David Youngberg

Econ 304—Bethany College

**Lecture 32: Public Choice II**

1. Rent
	1. Cities often compete with one another, as firms do. In the context of stadiums, they will offer larger and larger subsidies to whatever team comes to them.
		1. In 2007, the Seattle Supersonics wanted a new arena to fit NBA standards but the city refused to pay the needed $500 million. So the team started looking for a new home.
		2. Oklahoma City wanted a sports team and it had an unused arena. So they offered the Seattle-based basketball team $100 million to renovate the arena and bring it up to NBA standards if they moved. They also promised $20 million practice facility. In 2008, the Supersonics moved and changed their name to the Oklahoma City Thunder. They haven’t moved back and Seattle still lacks a men’s professional basketball team.
	2. We discussed that stadiums aren’t a good deal, but OKC’s stadium was unused, being built as part of a 1990s redevelopment plan. Why didn’t they already have a team?
	3. To make a team, the NBA has to approve the creation of a new one. It’s a monopoly, so naturally they get to constrain entry and raise prices (as monopolies like to do).
	4. This economic profit they get is called *economic rent* (or simply *rent*), or revenue beyond what’s needed to maintain the resource.
		1. Its name comes from landownership since owners of any natural resource, especially with their political power, were notable collectors of economic rent.
	5. The role of monopoly power and economic rent plays a similar role in:
		1. *NCAA*: their monopoly on college sports is why athletes don’t get paid and why they have such high demands on their time. Athletic directors, who run the NCAA, run it for the benefit of the athletic departments (including the coaches). A coach’s primary job is to recruit and because there’s a cap on price (one scholarship), that frees up rents to go to coaches, the athletic director, and the school as a whole. It also means the only way to get the best players is to have the best recruiters. To be clear, this advantage only applies to top-tier athletic schools, which are flagship state universities. Funded by the government, their size enables large ticket sales from alumni (which then goes to get the best recruiters). All in all, it means the top 25 or so schools stay on top.
		2. *Certificate of Need*: If you wanted to open up a specialty clinic, a hospital, or even buy a major piece of equipment, you must get approval from a state board. The board, made up of existing hospitals, awards you a “certificate of need” if you are successful. This barrier to entry is explicitly there to increase profits for hospitals.[[1]](#footnote-1)
2. Rent seeking and dissipation
	1. You can’t give money away (in the long run).
		1. Suppose I gave $100 to the first panhandler I saw every day. That means, as word gets out, panhandlers will line up try to be the first one I see. They might even break out into fights to get closer to my door.
		2. In other words, when you give things away, people will work really hard to make sure they get the bonus.
	2. The process of pursuing rent is called *rent-seeking*. Buchanan (1980) identified three types of rent-seeking expenditures:
		1. Efforts by the recipients of monopoly
		2. Efforts by the government agents to obtain expenditures by recipients
		3. Efforts by third parties who indirectly benefit from the monopoly
	3. When the total amount of rent-seeking expenditures equals the amount of the rent, we say the rent has dissipated.
		1. If the agents are risk-averse, the rents are under-dissipated
		2. If the agents are risk-neutral, the rents are fully dissipated
		3. If the agents are risk-loving, the rents are over-dissipated
	4. Note that rents and rent seeking occurs outside of the political sphere, such as a CEO giving his nephew a do-nothing job.
3. Median Voter Theorem
	1. While some politicians could sometimes be described as benevolent, all want to be reelected.
	2. To be elected, you need to appeal to the *median*—or middle*—*voter.
		1. Note “median” is not the same as “average.” If one person has $60 and two people have $0, the average amount of money is $20, but the median is $0.
	3. The *median voter theorem* states when voters vote for the policy that is closest to their ideal point on a line, then the ideal point of the median voter will beat any other policy in a majority rule election
		1. In other words, the median voter determines the election results
	4. To see why, consider how much five voters and two politicians prefer to spend on military:

Less Spending

More Spending

Shane

Roberta

Andrea

Raul

Inez

Santos

Vinick

* + 1. Candidates Santos and Vinick prefer less and more spending, respectively. But what each really wants is to be elected.
		2. Note how Santos gets more votes if he moves right and goes out for more spending. Note that Vinick can respond by going left and demands less spending. Eventually, they will meet at the median voter.
	1. MVT clearly plays out when politicians change their speeches when they are running in a primary election versus in a general election.
	2. MVT doesn’t always apply. If Santos or Vinick moves too far to the middle, the extremes might not vote at all. At the same time, most voters are in the middle; losing a few fringe voters is worth gaining several mainstream voters.
1. Bureaucracy
	1. What motivates bureaucrats? It’s a little trickier than politicians who have a clear motivation, especially when there are no term limits.
		1. Like rent seeking, this section can apply to the private sphere. Large corporations, for example, have bureaucracies as well.
	2. We must then turn to nonprecuniary goals. Bureaucrats are not a uniform group, of course, so we have several different theories as to what they might want.
		1. At the heart of each theory is the role of information. As G.I. Joe taught us, knowledge is power and the bureaucrat leverages her information advantage about her bureau to pursue her own ends.
	3. *Budget-maximization*—this bureaucrat focuses on power and to get it, she focuses on increasing the bureau budget. She wants more money for her bureau because it grants her more opportunities for patronage, justifies a higher salary and more perks of office, and increases her public reputation and power.
	4. *Slack*-*maximization*—this bureaucrat wants a higher budget not for power or prestige but to maximize free time or minimize intensity of work. The budget is used to hire additional workers or make up for inefficiencies due to inactivity. Higher budgets are not uniformly preferred, however, as the more the sponsor gives up elsewhere, the more it will expect of the bureaucracy and the less slack the bureaucrat will consume.
	5. *Risk*-*avoidance*—this bureaucrat wants to avoid scandal or embarrassment since either can result in demotion or dismissal. While this can increase efficiency and reduce budgets, it more often leads to neither due to poor prioritization. The bureaucrat will avoid good projects that are risky (FDA’s aversion to approve drugs) or focus on easy-to-measure outputs (VA hospitals concentrate on patients per day rather than quality of care).
	6. These three theories cast bureaucrats in a poor light (but to be fair, no economic agent is an angel). One could argue that bureaucrats are quite selfless since they are mobile workforce and the chance for promotion is high and many. With such a competitive market, they have a strong incentive to be efficient.
1. <http://www.econtalk.org/archives/2012/11/cochrane_on_hea.html> [↑](#footnote-ref-1)