The real cost of RENT SEEKING

In the second of our articles on Public Choice, MICHAEL MUNGER explains why there's no such thing as free money

"I don't know if we should stay in this business".

The "business" the Charlotte N.C. city official was referring to was applying for grants from the Department of Housing and Urban Development (HUD), the federal agency charged with increasing home ownership.

Twenty-five years ago, when I had this conversation, I didn't understand what he meant. Why would a city official think twice about getting free money to help local citizens?

The answer is one of the lessons 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 through taxation. Then you have to pay for the money again, because the benefits are dissipated by what economists call "rent-seeking".

Robert Tollison, a leading public choice economist defines rent-seeking as "the expenditure of scarce resources to capture an artificially created transfer".

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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 realise that this system of distributing grants has some 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 city tax dollars just to win grants funded by federal tax dollars, but Charlotte was winning less often. With the same thing surely occurring in other cities chasing the same money, this "free money" was getting expensive.

In my classes, I ask students to play a game 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 this game with students I can sometimes make $50 or more, even after paying off the prize.

Take a walk along K Street in Washington, D.C. where many of the political lobbying firms have their offices. It is lined with tall buildings, peopled by men and women with excellent educations and 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 win that tax provision or defence bid or road 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 organisations with offices on K Street? Not really.

Playing a rent-seeking game like this means those firms spend just about all they expect to win. It is true that some firms get large contracts and big cheques, 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 this destructive kind of political competition. When so much government money is available to the highest bidder, playing this lottery begins to look enticing.

THE RULES OF OUR POLITICAL SYSTEM HAVE CREATED THIS DESTRUCTIVE KIND OF POLITICAL COMPETITION

When politicians set up a rent-seeking contest, they are gambling not with their own money but with money they have collected from taxation.

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 1 August, 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? •

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