

Rent-Seek and You Will Find

By Michael Munger



By Michael Munger, Jul 3 2006

SHARE
POST:



“In politics you try to move money around and take credit for it. In markets you try to create value and make profits.”

I don't know if we should stay in this business.” That city official was just being honest, but his framing of the problem surprised me. The “business” he was referring to was writing and winning grants from the Department of Housing and Urban Development

(HUD), the federal agency charged with improving home ownership and low-income housing availability. Fifteen years ago, when I had this conversation, I didn't understand what he meant.

As Director of the Master of Public Administration Program for UNC-Chapel Hill in the early 1990s my job was training city and county managers, sending them out to serve the public weal. Public grants were the mother's milk of city management; why would any city official think twice about getting free money to help citizens?

The answer is one of the paradoxes of public choice: free money isn't free. In fact, you have to pay for free money twice: first you have to collect the money, out of tax revenues. And then you have to pay for the money again, because the benefits are dissipated by what economists call "rent-seeking." Let me explain.

The technical definition of **rent** is any return to investment, or effort, that exceeds the opportunity cost rate of return. So, Alex Rodriguez of the New York Yankees earns a large rent, or premium, because of his scarce talents as a baseball player. He could earn a living as a banker, or a waiter, or something else. But it is unlikely that he could earn anything close to the \$25 million per year he makes as a baseball player. Those rents encourage competition. And in most economic situations, that competition for profits produces benefits. But in politics, competition for those rents is often destructive.

The greater the rent, the greater the costs people are willing to incur to win it. When government hands out what appears to be free money, people are going to scramble to get some of it, incurring costs as long as those costs raise the chances of winning the "free" money sufficiently.

Robert Tollison, one of America's premier students of public choice and government, defines **rent-seeking** this way: "Rent seeking is the expenditure of scarce resources to capture an artificially created transfer." Competition for government goodies—rent-seeking—is a wild goose chase, no matter how well-intentioned the goose or the chasers.

The city official told me that his office employed 15 people whose sole jobs were to identify and win federal grants. Their total salaries, and the staff and utilities required to support them, exceeded one quarter of the federal funds they had secured in grants the previous year. It seems like a pretty good deal to spend only 25 cents to win a dollar. But if you think about all the other cities doing the same thing, you realize that this system of distributing grants has some pretty perverse costs.

And the costs were climbing. Other cities around the nation, in the mid-1990s, had begun to get better at the HUD-grant game. At first, Charlotte had been able to win grants with a relatively short proposal, and some supporting documents. But as time passed, the amount of effort and resources required to win was increasing. Not only was Charlotte spending more and more city tax dollars just to win grants funded by federal tax dollars, but Charlotte was winning less and less often. It did sound like a dysfunctional system.

But I was stumped: this just seemed like competition. Isn't competition supposed to be good? How could the outcome seem so bad? It turns out that rent-seeking "competition" is a contest for a fixed price, a zero-sum problem that works like a transfer, at best. Competition in markets has no fixed price, and is robustly positive-sum. In politics you try to move money around and take credit for it. In markets you try to create value and make profits.

Competition in Other Places

From Madison, [The Federalist](#) #51, online at the Online Library of Liberty:

... the great security against a gradual concentration of the several powers in the same department, consists in giving to those who administer each department the necessary constitutional means and personal motives to resist encroachments of the others. The provision for defense must in this, as in all other cases, be made commensurate to the danger of attack. Ambition must be made to counteract ambition. The interest of the man must be connected with the constitutional rights of the place. It may be a reflection on human nature, that such devices should be necessary to control the abuses of government. But what is government itself, but the greatest of all reflections on human nature? If men were angels, no government would be necessary. If angels were to govern men, neither external nor internal controls on government would be necessary. In framing a government which is to be administered by men over men, the great difficulty lies in this: you must first enable the government to control the governed; and in the next place oblige it to control itself. A dependence on the people is, no doubt, the primary control on the government; but experience has taught mankind the necessity of auxiliary precautions.

My understanding of competition, after all, was that of the economist who studies markets. Lots of choices, lots of choosers, prices driven down toward the cost of production. New goods and services come constantly to the market, because producers' self-interest forces them to think of new and better ways to serve customer needs.

Can public policy work the same way? To put it in other terms, is competition always good? Is an increase in competition always the first solution we should think of, to any problem?

In political markets, there is good competition and bad competition. The fundamental human problem is to foster the good and block the bad. If the design of the institution fails to render the clash of self-interests beneficial to the community, then competition can make bad things happen to even the best people.

Not all political competition is bad. Madison, in [Federalist #51](#), famously argued that a government characterized by separation of powers among its branches would be more stable and more reliable than other forms. The reason? Competition! "Ambition must be made to counteract ambition..." But, as we will see, not all political competition works this way.

Tullock Lottery

In my classes, I ask students to imagine an experiment that I call a Tullock lottery, after one of the inventors of the concept of rent-seeking, Gordon Tullock.

The lottery works as follows: I offer to auction off \$100 to the student who bids the most. The catch is that each bidder must put the bid money in an envelope, and *I keep all of the bid money no matter who wins.*

So if you put \$30 in an envelope and somebody else bids \$31, you lose both the prize *and* the bid. When I run that game with students I can sometimes make \$50 or more, even after paying off the prize. In politics, the secret to making money is to announce you are going to give money away.

Take a walk along K Street in Washington, DC. It is lined with tall buildings, full of fine offices and peopled by men and women with excellent educations and a real sense of ambition, a desire to make lots of money and achieve great things. What are those buildings, those people? They are nothing more than bids in the political version of a Tullock lottery. The cost of maintaining a D.C. office with a staff and lights and lobbying professionals is the offer to politicians. If someone else bids more and the firm doesn't get that tax provision or defense bid or road system contract, it doesn't get its bid back. The money is gone. It is thrown into the maw of bad political competition.

Who benefits from that system? Is it the contractors, all those companies and organizations with offices on K Street? Not really. Playing a [rent-seeking](#) game like that means those firms spend just about all they expect to win. It is true that some firms get large contracts and big checks, but all the players would be better off overall if they could avoid playing the game to begin with.

My students ask why anyone would play this sort of game. The answer is that the rules of our political system have created that destructive kind of political competition. When so much government money is available to the highest bidder, playing that lottery begins to look very enticing. The current Congress has, to say the least, failed to stem the rising tide of spending on domestic pork-barrel projects. Political competition run amok has increased spending nearly across the board. And sometimes, you have to bid just to keep from having money taken away from you through regulation.

...To widen the market and to narrow the competition is always the interest of the dealers ... The proposal of any new law or regulation of commerce which comes from this order, ought always to be listened to with great precaution, and ought never to be adopted, till after having been long and carefully examined, not only with the most scrupulous, but with the most suspicious attention. It comes from an order of men, whose interest is never exactly the same with that of the public, who have generally an interest to deceive and even to oppress the public, and who accordingly have, upon many occasions, both deceived and oppressed it. [An Inquiry Into the Nature and Causes of the Wealth of Nations, Book I Chapter XI](#), par 1.11.264.

In a well-functioning market system, competition rewards low price and high quality. Such optimal functioning requires either large numbers of producers or relatively low-cost entry and exit. Suppose that Coke and Pepsi not only had all the shelf space for drinks, but asked in addition if they could make their own rules outlawing the sale of any other drink. As [Adam Smith](#) pointed out, “To widen the market and to narrow the competition is always the interest of the dealers...”

In the market system, we have safeguards set up, however imperfect they are. If nothing else, the Federal Trade Commission would not look favorably on the request, or the industry.

But in our political system, we have an industry dominated by two firms, Republicans and Democrats. Together they have a 99 percent market share. They have undertaken actions at the state and national levels to make it practically impossible for any other party to enter. This system forecloses *good* competition, the kind that raises new ideas or asks embarrassing questions. We have been fooled into thinking the system is competitive, because we constantly see vigorous rent-seeking competition for access to the public purse. This bad competition is an expensive gladiatorial combat, where Congress keeps a lot of the ticket receipts. Some of the rest of the spending is simply wasted building those expensive office suites on K Street and using the time of those lobbyists who could be doing something more productive.

Rent-Seeking: Politically, You Can't Lose

When they set up a rent-seeking contest, politicians are gambling with house money. To simulate the real world of rent-seeking more closely, I would need to amend my classroom exercise. First, collect \$10 from each student. Next, run the auction, giving the students a chance to buy their money back. I'm not sure what would happen, but this procedure would give you the “pay for it twice” aspect that real political rent-seeking games exhibit. And I wouldn't be surprised if some students just stayed home sick that day, as a way to avoid playing the game at all.

What did Charlotte decide? Did they drop out of the game? Of course not. True, spending city money to win pretty much the same amount of federal money makes little sense economically. But it makes a lot of sense politically. As long as politicians are able to claim credit for bringing new federal spending to their state, district, or city, it doesn't matter that each dollar "won" actually cost 30 cents, or even \$1.20. On August 1, 2005, a story was published in the Charlotte Observer:

WASHINGTON, DC—Senator Richard Burr today announced \$8,329,494 in United States Department of Housing and Urban Development (HUD) grants for the City of Charlotte. The funds will expand affordable housing and emergency shelter to the homeless and sick and extend homeownership opportunities to low-income and minority households.

Homeless, sick, low-income, and minority households? Who could object to that? Besides, it's free money! Isn't it?

Further Reading

Anne Krueger. 1974. ["The Political Economy of the Rent Seeking Society."](#) American Economic Review. 64: 291-303. Online at JSTOR (subscription required).

Robert Lawson and G. Dirk Mateer. "The Thrill of Victory, The Agony of Defeat." Public Choice 83: 305-312, 1995.

William C. Mitchell and Michael Munger. "Doing Well While Intending Good: Exploitation and the Pareto Criterion," Journal of Theoretical Politics 5:34-79.

Charles Rowley and Robert D. Tollison. 1988. The Political Economy of Rent-Seeking. Kluwer Academic Press.

Robert D. Tollison. 1982. "Rent Seeking: A Survey", Kyklos, vol 35: 575-602.

Gordon Tullock, ["The Fundamentals of Rent-Seeking."](#)

Gordon Tullock, The Rent-Seeking Society. In The Selected Works of Gordon Tullock series, V. 5 edited by Charles K. Rowley, 2005. Indianapolis, IN: Liberty Fund.

Gordon Tullock. 1967. "The welfare costs of tariffs, monopolies, and theft." Western Economic Journal. 5: 224-232.

*[Michael Munger](#) is Chair of Political Science at Duke University.

For a podcast on this topic with Russ Roberts and Michael Munger, see [EconTalk](#). For more articles by Michael Munger, see the [Archive](#).

RELATED CONTENT

[Michael Munger on Crony Capitalism](#)

Michael Munger of Duke University talks with EconTalk host Russ Roberts about whether real capitalism is unstable and leads inevitably to crony capitalism. They also discuss ways to prevent the descent into cronyism and speculate on their own blind spots.

[READ THIS ARTICLE](#)