

The Neoclassical and “New” Concepts of Rent-Seeking

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Abstract

Rent-seeking is both ubiquitous and inevitable. One would think the best and easiest way to avoid the rent-seeking problem is to avoid establishing the institutions that create rents. What one may fail to recognize is that the problem is much more general, that it is the presence of or potential for rights that leads to rent-seeking behavior. All rights create rents by their very nature. Rent-seeking is both an agent-government phenomenon and an agent-agent phenomenon. The neoclassical rent-seeking concept has labelled the former as wasteful while ignoring the presence of the latter. The paper provides a different view of the problem and follows institutional concept of rent-seeking.

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1. Introduction

The presence of rents in the economic system has been recognized since the work of David Ricardo and since at least 1967 it has been a subject of durable interest among economists, political scientists, and others. Generally, the terminology describes a scenario in which firms compete to secure a monopoly rent effected and maintained by some sort of governmental action. The competition to secure the rent is usually manifested as expenditures of resources by rival firms. One of the modern manifestations of the idea of rents in the economy is the analysis of rent-seeking behavior on the part of actors in the political-economic sphere, a topic featured prominently in the literature of the neoclassical public choice school. The main thrust of neoclassical rent-seeking theory is that the government creates rents, economic actors expend resources in the pursuit of these rents, and that such expenditures are “wasted” from society’s perspective.

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The published research on rent-seeking is large and getting larger. Nearly all of the literature is focused on individual rent-seeking – that is, contests in which rivals compete individually to win the rent. Nitzan (1994) provides a good survey of the literature on rent-seeking. The published research has analyzed many of the variations on the theme of rent-seeking behavior. These include valuations of the opportunity costs of rent-seeking activities, as in Krueger (1974), Posner (1975), Tullock (1967, 1980), Hillman and Katz (1984), Appelbaum and Katz (1987), Hirshleifer (1989), Leininger (1993), and Hurley and Shogren (1998); the responses of consumer groups to rent-seeking, as in Baik (1999); the ways in which rent-seeking expenditures are affected by rivals' differential valuations of the rent, as in Hillman and Riley (1989); the ways in which rent-seeking expenditures are affected by differentially situated rivals, as in Mantell (1996); rent dissipation when the rent-seekers are budget constrained, as in Che and Gale (1997); and collective rent-seeking, as in Baik and Lee (2001) and Sylwester (2001).

The purpose of this article is to analyze rent-seeking and rent-seeking theory from an institutional perspective. At first we define the term “rent-seeking” and present an analysis of the economic role of government. The neoclassical theory of rent-seeking is explained in the third section using two main theoretical models. The fourth section deals with problems with the neoclassical approach, specifically the problems that attend the definition of waste and the fundamental inconsistencies in the theory of rent-seeking. In the fifth section, we examine constitutional economics as a possible solution and use the insights gleaned from the preceding analysis to present elements of an institutional theory of rent-seeking. The final section concludes the article.

2. Definition of Rent-Seeking

The institutional approach to economics has long recognized both the importance and the inevitability of government participation in the economy, that the issue is not more versus less government (or big versus small government), but rather to whose interests government gives effect. Thus, a movement from more to less stringent requirements for the emissions of polluting firms is not a move from more to less government (“deregulation”), but a change in the structure of rights from pollutes to polluters. The big versus small government arguments are rhetorical devices, persuasive mechanisms reflective of and reinforcing traditional Western liberal ideology. The terms “regulation” and “deregulation” are rhetorical reflections of this ideology, since whenever rights are being changed, one party is being “regulated” and the other “deregulated”. Government is both a dependent and independent variable, simultaneously being determined by and determining various forces in society.

One important facet of the role of government in the economy is that government is used by various economic actors desirous that government act in their interest. These actors desire to obtain rents of one form or another and are often able to do so with the help of government. Commons (1924) recognized this incentive and the effect that the ability to obtain these government-endowed rents has on the value of the firm (Commons, 1924). He called this portion of the value of the firm “political value” and defined it as “...the value added by advantageous treatment from politicians, whether legislators, judges, executives, or administrative boards in the exercise of the several powers of sovereignty, in so far as this value exceeds that of the ordinary lawfulness and exposure to competition out of which the value of going plant or goodwill emerges. As a use-value this political value does not usually represent an additional service to customers, creditors, or laborers, inspiring their confidence, loyalty, or patronage, but is rather the superior privilege emanating from the blunders, corruption or wisdom of public officials as shown in the tax exemption bonuses, special franchises, inside information, judicial opinion, and similar exercise of the royal prerogative or the modern sovereignty superior to that received by competitors who enjoy only ordinary lawfulness” (Commons, 1924, pp. 199 – 200).

The ability to capture and use government owes to the asymmetries that exist in society. Those with the most power (dollars, votes) are able to capture government for their use. This, in turn, reinforces their power, which leads to the perpetuation of the status quo. Commons recognized this early on:

“By *Laissez faire* was really meant a maxim of advice to these officials of sovereignty recommending the use of physical force against persons who interfered with ownership, but alternatively recommending the use of physical force in favor of the owners themselves... what businessmen and economists really meant by *laissez faire* was: prevent everybody else at home and abroad from doing as they please, in order that we may do as we please with what we claim as our own” (Commons, 1950, pp. 82 – 83).

These ideas were long ignored in neoclassical economics, with its emphasis on symmetry across actors and firms, and its minimalist conception of the state. This began to change with the development of the public choice literature, and especially, for our purposes, with the publication of Tullock's article on rent-seeking (Tullock, 1967).

Rent-seeking is usually defined as the political activity of individuals and groups who devote scarce resources to the pursuit of monopoly rights granted by governments. The basic propositions of rent-seeking theory are (1) that the expenditure of resources to gain a transfer is itself a social cost and that (2) the resulting market privileges or rents represent a welfare loss on consumers and

taxpayers. The numerous actual actions and policy instruments by which rents are created and conveyed are designed to conceal the gains. They range from outright bribery to sales of subsidies, tax privileges, price supports, tariffs, farm or import quotas, or licenses to the highest bidders, with the proceeds going to officials in the form of higher salaries and perquisites. The intensity with which such rents are sought by citizens or officials depends of course on the size of the rents and the number of prospective competitors.

Following the seminal works of Posner (1975), Tullock (1967) and Tullock (1980) many authors have extended the theory of rent-seeking in several directions. (For a survey of the literature, see Tollison (1982) and Brooks and Heijdra (1989).) The received literature focuses mainly on the extent of social wastes due to rent-seeking competition under a variety of assumptions on the number of rent-seekers, the possibility of rent-avoidance, uncertainty, etc.

3. The Neoclassical Concept of Rent-Seeking

At the most general level, rent-seeking is said to involve the expenditure of resources for the purpose of obtaining some transfer. Several definitions of rent-seeking have been put forth by various authors, a fact that suggests there is no settled definition. A few of the proffered definitions follow.

“Rent-seeking is meant to describe the resource-wasting activities of individuals seeking transfers of wealth through the aegis of the state.” (Buchanan, Tollison, and Tullock, 1980, p. ix, cited in Samuels and Mercuro, 1984, p. 55)

“The term rent-seeking is designed to describe behavior in institutional settings where individual efforts to maximize value generate social waste rather than social surplus.” (Buchanan, 1980, p. 4) “...rent-seeking is defined as the pursuit of profits via the use of government coercion.” (Anderson, Rowley, and Tollison, 1988, p. 100, cited in Brooks and Heijdra, 1989, p. 33)

“Rent-seeking is the expenditure of scarce resources to capture an artificially created transfer.” (Tollison, 1982, p. 578, cited in Brooks and Heijdra, 1989, p. 32)

Thus, attempts by individuals, firms, and groups to get the state to act in their interest are labelled “rent-seeking”. Firms have an incentive to expend resources on rent-seeking up to the point where the expected gain from doing so is equal to the cost. That is, under certain restrictive assumptions it can be shown that all rents will be dissipated by expenditures to capture them.

A substantial portion of the research on rent-seeking addresses the issue of rent-dissipation. This line of inquiry is drawn directly from Tullock's (1967) stated intent to identify the total social costs of monopoly. Early studies, which were concerned with the measurement of Tullock costs, simply assumed dissipation

would be complete (see e.g. Krueger, 1974 and Posner, 1975). However, Posner (1975) and Fisher (1985) observed the question of dissipation can be answered only for overtly specified game structures.

Tullock (1980) and Rogerson (1982) introduced a rent-seeking game which yielded incomplete dissipation under a wide variety of cost conditions. In spite of Tullock's suggestion that the incomplete-dissipation result might be the more interesting, several authors responded by introducing variations of the game in attempts to obtain a general complete dissipation result (see Corcoran, 1984; Corcoran and Karels, 1985; Higgins, Shugart and Tollison, 1985).

Along similar lines, several authors have considered necessary conditions for excess dissipation. Lott (1987) argues that non-transferable licenses yield this result. However, Gahvari (1989) has questioned his conclusion. Additionally, Tollison (1989) has posited the occurrence of excess dissipation when the rent-seeker can generate extra-game revenue as a result of insider information generated by participation in the rent-seeking game.

Wenders (1987) addressed the social costs of rent-seeking to obtain a monopoly and concludes, "recuring or sunk, even the largest specification of the Harberger and Tullock costs of regulation may fall far short of the actual welfare costs. This is because the analysis concentrates on the rent-seeking Tullock costs and largely ignore, the parallel rent-defending Tullock costs." (Wenders, 1987, p. 456)

In most of the literature rent-seekers are assumed to behave non-cooperatively against each other. That is, the possibility of partial or full cooperation between rent-seekers is excluded from consideration. However, it is often observed that rent-seekers form a group to share the prize (rent) and costs of rent-seeking. For instance, as Appelbaum and Katz (1986, p. 175) notes, "...car manufacturers may fight jointly against tariffs on steel imports...". Tollison (1982) also acknowledges the possibility that consumers form a group to fight against the monopoly rent. The possibility of group formation by rent-seekers indeed raises several interesting issues, aside from its effect on social welfare, such as those on the internal organization of groups and the free-rider problem associated with it.

Neoclassical theory asserts that resources used by agents in the rent-seeking process are wasted from a social point of view, since they could have been, but were not, used to increase the value of output generated by society. Thus, in computing the total loss from government creation of a monopoly position, one must not only examine the loss in welfare arising from the monopoly position *vis-à-vis* the competitive outcome; one must also include the cost of the rent-seeking process.

It should be emphasized at this point that rent-seeking is different, in neoclassical jargon, from profit seeking. Profit-seeking activities refer to taking advantage of market opportunities in order to increase one's profits, allowing one to produce a higher level of output for a given cost or the same level of output at lower cost. The resources expended on rent-seeking, however, are said to be spent on attaining some artificially created transfer, such as a government-franchised monopoly position.

3.1. The Posner Model

While Wenders inappropriately applies the Magee and Young prisoners' dilemma mechanism, rent-defending has some interesting welfare implications, but specific implications depend on the type of rent-seeking model employed. Wenders adopts Posner's (1975, p. 76) construct by assuming rent-seekers bid the expected value of the transfer.

In Posner's example, if ten risk-neutral firms have an equal chance of capturing a monopoly with a present value of EUR 1,000,000 each will spend EUR 100,000. The rent is completely dissipated. Assuming consumers are organized and capable of raising and spending an amount equal to producers, the probability of monopoly pricing falls from 1 to 0.5 and the expected value of the Posner game for any one of ten producers becomes $0.1(0.5(\text{EUR } 1,000,000)) = \text{EUR } 50,000$. The total expenditure of the organized consumer group is $0.5(\text{EUR } 1,000,000) = \text{EUR } 500,000$. Expenditures by rent-seeking producers and rent-defending expenditures by consumers sum to the rent value of EUR 1,000,000. Dissipation is still complete but not excessive.

To assess rent-seeking costs, the rent at stake must be identified and the model formalizing these activities selected. In the monopoly pricing case, rent-defending consumers behave similarly to rent-seeking producers because the stake for which they are competing is the same: the property right to set prices. If the right is won by producers, prices increase to the monopoly level. If consumers win, prices remain at the competitive level. Consumers may well be interested in defending the competitive price, but the return to their rent-defending expenditures is affected by their probability of winning.

Wenders reached an excess-dissipation conclusion by failing to explicitly formulate the impact of consumer participation on the expected value of the contested rents.¹

¹ Using a general equilibrium model, DeLorme and Snow (1990) reach a similar conclusion. Specifically, they show rent-avoidance typically reduces social waste and dissipation is less than the Harberger-Tullock trapazoid as long as rent-seeking and/or rent-defending is not subsidized by the government.

3.2. The Tullock-Rogerson Model

As previously noted, a strategic game model of rent-seeking behavior has been posited by Tullock (1980) and Rogerson (1982). They envision seekers who influence the probability of winning by investing sums in the game. With two identical risk-neutral players, A and B , the expected value of rent-seeking for player A is

$$E(a) = \frac{a}{a+b}(T) - a \quad (1)$$

where a represent A 's rent-seeking expenditures, b is B 's expenditures and T is the rent at stake. Player A maximizes the expected value, and the optimal bid, a^* , depends on B 's effort and the rent at stake.

$$a^* = -b + \sqrt{bT} \quad (2)$$

B faces an identical choice and generates a similar reaction function. As each player responds in turn, a Cournot-Nash type equilibrium is attained where each player bids $1/4$ of the rent value. With n players the equilibrium investment by A is $a_{eq} = \left[(n-1)/n^2 \right] T$.

Now, suppose consumers, or any party currently holding the property right to this pricing power, engage in rent-defending activities. This formulation merely changes equation (1) for the rent-defender by transorming the rent to a negative value. Specifically, the defender is now competing to maintain the rent. Make player A the rent-seeker and player B the rent-defender. While A 's expected value calculation remained unchanged B 's expected value becomes

$$E(b) = \frac{a}{a+b}(-T) - b \quad (3)$$

B 's expected value in negative. If B 's rent-defense in unsuccessful, all previously controlled rent is lost, while a successful defense reduces the defender's wealth by the amount of the expenditure. Solving for B 's optimal response function, b^* , yields

$$b^* = -a + \sqrt{aT} \quad (4)$$

a^* is given by equation (2).

If both players maximize their expected value the equilibrium solutions is unchanged from the simple two-player game with $a_{eq} = (1/4)T$ and $b_{eq} = (1/4)T$. The total rent-seeking investment remains $(1/2)T$. The equilibrium level of rent-dissipation is unchanged.

4. Problems with the Neoclassical Concept

Neoclassical rent-seeking theory says that resources devoted to competing for artificially created transfers are wasted. However, there are several problems with this and any other conception of waste.

4.1. The Structure of Rights and the Social Welfare Function

First, this conception of waste assumes that the status quo structure of rights is correct (Samuels and Mercurio, 1984, pp. 60 – 63). Rights change only when there is challenge to/competition for a right. This inevitably involves the expenditure of resources. Hence, to label such expenditure “waste” presumes that rights should not be changed, that the status quo structure of rights is in some sense “natural”. Buchanan does as much in the following passage:

“So long as governmental action is restricted largely, if not entirely, to protecting individual rights, personal and property, and enforcing voluntarily negotiated private contracts, the market process dominates economic behavior and ensures that any economic rents that appear will be dissipated by the forces of competitive entry... If however, governmental action moves significantly beyond the limits defined by the minimal or protective state, if government commences, as it has done on a sweeping scale, to intervene piecemeal in the market adjustment process, the tendency toward the erosion or dissipation of rents is countered and may be wholly blocked... Hence, attempts will be made to capture these rents, and the resources used up on such attempts will reflect social waste... Rent-seeking activity is directly related to the scope and range of government activity in the economy...” (Buchanan, 1980, pp. 8 – 9)

The state is in the business of rights creation and recreation. While natural rights theorists will dispute this, there is no *a priori* basis upon which one can declare one rights arrangement “natural” and others unnatural. There are no rights apart from the state. By enforcing certain claims and rejecting others, the state *de facto* determines who has rights and who does not. Apart from the state, the very concept of rights is vacuous, since any so-called right would be freely violable.

Thus, moving from the state of nature to a society with a government that protects property rights involves rights creation as well as protection. This, in turn, creates competition for rights: *A* wants the right to possession, use, and disposition of the apple tree he tends, while *B* wants the right to be able to raid that tree for fruit whenever the mood strikes. The result is that each of them engage in lobbying activities to get the government to specify rights in their favor. That is, they engage in rent-seeking.

Because the state is the source of all rights, however, the state also has the power to change rights, to remove a right from *A* and give it to *B*. It is this very function that Buchanan is protesting against when he says that:

“Rent-seeking emerges under normally predicted circumstances because political interference with markets creates differentially advantageous positions for some persons who secure access to valuable rights.” (Buchanan, 1980, p. 11)

Yet, Buchanan seemingly fails to realize that the market system was not created out of a vacuum. Rather, the market system evolved due to rent-seeking behavior on the part of individuals and groups who were “losers” under the mercantile system.

Thus, while the market is made out to be the natural system from which waste is measured, there is no inherently natural structure of rights. This is, rather, a rhetorical device used to imbue the rights structure being advocated with an aura of “correctness” where no such thing is possible. Since all legal change involves an artificially created transfer, all legal change is seen as wasteful under the neoclassical definition of waste. Since there is no *a priori* reason to label any one structure of rights “correct” *vis-à-vis* all others, there is no reason that any given expenditure of resources can be labelled “waste” apart from a particular view of the world with its associated normative premises.

Further evidence of the selective nature of the definition of waste can be seen in Mueller (1989, pp. 230 – 231). Here, Mueller looks at the example of an airline lobbying for a monopoly over certain routes. He claims that the fees paid by the airline to the lobbyists and the time that the legislators spend competing with each other for the bribe money are social waste. Yet, at the same time, Mueller claims that:

“If an airline could win a monopoly position simply by offering a bribe, and this bribe could be costlessly transmitted to the government official awarding the routes, and this was all that the bribe brought about, then no social waste would be created by the bribe.” (Mueller, 1989, p. 231)

It would seem, however, that the bribe money paid out could instead be used by the firm to increase output, and hence the bribe should fall under the neoclassical categorization of waste. That it does not points to the selective perception as to what constitutes waste. Indeed, with the appropriate antecedent normative premise, anything can be said to be waste or not waste.

This attitude is also reflected in the rhetoric that makes the government out to be the villain. In some cases, government may be seeking to alter the structure of rights, say, to use the typical rent-seeking case, to create a monopoly situation. Responding to the potential for increased profit opportunities, firms will seek to attain this monopoly position by spending resources on lobbying.² That is, the

firms will engage in rent seeking. What is often overlooked, or at least underemphasized, in neoclassical rent-seeking theory is that rent-seeking does not just occur in response to government-created opportunities. Rather, rent-seeking is a demand-side as well as a supply-side phenomena. Firms and other interest groups may engage in lobbying activities to get government to alter the structure of rights in their favor – to give them more power in the market to increase their opportunity set/lower their cost constraint in some way.

Second, the determination that these rent-seeking expenditures are wasted from a social perspective because they do not increase the value of social output is also presumptive of the form of the social welfare function. If we assume that individual utility functions have items besides the value of social output as arguments, and if we further assume that the social welfare function is the weighted sum of the individual utilities of all of the members of society, assumptions certainly consonant with neoclassical theory, then one cannot say, even within a given rights structure, that rent-seeking is wasteful. As Brooks, Heijdra, and Lowenberg (1990, pp. 8 – 10) have demonstrated, expenditures by those seeking rents go into the pockets of others - middlemen, such as lobbyists, and those who grant the rent-producing right. These revenues increase the utility of those receiving them and hence increase social welfare under the assumption that social welfare is some function of individuals' utilities.

4.2. Inconsistencies

Even with the assumption of a given rights structure and a given social welfare function, there are at least two types of situations where rent-seeking cannot, under the standard neoclassical concept, be considered wasteful. The first is where such expenditures are information-enhancing. Suppose that government is planning to build a hydroelectric power plants chain (HPPC). The project involves elaborate geographical and demographic specifications and will take up such a huge area that the competition for the project is on a region versus region basis. The government is building one HPPC, and in doing so is providing both a monopoly position and a boost to the economy of the region that is awarded the project. As might be expected for a project of this magnitude, the competition was fierce. Each region competing for the project was providing information to the government as to how its site fit the various specifications the government had set forth. Based on this information, the government was able to choose the site that best fit the specifications.

² Note that this is the neoclassical story. Firms could actually be responding to the ability to have more slack with some given profit level.

Thus, the greater the extent to which rent-seeking expenditures are information-providing, as opposed to “wining and dining”, the smaller is the extent to which rent-seeking can be called wasteful.³

The second case in which the neoclassical conception of rent-seeking expenditures as waste is flawed, even given the status quo rights structure and social welfare function, is in the presence of X-inefficiency or other non-profit-maximizing behavior. The standard neoclassical assumption is that all firms maximize profits, which leads to the result that any resources expended on rent-seeking reduce the value of social output. By dropping the assumption that firms maximize profits/minimize costs, we are left with the potential for slack within the firm. The usual types of examples include increasing managerial perquisites, power, and so on. That is, there exists what neoclassical theory would call “waste” within the firm's operations. For example, assume that management engages in a form of satisficing behavior such that they must satisfy a minimum profit constraint to keep shareholders happy (and hence to keep their jobs), and that the difference between this position and the profit maximization position is “wasted” in the form of managerial perquisites. Then, the opportunity to attain some sort of rent-garnering position presents itself and resources are expended to that end, while still satisfying the minimum profit constraint. It cannot then be stated that these resources are wasted and should be counted on top of the welfare loss due to the monopoly position attained through rent-seeking. The resources expended by this firm on rent-seeking are merely shifted from one kind of “wasteful” activity (perks) to another (seeking rents). Thus, the net level of “waste” has not increased due to these rent-seeking activities. Of course if one is not willing to give up the assumption that all firms maximize profits, this argument has no validity. Given the strong presumption against the existence of wide-spread profit maximization in the institutional and other traditions, however, this argument has a good deal of validity.

There is also a case that neoclassical rent-seeking theory seems unwilling to discuss the case of the-so-called “vertical rent-seeking”. This vertical rent-seeking takes the form of input supplier-input buyer rent-seeking. When it comes to courting the favor of the monopoly – granting queen, Buchanan claims that “Promotion, advertising, flatter, persuasion, cajolery – these and other attributes will characterize rent-seeking behaviour” (Buchanan, 1980, p. 8), and that “Rent-seeking on the part of potential entrants in a setting where entry is either blocked or can at best reflect one-for-one substitution must generate social waste” (Buchanan, 1980, p. 8). He is not willing, however, to apply the same criteria to

³ For more on the information-revealing character of so-called “rent-seeking” outlays, see DiLorenzo (1984).

inter-firm relations. Indeed, in listing the three levels of rent-seeking behavior that generate social waste – (1) the expenditures incurred by those seeking the monopoly position, (2) actions undertaken by government officials to secure some of the dollars expended by the rent-seekers, and (3) distortions in the behavior of others in the system that result from (1) and (2) – Buchanan (1980, pp. 12 – 13) deals solely with agent-government rent-seeking.

As an example of this vertical rent-seeking, take the case of inter-firm New Year gift giving. Be it fruit cake, alcohol, or desk calendars, these gifts are given to cement one's relation with another firm, so that when firm *A* needs something it turns to firm *B* rather than firm *C*. Such activity is rent-seeking, plain and simple, and any attempt to label it profit seeking, as opposed to rent-seeking, is selective and dispositive of an ideology that sees inter-firm (that is, market) activity as non-wasteful but government-related activity as wasteful. Such expenditures are devices used by *B* in an attempt to transfer *A*'s business from *C* to *B* in the same way that “wining and dining” and campaign contributions are used by firms to attain a government-franchised monopoly position.

5. The “New” Concepts of Rent-Seeking

5.1. Constitutional Economics

Brooks, Heijdra, and Lowenberg (1990), as noted above, recognize the fact that rent-seeking expenditures increase the utility of some people and hence do not unambiguously constitute waste, that “the line between (wasteful) rent-seeking and (productive) profit seeking is a thin (and, one might add, selectively perceived) one... that the subjectivity of benefits and costs makes it impossible to measure objectively these welfare effects” (Brooks, Heijdra, and Lowenberg, 1990, p. 420). They assert that to get a basis upon which to determine what constitutes waste, one must turn to the constitutional approach to rights, which holds that “the desirability of social institutions and rules depends on the process by which rational individuals supposedly agreed to them” (Brooks, Heijdra, and Lowenberg, 1990, p. 421).

The constitutional theorist posits the existence of a constitutional stage of decision making, in which agents are faced with a choice of alternative institutional arrangements. During this state, each agent operates behind a Rawlsian “veil of ignorance”. He does not know whether he will be a net beneficiary or loser in the distributional conflicts that will inevitably occur in the future post-constitutional society. In such a situation, the only rules that rational individuals will unanimously agree upon are those which, in some sense, are perceived as

“fair”. According to this approach, unanimity is the key to a mutually beneficial and therefore efficient constitution.

If it could conceptually be shown that individuals in the constitutional stage of deliberation would unanimously agree to replace the institutions that currently exist in society with new ones, or at least establish procedures to reduce the costs of rent-seeking associated with the existing institutions, then the constitutional theorist would argue that the status quo situation is inefficient. The level of waste from rent-seeking would then be determined as the difference between the combined individual payoffs under the new and the old set of rules (Brooks, Heijdra, and Lowenberg, 1990, pp. 421 – 422).

It is important to note that this is a conceptual rather than a physical, process. Yet, it is still beset with some of the same problems that would be present if the process were, in fact, physical. If we assume perfect information, no frictions, and perfect symmetry across agents, such a basis upon which to measure waste is theoretically plausible. However, we are dealing with a complex system in which one must come up with a set of rules that tens of millions of people would hypothetically agree upon. Such an algorithm is computationally impossible to solve. The untenable nature of the constitutional approach is further magnified when one realizes that society is constantly evolving. This has at least two important implications.

First, this evolution often requires the creation of new rights where none existed before (such as, the human genome). An existing constitution would have to be modified again and again, each time by a hypothetical unanimous vote, to meet the need for new rights. Second, at any given time some members of society are leaving (through death) while others are becoming members (by reaching voting age or gaining citizenship). If the preferences of these new members of society are not identical to those of the departed members, we no longer have a unanimously agreed upon constitution, and hence we do not have a unanimously agreed on definition of waste. Thus, a particular conception of waste will only apply for a short time, and the definition of waste will be changed so often as to render the entire concept devoid of content.

Furthermore, the fact that a given constitution commands unanimous assent does not mean that everyone has agreed to the same constitution. Different people interpret the same phenomenon in different ways, owing to different cultural experiences, different observational processes, and so on. As a result, “perceptual fault lines run through apparently stable communities that appear to have agreed on basic institutions and structures and on general governing rules. Consent comes apart in battles of description. Consent comes apart over whose stories to tell” (Scheppel, 1989, p. 2082).

Rent-seeking will also occur in the constitutional choice process. At one level, each party has a strong incentive to hold out during the constitutional choice process in hopes of shifting the distribution of rights to their favor. This increases the time necessary to reach a solution, and in doing so makes the constitutional choice process more costly. Simply put, holding out is a form of rent-seeking. Equally important, however, is that each party will seek to manipulate the structure of rights to his or her own advantage. One might argue that rent-seeking is either impossible or not feasible behind the Rawlsian veil of ignorance, where no one knows what their ultimate position will be, but this is not an issue for a constitution or a constitutional change voted on by society. All individuals have some degree of information as to what their place will be, and will engage in rent-seeking activities in order to improve or cement that position. Of course at the preconstitutional level there is no standard against which to measure waste, and hence the entire concept becomes problematic. Thus, in contrast to the claim of Brooks, Heijdra, and Lowenberg, the use of constitutional economics is not “operational” either as a theory of constitutional choice or as a method of determining the wasteful component of rent-seeking (Brooks, Heijdra, and Lowenberg, 1990, p. 22).

Finally, the assumed primacy of any one conceptual constitutional system is necessarily selective on at least two levels. First, different people will likely have different views as to what set of rules could hypothetically command unanimous assent. In light of this, the characterization of any type of behavior as “waste” is selectively elevating one assumed, unanimously agreed-on constitution over others, where no such differentiation is possible. Second, the constitutional approach itself has no *a priori* claim to legitimacy over any other approach. The logical extension of its own criteria is that the constitutional approach itself would have to command unanimous agreement to be used as the approach to the problem. Further, all of this assumes the primacy of the unanimity voting rule over all other rules. Thus, the constitutional approach, while perhaps as legitimate as any other approach, has no more validity than any other approach as the absolute criterion.

5.2. Institutional Economics

The above analysis has, largely by way of critique, given some insights as to how an institutional approach to rent-seeking might be formulated. Here, we will formally set out some basic elements of an institutional approach.

The fact that rents are ubiquitous becomes very apparent if we define rent as “income received over and above the amount that would be received under a different institutional, or rights, arrangement” (Samuels and Mercuro, 1984, p. 55).

Legal change, by altering rights, alters the pattern of liberties and exposures in society and thus creates rents. Further, the possibility of legal change presents the potential for a reallocation of rents. Rents also exist in the realm of relations between private agents (as opposed to relations between private agents and government), and these are no less important than rents created within the public sector.

If rents are available through the alteration of legal arrangements, then some agents will devote resources toward securing a change in their favor, while others will devote resources toward the maintenance of the status quo in order to protect their rents. Analogous reasoning applies to rent seeking between private agents (such as, gift-giving). The only way to avoid rent seeking is to prescribe an unalterable set of relations within society. Once we allow for the possibility and desirability of change in legal and economic relations, we inevitably introduce rent-seeking, since social arrangements do not change apart from an allocation of resources to secure that change. Thus, any model that contemplates zero rents or zero rent-seeking is tantamount to an assumption that no legal change of legal rights (or of relations between private agents in the case of inter-agent rent-seeking) is possible.

The concept of “waste” is at once both highly normative and problematic. Any conception of waste hinges crucially on an antecedent normative premise as to the appropriate distribution of resources and rights in society, different ones of which may lead to conflicting evaluations, and no one of which has any *a priori* claim to legitimacy over the others.

To take an example from a slightly related vein, Veblen classifies the activities of the speculator as wasteful, (Veblen, 1990, pp. 279 – 323) while the neo-classical position is that the speculator serves an efficiency-enhancing function (Cooter and Ulen, 1988, p. 260). While a detailed explication of the opposing arguments here goes well beyond the scope of this article, the role of preconceptions and normative premises is prominent.

The issues raised above suggest that the focus of rent-seeking theory is currently misplaced. Since rents are inevitably created and reallocated through changes in the rights structure (as well as through changes in inter-agent relations) in society, we need to move toward an analysis which assesses the impact of alternative rights/rent (that is, institutional) structures. When we recognize the ubiquity and inevitability of rent-seeking, the idea of waste assumes at best a secondary role. If we cannot prevent, or even minimize, rent-seeking activities, then whether or not such activities are wasteful becomes much less interesting. This is especially important when the idea of rent-seeking as waste is used as an argument for so-called “small government”.

In the public policy realm, the decision as to whether to alter social arrangements should be made in light of the merits of the claims of competing interests. It is the rent-seeking process that brings to light these competing claims. The issue is not more versus fewer rents, but rather rents for whom. The resolution of this issue depends on the goals we set for society, and how different distributions of rights fit in with these goals.⁴

Conclusion

It should be clear by now that rent-seeking is both ubiquitous and inevitable. Mueller (1989) says that the simplest and best way to avoid the rent-seeking problem is to avoid establishing the institutions that create rents, that is, the regulations and regulatory agencies that lead to rent-seeking. What Mueller fails to recognize is that the “problem” is much more general, that it is the presence of (or potential for) rights that leads to rent-seeking behavior. All rights create rents by their very nature, for those who get the rights are receiving a transfer from those who the rights are being taken away from and those who do not have rights will continue to attempt to get rights transferred to themselves. Thus, as long as there are rights there will be rent-seeking.

It has further been demonstrated that rent-seeking is not just an agent-government phenomena but also an agent-agent phenomena. The work to this point in neoclassical rent-seeking theory has decried the former as wasteful while ignoring the presence of the latter.

Also, the church expending resources to get resources transferred into its own coffers may or may not be wasteful, but when a firm does the same in the pursuit of legal change, such activities are wasteful. This, coupled with the ignorance of agent-agent rent-seeking activities illustrates the selective nature of the application of neoclassical rent-seeking theory and the rhetoric used to espouse it.

There is, then, no single, correct definition of “waste”. Any statement that one activity is wasteful *vis-à-vis* other potential activities is selective, a function of one's view of the world, and especially ideology. This suggests the need for a different view of rent-seeking, and this paper has attempted to make some steps in this direction.

⁴ Schmid (1987, pp. 251 – 252) presents an excellent analysis of various criteria for evaluating alternative institutional and rights structures. He concludes that none of these criteria have any prior claim to legitimacy over the others, as each relies on an antecedent normative premise. What is crucial is that these premises must be made explicit which in turn allows for the comparison of results generated under alternative premises. We are not, then, in the realm of “better versus worse”, but rather “better for whom”.

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