional economic explanations.
NOTES


16 Significant in the real world in our judgment, considering how rent-seeking’s opportunity costs affect real people. The effect may or may not be statistically significant, depending on one’s choice of data. Stephen T. Ziliak and Deirdre N. McCloskey, *The Cult of Statistical Significance: How the Standard Error Costs Us Jobs, Justice, and Lives*, (Ann Arbor: University of Michigan Press, 2008).


At least to extent that Smith begat Ricardo, who begat Bentham, who begat Mill, who begat Walras, who begat Marshall, who begat Keynes, who begat Samuelson … all of these post-Smith economic titans are more directly responsible for today’s *Homo economicus* monomania than Smith himself. Smith was vocal about his emphasis on *Homo sapiens*, and likely would be very surprised at the state of economic analysis today.

Aristotelian happiness is the deep satisfaction one gets from a life well-lived. It is big-picture happiness, not the fleeting, moment-to-moment joy over daily trifles.


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