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Reducing Rent Seeking by Providing Prizes to the Minority

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August 2013

Center for Economics & Public Policy | University of California, Irvine

Downloadable copy available online

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Reducing Rent Seeking by Providing Prizes to the Minority

Elected officials or others with influence over decisions by a government agency often exert costly effort to obtain outcomes (“prizes”) that further their own goals. Such activity is an example of rent seeking, which occurs when a person spends resources or exerts effort to increase his share of existing or anticipated wealth, without creating wealth. The prizes sought can take many forms: a profitable government contract, a government facility that provides improved service or higher employment in a city, a bus stop or a train stop at a location local residents desire, or the removal of a toxic waste dump. Rent-seeking behavior is both common and – because of the costly effort – wasteful. Under some conditions, rent-seekers may spend so much effort as to dissipate the value of the prizes sought. We might, therefore, expect potential rent-seekers to seek ways of reducing their rent-seeking efforts. In this paper, Glazer and Proost construct a model consisting of a legislature which determines the number, and quality, of prizes to be awarded. The legislature determines the number of prizes, but another agency determines who receives them. Legislators can engage in rent-seeking to try to obtain prizes from the agency. The authors assume that the majority in the legislature aims to maximize their own welfare – defined as the values of the prizes won by members of the majority, minus the taxes they pay to finance the prizes, minus their rent-seeking efforts. The authors consider several strategies the majority may use to reduce their own rent-seeking costs, including:

- Increasing the number of prizes, even if that allows some members of the minority to win prizes.
- Reducing the quality of the prizes.
- Introducing a cost-sharing scheme between the central government and the localities receiving the prizes.

In all cases, Glazer and Proost show that the reduction in rent-seeking costs can be so large that members of the majority can benefit even if they have to pay for the additional prizes, or receive prizes of lower value.

Analysis

Glazer and Proost consider a legislature consisting of N members. Each legislator wishes to obtain a prize, and each has one vote on a committee which decides by majority vote how many prizes, s , will be awarded. Though the majority sets the total budget (or sets the number of prizes), an independent agency selects which legislators are awarded a prize. Each legislator can lobby the agency. The financial cost of providing s prizes is C . C can be thought of as the total amount of taxes which must be collected to finance the prizes. If each legislator pays an equal share, each pays a tax of C/N . Legislators pay the tax whether they receive a prize or not. The net benefit received by a legislator who receives a prize consists of the value of the prize, minus the taxes paid for the prize, minus the cost of lobbying.

An analysis of this model leads Glazer and Proost to the observation that the net benefit of a member of the majority equals the difference between his valuation of the prize, and the valuation by the member of the minority who most highly values the prize (less the taxes required to finance the prizes). The results which follow flow from this observation.

Results

Majority may favor universal prizes

If legislators equally value the prize, the analysis shows that rent-seeking would exhaust all benefits. If, however, the majority chooses a number of prizes which equals the number of legislators, rent-seeking is eliminated. Examples of universal, or near universal, prizes abound. In many instances this results in an excessive number of prizes. Consider the example of bus stops. Studies comparing the actual number of stops to the efficient number of bus stops along a route find too many stops: by about 30% in Portland, Oregon and by about 100% in Boston.

Majority favors low quality of prizes

A reduction in the quality of the prizes reduces the incentives of legislators to lobby, and so may increase the welfare of the majority.

Majority favors cost sharing

In many countries, the central government finances only some of the cost of service, requiring those who receive a prize to bear a share of the cost. The share that prize winners pay reduces the ultimate value of the prize, and in turn reduces the rent-seeking effort of legislators, similar to that of the reduction in quality. This, too, can increase the welfare of the majority.

Majority may favor more prizes than does the minority

As previously demonstrated, the majority gains from increasing the number of prizes partly because rent-seeking declines. Some members of the minority, however, will prefer that the number of prizes not be increased as their taxes and rent-seeking will increase, and they still may end up without a prize.

Policy Implications

Legislators who design policy should care not only about the costs of the policy, or about the benefits that a prize would yield to those legislators who get a prize. When the majority imperfectly controls policy implementation (as when an independent agency controls implementation), members of the majority should also care about their rent-seeking activity. That means that members of the majority should worry about the benefits to members of the minority. The general principle is that the members of the majority gain from reducing the benefits to the member of the minority who values the prize most. Such reductions can take several forms including awarding many prizes, reducing the quality of the prizes, or implementing a cost-sharing scheme for prize winners.

While the analysis focuses on awarding a prize, the same logic can apply to avoidance of a loss. Consider a cut in the governmental budget. If agencies have discretion on what to cut, then legislators or constituents may exert great effort in preserving their favored programs. If, instead, the cuts are universal, or across the board, then such lobbying activity will be restricted. The cuts to the USA federal budget in 2013, under the name of sequestration, cut everything, rather than only programs that benefit the minority. This study offers one explanation for such universalism.

Similar reasoning can apply to other situations where one group determines the number of prizes, with members of the group recognizing that the number of prizes will affect how much rent-seeking effort each of them will later seek to exert. For example, elite research universities with influence over policies of the National Institutes of Health or of the National Science Foundation may want the granting agencies to offer a large number of grants, even if each grant thereby becomes smaller, to reduce the time and effort their faculty must spend on applying for grants. Policies which may appear to be

irrational or motivated by altruism may instead reflect efforts by a powerful group to reduce their own wasteful rent-seeking.