Rent Seeking and Rent Dissipation: A Critical View

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Introduction

The developing literature on rent seeking has added a new dimension to measurement of the welfare cost of government redistributive activity, particularly that which emerges in the form of restrictions on market competition. The simplest model of rent seeking, and the one most commonly employed, hypothesizes that any artificially contrived rents will be competed away by parties seeking to secure a share of such rents. To the extent that this competition employs real resources, these resources are wasted, and their cost must be added to the standard welfare triangle as a measure of the deadweight loss resulting from government action. In the simple competitive rent-seeking model, all potential rents are dissipated.[1]

One implication of the competitive rent-seeking model is that *no one* gains from the relevant government action. From a public choice perspective, this seems a puzzling result. Why does the political process tolerate institutions that prevent it from performing what arguably is its primary function, that of redistributing income or wealth from some groups to other groups? Alternatively, are such institutions actually as pervasive as some of the general discussions of rent seeking suggest? The assumption of complete dissipation has been used to provide the basis for empirical estimates of rent-seeking

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The author is Associate Professor of Economics at the University of Oklahoma. She thanks James Buchanan for his helpful comments on an earlier version of the paper. The usual caveat applies.

[1]See Tullock (1980) for a critique of the hypothesis that competitive rent seeking will exactly dissipate rents. He offers examples in which the resources devoted to rent seeking can be either less than or possibly greater than the initial rents created by government policy. However, this analysis is not directly relevant to the issues discussed in this paper and, therefore, will be ignored.

costs.[2] A theme of this paper is that such an approach is questionable. Various factors will be examined that would seem to limit the potential for rent dissipation. At the very least, there seems to be a need for careful case studies to provide an empirical basis for generalizations about the costs of rent seeking.

Examination of the potential for waste resulting from rent seeking can be divided into some broad categories. An important distinction can be made between rent-seeking activities devoted to securing favorable legislation to create rent and those activities devoted to allocating shares of such rent once it has been created. There also would appear to be significant differences between rents that emerge as a result of government restrictions on market output and government redistributive activity emerging directly from the tax-transfer process. These issues are examined below.

Rent Creation versus Rent Allocation

Edgar Browning (1974) has correctly identified a critical distinction between rent creation and rent allocation in terms of the incentives for affected parties to invest resources in pursuit of a favorable outcome. Passage of legislation that makes possible the emergence of rent in a particular market is a type of collective consumption good in the sense that multiple parties will have potential access to shares of that rent. It follows that the free-rider problem will limit the parties' willingness to invest in lobbying and other types of activities to secure the relevant government action. Once created, however, rent is divisible, which suggests that the social waste associated with rent seeking is probably more serious when the issue is rent allocation as opposed to rent creation.[3]

Another consideration, which perhaps has not been sufficiently appreciated, is that the willingness of potential individual beneficiaries to invest in rent seeking at the creation as opposed to the allocation phase of the process depends on their expected share of such rents once created. If final allocation is fairly assured, as, for example, restrictions on foreign competition to the benefit of domes-

[2]See, for example, Krueger (1974) and Posner (1975).

[3]Browning acknowledges that some care must be used interpreting the limitations imposed by the collective consumption characteristic of rent creation. Lobbyists abound in every legislative environment, and much of their activity is devoted to the creation of new rent, thus suggesting that the free-rider problem does not preclude some investment in procurement of nonexcludable public goods. The free-rider problem predicts underinvestment relative to potential benefits, not zero investment. Browning recounts the trenchant analysis of Mancur Olson (1965) as a primary explanation of the existence of some lobbying for collective benefits.

tic producers, it seems more likely that individual domestic producers will contribute than if there is a general perception among members of the potential beneficiary group that further investment will be required at the allocation phase to garner a share. This suggests that a higher proportion of government rent creation will be of the sort that will not necessitate rent seeking at the allocation phase.

Some final points can be raised about rent seeking at the creation phase that are more or less independent of free-rider considerations. Rents are dissipated in the competitive model because of free entry into competition for fixed total rents. This description is well-suited to the problem of rent allocation but seems inappropriate for rent creation. The competitive model might be relevant if the government had limited total rents available to allocate, as, for example, if limitations on competition in the auto industry had to be achieved at the expense of forgone rents granted to the airline industry. However, this does not seem empirically relevant.

Examination of the demand for government rent-creation activity suggests that the effective demand expressed in the political marketplace probably understates true willingness to pay. Other issues relevant to the dissipation hypothesis can be raised with respect to the supply side. One way of framing the issue here is to ask whether it seems plausible that politicians—the "suppliers" of such rents—will be able to fully exploit whatever effective demand exists in the sense of extracting the maximum of expressed willingness to pay for their services.

Some contributors to the rent-seeking literature have suggested a model of supply-side dissipation of rent in which politicians are able to extract payments for their services. The rewards to a successful political career are correspondingly increased and rents are dissipated by competition among politicians for the limited number of elective offices.[4] This hypothesis suggests some rather unusual implicit assumptions about the nature of the political process and specifically about political competition. A presumption that politicians can appropriate all rents they create ignores both the demand-side problems discussed earlier and also seems to assume that political entrepreneurs are able to make all-or-nothing offers or otherwise engage in perfect price discrimination in order to capture all of the political surplus. Behavior of this type generally is associated with the absence of competition in the private marketplace. In the political marketplace, one must ask why competing political entrepreneurs do not engage in price competition? Why would politicians compete by

[4]See Tullock (1975, pp. 675–76) and Tollison (1982, pp. 578–79).

charging high prices for their services and expending the revenue (wastefully?) to capture public office rather than simply lowering the prices charged for their services? Incentives for price competition seem strengthened when one considers that an existing group of elected representatives may be competing among themselves for payment from those seeking favorable legislation. This is because only a simple majority of their votes need be purchased. If the potential buyers of a government favor have succeeded in organizing a single bargaining unit through a trade association or similar group, they may have a distinct advantage in negotiating with competing sellers of votes.

Rent Allocation and Property Rights

Suppose that the government has decided to limit the number of widgets sold to 100 per week and that this quantity is 30 widgets fewer than the number of widgets that would be produced and sold in an unrestricted market. Rent has been created, and at issue is the allocation of that rent among competing widget producers. As noted previously, this rent is divisible. Producer A's right to produce one more widget must be obtained at the expense of some other producer who loses the right to produce that widget. Correspondingly, competition for limited production rights may occur uninhibited by free-rider considerations, and any resources expended in this competitive process constitute social waste, which is at the heart of the rent-seeking literature.

The extent to which pursuit of the artificially contrived rent results in social waste depends critically on the nature of the institutions that allocate the rent. If the scarcity rights were directly auctioned, no deadweight loss beyond the traditional welfare triangle would be incurred except for the presumably minor costs associated with administering the auction. The taxpayers at large would capture the rent as opposed to producers. There is, of course, the possibility that the availability of the added government revenue will itself give rise to rent seeking by potential beneficiaries of government spending programs or tax reductions.[5] Rent seeking at this secondary level, however, seems likely to be constrained by the same factors that constrain rent creation and will be ignored for the remainder of this paper.

The direct auction is rarely observed. It is, however, not the only institutional arrangement that avoids wasteful rent dissipation. Alter-

[5]See Buchanan (1980) for a discussion of the auction problem.

native methods are available, and their use in the examples discussed below suggests that the deadweight loss associated with allocational rent seeking may not be as large as the traditional rent-seeking literature suggests.

An obvious alternative to the direct auction is an implicit auction resulting from the capitalization of rent into asset values. For example, limitations on entry into the taxicab market in New York City are capitalized into the price of medallions, which represent the license to operate in that market. Similarly, Coase (1959, p. 22) argued that the monopoly rents made possible by the Federal Communication Commission's limitations on entry into the commercial broadcast market were effectively capitalized into the value of the capital assets of existing stations:

> [P]art of the extremely high return on the capital invested in certain radio and television stations has undoubtedly been due to this failure to charge for the use of the frequency. . . . Strictly, of course, all that can be sold is the station and its organization; the frequency is public property, and the grant of a license gives no rights of any sort to that frequency. . . . However, the [Federal Communications] Commission almost always approves such negotiated transfers, and when these take place, there can be little doubt that often a great part of the purchase price is, in fact, payment for obtaining the use of the frequency.

Other examples can be cited. Licenses granted by the Interstate Commerce Commission to provide common carrier service between specific locations often were not used by their owners directly. Rather, the owners rented the rights to other firms. Tobacco price supports are maintained by the Department of Agriculture's designation of specific acreages that can be used for tobacco growing, and substantial penalties are imposed on tobacco grown on other land. Rents are correspondingly capitalized into land prices.

In the examples cited, marketable property rights have been effectively established for the scarcity rents created by government policy. Several issues can be raised with respect to the rent-seeking implications of this phenomenon. First, that which the government giveth can also be taken away. To what extent must the holders of assets exhibiting policy-enhanced value invest resources to protect that value? Two groups have the incentive to seek policy changes detrimental to current recipients of artificially contrived rent—consumers and potential (as opposed to actual) producers. In both cases, if the option available to the group is a general change in policy, the context is one of rent creation (or destruction, in the case of consumers), and their efforts should be correspondingly limited for reasons discussed

earlier. On purely empirical grounds, it should be noted that a perceived necessity on the part of current holders of the assets in question to invest resources to protect the value of those assets should limit the extent to which capitalization of rents will occur. Positive capitalization can be taken as evidence that current dissipation of rents is not total.

There remains the possibility that rent seeking occurred when the government established the policy that led to the emergence of marketable property rights. What resources were expended to influence the initial allocation of taxi medallions, broadcast licenses, and the like? Some have suggested that this phase of the process is the one to be examined for evidence of rent dissipation. Resources equal to the present value of the expected future stream of rents could have been invested to influence the initial allocation.[6] Casual evidence does not support this hypothesis. Taxi medallions in New York City, for example, were initially granted to all cabs operating at the time the policy was established. Rent emerged over time because new medallions were not granted in response to growing demand.[7] Similarly, designated acreage for the tobacco support program is simply a proportion of those acres that were devoted to tobacco cultivation when price supports were established.[8]

These observations are consistent with the point made above that the willingness of a group's individual members to invest in rent seeking at the creation phase is positively affected by the degree of certainty relating to their own shares of the rent once created. One suspects that many of these policies developed as attempts to benefit existing producers at the relevant point in time to the detriment of potential future producers. This interpretation is also consistent with frequent observations that politicians have short time horizons. Institutions that allow expected future rents to be capitalized into asset values concentrate the benefits of rent-creating policies on those constituents extant at the time the policies are established.

Farm price supports would seem to provide additional examples of institutions that limit the dissipation of rents created by government policy. Government purchases of any excess supply at the support price eliminate direct allocational problems. The reason is, of course, that such a policy, taken by itself, does not impose an

[6]This point is made in a slightly different context in McCormick, Shughart, and Tollison (1984).

[7]For a historical discussion of the emergence of the medallion system in New York City, see Vidich (1976).

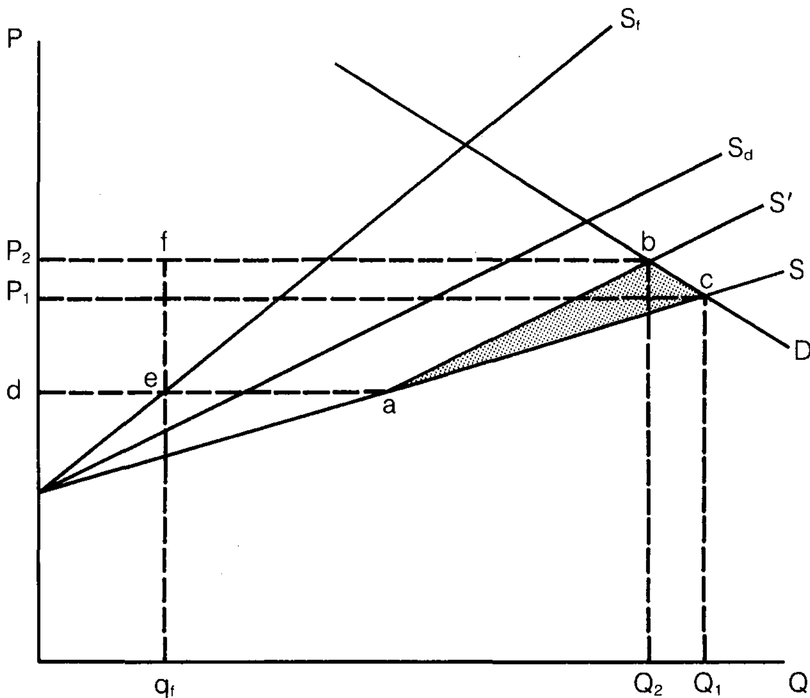
[8]For a discussion of the history of federal tobacco programs, see Johnson (1984).

artificial restriction on output. Attempts to restrain output generally have accompanied price supports, primarily to protect the government from the embarrassment of accumulating large stores of agricultural commodities. These restrictions, however, have primarily taken the form of financial incentives to farmers to hold land out of cultivation. Such use of a price mechanism significantly limits the potential for wasteful allocational rent seeking.

Restrictions on foreign trade provide an example of government rent creation in which allocation of the resultant rent is more or less determined by the nature of the restrictions imposed in the market. If an import quota or tariff is imposed, for example, the normal process of the market can still determine the allocation of production among domestic producers. The object of the legislation is simply to limit the market share going to foreign competitors. That the potential for wasteful allocational rent seeking is sharply limited in this case can be illustrated using Figure 1.

FIGURE 1

LIMITS TO WASTEFUL ALLOCATIONAL RENT SEEKING



Suppose that Figure 1 represents the domestic market for widgets. Domestic demand is indicated by *D*, and total supply in the absence of government intervention, S, is the horizontal summation of foreign supply, S_f, and domestic supply, S_d. The unrestricted market equilibrium is characterized by price and quantity of P_1 and Q_1, respectively. If an import quota, q_f, is imposed, the market supply curve becomes *S*′. Market equilibrium price and quantity rise and fall respectively to P_2 and Q_2. The standard (that is, nonrent-seeking) excess burden from this policy is the shaded triangle *abc*, which results from lost consumer surplus and inefficient production due to the exclusion of low-cost producers. The potential for loss resulting from allocational rent seeking is limited to the additional rectangle defP$_2$. This is less than the actual increment in producers' surplus of dabP$_2$ created by the policy.[9]

The examples cited suggest that institutional arrangements often do avoid dissipation of rent at the allocation phase. In the first set of cases, rents were capitalized into marketable asset values, thus making possible an implicit auction of the artificial scarcity rights created by government policy. In the foreign trade example, rent seeking was confined to foreign producers who are not direct clients of domestic politicians. Agricultural production restrictions generated by financial incentives provide yet another example of allocational arrangements that avoid competitive dissipation of rent.

Rent Seeking and Entitlements

The focus of concern thus far has been on government redistributive activity that takes the form of restrictions on normal market processes. Government also engages in more direct redistribution through the tax-transfer process. Incentives for rent seeking at the creation phase are basically the same regardless of whether the transfer being pursued is through market intervention or the grant of a direct transfer or subsidy from the "fisc." At the allocation phase, however, the incentives are very different. The rents available through market restrictions are limited, whereas transfers are generally open-ended entitlements available to any parties who meet legislatively determined eligibility requirements. The open-ended nature of entitlements eliminates the necessity for potential recipients to compete among themselves for available benefits. Thus, an important source of incentive for wasteful rent seeking is eliminated.

[9]It is worth noting with respect to this example that any losses associated with allocational rent seeking will not come at the expense of domestic GNP and correspondingly are probably not of concern to domestic politicians.

There is one situation in which the rent-seeking model might be applicable to entitlements. If the government is interested in controlling outlays for a program, costs may be imposed on potential recipients to discourage their participation in the program. Examples might be excessive record-keeping requirements for tax preferences and delays and queuing required for welfare recipients to have their applications processed. These may be examples of the political process compromising between the objective of providing transfer programs but simultaneously trying to conserve actual outlays.

Conclusion

It would be puzzling from a public choice perspective if the political process generally tolerated dissipation of the redistributional gains, which are the primary product that politicians offer voters. The discussion in this paper is suggestive, though by no means conclusive, of a proposition that institutional arrangements often do emerge that avoid the dissipation of policy-created (as opposed to market-created) rents.

In considering what factors might influence the choice of institutions to allocate rent, an analogy with nonprice rationing in a market subject to a price ceiling is useful. Wasteful allocation mechanisms emerge in such markets because sellers, who ultimately must allocate the commodity, are legally prevented from capturing any of the potential gains available from efficient allocation. They are not rewarded for considering the interests of buyers, and presumably their choices are influenced by a desire to minimize the transactions costs associated with allocation that they must bear. In the political arena, politicians or their agents, regulators, have responsibility for determining the allocation mechanism for policy-created rent. As in the price control example, the most efficient allocative institution, direct auction, is not a relevant possibility. However, unlike that example, those responsible for determining the allocative rules have an interest in the procedure other than simply minimizing the costs imposed on themselves. If votes are to be won, there must be gainers. If votes are the relevant currency of politics, institutional arrangements which deliver that currency should be expected to emerge. This, in turn, would seem to favor institutions that avoid the complete dissipation of rent.

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