Rent Seeking: Some Conceptual Problems and Implications

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There is increasing use of the concept of rent seeking to describe resource-wasting activities of individuals and groups seeking wealth transfers.[1] A wide range of activities are presumably of this type including agricultural price supports, occupational licensing, labor unions, import and export quotas, and education subsidies. The term *rent seeking* is used to describe attempts both to obtain and to maintain wealth transfers. Although the terminology of rent seeking is quite recent, the behavior that it describes "has been with us always" (Buchanan, 1980, p. 3). Moreover, rent-seeking behavior has become more important as institutional changes have created opportunities that did not exist when there was general agreement that the state should play a more limited role. Mancur Olson (1982) contends that the increase in specialized pressure groups is a key factor in the declining economic growth rate of nations—adding to the criticism of this widespread phenomenon in which organized groups use the power of the state to further their own economic ends.

There is an implicit assumption in the literature that rent-seeking behavior can be objectively identified and that waste due to rent seeking can, at least in principle, be measured (Posner, 1975; Tullock, 1967). The problem of identifying rent-seeking activity under real world conditions is shown in this article to be similar to that of determining monopoly waste and other market inefficiencies.[2] It follows that rent-seeking waste can only be identified by substituting the observer's own standard of value. Moreover, if an activity is a legitimate function of the state, it is held that the lobbying associated with instituting and maintaining the activity is not necessarily wasteful. Consequently, since the appropriate role of the state is normative, identifying a particular activity as wasteful must necessarily be based on norms that lie outside of economic theory.

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The procedure of this article is as follows. Shortcomings of the conventional long-run equilibrium approach used in identifying monopoly waste are first described. The problem of groups attempting to achieve income transfers through the power of the state—nonmarket rent seeking—is then discussed. The lack of an appropriate benchmark in identifying inefficiency and waste under real world conditions of uncertainty (which renders information costly and is a major source of "government failure") is emphasized throughout the analysis. Despite the fact that rent-seeking theory provides no objective means of separating beneficial from wasteful government activities, it is argued that such waste exists because of imperfect coordination in political markets. There is increasing concern about the effects of activities by individuals and groups on the economic and political order and a growing perception that redistribution is the explanation for many government activities ostensibly justified on the basis of the "public interest." Implications of the increase in redistributive activities are discussed in the last section of the article. Although economic education is identified as a necessary precondition in reducing the scope for rent-seeking behavior, it is argued that ethical considerations are inherent in the use of state power to stifle competition where individuals are assumed to have the right to engage in mutually beneficial exchange.

Downward-Sloping Demand Curves and Resource Misallocation

There is a close relationship between rent-seeking theory and conventional measurements of monopoly waste. Monopoly is traditionally defined as a situation where demand is not perfectly elastic (Friedman, 1976, p. 126). In analyses of the resource (or "welfare") cost of monopoly by A.C. Harberger, Richard Posner, Gordon Tullock and others, long-run equilibrium is taken as the point of reference, and real world markets are compared with the perfectly competitive equilibrium. If the economy were perfectly competitive, there would be no profits or losses. Consequently, in this long-run competitive equilibrium framework, all profits are due to monopoly, are considered to be permanent, and imply a welfare loss (Littlechild, 1981).

The alternative to considering monopoly as a market situation where demand is not perfectly elastic is to view market competition as a *process* (Hayek, 1948; Kirzner, 1973, 1979). In the analysis of firms facing downward-sloping demand curves, the market process approach stresses the necessity of using a model that allows above-average rates of return due to entrepreneurship. While there is no role for entrepreneurial activity in competitive equilibrium where all decisions by market participants are perfectly coordinated, there are often profit opportunities for alert entrepreneurs under real world conditions where markets are seldom (if ever) in equilibrium.

Consider the example of an entrepreneur who develops a product before other potential producers and, consequently, faces a downward-sloping demand curve. The seller charges the monopoly price, *OP* (figure 1). In the conventional long-run equilibrium approach, the rectangle (*T*) is considered to be monopoly profit and the triangle (*W.C.*) a deadweight resource cost.[3] In this approach, all traces of monopoly power represented by less than perfectly elastic demand involve a "welfare cost" and are branded as socially harmful. However, the relevant alternative to output oq_1, for the time being at least, is not OQ_2, but rather no output at all. Under these conditions, it is inappropriate to depict the producer's action as socially harmful and generating a deadweight loss (*W.C.*). Instead, using the same analytical tool, the action of the decision maker can be said to generate a social gain given by his own entrepreneurial profit (*T*) plus the consumer surplus (*C.S.*) (Littlechild, 1981, p. 358).

The long-run equilibrium approach overlooks or discounts the importance of entrepreneurial activity to cope with change and the returns necessary to induce the decision maker to perform that function. In the words of Buchanan (1980, p. 5): "By seeking always to find new opportunities . . . and to exploit more fully existing opportunities, profit-seeking entrepreneurs generate a dynamic process of continuous resource reallocation that ensures economic growth and development." In marked contrast, there is no scope for beneficial profits in the conventional approach to economic analysis. The extra income earned by successful entrepreneurs is taken to be a measure of welfare loss rather than the return necessary to evoke beneficial entrepreneurial activity. This

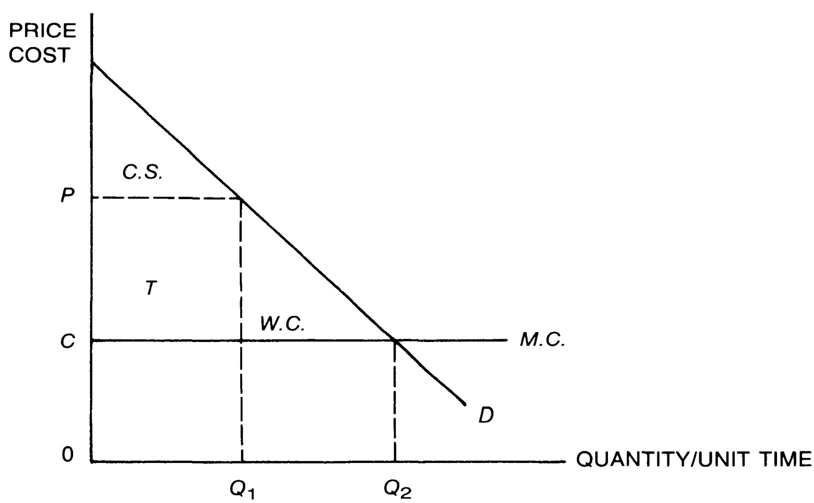

Figure 1. Monopoly Waste—Conventional Approach

approach fails to recognize that profits and losses are the signals that direct economic activity in a market economy. In the words of von Mises (1974, p. 119): "Profits are never normal. They appear only where there is a maladjustment. . . . The greater the preceding maladjustments, the greater the profit earned by their removal." For economic decision makers who are risk averters, it may be necessary to have even higher expected returns to remove maladjustments in resource use. Thus it is necessary to consider a long-run view of the market process in understanding the importance of entrepreneurial returns.[4]

The long-run equilibrium framework used in identifying the welfare cost of monopoly is inappropriate under real world conditions where returns include short-run disequilibrium profits due to entrepreneurial alertness. The entrepreneurial profits which may appear to be "rents" from a short-run perspective are, in fact, the driving force of the market system.[5] Moreover, since the amount of entrepreneurial activity hinges on the expected returns, a social policy which arbitrarily confiscates the returns due to entrepreneurial alertness will inevitably discourage such alertness in the future (Kirzner, 1973). In summary, by considering all downward-sloping firm demand curves to be socially wasteful, conventional analyses of monopoly fail to take into account the nature and role of profits in the market process.

The long-run equilibrium framework used by Tullock, Posner, and others in analyzing rent-seeking waste associated with monopoly is also inappropriate. Although rent seeking mainly focuses on transfers obtained through the aegis of the state, the term is also used to describe activities motivated by lure of profits when the monopolies are not rooted in government power.[6] Specifically, it is held that rent-seeking resource waste in the market situation shown in figure 1 consists not only of the traditional deadweight loss (*W.C.*), but also of some or all of the transfer (*T*) which, it is argued, is dissipated in attempts to obtain or maintain monopoly profits. As suggested, however, the description of these areas as resource waste ignores the benefits of entrepreneurial activity. Although the competitive entrepreneurial process (if successful) generates profits, the cost inherent in the uncertainty and innovation associated with attempts to obtain such profits should not be regarded as waste since effective resource use "will continue to require resources devoted to coping with and initiating changes" (Worcester, 1982, p. 86). Thus, entrepreneurial activity, reflected in downward-sloping demand curves, results in the creation of added value rather than rent-seeking waste. Moreover, except when monopoly is defined in terms of government restrictions on entry, there is no way to distinguish downward-sloping demand curves due to entrepreneurial foresight from other cases of "monopoly." Consequently, in the case of downward-sloping demand curves, there is no way to distinguish rent-seeking activity from the profit seeking of the market process except where competition is restricted through state power.

Nonmarket Rent Seeking

Rent seeking, as suggested, is mainly used to describe the effects of attempts by groups to achieve profits through government restrictions on entry (Buchanan, 1980, p. 9).[7] So long as the functions of government are restricted to those of the classical minimal state, there are relatively few opportunities to obtain income transfers in this way. As the functions of government have increased, however, there has been a concomitant increase in attempts by individuals and groups to create income opportunities through political activity. Lee (1983, pp. 15–16) describes the increase in rent-seeking activities in the United States:

> For over a century most government activity, as measured by revenue raised and spent, took place at the state and local level where intergovernmental competition imposed restraint. . . . In the environment established by this government restraint there was little to gain from political enterprise, or transfer activity, but much to gain from market enterprise, or productive activity. . . . But the existence of political power, even when restrained, establishes potential opportunities for some to benefit at the expense of others that will never be completely ignored. . . . There can be no reasonable doubt that there has been a dramatic expansion in the range of activities that have been subjected to government control over the last century.

Consider, as an example of rent seeking, the case of agricultural price supports where product prices and producer incomes are increased by restricting output through the use of production allotments. Traditionally it has been assumed that producers initially assigned allotment rights receive windfall gains. Posner (1975, p. 809), assuming that supply is perfectly elastic, however, shows that, "at the margin, the cost of obtaining a monopoly is exactly equal to the expected profit." If this is correct, the cartel gains would be completely dissipated through competitive rent-seeking activity. The forgone consumer surplus would not be converted into monopoly profit but would instead be dissipated in the form of real resource expenditures including lobbying and other activities required to obtain (and maintain) the favorable legislation (figure 2).

In figure 2, as cost increases from MC to MC_9, the entire value of the expected returns is exhausted through rent-seeking activity. This rent-seeing model then is similar to the theory of the firm in the conventional equilibrium approach of neoclassical theory. In market equilibrium, all decisions perfectly mesh, all profit opportunities are exhausted, and since competition is no longer an active force, there is no scope for entrepreneurship. Similarly, there is no scope for rent-seeking activity in the equilibrium depicted in figure 2. Stated differently, the equilibrium condition depicted implies the cessation of rent seeking since all opportunities to secure income transfers through political means have been exhausted and there is no further potential for gain.

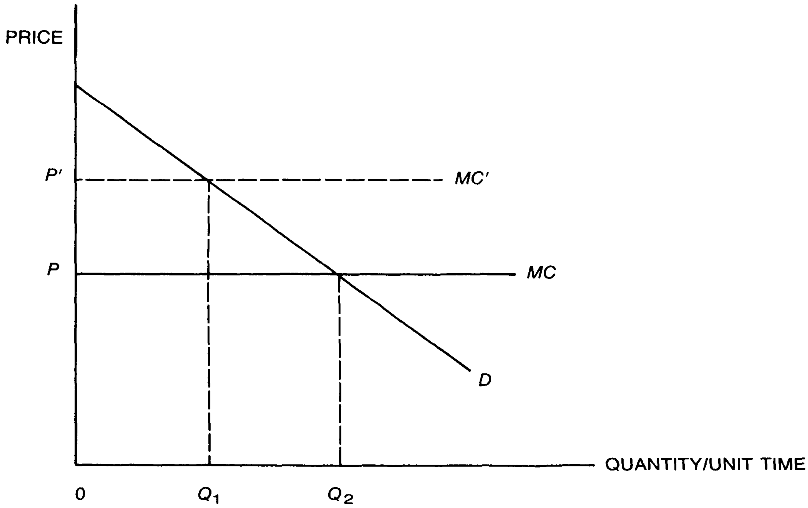

Figure 2. Rent Seeking—Constant Costs and Competitive Conditions

Noncompetitive Rent Seeking

Tullock argues that the rent-seeking incentive remains "even if we can find an equilibrium" (1980b, p. 98). He contends that costs are likely to be increasing rather than constant (as in figure 2) so that "the supply curve slants up and to the right from its very beginning" (ibid). Using an experimental game with some special assumptions about individual knowledge, Tullock examines the properties and outcomes of strategy games. In the specific game analyzed, a fixed prize is offered and participants are asked to make sealed bids for the prize. It is assumed that "if there is a correct solution for individual strategy, then each player will assume that the other parties can also figure out what the correct solution is" (ibid., p. 99). Marginal adjustments in bids are allowed and players are considered to be able to compare marginal costs and marginal returns. Tullock finds situations in which individual players will make contributions larger than the expected prize (overbidding) and cases in which the sum of players' bids is less than the value of the prize (underbidding). Since both underbidding and overbidding are observed, there appears to be no general tendency toward exact dissipation of the prize. Thus, it is argued, the competitive model where the expected return is exactly wasted cannot be taken as *the* general rent-seeking model (Tollison, 1982, p. 586).

It is not clear, however, that games that assume that individuals can figure out the correct strategy by comparing marginal costs and returns provide any useful information about rent-seeking activity under real world conditions of uncertainty. In rent seeking through the political process, there is uncertainty both about the size of the prize (value of the advantage secured through political means) and the probability of success in achieving it. Under these conditions, one might expect each rent-seeking group to invest in political activity so long as the expected benefits exceed the expected costs. As in the case of market entrepreneurship, however, there is no reason to think that returns would be exactly dissipated where choices are always shrouded in uncertainty. The decision maker faces similar information problems whether the wealth-seeking activity is directed toward the market process or the political arena. In either case, neither the alternative outcomes nor the probabilities of their occurrences can be fully known at the time of choice—raising questions as to the usefulness of probability theory in analyzing choice.[8]

Although individual interpretations and expectations will differ where real world conditions are constantly changing, there are opportunities for individuals and groups to engage in rent seeking through the political process just as there are opportunities for alert entrepreneurs in markets for goods and services. It is ironic that while profit maximization in both conventional neoclassical theory and rent-seeking theory is developed within an equilibrium framework, the emphasis placed on wealth-seeking behavior is quite different. In the conventional theory of the firm, the focus is on equilibrium conditions and entrepreneurship is largely neglected (Kirzner, 1973, 1979; Schultz, 1980). In the case of rent seeking, in contrast, the focus is on lobbying and other activity of groups attempting to use the political process for economic gain.

Problems in Identifying Rent-Seeking Waste

Since rent seeking is but one form of economic waste or inefficiency, first consider the general problem of identifying inefficiency in economic activity. Economic efficiency studies in conventional welfare economics typically use the benchmark of perfect competition which assumes price-taking behavior and perfect markets requiring perfect communication, instantaneous equilibrium, and costless transactions (Hirshleifer, 1980, p. 232). Since no real world market can match these conditions, *all* real world markets are inefficient on the basis of this criterion.[9] Consider, for example, conventional monopoly theory which evaluates the extent of monopoly waste by comparing market conditions against the perfectly competitive norm (Armentano, 1982). Resource waste (as just shown) will appear to be an important problem on the basis of this criterion even when the extra income earned in any period is due to entrepreneurship. Moreover, market failure in the form of advertising, incomplete information, and externalities (as well as monopoly) will inevitably appear to be pervasive when real world markets are compared against the competitive norm (Pasour, 1981).

Demsetz (1969) has labeled this procedure of comparing existing "imperfect" arrangements with an unattainable ideal "the nirvana approach." Although it is clearly inappropriate to use a model that assumes away problems facing the entrepreneur in assessing entrepreneurial efficiency, no one has discovered an appropriate benchmark for evaluating the efficiency of real world choices made under conditions of uncertainty and costly information. Efficiency inevitably involves valuation; to be meaningful in a choice sense, any efficiency measurement must be based on the costs and returns confronting the decision maker. It is opportunity cost that influences individual choice, however, and the value of the sacrificed alternative to the decision maker cannot be determined by an outside observer. Moreover, the ultimate end of action is always the satisfaction of desires of the acting individual and "no man is qualified to declare what would make another man happier" (von Mises, 1966, p. 19). Since individuals base choices on data that are inherently subjective, the economist can identify waste in the actions of other people only by imposing his own standard of value (Buchanan, 1979, p. 61; Sowell, 1980, p. 218).[10]

A similar problem arises in identifying wasteful rent-seeking behavior where individuals attempt to achieve wealth transfers through the political process. Little attention has been devoted to the problem of identifying wasteful behavior in the rent-seeking literature. The examples of Tullock (1967) and Posner (1975), using the competitive norm as a benchmark, suggest that efforts to achieve monoplies, tariffs, and labor unions are rent-seeking waste. Bhagwati (1982), on the other hand, argues that rent-seeking behavior is not necessarily wasteful.[11] In the case of lobbying to restore free trade, for example, it is contended that rent-seeking activities may be beneficial or harmful depending upon whether "the resources used up in restoring free trade that is the lobby's economic advantage are socially more valuable than the social gains from free trade" (Bhagwati, 1982, p. 997).

In a book on income transfers, Tullock (1983) suggests that harmful redistribution can be identified by the motive.[12] The effect of government intervention, however, is not determined by the motives of those responsible for obtaining and maintaining a particular activity. The effects of minimum wage legislation, for example, are similar whether or not the motive of the proponents is self-serving. Moreover, most transfer programs involve a mix of motives; in analyzing any real life redistributive activity, there is no reliable way to determine *the* choice influencing motive.

The Bhagwati and Tullock analyses have the same shortcomings as all other approaches based on measurements of social costs and gains. The opportunity cost of any decision, as suggested above, depends upon the decision maker's anticipation of future conditions. Thus, opportunity cost is inherently subjective and distinct from data that can be objectively measured by the outside observer (Buchanan, 1969). The difficulties are magnified when the economist attempts to make interpersonal comparisons of gains and losses in utility.[13] Utility is a subjective concept and gains and losses in utility by different individuals cannot legitimately be measured or weighed against each other (Rothbard, 1982, p. 204).

Consider again the problem of identifying inefficiency on the part of the individual decision maker. If the economist identifies an activity as wasteful and the decision maker continues the activity, one cannot legitimately conclude that the activity is wasteful; instead, it might be concluded that the analyst has not measured the choice-influencing opportunity costs and benefits. Similarly, if after pointing out the wastes of rent controls, the necessary political changes are not made, what conclusion can one draw.?[14] In attempting to identify institutional inefficiency, the economist faces problems similar to those in identifying inefficiency on the part of the individual decision maker.[15]

Once, it is recognized that cost and value are subjective concepts, it becomes clear that "net social benefit is an artificial concept of direct interest only to economists" (Littlechild, 1978, p. 92). Consequently, the effects of trade barriers arising through rent-seeking activity cannot be determined by comparing the gain in utility of producers at the expense of consumers. In the words of Robbins (1981, p. 5):

> [W]henever we discuss distributional questions, we make our own estimates of the happiness afforded or the misery endured by different persons or groups of persons. But these are *our* estimates. There is no objective measurement conceivable.

Thus, utilitarian approaches do not present a way of determining which activities are wasteful. Furthermore, as shown in the following section, whether or not an activity is considered to be rent seeking hinges on one's view of the legitimate role of the state.

Rent Seeking and the Role of the State

Consider first the minimal state where law and order are deemed to be the only appropriate functions of government. In this case, the lobbying and other resource costs necessary to achieve and maintain the proper level of support for these essential activities would not be rent-seeking waste. On the other hand, resources expended by teachers to enact (or preserve) a system of public education would be wasteful if education were not a proper function of the state. Thus, as in other cases of alleged inefficiency, rent-seeking waste can be identified only by substituting the observer's own standard of value.

Consider again the example of education. It is often argued (at least by educators) that education is a public good and, consequently, is a proper function of the state. If education is a proper role of the state, the use of resources devoted to lobbying efforts to improve schools and teachers' salaries would not necessarily be wasteful. Resources used in this way will appear to be wasted, however, if the real world is compared with an ideal polity where no information or transactions costs are required to initiate or maintain the appropriate functions of the state. Labeling the resource cost required to maintain legitimate political activity as rent-seeking waste ignores the problem of the "ideal benchmark" in evaluating government activities, and is another example of the nirvana approach where the real is compared with an unobtainable ideal.

A real world market will always appear inefficient when measured against the norm of perfect competition, and a real world political institution will always appear inefficient when compared to an idealized polity. The problem of identifying actual examples of "political failure" is similar to that of isolating examples of "market failure" in the sense that no one has discovered an appropriate benchmark against which to compare real world political institutions when information problems, transactions costs, and uncertainty are taken into account. In the absence of such a benchmark, there is no legitimate way to measure the efficiency of activities in the real world political process. It can be said, however, that to the extent that any particular activity is an appropriate function of government, it is not legitimate to consider all resources associated with securing and maintaining that activity as wasteful rent seeking.

In reality, there is no objective procedure for distinguishing productive from wasteful activities.[16] Consider several widely cited reasons for government intervention. The public goods model is taken by many economists to justify a wide range of activities including public education, income redistribution, publicly subsidized research, and national defense. Externality theory is used to justify a host of government programs, agencies, and activities including the Environmental Protection Agency, the Occupational Safety and Health Administration, the United States Department of Agriculture, SCS and land-use zoning. Monopoly theory is used to rationalize various antitrust policies. Many other restrictions on competition are justified on the basis of consumer ignorance. There is widespread disagreement, however, both as to when these market failure factors justify government intervention and as to which activities are legitimate functions of the state.[17] Nor is there agreement as to a benchmark against which to evaluate the efficiency of government activities in those areas where government intervention *is* deemed to be desirable.[18] Consequently, in the absence of a consensus on these issues, there is no objective basis for identifying which lobbying efforts are wasteful and which are beneficial.

Consider agricultural policy and the farm problem. The public interest model holds that the purpose of federal agricultural programs is to provide a remedy for chronic price and income instability in agriculture. Although agricultural price support programs are frequently attacked in the press and by many economists as prime examples of wasteful government activity, many agricultural economists justify these programs on market failure grounds.[19] For example, a recent analysis of the milk price support program concluded: "The relatively small implied consumer-to-producer transfers of the late 1970's resulting from classified pricing may be a small price to pay for the stabilizing aspect of classified pricing" (Song and Hallberg, 1982, p. 7).

Agricultural marketing orders are frequently justified on similar grounds. Marketing orders for fruits, vegetables, and specialty crops were provided to agricultural producers ostensibly as a tool for achieving "orderly marketing" conditions under the Federal Marketing Agreement Act of 1937. Oranges and other crops marketed under federal marketing orders are subject to quantity and/or quality controls reducing the amounts available for sale. Despite the fact that marketing orders from their inception were intended as means of increasing producer incomes (French, 1982), economists continue to attempt to justify this type of restriction on competition on the basis of economic efficiency.

> These regulations are designed to compensate for, or overcome certain characteristics of agricultural markets—imbalances in marketing power, instability, incomplete information, and the external effects of individual firms' actions—that prevent free trading from being fully efficient (U.S. Department of Agriculture, 1981, p. 81).

Opinions of economists and the public at large vary widely as to whether incomplete information, imbalances in market power, price instability, and other market imperfections provide a legitimate basis for government price support programs in agriculture. What are the implications for the theory of rent seeking? If an orange-marketing order, for example, is considered to be a legitimate function of government, lobbying efforts to maintain the marketing order would not necessarily be rent-seeking waste. If, however, it is held that restrictions on competition of this type are not justified, the activity of obtaining or maintaining the marketing order would be considered rent-seeking waste.

The situation is similar in the case of labor cartels. Richard Freeman and James Medoff (1979) contend that the cartel view of labor unions as rent-seeking organizations is seriously misleading. While accepting the idea that one goal of unions is to raise wages, they argue that by providing workers with a "voice" in the workplace as well as in the political arena, "unions can and do affect positively the functioning of the economic and social systems" (p. 70). If one agrees with Freeman and Medoff that the positive effects of unions are often more important than their negative effects, the lobbying efforts associated with obtaining and maintaining such unions would not necessarily be considered rent-seeking waste. If, however, the net effect of unions is deemed to be negative, resources devoted to unionizing activities would be considered waste.

A similar problem arises in the evaluation of lobbying activities to eliminate existing restrictions on competition. Consider the examples of interest rate ceilings and price controls on natural gas. If the restrictions are considered to be harmful distortions of the market process, lobbying efforts to eliminate them cannot legitimately be considered as waste.

A difference of opinion concerning the desirability of government intervention is evident in many areas including education and research subsidies, occupational licensing, and environmental and safety regulations. Are those programs merely due to imperfections in the political process that often favor the few at the expense of the many? Or, are there bona fide market failure reasons for such programs?[20] In the absence of a benchmark against which to measure the performance of the real world political process, there is no objective procedure for determining when government intervention is warranted or for judging the efficiency of government activities.[21] In all of the examples discussed here, an activity is beneficial or harmful depending upon the observer's values.

In reality, then, there is no objective procedure either in determining which activities of the state are illegitimate, or in determining the extent of rent-seeking waste associated with activities considered to be legitimate.[22] While economic theory is useful in explaining activities of individuals and groups in using the state to further their own ends, it does not provide an objective procedure for determining inefficiency or rent-seeking waste. Since utility and cost are subjective, they cannot be measured and aggregated by outside observers to determine social cost or utility. Consequently, on strictly economic grounds, the economist cannot reject (or advocate) any public policy (Rothbard, 1982, p. 212). Economic theory, in this sense, is not a substitute for ethical or philosophical analysis.

Decentralized markets are a necessary condition in maintaining individual freedom. The market, based on free exchange, is the only voluntary method of allocating resources. Yet, even if one agrees that the central issue is freedom and that reliance on market signals where feasible is ethically superior to known alternatives, the question just alluded to is still present, namely, what is the proper role of the state in a market economy? There are almost as many answers to the question as there are economists, philosophers, political scientists, and other analysts studying the problem. Consider Albert J. Nock's attempt to discriminate between productive and unproductive activities.

Nock suggests that man attempts to increase his welfare through two approaches—the economic and the political. The economic means is defined to involve the production and exchange of wealth whereas the political means involves the uncompensated appropriation of wealth produced by others (Nock, 1973, p. 26). The Nock approach to isolating wasteful activities is operational, however, only if one accepts Rothbard's conclusion that "no act of the State can ever increase social utility" (1982, p. 13). In this case, there is an unambiguous standard by which to identify rent-seeking activity. *All* activities by individuals and groups designed to achieve involuntary wealth transfers (programs financed by taxes, price increases through quotas, and so on) would, by definition, be labeled rent-seeking waste.

The Nock approach does not appear to be of much help, however, in the task of defining the scope of the "limited-government" market economy. Consider the example of lobbying by lawyers or police for increased appropriations for law and order. If successful, these activities clearly result in an uncompensated appropriation of wealth produced by others. If, however, law and order are legitimate functions of the state, expenditures to improve these services are not necessarily wasted. Moreover, the efficiency of production of law, order, and other services deemed appropriate by the state is not susceptible to measurement. In the words of Knight, "The question whether any type of political machinery will work 'better' or 'worse' than another is . . . a matter of opinion" (1935, p. 311). And, since opinions vary widely, the identification of rent-seeking activities is inevitably based on value judgments (often concealed ones).

The analysis of this article suggests that neither the appropriate role of government nor rent-seeking waste can be identified through the cost-benefit approach. If one accepts the limited state as the norm, there is at least a partial basis for identifying rent-seeking activities. Efforts by the steel industry to limit imports, for example, would be rent-seeking waste in the eyes of one convinced of the merits of free trade. There remains the normative problem, however, of specifying the appropriate functions of government or, alternatively, of determining *how limited* the role of the state should be.

Rent Seeking—Measurement versus Existence and Implications

The fact that wasteful government activity cannot be objectively determined does not suggest that the problem of rent seeking is unimportant. Stated differently, the fact that economists cannot identify or measure inefficiency in economic or political markets implies neither the absence of rent-seeking waste nor that political markets are efficient in the sense that there is no scope for improvement.[23] In the remainder of this article, it is assumed that use of the power of the state to achieve wealth transfers is an increasingly serious problem. Applying an insight from Kirzner's entrepreneurial analysis, there are opportunities to improve the operation of political markets because political decisions (like those of market participants) are never fully coordinated. The following analysis describes the effects of widespread rent seeking, problems in reducing redistributive activities, and reasons why a constitutional change may be required to reduce transfer activity.

There is evidence that the "special interest state" in which various segments of society organize, each seeking to get its share of government largesse, has incresed markedly in recent years.[24] In achieving their objectives, groups use their lobbying power to influence government policy bringing about an increase in the complexity and scope of government.[25] Olson (1982) argues that the effect of the increase in specialized pressure groups is to gradually strangle the economy.[26] Moreover, as special interest groups become more important and distributional issues more significant, political life tends to be more divisive.

Olson's argument concerning the harmful effects of transfers achieved through organized group activity is similar to that of F.A. Hayek. Hayek (1979) argues that the chief threat to the market order comes not from the selfish actions of individuals but rather from the selfishness of organized groups who "have gained their power largely through the assistance government has given them to suppress those manifestations of individual selfishness which would have kept their action in check" (p. 85).[27] While individual selfishness will in most instances lead the individual to act in a manner conducive to the preservation of the spontaneous order of society, the desire of individuals to become a closed group "will always be in opposition to the true common interest of the members of a Great Society" (Hayek, 1979, p. 90). The interest of organized groups is typically either to prevent entry of others wishing to share the profits or to avoid being driven out of production by lower-cost producers. Hayek suggests that more injustice is done in the name of group loyalty than from selfish individual motives and he emphasizes the implications of redistributive behavior on the political system.

> So long as it is legitimate for government to use force to effect a redistribution of material benefits . . . there can be no curb on the rapacious instincts of all groups who want more for themselves. Once politics becomes a tug-of-war for shares of the income pie, decent government is impossible (p. 150).

Thus, it might be argued that an "economic education revolution" is a necessary precondition for achieving a consensus concerning the need to limit the role of government and for devising institutional arrangements that can make these limits stick (Dorn, 1982). This approach implies that a shift in the focus of economic analysis is warranted—a shift toward political economy emphasizing the framework of institutions and rules within which people can effectively cooperate in pursuing their own diverse ends through decentralized coordination of their activities (Yeager, 1976).

Even if most people recognize the desirability of limiting government activity, however, there is a "you-first" problem in reducing transfers (Anderson and Hill, 1980). Each recipient of government aid has an economic incentive to favor a reduction in the transfers received by other people while maintaining his own. Thus, it might be argued that the need for an education revolution in ethics is no less important than in economics.[28] If individual freedom is accepted as an ethical standard, individuals have the right to engage in mutually beneficial exchange. Moreover, income redistribution through the aegis of the state inevitably involves coercive restrictions on free exchange and infringements on individual freedom. Thus, if people were convinced that it is ethically wrong to achieve wealth increases through political means, the cost of engaging in rent-seeking activities would increase with a consequent decrease in these activities. However, as discussed, the case for reducing redistributive activities has also been made on nonethical grounds. In the words of Mitchell (1983):

> Rational individual and group action will increase transaction costs, produce a smaller social product, and in the end leave most worse off. This is the disastrous dynamic of our democracy. . . . We face the dilemma of individual and collective rationality that general ruin can be the outcome of rational action (pp. 365–66).

Whether or not the problem of rent-seeking is viewed as an ethical issue, it is likely that a significant reduction in the bargaining society will require constitutional reform.[29] Buchanan (1977) suggests that the cost of the present system may become so great that the individual transfer recipient will agree to a change in an existing rule that imposes limited damages on him in exchange for a reciprocal agreement by others for another set of changes that will greatly benefit him. An analysis of alternative methods of limiting the harmful effects of special interest groups through constitutional reform is beyond the purview of this analysis. Possibilities include limits on taxation and spending, reverse revenue sharing, and Hayek's proposal to entrust the general rules of just conduct to a representative body distinct from the body entrusted with the task of government (Hayek, 1979; Lee, 1983).

Conclusions

Rent-seeking waste is a matter of opinion depending on one's view of the appropriate role of the state, which must ultimately be determined on the basis of ethics rather than economic theory. If emphasis is placed on the freedom of individual choice, there are genuine opportunities for improvements in the political system and strong reasons to reduce the current level of redistributive activity. Rent-seeking activities by organized groups are important in the growth of the bargaining society or transfer society with its stifling effect on the competitive market process and concomitant shrinking of liberty of choice. Moreover, while there can be little doubt that there has been a pronounced increase in the number of groups organized for redistributive purposes, group activities generally pose little reason for concern in the absence of government assistance. Thus, limiting the role of the state is essential in minimizing the effects of rent-seeking activity.[30] There is mounting evidence that a revision of the constitutional contract will be necessary to reduce the role of the state. Regardless of the approach taken in reducing the scope of government, however, a necessary first step is increased awareness of the economic and ethical implications of redistributive activities by individuals and groups.

Notes

1. While rent seeking is usually used to describe the effects of groups attempting to obtain wealth transfers through the aegis of the state, the term is also applied (as will be shown here) to the effects of "monopoly" not rooted in government power. In contrast to the orthodox analysis which implies that rent seeking generates social waste only in settings where *artificial* scarcities are created, Buchanan (1983) suggests in a recent paper that rent seeking emerges in any uncompensated transfer of value—notably with respect to gifts or bequests among persons.

2. This article mainly focuses on problems in *identifying* rent-seeking activities. Relatively little attention is devoted to the reasons why measurement of waste, even in principle, is not possible.

3. In the conventional approach, following a specific market event or act of government to increase or decrease competition, it is assumed that gains and losses to producers and consumers can be empirically compared. It is argued that this approach is not valid in a later section of this article.

4. Says Worcester (1982, p. 87):

> A longer run view of what may seem to be excessive profits or losses is appropriate because every successful penetration . . . because of artful foresight, scientific estimation, or plan luck—gives the entrepreneur an edge . . . that can be classified as a monopoly return. There would be no such return if buyers did not find the new superior to the old, and thus, in the large sense, the consequence of a more efficient use of resources.

5. Economic rent is defined in conventional neoclassical theory as the return in excess of opportunity cost. Since opportunity cost is subjective and profits are created through entrepreneurial activity, there is no way for an outside observer to objectively identify economic rent which, in practice, is taken to mean "excessive profits" or "unearned returns." As in the case of the distinction between profits and profiteering, the identification of economic rent depends on judgments of value (von Mises, 1974, p. 129).

6. According to Cowling and Mueller (1980, p. 134):

> Gordon Tullock and Richard Posner have argued that previous studies understate the social costs of monopoly by failing to recognize the costs involved in attempts to gain and retain monopoly power. These costs could take the form of investment in excess production capacity, excessive accumulation of advertising goodwill stocks, and excessive product differentiation through research and development.

[A]nd anyone can try to form a cartel with his competitors or, if he is a member of a cartelized industry, to engross a greater share of the monopoly profits of the industry." (Posner, 1975, p. 809).

7. The use of the concept of rent seeking for the remainder of this article is restricted to activities of this type where groups attempt to obtain wealth transfers through the aegis of the state.

8. Buchanan and di Pierro (1980, p. 699) write:

> There exists basic uncertainty . . . about the set of possibilities that might be realized upon choice or consequent to choice. In a very real sense, the entrepreneur creates his own opportunity set and the act of choice enters a new world that unfolds with choice itself. When this point is recognized, formal theories of probability have little or no contribution to make to our understanding of entrepreneurial choice.

9. "In short, when the entrepreneurial aspect of efficient allocation is taken into account, the system will *always* be in temporary disequilibrium when equilibrium is defined by static or stationary criteria" (Worcester, 1982, p. 87).

10. In efficiency measurements, welfare economists have generally finessed this information problem by implicitly assuming omniscience on the part of the observing economist (Buchanan, 1959).

11. Bhagwati (1982) proposes "directly unproductive, profit-seeking" activities as a general concept that includes conventional rent seeking as a special case.

12.

> How, then, do we tell a government action that we shall call redistributive . . . ? Essentially, we must look at the motives of the act. . . . When we observe a government that does not seem to be solely aimed at improving the efficiency of the economy, defending the country, suppressing murder, etc., we call it redistributive (Tullock, 1983, p. 13).

13. A dramatic example of the positivist approach appears in Tullock (1983, p. 7):

> Let us, for example, take a fairly clear-cut case in which income generates rather little utility: people who are seriously and permanently crippled, such as multiple sclerosis victims. It is fairly obvious that the marginal utility derived from each dollar put in the support of such people is low. If we were attempting to maximize total utility, we would surely cut back on our expenditures to them and increase our expenditures to the beach boys of Malibu.

14. Stigler (1982b) holds that although economic analyses of government intervention including minimum wages, rent controls, and so forth are "tolerably accurate" as to their effects, economists' policy advice on these issues is disregarded because economists are uninformed concerning political desires of the community: "The true account, then, is that the economists refused to listen to the society, not that the society refused to listen to economists. What the economists had to say that was relevant was heard and acted upon" (pp. 15–16). In this view, economics teaches the worthlessness of public policy advice. Studies by public choice economists, by the neoclassicists of the Chicago school, and by the Austrians, however, have helped to make the case for limited government and free markets (McKenzie, 1983, p. 53).

15. Says Buchanan (1959, pp. 137–38):

> The individual preference patterns which he incorporates into his models must be conceived as presumed or predicted, and the changes which are based on these must always be considered tentative hypotheses to be subject to testing in the polling places. The economist can never say that one social situation is more "efficient" than another.

16. Self-interest is likely to play a role in people's attitude toward particular transfers. In the words of Stigler (1982b, p. 15), "One is entitled to suspect that a person's disapproval is related to his circumstances: economists believe that federal support of their research is more desirable than federal support of industrial research."

17. For example, occupational licensing of real estate salespeople, medical doctors, and the like means that the licensed businesses are not as competitive as they otherwise would be (Tullock, 1980a, p. 17). Yet many (most?) people appear willing to pay a higher price in exchange for a perceived increase in information and decrease in uncertainty associated with such restrictions on competition.

18. Browning (1974) points out that rent-seeking behavior may be important in providing information to legislators, which further complicates the benchmark problem in identifying rent-seeking waste.

19. Gardner (1981) discusses the theory that agriculture has special characteristics that unregulated markets cannot properly handle.

20. Ruttan (1980, p. 531) argues, for example, that there is currently underinvestment in publicly supported agricultural research.

> The observed annual rates of return typically fall in the 30–60 percent range. . . . It is hard to imagine very many investments in either private or public sector activity that would produce more favorable rates of return. There is little doubt that a level of expenditure that would push rates of returns to below 20 percent would be in the public interest.

If Ruttan's conclusion were correct, the lobbying necessary to bring about this result could not legitimately be considered rent-seeking waste.

21. Worcester (1982) discusses the "forbidding task" of developing an economic model that can properly be used as a basis for policy making. He concludes: "Economic analysis suitable for policy must provide a negative answer to the first and a positive answer to the second of these questions:

a. Is any unavoidable task ignored or excluded by assumption?

b. Has an equally skeptical investigation been made of the viable alternatives?" (p. 87).

22. Rothbard (1982) explains why utilitarian approaches cannot be used to make the case for or against particular restrictions on competition.

23. There is a subtle difference between the existence and the measurement of inefficiency (or errors) by decision makers. The outside observer cannot detect error or isolate inefficiency on the part of decision makers since utilities and costs are subjective. The individual may err, however, in the sense of acting in a way so that he or she is placed on a position viewed "as less desirable than an equally available state" (Kirzner, 1979, p. 120). Moreover, as Mitchell (1983) suggests, individuals and groups may knowingly be induced by short-run considerations to engage in activities which, if widely adopted, can lead to general ruin.

24. "[T]ransfer activity, originally quite limited, has come to play a much more significant role in the lives of all Americans" (Anderson and Hill, 1980, p. 91). Johansen (1979) refers to the proliferation of groups being organized with the aim of negotiating with the state to improve their economic condition as "the bargaining society."

25. Says Olson (1982, p. 69):

> Lobbying increases the complexity of regulation and the scope of government by creating special provisions and exceptions. A lobby that wins a tax deduction for income of a certain source or type makes the tax code longer and more complicated; a lobby that gets a tariff increase for the producers of a particular commodity makes trade regulation more complex than it would be with no tariff at all.

26. Olson is ambivalent about the effects of conventionally defined monopoly power. Monopoly gains are said to arise because output is reduced to obtain a higher price (p. 45). He argues, however, that though supranormal profits are common, their source is innovation.

> But what gives rise to these temporary profits? Most notably, innovation of one kind or another. . . . And the greater the extent of the profits due to difficulties of entry and imitation, the greater the reward to the innovations that mainly explain economic growth and progress (Olson, 1982, p. 61).

27. Although Olson (1982) stresses the harmful effects of special interest groups, he fails to recognize the importance of the state in creating and maintaining such groups.

Indeed, he holds that "there often will *not* be competitive markets even if the government does not intervene. . . . There will be cartelization of many markets even if the government does not help" (Olson, 1982, pp. 177–78).

28. I am indebted to Robert Batemarco for this insight.

29. Yandle (1982) traces the roots of government to rent-seeking behavior. Government emerges as a producer and monitor of property rights because of common access problems. A useful way of analyzing the conditions giving rise to decay in the legislative process is to view public officials as rent seekers in the legislative commons.

> With representative government the legislative arena is the commons upon which property rights are formed. The legislators are the sheperds and the laws passed by them are the grazing. The constitution is the monitoring device. If the basic contract—the constitution—fails to monitor the commons, overgrazing occurs. (Yandle, 1982, p. 324).

30. "While collective choice stands in the sharpest contrast to the market, marginal improvements are possible. But of all improvements the most effective is a steady diminution of the scope of government" (Mitchell, 1983, pp. 367-68).

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