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Political Entrepreneurship and the Democratic Allocation of Economic Resources

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Abstract. Political entrepreneurship occurs when an individual acts on a political profit opportunity. These profit opportunities can be divided into two categories: productive, and predatory. Productive opportunities enable entrepreneurs to profit from enhancing the efficiency of government, while predatory opportunities enable entrepreneurs to profit from forcibly transferring resources from some to others. This analysis shows that political institutions tend to favor predatory over productive political entrepreneurship, and shows that what is sometimes referred to as political exchange does not have the same efficiency characteristics as voluntary exchange in private markets.

Key Words: entrepreneurship, democracy, public choice

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Political entrepreneurship occurs when an individual observes and acts on a political profit opportunity. As with market entrepreneurship, entrepreneurial actions require, first, that a profit opportunity exists, second, that someone is alert enough to spot the opportunity and recognize the opportunity for profit, and third, that the individual is willing to act on the opportunity once it is spotted. Each of these three requirements are common elements of political and market entrepreneurship, yet in each of these requirements there are both subtle and substantial differences between entrepreneurship in markets and in politics. The fundamental differences arise from the fact that market exchange is based on voluntary agreement, whereas political action always has an element of compulsion behind it. The fact that force can be used to generate political outcomes produces two key differences in the nature of political versus market entrepreneurship. First, opportunities for political entrepreneurship will always exist. One might imagine an economy in complete general equilibrium, implying that there are no unexploited profit opportunities, but there will always be opportunities for political profit from the forced transfer of resources from some to others. Second, whereas successful entrepreneurial acts will always be welfare-enhancing in markets, that may not be true in politics, because the costs forced on the losers may be less than the gains to the gainers.

In order to examine the welfare implications of political entrepreneurship, this paper first presents a framework that shows how entrepreneurial opportunities are generated in politics. That framework clearly shows that acting on some entrepreneurial opportunities will enhance welfare, whereas acting on other opportunities will reduce welfare. This comparison shows that entrepreneurial opportunities in politics and markets arise in different ways, and demonstrates why there always must be opportunities for political entrepreneurship. As a result, there are important differences in the ways that political and market opportunities are noticed and acted upon. In the same way that market exchange can occur between two individuals whereas political agreement typically involves a large number of participants, acting on an entrepreneurial opportunity in a market often can be done by a single entrepreneur who observes a profit opportunity and acts on it through market exchange. Acting on an entrepreneurial opportunity in politics requires collective action. The entrepreneur cannot simply rely on market data, because the entrepreneurial action requires anticipating whether the entrepreneur can entice a sufficient number of others to cooperate in collective action.[1]

If the entrepreneurial opportunity is a Pareto improvement, then enlisting the cooperation of others should be relatively easy for the entrepreneur, because nobody has a strong reason to object to the change. If, however, the opportunity creates gains for some but losses to others, as is almost always the case in politics, lining up the support of others is crucial to the success of the entrepreneurial action. Given the problems of coordinating collective action, one might at first think that entrepreneurs should be biased toward productive actions that avoid these problems, but this paper shows that there is a significant bias in the other direction. The incentive structure in politics leads political entrepreneurs toward actions that benefit some at the expense of others rather than toward actions that benefit everyone, and leads entrepreneurs toward an inefficient allocation of resources rather than toward an efficient allocation. There is a subset of the public choice literature that argues otherwise,[2] so one of the main goals of this paper is to show why the incentive structure in democratic politics entices entrepreneurs to act on opportunities for inefficient resource allocation and to by-pass opportunities for efficient resource allocation.

The fundamental difference between the invisible hand of the market and the coercive hand of government is that government allows some to impose their preferences on others by force. The reallocation of resources through coercion is not an anomaly that sometimes arises in politics, but the way that the democratic political system was designed. What follows is an examination of the implications of democratic decision-making on the opportunities for political entrepreneurship, and in turn the implications of political entrepreneurship on the political allocation of economic resources.

After examining the concept of entrepreneurship in more detail in the next section, the paper then shows what causes entrepreneurial opportunities to arise in politics. Entrepreneurial opportunities in politics are tied closely to both the efficiency and stability of the political system. If the political system is inefficient (in the Paretian sense that there are potential changes that could benefit some without harming others), entrepreneurial opportunities arise in politics for many of the same reasons that they appear in markets, to reduce the inefficiency. However, entrepreneurial opportunities arise regardless of the efficiency of resource allocation, and acting on many of these opportunities can result in a less efficient allocation of resources. An important conclusion of this analysis is that the incentives to act on opportunities to reduce the efficiency of the system are likely to overwhelm the incentives for efficient entrepreneurship. If the political system is unstable (in the sense that the status quo is always dominated politically by some alternative), then change is more likely, and entrepreneurs can profit from leading the way toward political change. Political instability creates entrepreneurial opportunities.[3] The model shows that inefficiency and instability are more closely linked than the literature on the topic typically has recognized. The introduction of political entrepreneurship provides a crucial link between political efficiency and political stability, and thus sheds light on some long-standing questions in public choice theory.

Entrepreneurship

In both markets and politics, entrepreneurship can be defined as the observing and acting upon a profit opportunity.[4] In the neoclassical model of competitive equilibrium, entrepreneurial opportunities are ruled out by the assumptions of no transactions costs and perfect information on the part of all market participants. As Coase (1960) noted, in a zero transactions cost world, there would be no reason for government to aid in the allocation of resources, because all potential Pareto improvements would be made through market exchange. In the real world, transactions costs are significant, giving a justification for government intervention, but there is a substantial literature arguing that transactions costs and agency costs are higher in politics than in markets.[5] This is partly due to the fact that government can act without the explicit consent of its constituents, requiring constituents to have to actively seek out information about the behavior of principals in this principal-agent relationship, coupled with the rational ignorance of constituents noted by Downs (1957), and the monopoly power that political institutions give to those in government.

The informational differences between private markets and political markets have not been sufficiently recognized by those who argue the efficiency of political institutions. As Hayek (1945) emphasized, the market serves as a mechanism that coordinates all of the decentralized knowledge shared by market participants that could not be effectively shared or communicated directly. Hayek persuasively argues that any one person can comprehend only a small fraction of the total amount of available information. The marketplace allows people to take advantage of the information they acquire, but the market process does not actively harm people for the information they do not acquire. In private markets, people can act in areas where they are informed, but only through voluntary exchange, and ignore areas in which they have limited information. In political markets, predatory politics causes people to be harmed unless they find it worthwhile to actively prevent that harm. Because of the coercive nature of government action, the informational requirements for the Coase theorem to imply the efficient allocation of resources in the public sector are much greater than to achieve the efficient allocation of resources in the private sector.

People cannot be informed about every market and every exchange, in either private markets or in politics. The information costs are too high, and the opportunity cost of gaining more information about some potential exchanges is a reduction in resources available to gain information about other potential exchanges. In private markets, people gather information about those exchanges where they see potential profit opportunities, but do not have costs imposed on them by ignoring activities in other markets. In politics, people also become informed about potential exchanges where they perceive the potential costs to exceed the potential benefits. As in private markets, this means focusing one's attention narrowly, and specializing in a particular area of the market, forgoing activity in areas outside one's specialization. The idea of rational ignorance in politics is exactly parallel to people's acquiring of information in markets. People profit by specializing, so they know a lot about the narrow area in which they specialize, and know relatively little about other areas, because it would not pay to become very informed in areas where others are specializing. But in markets people do not have costs imposed on them by force in areas where they do not specialize. In politics, the coercive nature of government action means that costs can be imposed on those who are relatively uninformed. The opportunity cost of becoming informed guarantees that most people will be uninformed about most political decisions, opening up the opportunity for predatory politics.

The fact that most people are relatively uninformed about most markets and most potential exchanges does not impede the efficiency of market exchange because the voluntary nature of exchange guarantees that people will engage in exchange only when they believe they will receive net benefits, and people cannot have resources transferred away from them without their consent. In politics, the lack of information creates the opportunity for predatory politics, precisely because resources can be transferred from those who are uninformed without their consent. Thus, with the same level of information, conditions that lead to efficient exchange in markets create predatory entrepreneurial opportunities in politics, resulting in inefficiencies. When one recognizes the differences in informational requirements, it becomes apparent that the analogy between efficient market exchange and efficient political exchange is, at best, incomplete.

Market institutions are relatively transparent by design. Their role is to facilitate voluntary exchange when parties have an incentive to trade for their mutual benefit. Political institutions must be more structured and less transparent because they are used in to produce outcomes that would not be generated by voluntary action, and where all participants may not agree with the government's action. Government action might be undertaken for several reasons. The literature on market failure argues that resource allocation can be improved through government intervention, but the fact that government can coercively reallocate resources opens the possibility that government intervention is demanded by those who have political power in order to transfer resources from others to themselves. Regardless of the reason for government intervention, all government action makes people interact in ways that they would not choose to voluntarily, for if that were not true, there would be no reason for the government intervention. This coercive aspect to political institutions creates the key difference between political and market entrepreneurship. It creates the possibility that a political profit can be generated by giving some people benefits at the expense of others.

The market failure explanation for government intervention is fundamentally incomplete, because it does not explain who has the incentive to rectify the inefficiency. From a Coasian perspective, it might appear self-evident that any inefficiency generates a profit opportunity for the entrepreneur who allocates resources more efficiently, but political institutions stand in the way of a political entrepreneur who wants to be a residual claimant in such a situation. Thus, one must look at political institutions and political incentives to see where the opportunities for political entrepreneurship lie, and what those opportunities imply for the democratic allocation of economic resources.

Two Sources of Political Profits

Entrepreneurial opportunities in politics originate in two ways. The first way is through the removal of inefficiencies, or the discovery of potential opportunities for gains from trade through the political process. This process of political exchange has been analyzed extensively, and the concept of the political marketplace based on efficiency-enhancing political exchange has been promoted by Becker (1983) and Wittman (1989, 1995), and tends to be associated with the Chicago school. The basic idea behind this approach to political entrepreneurship is that if political goals are not being implemented in the least-cost way, then there is a profit opportunity from restructuring the nature of the government activity so that the goals are achieved at least cost. The cost savings are a political profit that the entrepreneur can then apply toward the satisfaction of other goals.[6] Following this line of reasoning to its logical conclusion, the political allocation of resources can be just as efficient as the economic allocation of resources.

The second way that entrepreneurial opportunities are created in politics is by forcibly transferring wealth from one group of people to another. If the political support lost from those who pay for the transfer is less than the political gain in support from the recipients, then the political entrepreneur can profit from such a forced transfer. A simple way to contrast these two sources of entrepreneurial opportunities in politics is to note that people can enhance their incomes in two ways: production and predation.[7] The first way in which profit opportunities arise in politics is through production: through the use of resources in a more economical way to produce a profit for the political entrepreneur. The second way in which profit opportunities arise in politics is through predation: taking from some for the benefit of others. Of course, these same two methods of income enhancement are available in the private sector too. However, private sector predation is discouraged and viewed as unethical and illegal. People take actions to prevent themselves from becoming victims of private sector predators, and governments universally view as one of their missions the prevention of non-governmental predation.[8] Government predation, on the other hand, is often viewed as one of the core functions of the state. For example, Musgrave (1959), in his classic textbook on public finance, conceptually divides the government into three branches: the allocation branch, the distribution branch, and the stabilization branch. Thus, through redistribution, Musgrave legitimizes political predation, and raises predation to the level of one of the three core functions of government.

One feature of the profit opportunities presented through political predation is that such opportunities are always present in a democratic political system. This point deserves some emphasis because of the way that it contrasts with entrepreneurial opportunities in the market. In economic equilibrium, all profit opportunities are competed away.[9] In politics, an equilibrium will also eliminate profit opportunities from productive political activities, because inefficiencies will be eliminated.[10] However, potential profits from political predation always remain in a democracy. Thus, as McChesney (1987, 1997) notes, under any circumstances people must devote resources to protecting themselves from political predation, or they become easy targets.

This does not imply that an equilibrium condition will ever be attained, either in markets or in politics, or that all productive entrepreneurial opportunities will be exhausted. Rather, it implies that should an equilibrium be attained, that would eliminate profit opportunities from the market, and it would eliminate profit opportunities from political production, but profit opportunities from political predation remain in equilibrium in a democracy. The reason is that there is always a way to construct a majority coalition in a distributive setting that will favor an alternative over the status quo.

A simple example can illustrate this point. Assume that a dollar is to be divided up among three individuals, who will determine the distribution of the division by majority rule. One possibility would be for two individuals to form a coalition against the third, dividing the dollar in the proportions (1/2, 1/2, 0). The third individual, who has nothing in this division, could propose an alternative, which can be labeled alternative A, (0, 2/3, 1/3). Alternative A would be favored over the original division by both persons two and three, who could outvote the first person by majority rule. Now the first person could propose alternative B, (1/3, 0, 2/3), which would be favored by individuals one and three over A. Similarly, person two could propose alternative C, (2/3, 1/3, 0), which would be preferred to B by both one and two, making C dominate B by majority rule. But alternative A could now defeat C by majority rule, so B defeats A, C defeats B, and A defeats C, setting up the classic cyclical majority. The possibility of a cyclical majority is widely known, but the thing to note here is that this cyclical majority exists only because the status quo can be changed by the approval of a simple majority.

If unanimous approval were required to change the status quo, so that like in the market, a person would have to agree to give up some of his share, then any outcome in the above distributive game would be a stable equilibrium. Once a distribution became the status quo, it would then require the approval of all voters to change it, and because the example above is purely distributional, any benefit to one person must come at a cost to someone else. Every outcome is, in that sense, Pareto optimal, and there would be no profit opportunities lying in wait for potential political entrepreneurs. This is analogous to the market setting, in which a Pareto optimal allocation of resources implies the absence of entrepreneurial opportunities. However, with simple majority rule, the political entrepreneur does not need to provide benefits to every individual, but just to a majority, and because resources can be taken away from a minority to enrich a majority, there are always predatory (distributional) entrepreneurial opportunities available in a democracy.

Predatory Entrepreneurship and Efficiency

Productive entrepreneurship leads resources to be allocated more efficiently. The same is not true for predatory entrepreneurship. Returning to the three person example, a majority would favor a program that provides $1 in benefits for two people while imposing a cost of $2.50 on the third. An outcome with a payoff of ($1, $1, -$2.50) would win the approval of a majority. This example makes it clear that under majority rule, predatory entrepreneurship does not have to be efficient. Of course, a numerical example could be constructed where the total benefits exceeded the total cost, but political institutions weigh in favor of actions in which the total costs exceed the total benefits. For one thing, all purely redistributive programs have the feature that, because of the cost involved in implementing the transfer, the dollar costs exceed the dollar benefits. Another factor leaning toward the political demand for distributive programs is that people enter the political process to try to produce benefits for themselves, and it is easier to devise a scheme for doing so that takes resources from others than it is to devise a scheme that results in efficiency enhancements. On top of that, in simple majoritarian politics, where each vote is weighted equally, there is less incentive to consider total costs and total benefits. Political support, not economic efficiency, is the criterion for success in a democratic environment. As a result, political entrepreneurs can always find opportunities for predatory entrepreneurship.

The predatory nature of political proposals is never revealed in their packaging. Rather, potential beneficiaries will lobby for the program that gives them $1 in benefits based on the argument that it is in the public interest, and will either ignore the $2.50 in costs or claim that either the benefits are really greater than $1 or the costs are really less than $2.50, or both. Sometimes costs are even presented as benefits (Weingast, Shepsle, and Johnsen 1981). For example, a program might bring jobs to an area, increasing the local payroll by $1 million. In the private sector, this labor cost of a project is correctly considered as a cost of the project, but in the public sector the labor cost is tallied as a benefit. Thus, proponents often overstate the benefits of a proposal by listing its costs as one of its benefits. Sometimes costs and benefits are simply budgetary matters, as with jobs or cash transfers, but often they are not. When the costs and benefits are the result of regulation, it is easy to overstate the benefits and understate the costs. The major point, however, is that with democratic decision-making, opportunities for political profit often imply a less efficient use of resources, and successful political entrepreneurship does not necessarily lead toward efficiency or equilibrium. It does not necessarily lead toward efficiency because changes are based on weighing political support and opposition, rather than dollar benefits and dollar costs. It does not necessarily lead toward equilibrium because no matter what the status quo, there is always some purely distributional change that could win the support of a majority.

Productive versus Predatory Entrepreneurship

The efficiency question, addressed in the previous section, has not been completely answered. Predatory entrepreneurship has the potential for inefficiency, but productive entrepreneurship is efficiency-enhancing. As Becker (1983) notes, distributional goals are a part of the political system, but there is an incentive to achieve all political goals, including redistributional goals, as efficiently as possible. Two questions suggest themselves. First, why would political entrepreneurs engage in predatory politics, which amount to a negative sum game, when productive opportunities are available to them? The productive opportunities are a positive sum game, increasing political benefits which then can be added to the entrepreneur's profit. Second, even if predatory entrepreneurship does take place, that creates a productive profit opportunity, allowing a political entrepreneur to later remedy any inefficiency, which results in efficient redistribution and more political profit. Thus, why does productive entrepreneurship not eliminate any inefficiencies caused by predatory entrepreneurship? The answers to both questions lie in the nature of the political marketplace. This section answers the first question, while the following section covers the second.

The tautological answer to the first question is that predatory entrepreneurial opportunities offer greater profit to the political entrepreneur, so political entrepreneurs act on those more profitable opportunities even though they result in a more inefficient allocation of resources. Becker (1983), who emphasizes the efficiency-enhancing aspects of political exchange, depicts the legislature as a marketplace where interest groups express their demands for and against political programs and policies, and the legislature clears the market by passing legislation up to the point where the marginal political benefits of legislation just equal the marginal political costs. If the Coase theorem applies, so that transactions costs do not keep anyone from registering their political demands, then the legislative market should clear efficiently, as Wittman (1989, 1995) suggests. However, most people have very limited access to political markets because the opportunity cost of expressing political demands on most issues is so high relative to the benefit. As Denzau and Munger (1986) note, legislators do have an incentive to pay attention to the preferences of unorganized constituents, because unorganized but informed constituents will vote in upcoming elections, and Wittman shows that interest groups have an incentive to provide information to uninformed constituents who would be likely to side with them. Still, any individual opposition to legislation that spreads costs across a large number of citizens is a public good. The individual opponent bears the costs personally, but if successful must share the benefits with all of the citizens who would have borne the cost. Thus, while in the aggregate, the benefits of opposing inefficient legislation exceed the costs, the public good nature of this opposition means it is not worthwhile for any one opponent to do so, allowing inefficient legislation to be passed.[11]

A straightforward analysis of the nature of the political marketplace shows that individuals do not have an incentive to register their demands against political predation. A comparison with the private sector emphasizes this point. Those who champion the efficiency of political markets argue that there are the same incentives to reduce inefficiencies in the political marketplace as there are in private markets. A careful analysis shows that this is not true, because people are coerced into being participants in the political process whether they consent or not, whereas in private markets people participate only in those exchanges that they anticipate will benefit them. In private markets, just as in political markets, individuals do not have the incentive to become informed and to register their demands in most markets. Thus, in both cases, most people choose not to participate in most markets. The crucial difference is that in private markets where individuals choose not to participate, people on the other side of those markets cannot coerce transfers from the nonparticipants. In contrast, democratic politics allows those who choose not to participate to be the victims of political predation.

The reason why political entrepreneurs pursue predatory opportunities is that they tend to be more profitable. Lobbyists and special interests come to legislators seeking predatory policies that provide them with transfers, tax breaks, or favorable regulations, but only rarely approach legislators with productive policies because predatory policies tend to provide concentrated benefits to those seeking them whereas productive policies tend to produce public goods that benefit a wider group, so have a weaker constituency. Because information on pending legislation is costly to obtain, and even with information in hand, action against legislation is costly to undertake, most people passively accept most legislation, creating a set of victims that can always be raided to pay for predatory policies. Again, it is worth emphasizing that the profitability of predatory policies comes from the fact that the costs of such policies can be coercively imposed by government.

Why Do Productive Opportunities Remain?

The answer to the second question, about why productive policies do not eliminate the inefficiencies of predatory policies, lies in the opportunity cost of political entrepreneurship. Yes, after inefficiencies are created there is an entrepreneurial opportunity to reallocate resources more efficiently, but political entrepreneurs are limited in the number of issues they can pursue, so choose the options that are most profitable. The passage of legislation requires a majority of votes in the legislature, and the legislative process involves logrolling. While at first it might appear that political exchange is inefficient and vulnerable to bad-faith promises, that is less true in an environment where there are a small number of people, where they all know each other, and where future support is necessary for professional success. If legislators do not make good on their IOUs, they will not be able to trade in the future; thus, legislators have an incentive to reciprocate when they have been helped by others, and they have an incentive to be careful about when they ask for support.

Just as consumers must be careful not to charge too much on a credit card and accumulate too much debt, legislators must be careful not to accumulate too much political debt, and skillful legislators must discipline themselves to ask for support only when the benefits of passing legislation (or maybe just bringing it to a vote) exceed the future costs of having to reciprocate and support those with whom they exchange. In short, legislators have a budget constraint that limits the policies they can actively pursue. This limits their ability to pursue productive policies even when they would be in everybody's interest.

The free rider problem applies again, because a policy that provides efficiency gains to everyone imposes a cost on the legislator who sponsors it, because votes must be traded to get it passed, but the gains are more widely shared. Meanwhile, the effort spent to provide this type of public good takes away from the effort that the legislature could be devoting to producing predatory legislation that will garner special interest support and provide a higher private payoff. Without the budget constraint it would be feasible for legislators to pursue both predatory and productive policies, but when the legislator's budget constraint is factored in, it causes legislators to favor predatory policies over productive ones. One might be tempted to think that legislators could pursue both productive and predatory profit opportunities, but just as in the market, where buying one thing precludes buying another, any productive opportunity that a political entrepreneur chooses to seek support for displaces a predatory opportunity that the entrepreneur could have pursued. And as the above analysis has shown, unlike productive political opportunities, predatory profit opportunities never run out, and are always available.

Political Stability and Political Entrepreneurship

Theorists studying the democratic political process have long observed that under many circumstances, majority rule voting has no unique stable outcome, yet the democratic decision-making process does appear to be stable in most cases. Understanding why that is the case lends insight into the process of political entrepreneurship.[12] To be successful in politics, political entrepreneurs need political support. To gain the support of constituents, elected representatives must provide them with benefits, and such benefits might come in efficiency gains that are a public good shared with the constituents of all representatives, or might come as programs targeted toward that representative's constituents and paid for by others. Pork barrel projects and transfers targeted to constituents provide a surer route to political support than the benefits from productive activity for a number of reasons. First, the magnitude of the potential benefits from forcibly transferring resources from some to others is much greater. Efficiency gains are limited by the degree of inefficiency, but there is no limit to the magnitude of transfers that could garner majority support. Second, constituents tend to reward legislators more for bringing programs and dollars to them than for the production of public goods. Constituents prefer to let other people's representatives enhance the efficiency of the system, so that their own representative can concentrate on diverting as many programs and expenditures toward the home district as possible.

All representatives find themselves in a similar situation, and in a democracy, representatives cannot carry out their goals without the cooperation of other representatives. Thus, representatives must form coalitions and engage in political exchange in order to succeed in transferring resources from the general treasury to their constituents. One way to do this would be for a group of legislators to form a minimum winning coalition, and for those in the coalition to use their political power to transfer resources from others to themselves, as Riker (1962) suggested. A minimum winning coalition creates an entrepreneurial opportunity for those not in the winning coalition to conspire with a subset of those in the coalition, offering them an even larger payoff if they break ranks. Thus, Groseclose and Snyder (1996) argue that it is cheaper to form a larger coalition to prevent such defections, which Carrubba and Volden (2000) refer to as the minimum necessary coalition. The minimum necessary coalition is the smallest necessary to maintain a stable winning coalition. But any coalition that does not include everyone always opens up some opportunity for political entrepreneneurship within the minority to disrupt the majority coalition.

Kurrild-Klitgaard (1997) and Aaronson (1996) discuss the incentives for those out of power to destabilize the political system, which gives insiders have an incentive to bargain with everyone, in order to maintain stability, and thereby to maintain their power. The entrepreneurial incentives for instability are always present, because predatory politics always pits some against others, but the entrepreneurial incentives to promote stability have an important advantage. The incumbents, who already have political power, have the incentive to stabilize the political system, and the incumbents also have the greatest amount of political power to change the political environment. One implication of this is that unless those with political power miscalculate, political change should be evolutionary, to maintain the power of those in power, rather than revolutionary. This creates incentives for a more universal coalition in which all interests enter the bargaining process to some degree, and with everyone having a chance to benefit from political exchange, political entrepreneurship tends to create political stability.[13]

Entrepreneurial Opportunities in Politics

An analysis of democratic political institutions shows that while there are entrepreneurial opportunities that can lead toward an improved allocation of resources, the institutions of democracy tend to pull political entrepreneurs toward predatory opportunities rather than toward productive ones. The potential profits are greater through predation, and the gains are more appropriable; productive opportunities too often are non-appropriable because the benefits are spread throughout the population rather than concentrated on the entrepreneur's constituents. The nature of political budget constraints also implies that potentially profitable productive opportunities may go unexploited even if they are noticed, because there will be more profit in predatory opportunities, and predatory opportunities always exist. Because democratic politics always allows some people to coercively obtain resources from others, elected representatives have the incentive to pursue those opportunities for their own political benefit.

Legislators can act on these opportunities only by cooperating with other legislators, because they need the support of a majority to get their legislation passed. Thus, legislators cooperate with each other in order to obtain their political goals. Part of being an effective legislator means being a good bargainer, so that the legislator can obtain as much as possible in exchange for supporting the programs of other legislators. The result is that legislative exchange takes place as legislators cooperate with each other, in the process enhancing the opportunities for all legislators. Legislators have an incentive to enhance their ability to create effective exchanges, to enforce those exchanges, and to enhance the security of their positions as legislators. In this sense, democratic institutions provide the incentive for all legislators to cooperate with each other to further their collective goals.

The mechanisms by which legislators enhance their security and ability to cooperate with each other through predatory democracy have been discussed in detail in the literature. Weingast, Shepsle, and Johnsen (1981) describe the universal political coalition in which all legislators cooperate to share the benefits of resources obtained through political predation. Crain (1977) has described how the political marketplace is divided among incumbents for their benefit. Holcombe and Parker (1991) have described the way that the committee system acts as a method of establishing clear property rights to areas of the legislative agenda to enhance the ability of the legislature to produce benefits for special interests. Holcombe (1991) discusses the wide varieties of barriers to entry that provide incumbent advantages, including the franking privilege, the staff and expenses paid for with tax dollars, and the use of single-member districts and staggered senate election terms to prevent incumbents from competing with each other. These political institutions, often designed by the legislature itself, are created to enhance the ability of legislators to produce special interest benefits through predatory politics, and to protect legislators from the challenges of incumbents.

The nature of political entrepreneurship in a democracy, then, is that a group of representatives work together to systematically transfer resources by force from some groups of citizens in order to provide benefits for other groups. Because each legislator has an agenda, many transfers occur from many groups to many groups. The typical citizen will be on the receiving end of some transfers and on the paying end of others. Legislators initiate these transfers for their own benefit, because the political cost to them of taking resources from the groups that are preyed upon is less than the political benefit they receive from the groups that get the transfers.

Two Dimensions of Political Competition

This view of the political marketplace contains within it an important insight about the nature of political competition. As the political marketplace has been depicted above, incumbent legislators have the incentive to maintain stability by forming a coalition among all incumbents to prevent themselves from being displaced. Thus, the critical dimension of political competition is not along ideological or party lines, as it is typically depicted, but between incumbents and non-incumbents. When an election is held in the United States, typically a Republican candidate will run against a Democrat, and one will be the incumbent while the other will be the challenger. In this situation, political competition is commonly viewed as competition between parties: Republicans versus Democrats. This view of political competition obscures the fact that the more significant dimension of political competition is not between parties, but rather is between those who hold political power (incumbents) and those who want to take that power away from them (challengers). In fact, legislators in one party have more interests in common with their fellow legislators in the other party than they have in common with challengers in their own party.

Looking at the interests of an incumbent legislator, that legislator's primary political goal is to maintain power, which automatically puts the incumbent in an adversarial relationship with all non-incumbents. In most cases, measures that would help legislators elect more members of their own party will weaken the benefits of incumbency, and an incumbent would rather strengthen the benefits of incumbency than undertake measures that could help challengers. All incumbents share the same interests in this regard, in opposition to all challengers. Furthermore, incumbents must cooperate with each other to gain majority support in the legislature to pass the legislation they favor. Through cooperation among themselves, incumbents use their political power to coercively transfer resources from some citizens to others in order to further the goals of the representatives. When one examines the incentives of the political system, it is apparent that the primary dimension of political competition is not between parties or ideologies, but rather between incumbents of all parties against challengers of all parties. While an election that pits an incumbent of one party against a challenger of another at first appears to be primarily a competition among individuals of different parties, upon closer examination, the party affiliation is secondary, and the competition is primarily between an incumbent who wants to retain political power and a challenger who wants to take it away.[14]

The different impressions conveyed by these two different dimensions of political competition have significant implications for the nature of political resource allocation. If political competition is primarily among parties to claim the benefits of incumbency, then from an industrial organization standpoint, it might be viewed as competition among various firms for the right to be a temporary monopolist. Following Demsetz (1968) and Tullock (1965), this competition for the right to monopoly power can lead to an efficient allocation of resources as monopoly profits are bid down to zero. Party competition is analogous to economic competition in the marketplace. If political competition is primarily between those who have political power and those who do not, a different picture emerges. Incumbents erect barriers to entry to provide profits to those who have political power, and the source of the profits is the coercive power of government.

One factor that casts doubt on the competitive view of politics is that people are willing to invest so much to win the political competition. If once victory is attained, the winners must follow the dictates of the voters to retain their power, as Downs (1957) suggests, and all profits are competed away, there is little benefit to gaining political power, and the distribution of benefits to the general population will be roughly the same no matter who wins. If political competition instead is between incumbents who erect barriers to entry in order to keep the profits of political power for themselves, and this power is used to produce benefits the interest groups that support them at the expense of others, then there is a substantial potential reward for political victory, and there is a good reason to devote a considerable amount of resources toward trying to win this competition.

The mere fact that there is such heated competition for elected office, and that people are willing to spend so much money to try to influence the outcomes of elections, suggests that there are substantial profits to be gained by the victors. This, in turn, suggests that democratic politics is not like a competitive marketplace where there are no above-normal profits to be reaped, but rather that barriers to entry have created a profitable monopoly for incumbents, who use their power to keep challengers out and to channel benefits toward themselves and their supporters. The competition is always stacked in favor of incumbents, because if a challenger does win, the challenger then becomes a member of the incumbent coalition. This is yet another factor that works for the benefit of those who already hold political power.

When reviewing the advantages that favor incumbents over challengers, the amount of money that people invest to attain political power, and the barriers to entry that enhance the profitability of political power, it is apparent that the essence of political competition is that those who have political power are competing with those who are trying to get it. Incumbents of different parties have more interests in common than incumbents of one party have with challengers in their own party. Parties do compete with each other, just as sales people from the same company may compete with each other to see who can generate the most sales. This competition is incidental to the fundamental competition, which in politics is not parties competing with each other but incumbents competing with non-incumbents.

Conclusion

Political entrepreneurs, like those in the market, discover and act on unexploited profit opportunities. In many ways, there are parallels between political exchange and market exchange, and the political marketplace is, indeed, a market. Democratic political institutions are different from market institutions, however, and this paper has shown that two significant institutional differences mean that resources are allocated differently through democratic governments than they are through markets. One crucial difference is that governments use coercion to obtain resources, so those who pay for government decisions do not do so voluntarily. This is true even for those who completely support government intervention: even the strongest supporter of government action still has no choice but to abide by the government's conditions. The second crucial difference is that in a democracy, a majority has the power to take collective action for the whole group. This means that those with political power have the potential to exploit those who do not, but it also means that elected representatives need the cooperation of other elected representatives in order to accomplish their political goals.

Wittman (1995), Becker (1983), and others have made the argument that political markets tend to allocate resources efficiently, as do economic markets, because there is always the incentive to attain any goal as efficiently as possible, leaving the largest possible surplus to be divided among the participants. That argument might be viewed as a tautology: if there was a more efficient way of doing things, all things considered, people would be doing things that way. If it is interpreted as more than a tautology, the analysis in this paper shows that the characteristics of democratic politics create inefficiencies that do not exist in markets, and that democratic governments systematically allocate resources inefficiently.

The biggest reason for inefficiencies in government resource allocation is that people are forced to participate. In private markets, people can choose to participate in a market or not, based upon their expectations of the benefits. With government resource allocation, people are forced to pay taxes regardless of whether they expect a net benefit, and are forced to comply with regulations the same way. This opens the door for coerced transfers, but when taking account of Hayek's (1945) insightful analysis of knowledge, it does much more. It means that unlike private markets, government action forces people to participate in activities in which they are uninformed, and in which they are unequipped to make cost-benefit calculations. In the private sector, people trade in those markets where they believe they have sufficient information to make exchanges to enhance their well-being. In areas where they lack sufficient information, they do not trade. As Hayek (1945) notes, each individual can know only a small fraction of the total amount of information available. In the public sector, people are forced through coercive taxation and regulation to participate in activities in which they have no information, and have no incentive to become informed. The result is that those who are informed can use the political process to prey on those who are not. This is a significant and overlooked characteristic of government resource allocation, and because of the informational differences, political resource allocation can not be as efficient as resource allocation through markets.

This is more than just a matter of transactions costs or information costs. In markets, people choose to transact, and choose to become informed up to the degree where they view that the marginal benefits of more information are equated with the marginal costs. In government, people know that in some areas it does not pay them to become informed, but they are forced to participate anyway through coercive taxation and regulation. Those situations always produce potential victims of predatory programs. In markets, predation is illegal, but in government, predation is the standard mode of operation. Because of the limited information that anyone can possess, this necessarily means that many people are going to be victims of government predation because they have no option not to participate in those activities where they are likely to be victims of predation. The inefficiency in democratic politics is more than just saying the information requirements are greater, so political resource allocation will not be as efficient. In markets, the incentive structure is such that people have the incentive to seek out opportunities for more efficient resource allocation, whereas in democratic politics, the institutions give political entrepreneurs the incentive to seek out opportunities for predatory and inefficient policies. It is not just that the invisible hand does not pull quite as hard toward efficiency in politics, but rather that in politics the incentives pull toward inefficient resource allocation.

The political marketplace does present entrepreneurial opportunities for more efficient resource allocation which, once exploited, disappear, but predatory entrepreneurial opportunities are always present in government, because it is always possible to come up with a transfer of resources that can receive majority support. Predatory entrepreneurial opportunities are more readily available and are potentially more profitable than productive entrepreneurial opportunities in politics. In democratic politics, all political action requires cooperation from others, and the result is the formation of very inclusive political coalitions that cooperate to engage in predatory transfers from one group to another.

In both politics and markets, entrepreneurship consists of discovering and acting upon unexploited profit opportunities. In markets, the invisible hand leads entrepreneurial acts to enhance the productivity of the economy, but in politics entrepreneurship in the main leads to inefficient transfer activity. This should not be surprising, considering the coercive nature of political institutions. Centuries ago, Thomas Hobbes (1651) described a situation of anarchy as a war of all against all, where life would be nasty, brutish, short, solitary, and poor. The problem with anarchy, as Hobbes saw it, was that without clearly defined and enforced property rights, people would engage in predation rather than production, to the detriment of everyone. The same lessons should apply to government. When an institution is established that allows people to profit from predation, inefficiency results for the reasons Hobbes articulated so long ago. The American Founders were well aware of this, and tried to design a government insulated from democratic pressures, dedicated to protecting the rights of individuals. Over the next two centuries American government has become increasingly democratic, and because of this, increasingly predatory. Under these institutions, predation is where the bulk of opportunities for political entrepreneurship lie.

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Notes

1. The analysis that follows takes place mainly within the context of representative democracy, but this requirement that others must cooperate for successful political entrepreneurship is true in general. Dictators must have the support of underlings, and bureaucrats are subject to oversight and counterveiling actions, for example, by the courts.
2. See Becker (1983) and Wittman (1989, 1995) for prominent examples.
3. Aaronson (1998) notes that political entrepreneurs may have the incentive to create political instability to enhance their electoral opportunities.
4. Kirzner (1973) defines entrepreneurship similarly, emphasizing that the entrepreneurial act is observing the profit opportunity, and that while subsequent actions, such as production, may result from entrepreneurship, they are not a part of entrepreneurship. Thus, the definition of entrepreneurship used here starts with Kirzner's idea, but is broader because it requires both observing and acting on the profit opportunity. Note that Kirzner (1999) accepts a broader definition of entrepreneurship than appeared in his 1973 book.

5. A review of some of this literature (related to ideological voting) is found in Bender and Lott (1996). Bender (1991, 1994) notes that there is a substantial opportunity for ideological voting in congress, implying a weak principal-agent link between elected representatives and their constituents. As Tullock (1965), Crain (1977), and Crain, Holcombe, and Tollison (1979) have noted, this weak link is due to a political market structure that creates barriers to entry into politics, giving elected officials considerable monopoly power.
6. Niskanen (1998) analyzes political entrepreneurship within the context of Pareto-improving entrepreneurial opportunities.
7. See Usher (1992) for an excellent discussion of predation by government, and ways that it might be controlled.
8. Governments may often conspire with private sector predators for the benefit of both, and often are lax in enforcing their laws against private sector predation, but this does not change the fact that governments universally view predation as exclusively their domain.
9. This requires some qualification. See Holcombe (1999) for a discussion of concepts of equilibrium. It is true in the neoclassical setting, however, and is true following Kirzner (1973).
10. See Winer and Hettich (1998) for an application of the approach followed by Becker (1983) and Wittman (1989) to the tax system. Holcombe (1998) presents an alternative point of view.
11. Anyone who argues that the market underproduces public goods, thus justifying government production, ought to be sympathetic to the idea that political outcomes that are public goods create the same incentives to underproduction.
12. See Tullock (1982) for an insightful discussion of the issues. Moser (2000), especially Chs. 2 and 3, gives a good overview of the theoretical causes of political instability and the ways that political decision-making is stabilized by different institutional arrangements.
13. However, even if everyone is explicitly included in a political exchange, even the requirement of unanimous approval would not allocate resources the same way as market exchange, as Sobel and Holcombe (2001) argue.
14. Holcombe (1985) analyzes the competition between incumbents and challengers in more detail.

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