The Importance of the Private Legal Sector versus Aggregate Pressure Group Power for Income inequality: A Cross-State Analysis

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ABSTRACT

Previous rent-seeking research correlates the aggregate power of multi-sector pressure groups with income inequality among the American states. Other research correlates the intra-sector power of specific economic interests with economic development pathologies. Several studies conclude that the legal sector is a rent-seeking interest that generates development pathologies such as lower rates of growth and, possibly, economic bias. No previous study systematically compares the separate roles of multi-sector pressure groups versus the legal sector as predictors of income inequality. This research documents the importance of legal sector power as an autonomous predictor of income inequality.

WHAT IS THE LEGAL SECTOR?

The Bureau of Economic Analysis defines the legal sector as an autonomous source of "gross state product". The legal sector is bounded by several restrictive criteria: (1) It includes for-profit law firms and those who work for them. It includes contingency fee tort lawyers, but not government personnel. (2) The "legal sector" excludes "public service" lawyers working for government or non-profit membership organizations, following models set by Barack Obama. (3) The "legal sector" also excludes wage lawyers providing counsel for businesses in other sectors (such as real estate, manufacturing, and other separate autonomous producers of goods and services).

The legal sector is also a special interest group. The legal sector includes lawyers working as members of a self-regulated white collar guild. The legal sector enjoys monopoly roles in and over the judiciary and other government agencies and bureaus. It enjoys monopoly rights in enforcing professional recruitment standards for prospective lawyers and acceptable business practices for practicing lawyers - enforced by ABA-endorsed rules and government regulations.

Legal sector income generates private wealth through wages, firm profits, and other private earnings. The legal sector is an autonomous source of gross-state product. It is separate and distinct from public service jobs in public administration or non-profit membership organizations. It is similar to – but not the same as – jobs in other private businesses and for-profit firms.

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INTRA-SECTOR VERSUS MULTI-SECTOR RENT-SEEKING INTERESTS: A LITERATURE REVIEW

What are the effects of income inequality due to intra-sector interests like the legal sector versus intra-sector interests on income inequality?

Many different studies emphasize the importance of the legal sector as a major source of economic development pathologies. Since the legal sector is “rent-seeking”, it is a major cause of economic distortions. This theory is emphasized by Schleifer and Vishny (1988), Magee et al (1989), and Brumm (1999).

Other research identifies multi-sector groups or pressure group regimes as the major source of economic development pathologies. Shugardt, Tollison, and Yan (2003), for example, predict rent-seeking groups generate certain outcomes, which can be measured through correlations or regression analysis. Rent-seeking groups create negative externalities for economic development. They increase income inequality. Thus the scope of their power correlates positively and significantly with Gini coefficients for income inequality among the households in a state.

Other economists identify multi-sector pressure group power as the primary source of negative externalities for economic growth and prosperity. Mancur Olson (1982) popularized a focus on aggregate pressure group power as a predictor of negative externalities for economic development. He argued that economic power resources for collective pressure group coalitions in aggregate lead to “economic ossification”. He predicted a positive correlation between aggregate pressure group power resources and economic pathologies, including lower rates of growth and other forms of underdevelopment.

He and other economists proceeded to test this hypothesis with data for nations and states[1]. Some conclude that the evidence fits the Mancur Olson hypothesis that aggregate pressure group regimes produce efficiency costs, lower growth rates, and other economic development pathologies.

Many urban theorists use qualitative data to argue that multi-sector pressure group “regimes” exert influence on economic development outcomes. In particular, they suggest that these regimes are dominated by “business” interests who create economic bias and inequality in urban settings. This qualitative research validates empirical research that correlates inter-sector pressure group power with income inequality among states (Shughart et al, 2003).

However, the Shughart el al (2003) study only measures inequality effects from multi-sector pressure groups in aggregate. It does not study negative externalities from the legal sector in particular. Among these, quite a few indicate major effects.

To measure the power resources of the legal sector, several studies use the absolute or relative number of lawyers in a nation or state. These studies report significant correlations that link legal sector personnel with future economic underdevelopment. The studies explain the relationship as an example of rent-seeking (Scleifer and Vishny, 1988; Magee et al, 1989; Murphy et al, 1991; Brumm, 1999). They emphasize the rent-seeking effects of the legal sector - both at the national and sub-national level of governance. They measure adverse production effects that harm other sectors and/or society as a whole. Based on their research, one would predict major effects on economic development from the legal sector.

However, just because the power of inter-sector pressure group coalitions correlates with income inequality does not prove that the intra-sector power of lawyers separately correlates with inequality.

Even if the legal sector is a rent-seeking interest, prior research never shows it has a separate effect versus pressure groups in aggregate. Many students of pressure group politics assume that all interests pursue rent-seeking. All types of sectors engage in active lobbying efforts. All types of organizations support government rules and regulations that benefit their members. The ABA [American Bar Association] and the ATLA [American Trial Lawyers Association] are not unique. Such arguments imply that the legal sector is not alone in rent-seeking. It is simply part of the whole. It is not distinct.

If rent-seeking is generic, the legal sector would not have any autonomous influence on development outcomes. Controlling for inter-sector power, the correlation of legal sector power with inequality would be null.

A null theory permeates many law review studies. A null theory implies that the" partial" correlation of legal sector wealth with income inequality will be null, controlling for indices of aggregate power resources controlled by organized interests collectively.

Legal sector "apologists" vehemently reject the notion that the legal sector is ever "rent-seeking". Some argue that the legal sector consistently helps, not hurts, economic development (Epp, 1991; Cross, 1992a; 1992b; 2008). Others emphasize a null hypothesis. It generates no adverse effects on development outcomes. This null theory of legal sector rent-seeking is widely accepted by many social scientists who do not publish in law reviews.

Most political scientists who study courts and judicial politics assume that the effects of influence and pressure by the legal sector on government and the economy are favorable, and, at worst, benign. Typical studies of judicial behavior focuses only on public sector lawyers. However all lawyers are portrayed as serving the common good and the public interest, including private lawyers.

Typical American government texts imply that social equity and economic benefits for society require more resources for the legal sector - not less. They favor more lobbying efforts by lawyers and law firms - not less. The texts favor more power for the legal sector over government and the economy, not less. They fixate on the public face of the legal sector.

Most state and local government texts also focus on the public face of lawyers. They ignore possible negative effects from the private face of the legal sector. They implicitly validate a null or benign theory of legal sector power. Only one major text book even cites an opposing point of view. Dye (2008) summarizes an argument that legal sector power may actually harm the economy. However, Dye does this on only a few pages of a very long text.

A few students of state government and politics use econometric methods to study pressure group impacts. Kenneth Hunter (1999), and Virginia Gray and David Lowery (1988) use OLS MRA (regression analysis) to analyze interest group impacts. Both conclude that the effects of pressure groups are null, at least when measured by the aggregate number of lobbyists. For them, lobbying efforts measure aggregate pressure group power resources controlled by Mancur Olson – style collective interest. They conclude that these aggregate power resources (controlled by Mancur Olson inter-sector pressure group regimes) have little or no impact on economic development outcomes (Gray and Lowery, 1988).

Several other studies measure correlations between the “density” of registered lobbyists and economic outputs. Their outputs include both policy choices and economic growth. These studies conclude that the correlations of lobbyists and economic development are generally null. This is true even for specific sub-sets of lobbyists and the adoption of specific economic development policies to maximize group self-interest goals (Hunter, 1999). Such research supports a null theory of pressure group power. If the legal sector is like special interests in general, it also has little or no impact.

THE NEED FOR NEW RESEARCH

Most research on “special interests” ignores the unique status of the legal sector. In many respects the legal sector has far more power resources than other interests. These include a monopoly of power in and over government agencies, bureaus, and indeed entire branches of government. They also include powers of self-regulation enforced by courts to a degree not available even to other elite white collar guilds. Thus one suspects that the legal sector has autonomous impacts on economic development that excel rent-seeking impacts by interests in aggregate, since aggregate interests often produce countervailing powers that cancel each other out. In fact, a wide range of studies both argue and document that legal sector rent-seeking leads to development pathologies (Scleifer and Vishny, 1988; Magee et al, 1989; Murphy et al, 1991)

However, prior empirical research on rent-seeking is extremely limited. Studies of legal sector impacts do not distinguish between different types of lawyers. Few, if any, carefully differentiate public sector and private sector lawyers into two distinct groups. Few, if any, actually measure the extent to which the accumulation of private wealth by the private legal sector leads to, and correlates with, income inequality. Most studies focus only on growth outcomes, not inequality outcomes. This study will.

Most of the research on rent-seeking in development economics focuses on cross-national comparisons or case studies. Much less research focuses on states, and that research fails to differentiate multi-sector versus intra-sector interests.

Studies by Buscaglia (1997a; 1997b; 1995; et al, 1995), Mauro (1995), Schleifer and Vishny (1998), and Magee et al (1989) show that in many nations, the legal sector is a rent-seeking elite. Monopoly powers for the legal sector impose disproportionate costs on the poor. What about the U.S.?

To provide guidance for further research both in economics and political science, the present study offers new evidence to clarify the relative importance of intra-sector elites versus aggregate pressure group regimes. The analysis goes beyond prior studies of aggregate pressure group regimes, including the ground-breaking research by Shugardt, Tollison, Yan (2003).

ECONOMIC EVIDENCE FOR 48 STATES

For this analysis the sample includes only the 48 contiguous states. Multiple factors force the exclusion of D.C., Alaska, and Hawaii from an analysis of income inequality in 2000. If D.C. were a state, if would have the greatest degree of income inequality of any state. It also has the largest share of private sector wealth acquisition by lawyers, measured by the percent Gross State Product controlled by the legal sector. These scores are extreme outliers and thus excluded from the analysis. Among the states, Alaska has the least income inequality. It also has the lowest percent Gross State Product controlled by the legal sector. Thus Alaska is also an extreme outlier and excluded from the analysis.

There is another reason for this sample of only 48 contiguous states. Namely, Mancur Olson, among others, argues that the "age" of a regime strongly affects either how strong a pressure group regime is, or how the power of pressure group affects outcomes. Alaska and Hawaii are the "youngest" states. They were the last two states to join the present union. Of course, D.C. would be newer still if it were a state. From the point of view of the 'age" of a state, D.C. has not even been born yet.

From the point of view of age, D.C., Alaska, and Hawaii have extreme values on age. Thus they are omitted from this analysis as extreme outliers for yet another reason.

Moreover, D.C., Alaska, and Hawaii are also unique in physical geography. D.C. is uniquely small. In contrast, both Alaska and Hawaii are uniquely large in land mass and distance between borders. Moreover, Alaska and Hawaii are uniquely isolated from other states. D.C., Alaska, and Hawaii have other unique historical and geographical traits. As outliers they are omitted from this analysis. This leaves the 48 contiguous mainland states. They form a relatively homogenous sample more suitable for econometric analysis. In effect this sample controls for age, size, and location constraints.

Table 1 summarizes the central tendency and dispersion for all variables used in this analysis, based on the distribution of scores among the 48 states only. These variables are use to test a hypothesis that legal sector power correlates with income inequality among the American States differently from aggregate pressure group power.

The outcome variables both measure income inequality in 2000. The Gini coefficient measures inequality among all households in the state. The other index measures inequality between only the richest and poorest households in the state. The 2000 outcomes are lagged by a minimum of three years with respect to pressure group indices.

Three indices measure pressure group resources. One measures intra-sector power resources, in this case power resources for the legal sector, during 1990 to 1997. The other two measure inter-sector power resources. Lobbying resources for organized groups collectively is measured for 1997. Aggregate (perceived) pressure group power is measured for the 1980s, based on research by Hrebenar and Thomas (1999). States are classified by the relative power of their pressure group regime, and then assigned a score of 1 to 4 from minimum to maximum power. The present study uses the same data reported by Shugardt, Tollison, and Yan (2003), who measured each category separately. The present composite index is named the Hrebenar-Thomas-Harrison 1– 4 hierarchical scale.

TABLE 1:
Description of key variables for 48 contiguous (mainland) states

	Minimum	Maximum	Mean	Std. Deviation
OUTCOMES: INDICES OF INCOME INEQUALITY FOR 2000				
Percent range index for Gini coefficient in 2000	5.44	65.99	30.8248	14.08907
The percent ratio of mean incomes for the richest 20 percent to the poorest 20 percent of households in 2000	885.23	1859.20	1233.8519	219.27123
THREE INDICES OF PRESSURE GROUP POWER RESOURCES				
INTRA-SECTOR: % legal sector share of gross state product during 1990 to 1997	.62	2.59	1.1361	.37594
INTER-SECTOR AGGREGATE: The impact and influence of the overall collective pressure group system in aggregate during the 1980s (Hrebenar -Thomas - Harrison 1– 4 hierarchical scale)	1.0	4.0	2.562	.8970
INTER-SECTOR AGGREGATE: The ratio of lobby registrations in 1997 to total state legislators	.63	17.72	5.0939	3.15363
LAND, LABOR, AND CAPITAL ECONOMIC ENDOWMENT FACTORS				
Per capita square miles of (dry) land area 2000	.00	.20	.0257	.04011
% high school graduates among adults 25 and over in 1990	64.30	85.10	75.9917	5.51311
Per capita deposits (in millions) of deposits in FDIC insured banks and savings and loan institutions 1999	7.57	66.50	13.4668	8.44201
HISTORIC INCOME BASELINES FOR CENTRAL TENDENCY AND DISPERSION (40 YEARS IN PAST)				
Median family income in 1960	2884	6887	5290.27	976.424
Gini index for 1960 (scale of 1 to 1000)	394.0	510.0	436.354	28.0011

Two variables measure the historical income distribution in the state. Median family income summarizes the central tendency of income in 1960, four decades in the past. They dispersion of income is measured by a Gini coefficient of inequality for 1960. The need for attention to historical income variables is stressed in a wide range of research to test neo-classical economic predictions.

Other predictors measure the land, labor, and capital resources of each state. Their importance as “determinants” and “endowment factors” has been clear from Adam Smith’s research on economic development through the “new institutional economics” of the present. For this research, per capita dry land in each state measures “land” endowments. Presumably states with more open space will have more growth potential (omitting Alaska where much of the land is covered by ice, snow, or permafrost). “Labor” endowments are measured by the percent of the adult population 25 or more with at least a high school education. Presumably mass education improves the quality of the labor force, and its ability to implement new technologies that improve labor productivity. “Capital” endowments are measured indirectly by median family income in 1960. More directly, a separate index measures liquid capital in the late 1990s namely deposits in FDIC institutions.

PARTIAL CORRELATIONS OF PRESSURE GROUP POWER RESOURCES WITH INCOME INEQUALITY: THE RELATIVE IMPORTANCE OF THE PRIVATE LEGAL SECTOR VERSUS MULTISECTOR PRESSURE GROUP COALITIONS

Table 2 reports partial correlation coefficients obtained by various indices of pressure group power resources. Each correlation is measured “ceteris paribus”. The “ceteris paribus” relationships factor out five control variables. One set of controls measures the land, labor, and capital resources of each state. The other controls measure the state’s historical average income and income inequality in the distant past. To simplify comparisons of relative importance, the partial correlations produced by each index of pressure group power resources do not include controls for each other. Each pressure group predictor is entered into the estimation equation separately.

TABLE 2

“Partial” correlations of three pressure group power resource indices with Gini coefficient and rich/poor income gap, net of five control variables. The five control variables measure neo-classical economic endowment factors of land, labor, and capital during 1990 to 1999, plus median family income and income inequality for 1959-60.

		(Private) Legal sector economic power index for 1990 to 1997	The overall impact and influence of the aggregate pressure group system	The Lobbyist/ Legislator Ratio in 1997
Percent range index for	r	0.723	0.062	-0.032
Census Gini coefficient in 2000	sig	.000 ***	0.691 ns	0.837 ns
The percent ratio of mean incomes for the richest 20	r	0.767	0.049	-0.139
percent to the poorest 20 percent of households in 2000	sig	.000 ***	0.754 ns	0.375
The percent ratio of mean incomes for the richest 40	r	.765	.056	-.102
percent to the poorest 40 percent of households in 2000	Sig	.000***	.722 ns	.517 ns

REGRESSION COEFFICIENTS FOR ALL COEFFICIENTS - CONTROLLING FOR EACH OTHER

Partial correlation coefficients make it easy to compare the relative importance of different predictors, even if measured with different metrics. Larger absolute values for correlation coefficients show they explain more variation in income distributions. The correlations for legal sector power are always larger than the correlations for aggregate pressure group power. They are also more statistically significant.

The same pattern of results applies to three different indices of income inequality. Gini coefficients, the ratio of incomes for the top 20 to the bottom 20 percent of households, and the ratio of incomes for the top to bottom 40 percent of households all show the same hierarchy.

Legal sector power is always more important than either index for aggregate pressure group power.

To be specific, the correlation of legal sector economic power resources with income inequality is always significant at the .001 level of probability. It is never significant for either index of aggregate pressure group power.

The evidences shows larger beta coefficients for legal sector power resources than for either index of aggregate pressure group power. The absolute and relative importance of legal sector power for explaining income inequality is clear.

TABLE 3

Multivariate regression analysis of the 0-100 Gini range index of 2000 income inequality (48 contiguous states)

PREDICTORS	Unstandardized Slope B	Standardized Coefficients Beta	t	Sig.
% legal sector share of gross state product during 1990 to 1997	20.632	0.551	6.549	0.000
The impact and influence of the overall collective pressure group system in aggregate during the 1980s (Hrebenar-Thomas-Harrison 1– 4 hierarchical scale)	0.692	0.044	0.472	0.640
The ratio of lobby registrations in 1997 to total state legislators	-0.198	-0.044	-0.473	0.639
Per capita square miles of (dry) land area	67.430	0.192	2.382	0.022
% high school graduates among adults 25 and over in 1990	-1.544	-0.604	-5.374	0.000
Per capita deposits (in millions) of deposits in FDIC insured banks and savings and loan institutions	-0.243	-0.145	-1.930	0.061
Median family income in 1960	0.007	0.472	2.325	0.025
Gini index for 1960 (scale of 1 to 1000)	0.242	0.482	2.664	0.011

Interpretation of Slope: One percent more economic power for the legal sector (measured by percent share of total gross state product) correlates with 20.61 percent more income inequality (on a scale of 0 to 100 between minimum and maximum gin indices)

This relationship is statistically significant at the .001 level of probability. There is almost no probability of error in rejecting the null thesis that the relationship is due to chance. The relationship of legal sector economic power is vastly more significant than the relationship with income inequality obtained by either other index of pressure group power resources (which measure resources for the collective pressure group system in aggregate).

Table 3 takes the analysis up a notch. It reports a full multiple regression analysis. Every relationship achieved by each predictor is measured controlling for the other predictors. Thus the discrete index for legal sector power is measured controlling for the aggregate power of all pressure groups collectively.

Again the relationship of legal sector power is highly important, as measured by both a large beta coefficient and a small sig coefficient.

However, this time the relationship is measured controlling for the indices of aggregate pressure group power. The evidence is clear. The relationship of legal sector power with income inequality is separate and distinct from the collective power exercised by all other pressure groups in aggregate. Intra-sector power plays a separate role from inter-sector power.

The outcome variable in table 3 measures differences in income for every single household versus every other household. It measures aggregate inequality among all households in all income classes. The evidence confirms the general pattern. Where the power of the legal sector is greater, as measured by its share of gross state income, the degree of overall income inequality in the future tends to be greater. On average, places with greater legal sector power in the past become places with more income inequality in the future.

CONCLUSIONS

Among the states, the legal sector varies in how aggressively it maximizes private wealth, as measured by the ratio of its private earnings relative to gross state product. Nationwide, there is a positive correlation between private wealth accumulation by the legal sector and income inequality. A lagged relationship links legal sector power from 1990 to 1997 with income inequality in 2000.

Like labor unions, the legal sector has two faces. The private face is often ignored. This makes it hard to identify problems and cures. Both faces are important.

The public service legal sector can protect and promote a rule of law that benefits economic development. Public service lawyers can work to protect the quality of state court systems in ways that help the poor. The public face of the legal system – measured by the rule of law and the quality of state court systems – can promote equity goals.

The private face of the legal sector is “the dark side of the force”. Rent-seeking research in the New Institutional Economics shows negative externalities for nations and states from legal sector power. However prior research did not contrast inter-sector and intra-sector power, nor private and public sector lawyers.

This research focuses on a rent-seeking prediction that private wealth accumulation by a private legal sector harms economic development. This prediction contradicts competing null or benign theories of legal sector power. The rent-seeking prediction fits the evidence, when one measures the economic power of the private legal sector by its share of gross state product.

Many prior studies discount the importance of intra-sector pressure groups. Early research by Mancur Olson and others emphasizes the importance of collective pressure group regimes for income levels. Later research by Shugardt, Tollison, and Yan suggests that collective pressure group regimes may be the main force for income inequality, not more focused interests.

This research rejects that hypothesis, at least for 48 states, a given set of predictor variables, and a specific decade for analysis. The available evidence documents the importance of intra-sector rent seeking for income inequality, even with controls for inter-sector pressure group power.

Further research is needed to identify other contexts where private wealth acquisition by the legal sector correlates with income inequality, reforms necessary to improve the public face of the legal system, and different analytical tools to clarify the how and why.

ENDNOTES

1. Mancur Olson.1982. The Rise and Decline of Nations. New Haven, CT.: Yale University Press. Olson emphasizes macro-level rent-seeking that involves "institutional sclerosis" and "cumulative distortions". Over time aggregate pressure group power increases. This inter-sector power produces economic benefits for group members. However, society suffers.

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