

Rent Seeking Hobbles Economic Growth

Introduction

Excessively large government harms economic growth. The evidence is overwhelming, both from U.S. and international experience. The Joint Economic Committee (JEC) has published five studies that document the reasons excessive government reduces economic growth.^[1] One particular problem with excessive government is that it unleashes socially-destructive "rent seeking." Rent seeking diverts resources from productive uses.

Rent Seeking

A good understanding of rent seeking helps to explain much of our current economic situation. Rent seeking starts with economic intervention by government biased toward special interests. When bureaucrats and politicians reward particular special interests with favored treatment or burden their competitors with restrictions, they create what economists call "rents." An example of this type of rent is President Clinton's targeted tax-giveaways. He is using tax policy to reward favored constituencies to the detriment of society as a whole.

Another example of this type of rent is the Davis-Bacon Act. The Davis-Bacon Act requires federal contractors to pay "prevailing wages" as defined by the Department of Labor. Davis-Bacon does not allow contractors to compete on the basis of price. The act burdens new entrepreneurs who bid for federal contractors. They cannot provide their services at a lower price and thus find it difficult to compete. However, unions find the law beneficial and lobby vigorously to preserve it.

Politically-created rents are very valuable to the people who are fortunate enough to have received them. To maintain these privileges, special interests will hire lobbyists, make political contributions, and buy advertisements. Other special interests compete for these privileges in the same manner. These efforts to influence the political process for economic gain is called rent seeking.

The crucial thing to understand about rent seeking is that the resources spent to influence the political process are wasted to society. They are profitable to the special interest that profits from politically-targeted rents. However, new plants cannot be built, computers made or doctors educated with these funds.

Economic theory predicts that the sum total of funds spent to acquire political privilege exceeds the value of those privileges. People hire lobbyists because they know that in so doing they will increase the likelihood that they will be favored in the political process. However, competing firms will compete by hiring their own lobbyists. The more they spend -- the greater their chances. If a firm recognizes that they can obtain a rent worth \$1,000, they will be ahead if they spend \$900 through lobbyists and other efforts. They will obtain \$100. Other firms may also

spend \$900 making the same calculation. However, adding the money spent by all firms will exceed the value of the rent. The process is difficult for the losers. They spend their resources and receive nothing in return.

If the government keeps growing, eventually entrepreneurs will be more concerned with political maneuvers than earning a profit selling goods or services. The former Soviet Union provides a warning to all concerned; when an economy operates in a manner where politics trump all other concerns.

The major problem with rent seeking is that it is successful. Changes are made to the tax system to benefit special-interest groups. Regulations are passed in a manner that include special protections for various groups. Seekers of economic privilege are emboldened by past successes, so they pressure for additional assistance. The sum total of all these demands hobbles the American economy.

Conclusion

The American economy is losing its preeminent position as long-term economic growth falters. The major reason for the slow economic growth is the size of government. A major factor inhibiting economic growth is the attempt by citizens to petition for special privileges from the government. The solution to the problem of rent seeking is to remove the incentive to seek profit through the political process by reducing the size of government. We need a healthier economy to restore the American dream which is eluding too many Americans.

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Endnote:

1. Gallaway, Lowell and Vedder, Richard: *The Impact of the Welfare State on the American Family, The Impact of the Welfare State on Small Business the American Entrepreneur, The Impact of the Welfare State on America's Children, The Impact of the Welfare State on Workers, The Impact of the Welfare State on the American Economy.*