DEVELOPMENT OF RENT THEORY

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The simplest definition of rent seeking is the expenditure of resources attempting to enrich oneself by increasing one's share of a fixed amount of wealth rather than trying to create wealth. Since resources are expended but no new wealth is created, the net effect of rent-seeking is to reduce the sum of social wealth.

Rent-seeking generally implies the extraction of uncompensated value from others without making any contribution to productivity. The origin of the term refers to the gaining control oflandor other pre-existing natural resources. In the modern economy, a more common example of rent-seeking is political lobbying to receive a government transfer payment, or to impose burdensome regulations on one's competitors in order to increase one's market share.

It is important to distinguish between profit-seeking and rent-seeking. Some will try to say that rent-seeking is a creation of wealth. However, profit-seeking should be understood as the creation of wealth, while rent-seeking includes the use of the power of the state or government to distribute wealth between different groups of individuals.

The phenomenon of rent-seeking in connection with monopolies was first formally identified in 1967 by Gordon Tullock. The expression rent-seeking was coined in 1974 by Anne Krueger. The word "rent" does not refer here to payment on a lease but stems instead from Adam Smith's division of incomes into profit, wage, and rent. Rent-seeking behavior is distinguished in theory from profit-seeking behavior, in which entities seek to extract value by engaging in mutually beneficial transactions.

Critics of the concept point out that in practice, there may be difficulties distinguishing between beneficial profit-seeking and detrimental rent-seeking. Often a further distinction is drawn between rents obtained legally through political power and the proceeds of privatecommon-lawcrimessuch as fraud, embezzlementandtheft. This viewpoint sees "profit" as obtained consensually, through a mutually agreeable transaction between two entities (buyer and seller), and the proceeds of common-law crime non-consensually, by force or fraud inflicted on one party by another.

Rent, by contrast with these two, is obtained when a third party deprives one party of access to otherwise accessible transaction opportunities, making nominally "consensual" transactions a rent-collection opportunity for the third party.

From a theoretical standpoint, the moral hazard of rent-seeking can be considerable. If "buying" a favorable regulatory environment is cheaper than building more efficient production, a firm may choose the former option, reaping incomes entirely unrelated to any contribution to total wealth or well-being. This results in a sub-optimal allocation of resources— money spent on lobbyists and counter-lobbyists rather than on research, improved business practices, employee, or additional capital goods— which retards economic growth. Claims that a firm is rent-seeking therefore often accompany allegations of government corruption, or the undue influence of special interests.

Mancur Olson traced the historic consequences of rent seeking in The Rise and Decline of Nations. As a country becomes increasingly dominated by organized interest groups, it loses economic vitality and falls into decline. Olson argued that countries that have a collapse of the political regime and the interest groups that have coalesced around it can radically improve productivity and increase national income because they start with a clean slate in the aftermath of the collapse. An example of this is Japan after World War Two. But new coalitions form over time, once again shackling society in order to redistribute wealth and income to themselves. However, social and technological changes have allowed new enterprises and groups to emerge in the past.

Rent-seeking behavior, in terms of land rent, figures in Georgist economic theory, where the value of land is largely attributed to provision of government services and infrastructure (e.g., road building, provision of public schools, maintenance of peace and order, etc.) and the community in general, rather than resulting from any action or contribution by the landowner.

A study by Laband and Sophocles in 1988 estimated that rent-seeking had decreased total income in the country by 45 percent ultimately, it is difficult to truly know the cost of rent-seeking, affirmed by both Dougan and Tullock. Rent-seekers of government provided benefits will in turn spend up to that amount of benefit in order to gain those benefits. Similarly, taxpayers lobby for loopholes and will spend the value of those loopholes, again, to obtain those loopholes. The total of wastes from rent-seeking is the total amount from the government provided benefits and instances of tax avoidance. Dougan says that the “total rent-seeking costs equal the sum of aggregate current income plus the net deficit of the public sector."

Mark Gradstein writes about rent-seeking in relation to public goods provision, and says that public goods are determined by rent seeking or lobbying activities. But the question is whether private provision with free-riding incentives or public provision with rent-seeking incentives is more inefficient in its allocation.

Rent-seeking can also be quite costly to economic growth. This is because high rent-seeking activity makes more rent-seeking attractive because of the natural and growing returns that one sees as a result of rent-seeking. Thus, rent-seeking is valued over productivity. In this case there are very high levels of rent-seeking, while very low levels of output. Another reason rent-seeking may grow at the cost of economic growth, is that public rent-seeking by the state can so easily hurt innovation. Ultimately, public rent-seeking hurts the economy the most because innovation is what drives economic growth.