Has the War between the Rent Seekers Escalated?

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Abstract

Vedder and Gallaway (1991) develop and test a unique theory about the interactions between the levels of spending captured by rent-seeking interest groups. They hypothesize that initially rent seekers cooperate in ways that expand government spending and rents. At some point, however, groups can only expand their rents at the expense of other rent-seekers and that this relationship will strengthen over time. In this brief note, we update their empirical model 20 years into the future and find their prediction was accurate. The relationship is now stronger and more states have moved into the negative range.

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Has the War between the Rent Seekers Escalated?
An Empirical Note

1 Introduction

In their 1991 paper in Public Choice, “The War between the Rent Seekers,” Richard Vedder and Lowell Gallaway develop and test a unique theory about the interactions between the levels of spending captured by rent-seeking interest groups. Their model hypothesizes that at low levels of government spending and/or political influence, that interest groups complement each other. Multiple groups can simultaneously push for new taxes and higher levels of government spending that benefit all groups. They point to many states enacting new income taxes in the 1960s and 1970s as an example. In this part of the interaction, additional political pressure by one group results in the pie growing for all rent seekers.

At some point, however, this relationship switches from complementarity and cooperation to conflict, competition, and a war between the groups over funding. In a Laffer-curve-type relationship, at some point revenue maximization occurs, new tax sources become satiated, and beyond that point a rent seeking group can only gain at the expense of other groups. They depict their model graphically, and argue that the groups most well suited for testing the model are public school teachers and welfare recipients. We recreate their original graphical model in Figure 1, which illustrates that as public school teachers initially push for higher salaries, the pie expands and public welfare recipients also gain additional government spending. However, at as they continue to push for higher salaries, the positive relationship turns negative,
and higher teacher salaries only come at the expense of funding and benefits for welfare recipients.¹

Vedder and Gallaway empirically test their model using data for 1986 (or fiscal year 1985-86 where appropriate). They find strong support for their model, and find that:

“The results suggest that beyond $474.58 in per capita welfare spending, teacher salaries are negatively associated with increased public assistance expenditures; at lesser amounts, a positive relationship is observed. Five jurisdictions - New York, Massachusetts, Rhode Island, Alaska and the District of Columbia - had welfare spending in the negative range. In those states, the evidence suggests that gains to welfare recipients occur in conjunction with income losses to teachers.” Vedder and Gallaway (1991), pp. 287.

They proceed to argue that because state and local government spending is growing through time, that this relationship should be getting stronger through time, with more states moving into the upper portion where rent-seeking interest groups are at ‘war’ with each other:

“Since state and local government spending has been rising over time, not only in absolute real terms but also as a percent of personal income, it is possible that in earlier years the quadratic relationship observed above did not exist; no states had reached the point where rent-seeking had become a zero sum game for participants. To test this possibility, we replicated the model used in the table for 20 years earlier, the 1965-66 fiscal year.” Vedder and Gallaway (1991), pp. 287.

Indeed using data from twenty years prior they find that all states were on the lower portion and the relationship was positive and linear, suggesting that through time more states are moving into the negative upper portion of the figure:

“The quadratic (competitive) relationship between teacher salaries and welfare payments seems generally to be a recent phenomenon, although it appears that the previous linear (cooperative) relationship has been weakening over the past generation.” Vedder and Gallaway (1991), pp. 288.

¹ Note that their theory is in stark contrast to Becker’s (1983) theory in which the political influence of interest groups is basically a zero sum game, and the nature of the competition between rent seekers is independent of the size of government.
In the concluding section of their paper they made a bold prediction for the future, that through time more states should move into this upper area of the relationship where rent seeking interest groups are at ‘war’ with each other:

“In conclusion, it seems some states have experienced spending growth to the point where economic and political constraints on that growth have led to a situation where rent seekers can gain only at the expense of other rent seekers. As that fact becomes recognized, peaceful, cooperative political action between rent seeking groups that prevailed when such action resulted in a larger expenditure (rent) pool might give way to war between the rent seekers. If state and local spending continues its relative growth, we would expect the war between rent seekers to spread to other jurisdictions.” Vedder and Gallaway (1991), pp. 288.

In this brief empirical note, we attempt to see if their prediction is correct by moving their model twenty years into the future, using the exact same data sources and model in the original paper. Our results do indeed suggest that Vedder and Gallaway’s (1991) prediction has come true. We now find roughly nine states, almost double the number in 1986, have moved into the upper range of the relationship. The paper continues by describing our data and empirical results and comparing the results to those in Vedder and Gallaway (1991).

2 Empirical Model and Results

Vedder and Gallaway (1991) postulate a quadratic theoretical model as follows:

\[ R = a + bX - cX^2 \]  

(1)

where \( R \) is the rent payment to one group (as measured by average teacher salaries, their base rent-seeking group), and \( X \) represents spending on other governmental expenditures. In practice they argue it is best to single out welfare spending, so they estimate a final model of the form:
\[ S_i = a + bP_i - cP_i^2 + dO_i - eO_i^2 + W_i + \epsilon_i \]  

(2)

where \( S_i \) is the average public school teacher salary in state \( i \), \( P_i \) is public assistance spending per capita in state \( i \), \( O_i \) is other non-education, non-welfare state and local government spending, and \( W_i \) is the average annual pay for all nonagricultural workers to control for variations in local labor market conditions. They estimate their model using data for 1986 using all 50 states and the District of Columbia. As mentioned previously, they also estimate their model for twenty years prior, 1966 for comparison, but find only a (positive) linear finding for 1966, and then predict that as government grows through time that more and more states will end up in situations where rent seekers are at war, taking from each other, on the upper portion of the curve.

We now have the advantage of being far enough into the future to test their prediction. That is, we can go twenty years into the future to see what has changed, if anything. We use data for 2006, to compare to their results for 1966 and 1986. Using data for 2006 not only has the advantage of being the identical match of time as their 20 year gap, but it also allows us to estimate the relationship without the recent Great Recession clouding our results. A final advantage is that we can use their exact same data sources, as some are no longer as directly available.\(^2\)

We employ the exact same data series, from the same sources, and the same empirical specification as Vedder and Gallaway (1991). The results are presented in Table 1, and a column showing their original results for 1986 is also included. The results for 2006 seem to clearly support their prediction that the quadratic relationship between education and welfare is now stronger. The quadratic relationship with other spending, however, is not present like it was in

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\(^2\) In particular, the *Statistical Abstract of the United States* is no longer published.
the main results in Vedder and Gallaway (1991). In other specifications in their paper, however, Vedder and Gallaway find the relationship with other spending to be weaker as well and actually omit it in order to see how it affects the primary relationship between average teacher salary and welfare spending per capita. Thus, we as well show the results both with and without the quadratic (squared) term on other spending. The main relationship between teacher salaries and welfare payments is unaffected by whether this variable is omitted or included.

Their original results suggested that in 1986, beyond $474.58 in per capita welfare spending, teacher salaries are negatively associated with increased public assistance expenditures (and below that value a positive relationship existed). They find that five jurisdictions were in the negative range: New York, Massachusetts, Rhode Island, Alaska and the District of Columbia. Our updated results for 2006 suggest a value of $1,617 ($879 in 1986 dollars). In 2006 there are now nine states above this level. In addition to the five original states and District of Columbia from Vedder and Gallaway (1991), Maine, Vermont, Minnesota, and Pennsylvania have joined the list. It is interesting to note that in their 1991 paper they mentioned that Minnesota was one of the few states close to, but just below, the threshold. We have two states within 10 percent of our threshold: New Mexico and Delaware.

3 Conclusion

In their 1991 paper, “The War between the Rent Seekers,” Richard Vedder and Lowell Gallaway develop and test a unique theory about the interactions between rent seeking interest groups. In

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3 Using the CPI, in 2006 dollars, their value of $474.58 would become $872.95.
4 It is unclear why the threshold has risen in real terms over time beyond the fact that incomes have also risen and so the amount of revenue raised for any given tax rate has increased.
the conclusion of their paper they make a bold prediction about the future: “[i]f state and local spending continues its relative growth, we would expect the war between rent seekers to spread to other jurisdictions.” [Vedder and Gallaway (1991), pp. 288]. By this they meant more states entering the backward-bending portion of their hypothesized Laffer-type relationship.

Our results strongly suggest they were right. The number of states where rent seekers are now at ‘war’ in their terminology has approximately doubled, from five to nine, with two more states nearing the threshold. While the theory of their paper is about rent seeking, the empirics of Vedder and Gallaway focused on teachers and those receiving public assistance. While not a focus of this short empirical note, further research should examine whether new implicit battles have broken out among interest groups. For example, the rise in public health care expenditures at the state level seems to have coincided with a decline in state appropriations to higher education in many states.

References


Figure 1: The Hypothesized Salary/Welfare Benefit Relationship from Vedder and Gallaway (1991)

Table 1. Determinants of Average Teacher Salaries by State

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient (absolute t-statistic)</th>
<th>1986 from Vedder and Gallaway (1991)</th>
<th>2006 update</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>-1878.494 (0.665)</td>
<td>-6190.420 (1.055)</td>
<td>-6255.220 (1.456)</td>
</tr>
<tr>
<td>Welfare (P)</td>
<td>18.034*** (2.765)</td>
<td>22.565*** (6.488)</td>
<td>22.523*** (5.988)</td>
</tr>
<tr>
<td>Welfare Squared (P²)</td>
<td>-0.019** (2.309)</td>
<td>-0.007*** (6.693)</td>
<td>-0.007*** (6.924)</td>
</tr>
<tr>
<td>Other (O)</td>
<td>3.876*** (2.859)</td>
<td>0.605 (0.218)</td>
<td>0.660 (1.261)</td>
</tr>
<tr>
<td>Other Squared (O²)</td>
<td>-0.000’ (1.862)</td>
<td>0.000 (0.021)</td>
<td>- -</td>
</tr>
<tr>
<td>Wage (W)</td>
<td>0.957*** (6.960)</td>
<td>0.865*** (9.140)</td>
<td>0.864*** (10.910)</td>
</tr>
</tbody>
</table>

R² | 0.859 | 0.764 | 0.764 |
F-statistic | 62.158 | 88.349 | 106.258 |

Notes: The results for 1986 are taken directly from Vedder and Gallaway (1991), Table 1, page 287, absolute t-statistics in parenthesis. Their original results only contain three decimal places, and this format was continued. Model estimated using heteroskedasticity-robust standard errors.