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# 1. The nature of rent seeking

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## SUMMARY

This chapter provides a short introduction to the rent-seeking research program, including an analysis of the nature of rent seeking and its associated losses, evolutionary pressures for reducing those losses and the extent to which modest rent-seeking losses are natural and unavoidable.

### 1.1 THE ORIGIN OF THE LITERATURE ON RENT SEEKING

The term rent seeking was coined by Anne Krueger (1974) in her study of the resources drawn into the import and export businesses of Turkey and India because of their monopoly structure. She argued that competition for the ‘rents’ associated with those monopolies caused a good deal of competition for positions in those industries that consumed scarce resources – talent, time, training and other resources, without increasing the magnitude of industry rents. Competition to participate in import-export monopolies could thus to be a wasteful use of resources, and Krueger estimated that 7 percent of gross domestic product (GDP) in India and 10 percent of GDP in Turkey were wasted in that process. She called the activity of pursuing the higher wages available in the monopolized sectors, ‘rent seeking’.

Unbeknownst to her, Gordon Tullock had undertaken a similar analysis of crime, tariffs and monopoly privileges nearly a decade earlier (1967 [2008]). This was pointed out, the literatures joined, and a new field of public policy analysis was launched. Rent seeking, from the perspective of that early literature, was the wasting of resources in the pursuit of ‘unearned’ profits or wages, which often were obtained through public policies that were widely acknowledged by economists to be counterproductive.

This core idea produced a substantial literature that attempted to analyze the extent of losses from monopoly and a variety of public policies that tend to increase market power. The new methodology included losses associated with the pursuit of rents – broadly construed – in addition to the conventional deadweight loss triangles of mainstream welfare economics. New estimates implied that losses from monopoly and ‘protective’ policies were far larger than formerly believed. For example, estimates of losses from monopoly in the United States suggested that rent-seeking losses were approximately 2 percent of gross national product (Posner 1975 [2008]), whereas the older estimates of welfare losses were only 0.1 percent of GNP. Rent-seeking losses were 20 times larger than the original deadweight loss estimates of Harberger (1954).

## 1.2 QUESTIONS EXPLORED BY THE LITERATURE ON RENT SEEKING

The core ideas were generalized to include the nonproductive use of resources in a wide variety of contests. In rent-seeking contests, resource investments are made by all the participants without significantly increasing the prize competed for or producing significant benefits for persons outside the contests of interest. Other contests may be productive, in that competition increases net value, rather than diminishes it, as might be said of competitive markets, contests for political office or sporting games. Rent-seeking contests are not value increasing for the rivals in the contests or for those affected by them, because the opportunity cost of the resources consumed exceed any benefits produced by the contest. Theft has this character. Warfare has this character. Many lobbying contests over public policy have this character. Many status games also have this character.

To analyze how contests may elicit unproductive conflict, the theoretical literature on rent seeking investigates how different rules affect investments in contests in which no-net benefits are produced, as in contests in which rivalry over a fixed pie occurs. In such contests it is clear that the rules of the game affect losses by encouraging or discouraging competitive efforts. Another strand of the theoretical literature explores incentives of governments to create or eliminate contests in which such losses accrue. Some rent-seeking contests are arguably accidental features of policy making, but others seem to be the result of intent. In either case, different rules could have reduced rent-seeking losses.

To what extent are such loss-affecting rules adopted? An answer requires integrated models of rent-seeking behavior and officeholders with the authority or power to establish the rules of rent-seeking contests.

One major strand of the rent-seeking literature analyzes what might be regarded to be accidental losses from rent-seeking activities. In some political settings, contests emerge which elicit efforts to persuade government to adopt policies that reduce competition in markets, without producing much of value. This process requires information campaigns, the wining and dining of pivotal decision makers and perhaps the giving of gifts (or bribes). As long as the overall net benefits generated by the policies are not significantly increased by those efforts, it is clear that all the efforts to secure favors for oneself or one's industry can be regarded as a deadweight loss, because the resources invested in the contest could have been used elsewhere to produce new net benefits for consumers or others.

Losses from such counterproductive contests would be reduced if each competitor simply reduced its efforts by half (or more). In this sense, rent-seeking losses are conceptually avoidable, although reducing them is not always politically feasible under existing institutions, nor is it always obvious that particular reforms will reduce or increase losses.<sup>1</sup> Were policy makers to understand the nature of these losses, perhaps the mechanisms for selecting public policies would be modified to avoid such losses. The existence of rent-seeking activities and losses are thus relevant for the study of policy making and public economics, and many other areas of social science.

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<sup>1</sup> The effects that institutions have on the extent of rent-seeking losses was first explicitly analyzed in Congleton (1980 [2008]).

Insofar as resources are unproductively consumed by rent-seeking contests, those expenditures are miscounted in GNP statistics, where expenditures are assumed to reflect marginal revenue products of inputs – that is to say, the extent to which an input increases national output. The salaries of lobbyists create benefits for the lobbyists themselves but without increasing national output. Insofar as GNP is intended to represent the value of final goods produced economy wide, GNP should be reduced by the amount of the resources consumed in unproductive contests. Laband and Sophocleus (1992) suggest that up to 25 percent of GNP is consumed in such contests in the United States.<sup>2</sup>

### 1.3 THE NORMATIVE CASE AGAINST RENT SEEKING

The usual method of measuring rent-seeking losses relies upon the Kaldor-Hicks measures that dominate applied work in public economics. However, the normative effects of rent seeking can also be analyzed from other perspectives, with similar conclusions. For example, from a contractarian perspective, those who anticipate being affected by rent-seeking contests would unanimously agree to ban all contests in which the expected net benefits are lower than alternative uses of resources. Risk-averse persons would go a bit further and agree to ban contests in which the expected net benefits are zero, insofar as uncertainty is present for persons caught up in such contests or affected by them. Similar bans would also be agreed to from a justice or fairness perspective, insofar as the result of rent-seeking contests tends to be ‘unearned’ or ‘undeserved’ income, or ‘illegitimate’ shifts of net benefits from their ‘proper’ owners to others or from the relatively poor to the relatively rich, as with trade protection and agricultural subsidies.

Tullock’s (1967 [2008]) analysis of ordinary theft nicely illustrates the normative case against rent seeking and indirectly provides a clear utilitarian defense for private property. Suppose that ‘Al’ undertakes to grow some nice melons in her garden. Her neighbor ‘Bob’ likes melons but does not like gardening. He plans to simply harvest some of the melons grown by Al, when they are ripe. From a Kaldor-Hicks (K-H) perspective, this is mere redistribution and so no change in overall welfare occurs from Bob’s action. However, Al realizes that Bob will attempt to take the melons and erects a fence around her melon patch at a cost of  $R^A$ . Bob may reciprocate by purchasing a ladder or fence cutters at a cost of  $R^B$ . The net benefits of the melon for each have clearly been reduced by this contest for control of the melons, and the K-H measure of social welfare is reduced by the amount spent on the fence and fence cutters,  $R^A + R^B$ , even if Al’s gardening effort is unaffected by her efforts at fence building.

The K-H losses are even greater if the output of Al’s garden falls as she redirects her time and energy to fence construction and maintenance. Such losses provide a reason to ban theft from a K-H perspective, but this conclusion is obvious only when the resource costs of the contest over the melons are accounted for.

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<sup>2</sup> Several excellent compendiums of the rent-seeking literature have been assembled as the literature emerged. The first was by Buchanan et al. (1980). Others include Rowley et al. (1988), Tollison and Congleton (1995) and Congleton et al. (2008a, 2008b). The latter two volumes are the most extensive of the collections.

Theft would also be banned from a contractarian perspective for somewhat similar reasons. Essentially all persons can imagine themselves being in Al and Bob's situation – more than occasionally – and would realize that losses from such conflict can be reduced by establishing clear rights for gardeners over their produce. Similarly, a justice perspective might insist that Al is entitled to the fruits of her labor, rather than Bob. It is she that bore the cost of planting and tending to the melons and it is proper that she should realize the fruits of that effort, rather than her neighbor. Different meanings of fairness can affect one's conclusions, but it seems clear that if Bob could also raise his own melons at a reasonable cost, fairness would require that the melons produced by Al should be Al's, rather than Bob's.

All rent seeking involves costly investments to get more than one has 'earned', with results that run counter to mainstream normative theories. That rent seeking continues to occur provides evidence of the effectiveness of the efforts of rent seekers relative to all the rest of us (Olson 1965).

#### 1.4 LIFE, EVOLUTION AND UNPRODUCTIVE CONFLICT

It bears noting that it is completely natural that individuals and organizations attempt to profit from their efforts, as rent seekers do. It is not a human or cultural defect, but a survival trait. To survive, every species needs to find more food than required in calories to obtain it and more water than spent in sweat and tears finding and transporting it. Although there are many ways to obtain a surplus, doing so is a nontrivial activity and a necessary one for all living things.

Biologists have catalogued a wide range of strategies through which organisms survive. Some species use sunlight and minerals to construct their fabric of life and flourish when both are available at particular ratios and densities. Others use the bodies of other organisms as their principal source of raw materials. The bodies of those organisms may in turn be used as sustenance for others, as grass grazers are food for meat eaters. In this manner, a chain of life is formed from simple more or less independent organisms to species that depend more on others further down the food chain. The latter are often, although not always, biologically more complex than those that produce life directly from minerals and sunlight.

There is conflict over sustenance throughout the chain: at and between levels of the biological system. An ecosystem is not one large harmonious circle of life. Conflict within and among species absorbs both calories and time that could be used in other ways. The rent-seeking literature implies that the nature of these contests can be such that as many or more calories are consumed in such contests as is produced by them (exact or super dissipation). However, conflict over scarce food sources can consume as many or more calories than at stake only for short periods of time. One or more species will fail to survive such intense conflict. Survival requires rules, strategies, or decision-making procedures that avoid both the exact and over-dissipation results of rent-seeking contests.

As a consequence, all species have evolved a variety of ways for reducing conflict and also for surviving the conflict that nonetheless occurs. Conflict is reduced in a number of ways. Specialization can reduce conflict by using resources for survival that other species cannot. Genetically transmitted rules of conduct can reduce conflict, as with

territoriality and pecking orders. Indeed, that such rules become ‘hard wired’ in genetic codes demonstrates their importance. Hard shells, speed, stealth, self-repair, and fear responses further reduce losses from conflict. Statistical methods are also used; for example, reproduction rates tend to be much higher and average longevity somewhat shorter down the chain than up.

Evolution is sufficient to produce complex ecosystems in which conflict is reduced to less than all-consuming levels. This allows species and the overall pattern of life to be sustained for very long periods of time – until disrupted by major catastrophes, such as changes in climate, exhaustion of critical sources of sustenance or genetic innovation that increases competition or diminishes the effectiveness of older strategies to reduce it. Such strategies tend to be both efficient and robust in the sense that even after major disruptions, biological systems have been sufficiently flexible that a new balance has nearly always emerged, although occasionally with major disruptions in the composition of the biosphere, as with the disappearance of dinosaurs. The winners are not always the strongest or fastest, but the best at harvesting net calories from a given physical and biological environment.

Humans emerged rather late in this process and, like other species, were also predisposed to maximize net calories. Their success suggests that forward looking – rational – evaluation of alternative strategies and consequences may also help reduce such losses in dynamic or complex circumstances. As the particular talents of humanity were refined and knowledge and capital accumulated, they came to be so efficient at net-calorie maximization that essentially the entire food chain from brewer’s yeast to whales could be used in the production of human sustenance – for food, shelter and comfort.

Humans subsequently began to create their own artificial ecosystems, choosing particular species to support and others to challenge. Husbandry replaced nature’s Nash equilibrium of conflict over calories in many areas of the biosphere, which reduced losses from conflict for the desired species and often increased it for the undesired species. The result was fewer bears and wolves but more sheep, chickens and grapevines, as humans produced safe havens for domesticated animals and plants and organized efforts to exterminate their rivals.

Inter-human conflict has also occurred, and much of that had (and has) the structure of rent-seeking contests. It was clearly possible that more calories would be consumed (or destroyed) in warfare than realized as the fruit of battle. For those that survived, it was also possible that the quality of life would be reduced to levels below that which most humans sought, as argued by Hobbes in 1651. However, again, solutions emerged, although not only genetic ones.

Organizations were formed to realize the productivity gains of team production and to avoid the losses from conflict, as noted by Montesquieu (1748[1914]). Counterproductive conflict is often systematically punished through social norms or government coercion. For example ownership rights over particular resources may be established, and violations of those ‘rights’ punished by norms against theft and formal penalties imposed on thieves. That laws emerged to both encourage productive activities and discourage unproductive conflict is clear from the earliest recorded legal codes, such as the code of Hammurabi (1800 BCE). Whether the individual rules making up civil and criminal law resulted from intent or social evolution is less clear, but also less important.

Wasteful conflict among human organizations has proved to be more difficult to

reduce than among individuals and families. Again, territoriality and norms for engaging in conflict have played important roles (international law). Bans on the most destructive forms of warfare and agreements to reduce stocks of military capital goods also tend to reduce losses, and so agreements to do so have also been negotiated, although they have often been violated or undermined through innovation. Warfare and piracy, with their associated losses, remain problems in spite of boundary and peace treaties negotiated between governments and civil laws enforced within the territories governed.

As stressed by the rent-seeking literature, one of the perennial problems of humankind is managing losses from conflict. Successful strategies for doing so, as Hobbes (1651 [1982]) pointed out, allow far richer societies to emerge, although those strategies have not been sufficient to eliminate all unproductive conflict.

## 1.5 THE UNPRODUCTIVE CONFLICT THAT REMAINS AND THE CONTRIBUTION OF THIS VOLUME

It is that residual of unproductive conflict that has attracted the attention of economists, political scientists and game theorists attempting to understand the nature of rent-seeking losses and to devise institutional solutions. Although societies in which the scholars live all have rules that reduce losses from rent-seeking activities, the results are imperfect. Losses continue to accumulate, and analyzing them explicitly has been a productive intellectual enterprise. It has produced a clearer understanding of the use of resources in contests and how changing the rules of the game can and have reduced associated losses.

This book contributes to our understanding of counterproductive conflict by providing a comprehensive overview of the rent-seeking literature that emerged after 1967 and its wide range of applications and implications. Although rent-seeking losses have been reduced by both biological and social evolution, and by conscious institutional designs, unproductive conflict continues to pose substantial risks for even relatively well-functioning contemporary societies. The game-theoretic strand of the literature on rent seeking has examined the extent to which competition and conflict tend to be increased or diminished by changes in rules. The applied literature, in turn, demonstrates that losses actually exist – that rent seeking remains a problem – and increases our understanding of the real-world institutions and strategies that produce those losses.

Distinguishing contests that increase social net benefits, as competition in markets tends to do, from those that diminish social net benefits, as warfare and other forms of political conflict often do, is an important field of research with important policy implications. Applied work addresses this distinction through a variety of case studies: one policy, one market, one region or one period at a time. Theoretical work attempts to find general ways to undertake this classification.

Overall the present volume demonstrates that rent-seeking behavior is important as both a theoretical possibility and as a real-world phenomenon. Rent seeking affects how institutions work and why they do not work as well as economists, political scientists and philosophers often imagine or wish they did. These conclusions are demonstrated with thorough literature reviews, game-theoretic analyses, conceptual extensions and case studies – all written in a manner that is accessible to those interested in understanding

the counterproductive interactions that occur between and within political and economic systems.

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