In the closing weeks of 2005, Chang-Tai Hsieh received nearly a dozen calendars and refrigerator magnets from real-estate agents eager to represent him the next time he buys or sells a home. Just before Halloween, two agents left pumpkins on his doorstep.

Mr. Hsieh, an associate professor of economics at the University of California, Berkeley, thinks all this free stuff helps explain what’s wrong with America’s real-estate brokerage business: Rather than competing on the price of their services, agents tend to spend heavily on marketing gimmicks -- and pass that cost to the consumer.

As home prices soared in recent years, so did the percentage-based commissions charged by agents. Residential real-estate commissions in the U.S. totaled $61 billion in 2004, up 42% from 2000, estimates Real Trends, an industry publication. That’s bad news for people who buy or sell homes. But isn’t this trend at least making Realtors happy?

Alas, no. The number of real-estate agents has grown even faster than total commissions. Membership in the National Association of Realtors, the dominant trade group, totals about 1.25 million, up 63% since 2000. As a result, there’s not even close to enough commission income to keep all those agents in Porsches. The median annual income of real-estate sales agents in 2004 was only $37,600, down from $39,300 in 2002, according to the Realtors. Even that figure overstates agents’ well-being. Because most agents are independent contractors rather than employees of the firms where they work, they need to pay out of their own pockets for such things as health insurance, pension plans, driving customers to see homes, and even pumpkins.

Of course, some agents do get rich. Those most successful at selling luxury housing can earn more than $1 million a year. Even in average neighborhoods, the best-known agents tend to get...
the bulk of the listings because homeowners want a proven performer. In 2004, Realtors with 26 years of experience or more had median income of $92,600, up 37% from two years before.

The chance of joining the million-dollar club attracts hordes of greenhorns, though. A 2003 study by Mr. Hsieh and Enrico Moretti, a fellow associate professor of economics at Berkeley, found that when home prices go up in a city, more people become agents. Their productivity—the number of transactions completed per agent—then declines. The result is that income for the typical agent remains low, even though some top performers earn six-figure incomes.

"Somebody is paying more -- us, consumers -- but nobody is better off," Mr. Hsieh says. He calls it the "tragedy of the commission."

Realtors are feeling a lot of heat. The Department of Justice in September filed a lawsuit alleging that the Realtors' policy on Internet displays of listings data—which allows brokers to block their listings from being displayed on other brokers' Web sites—"restrains competition" from brokers that rely mainly on Web sites to engage with their customers. The Realtors deny that charge. The Justice Department and the Federal Trade Commission continue to probe other Realtor policies that may deter competition.

Realtors often point to the large number of agents and their relatively low pay as proof that the industry is highly competitive. But as Mr. Hsieh and other academics have found, a large number of competitors doesn't necessarily mean lots of price competition. Commission rates have come down only modestly in recent years. Real Trends estimates that the average fell to 5.1% in 2004, the latest year for which survey data are available, from 5.5% in 1998.

Of course, some brokers do compete on price, including a growing band that charge a flat fee for selling a home, no matter how high the price. But a recent report from the Government Accountability Office found that real-estate brokerage firms have "displayed more evidence of competition on the basis of nonprice factors, such as reputation or level of service, than on price."

One possible reason for this, the GAO said, is the use of multiple-listing services, databases for homes available in an area. These services allow agents to see how much commission is being
offered on each home. They have more incentive to show their customers the homes with higher commissions.

Another reason is that Realtors are well-organized and have persuaded states to pass laws discouraging price competition. For instance, about a dozen states prohibit agents from rebating part of their commission income to the consumer. Peer pressure also plays a role: Agents need to cooperate with one another to sell homes, and offering discounts isn’t a good way to make friends in the trade.

Yet consumers also are partly to blame. Many people don’t even consider using a discount service or negotiate with their agents on the commission.

Of course, many agents insist that their services are worth a high commission, and some consumers believe an agent from a well-known, traditional firm will fetch a higher price for their home than a discounter could.

The evidence on that is mixed. Two real-estate professors -- Abdullah Yavas of Pennsylvania State University and Ronald Rutherford of the University of Texas at San Antonio -- sifted through home-sales data from several Texas counties between 2002 and 2004. They found that homes listed by discount brokers were 12% less likely to sell than those listed with traditional firms but that there was little apparent effect on the prices obtained for homes that sold. The discount listings that did sell took 5% longer to do so.

Mr. Yavas says the differences probably reflect a couple of factors. Discount brokers tend to provide more limited service, he notes, and full-service agents sometimes avoid showing their customers homes listed by discounters.

The message for consumers is clear. Those looking for a new home should insist on being shown all of them, not just the ones that come with the fattest commissions. Home sellers should interview at least a few agents before choosing one to market their homes. If a home is attractive and reasonably priced, chances are there is no need to pay a commission of 5% to 6%.

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