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The costs of rent seeking: A metaphysical problem

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It is well known that one of the reasons that Congressmen vote for such things as protective tariffs and the farm subsidy program is that they think it will attract votes. Economists are almost always opposed to these items because they think that they injure the voters. Technically speaking, what happens is that the voters specialize their vote, i.e., concentrate their entire preference function on one particular issue (or a few issues) which has considerable importance to them. Other voters, concentrating their voting decision on other special issues, ignore the well-being of the first voter.

Economists would argue that all of the voters are worse off than if they had not so specialized their votes. On the other hand democracy is supposed to give the voter his choice, not what some economists think that they should choose. The voters vote for such things. Can we count this as a cost?

There is another problem here, which is that voters are apt to be very badly informed. Indeed any *Public Choice* scholar worth his salt at sometime during his teaching proves to his students that the rational voter who gives thought to the matter will decide not to be well informed about politics unless he happens to regard politics as a hobby.

As an example of the difficulties here, consider the following from the former Chairman of the President's Council of Economic Advisors Herbert Stein (1987:3): 'The "problem" of the deficit is to make the decisions as well informed and as responsive to the desires of the public as possible.' The problem, of course, is that if the public is systematically poorly informed, then the two criteria are inconsistent. And the public *is* systematically ill-informed.

The problem raised by individuals making choices, which from the outside seems to be unwise, is a real one. Do such choices impose a cost on the chooser? Note that in the market and in politics, this is a hard question to answer but fortunately in the market, it is rarely, if ever, an important question. If we are trying to measure the cost of rent seeking, it may be very important, indeed,

because it may be the principal payoff to a Congressman for votes for, let's say the farm program, come in his reelection by voters who are voting because of the farm program. Is this a cost?

Let us digress a little bit and talk about costs in the private market in cases where information is poor. 200 years ago someone who was ill would go to a doctor and ask to be bled. Suppose the doctor bleeds him, using a knife which he has earlier that day used to bleed eight or ten people with assorted diseases. He has never sterilized the knife because he has never heard of germs. Ignoring the germ problem, bleeding is a treatment which will make the person worse almost regardless of what disease he has. Is there a cost in this? With our present scientific knowledge, this was clearly an erroneous decision by the purchaser of medical services.

To make the problem a little more difficult, let us assume it is not 200 years ago, but 130 years ago and that most doctors and most patients have realized that bleeding is not a good treatment. Suppose, however, that an old-fashioned patient and an old-fashioned doctor reach a mutually agreeable bargain under which the doctor bled the patient once again, using an unsterilized knife. Does this impose a 'cost' on the patient?

These questions are not very important for a student of the market but, once again, when we turn to rent seeking, they are significant. Let us take an example where the people are well informed but where there are externalities. Suppose a car driver is polluting the air and this is in the early 1950s, where there are no regulations on it. He would be aware of the fact that if he stopped polluting the air, it would have almost no effect on him although everyone else in the society and, for the matter, he himself would be trivially better off. Since the cost would fall entirely on him and the benefit to him would be trivial, he would choose not to do so. This would be so even if the benefit from that act, summed over the entire society, was very considerably greater than the cost to him. Economists normally say that, in this case, he would be imposing a cost on the society and would favor social institutions to compel him to either stop imposing his pollution on the society or at least to pay its full costs.

Let us go to another case which is a closer fit to what we have in mind. Suppose that the society is proposing to restrict air pollutants and that the dry-cleaning establishments organized for the purpose of being exempted from the act. They make deals with various other pressure groups agreeing to vote for Congressmen who favor restricting the import of Japanese automobiles, favor the farm program, etc. As a result they get their exemption built into the act with the result that the level of air pollution is very considerably higher than it otherwise would be. Is this a cost?

The last is particularly important because it seems very largely true that rent seeking depends on just exactly that kind of maneuvering and the question of whether it is a cost or not, is important in attempting to measure the cost of

rent seeking. Suppose, for example, that we have perfect information and are able to investigate all of the influences which led to, let us say, the farm program getting through. We found that misinformation about the farm program on the part of non-farmers was important. As a result of their ignorance they did not push against it and the farmers used their influence to get it. These two factors between them are, let us say, 90% of the 'causal' factors, which led to its going through. There were, in addition to this, some campaign contributions, spectacular dinners with feminine companionship and possibly bribes, but these things added up to less than 10% of the 'causal' factors. Would we include the 90% in the cost of rent seeking or would we not?

Suppose that we have a political system like that which is sometimes seen in high school civics texts, in which the voters vote in terms of what they think is good for the country. These texts imply, probably not too inaccurately, that what is good for the country is also good for the individual voter. The voter, being systematically uninformed, would make a very bad choice of policies to benefit the country. If we turn to a realistic situation, in which at least a great many voters vote specifically to benefit themselves by such things as the farm program, the outcome would certainly be different than if they were voting in terms of the 'Public Interest', but it's not obvious that it will be inferior.

As a former Foreign Service Officer and a man much interested in foreign policy, I have paid careful attention to the development of American policies in this area. No doubt, some of them are motivated by fairly selfish drives on the part of the voters. At one time, for example, the aid program was keeping the American locomotive industry alive. On the other hand, there is equally no doubt that a number of the policies do not have any particular selfish group in the United States pushing them.

Our generally vague desire that foreign countries be democracies is an example. In this case, a great many Americans will maintain, without showing any signs of realizing how absurd it is, that such democratic governments are in the interest of the United States as well as something we think is ethically good. This is, however, pretty clearly a rationalization. Schumpeter (1942) described American policy as 'ethical imperialism', i.e., an effort to impose the American ethical system through the world. This is something that most Americans want, although most of them refuse to admit that it is their objective. It doesn't have very much in the way of selfish benefit for the average American.

The point, however, of this discussion is that, having studied the situation for a considerable number of years, it is my impression that the common good of the United States in foreign affairs is, on the whole, damaged more by the policies which aim (ignorantly) at the general public good rather than by the policies which are the result of rent seeking.

This is of course merely a subjective option and in any event, even granted the reader agrees with me about foreign policy, it would not prove the same relative damage was done by the two different criteria in domestic affairs. What we have here is a case of voters who, if they get involved in attempting to deal with the public good would do so in a very badly-informed way. If the rent seekers are pushing for some special benefit for themselves, they also will not be very well informed and not engage in a great deal of thought about the problem. But the odds are that the policy will be more likely to serve their selfish interests than 'publicly interested' policy is to serve the public good.

It is not at all obvious, even if we look at this from the standpoint of an abstract external observer who knows all, that we would object to the voters specializing their interests. It may not do as much damage as attempting to implement the public good.

Another problem is that in some cases we want the special interest to be implemented. My first article (1959) in this general area dealt with the situation in which road repairing, up to a point, benefitted people who lived on the road to be repaired more than the cost imposed on society as a whole. There are many cases of this sort, i.e., situations in which for some reason or another it is hard for a small group to provide something which is of interest to them, but where providing it would cost society less than the benefit to the small group. In these circumstances we would suggest that society provide it on the assumption that all of us will from time to time be in the same small group situation.

The problem is, of course, that the small group may push for things where the benefit to them is smaller, indeed in many cases immensely smaller, than the injury inflicted on other people. Unfortunately, these rent seekers may get their way.

Of course, our desire to impose our ethical system on other people may also have very negative effects. William Jennings Bryan was Secretary of State in the early part of the Wilson Administration. His policy towards China, which was an active one, aimed at the objective of not interfering with the rapid conversion of China to Christianity which he believed was taking place at that time. Indeed, he not only refrained from interfering with it, he was in favor of pushing it ahead. This was an ethically driven policy intended to do good and the most one can say for it is that quite possibly it did no positive harm.

In a way, the Chinese Revolution was brought on by President William Howard Taft who was making a very ill-advised¹ effort to obtain special privileges for American bankers.² In doing so he delayed the construction of some important railroads. The delay, through a set of devious channels, was the initiating cause of the revolution in the same sense that the assassination of Archduke Franz Ferdinand was the initiating cost of World War I.

All of this has been simply a general discussion. Let's try and do a little formal reasoning. For this purpose, let me assume someone has produced a computer which knows everybody's utility and is able to calculate those private and public decisions which will maximize that utility.³

Let us begin with private purchases and assume that this computer is in charge of somebody's purchases and buys the things for that person which will maximize his or her lifetime utility. In 1776 this would not have ordered a bleeding, for example. Compare this with the decision that would have been made by that person himself, assuming that he also had perfect knowledge about that nature of all products and services on the market, but not perfect knowledge about his own utility production function. The last seems a little absurd, but you do buy things which you think you'll enjoy and then discover that you don't. The computer would not make this kind of error.

Thus, the computer would do better than the purchaser would even if the purchaser devoted an infinite amount of time studying before each purchase.⁴ It would, in fact, do better than any human instrumentality because it would know things that have not yet been discovered. In reality, of course, the individual does not know very much about most of the products and services he buys. Further, he in essence depends on other people to make a lot of the preliminary decisions for him.

I buy clothes from stores that specialize in producing clothing for people who, like myself, are in the upper- but a long way from the top-income brackets. In doing so, I am assuming, first that my fellow consumers from this store do at least a reasonably good job in judging price and quantity and secondly, that the store owners who want to make money by pleasing their customers do a reasonably good job at meeting those standards. I am to some extent free riding on the other customers and each of them is free riding on me. If turned to such subjects as medicine, electronic devices etc. my state of knowledge differs even farther from that of our super computer.

Bentham, as mentioned above, dealt with this problem by saying that we should let the individual make decisions not because those decisions would necessarily be right, but because they were more in accord with his utility than any other mechanism we could design. In other words, he denied the existence of my super computer. Since it is only an imaginary construct, I naturally would not disagree with him. Thus, it is probably sensible to let people make decisions of this sort and indeed we can refer to a society in which such decisions control almost everything as being optimal in what is not a nonsensical use of the word 'optimal'. Those critics of the market system who point out that customers are frequently ill-informed are quite right. But once we get out of the market, the information problem is much more severe.

It's not widely known, but one of the things that the market provides to the private citizens is an opportunity to benefit other people. They may contribute

money to the American Cancer Society, George Mason University or simply give money to a beggar on the street. In all of these cases, you would say that they are purchasing a feeling of satisfaction gained by benefitting other people although, once again, information can be bad (see Tullock, 1966). Indeed, in this case the information is far more likely to be bad than in the straightforward purchase because the individual who is purchasing a feeling of satisfaction from having made the gift, will not himself directly benefit or be injured as a result of what the gift actually provides.

Once again, Bentham would say, and I do not disagree, that the individual should make this decision, seeking out whatever advice he thinks is sensible.⁵

So far we have been comparing the computer with decisions made by individuals in the market environment. Further, we have totally ignored externalities. We must now deal with externalities because we are going to turn now to talking about government, specifically democratic government. After all, externalities are the basic reason that we have governments. Hence it is sensible to leave them aside in discussing the market. The government should deal with them, although anyone who looks at actual governments realizes that they're almost as likely to generate externalities as to eliminate them.

Let us then turn, once again, to our perfect computer and assume that it is dealing with some decision which, due to externalities, must be made collectively. The computer, knowing all and making no calculating mistakes, determines whether some particular government activity should be undertaken and its scale. Of course, our perfect computer could also allocate the entire cost of the activity among the taxpayers in such a way that the cost was proportional to the benefit, but we will assume that it does not do that, it uses ordinary taxes. Thus, there will be probably some people gaining and some people losing. What the computer does, is to make certain that the total gain in utility is greater than the total loss. Once again, I would like to emphasize that the machine is a piece of science fiction designed for this article.

The actual behavior of the voters is apt to deviate sharply from this ideal pattern of behavior for two reasons, one of which is they're not perfectly informed nor perfect calculators. The other is that individuals will favor things that benefit themselves, even if the total cost is greater than the total benefit. Let us take these two problems up, one at a time, beginning with information.

As mentioned above, there is a very elderly and respectable proof in the *Public Choice* literature which demonstrates that individuals are normally badly informed in politics and this is particularly true with respect to what we might call public interest types of matters. These individual decisions are apt to deviate from the decisions of our computer in a fairly extreme way simply because of poor information.

This poor information is not just poor information in the sense of lack of calculation, however. Our computer not only makes all perfect computations,

but knows what other people's utilities are. The average voter will not know other people's utility.

When it comes to matters directly affecting the voter, he is apt to be better informed than in matters of general interest. To say that he is apt to be better informed is quite different from saying he is apt to be very well informed. Here too, public good consideration means that the single person who is one of a group of one hundred thousand who will be benefited by something or other will devote not too much time to becoming well informed about it. In fact, if he is well informed it is more likely to be for other reasons. He reads farming journals for technical help in running his farm and gets political information as a by-product.

When we turn to individual's knowledge of other people's utility, the situation becomes even worse. Firstly, he may not be interested in whether they are gaining or not, but, secondly, if he is interested in helping them, and most of us are to some extent interested in helping others, he has very little information as to what actually will help them. In particular, if we look at the programs to help the poor, it is obvious that the people who design them think that the poor's judgement of what will benefit them is bad. Payments in kind are very common under such circumstances and detailed efforts to regulate the lives of the people who are being aided are also very common. In a way, the charitably inclined person is like our giant computer attempting to give people what is good for them and not what they, ill-informedly, want.

There is an area where possibly bad information benefits society when looked at in the whole matter on a large scale. The individual probably has an ill-thought-out set of principles of public behavior and morality which will effect his voting behavior when he hears that something has gone on in government which he objects to. Scandals such as misappropriation of funds are an obvious example, but there are a whole collection of others. In particular, transfers or special regulations that benefit small groups have to be to some extent presented in deceptive ways which makes them much less efficient than they otherwise would be. This lack of efficiency, however, has the positive benefit that it reduces the profit from these activities and hence reduces the amount of energy that rent seekers will put into attempting to get them.

On the other hand, there is no doubt that the fact that these are ill thought out has a major disadvantage. Anyone who is attempting to sell a significant government reform knows the normal immediate reaction of simple objection with nothing very well thought out in the way of reasons for that objection and an unwillingness to devote much time and thought to the matter. The standard approach of the average voter is moralistic and he will accept moral criticism of the government and, in fact, suggest the government become more moral. But any attempt to convince him that the structure is somehow badly designed is normally resisted and the resistance is not based upon serious thought or good information.

The second problem is that the individual, unlike our machine, is interested in himself more than in other people. To repeat, he probably has, as most of us do, at least some interest in helping the country, the poor, the people who are suffering from cancer, etc. But this is usually less intense than his desire to help himself and his family.

If it were not for the externalities problem, and in politics the externality frequently takes the form of a tax on somebody else, we could ignore that matter. We could let individuals all make their decisions in terms of what benefited them, and assume that those issues which passed by majority vote, be it directly or by logrolling, on the average will be beneficial. They would not be quite as good as our machine's calculation, but they wouldn't be very much inferior.

Unfortunately, of course, governmental activities are externality laden, and the decision of the textile workers, for example, to push for a tariff on textiles⁶ will generate very decided external costs.

Suppose then that we observe a set of protective tariffs which were voted through democratically. We sometimes say they are costly because they differ from what would have been passed if the voters had all been simply interested in maximizing the public interest. But are they really costly? This is the problem that I have been leading up to in this article.

It seems possible that the principle payment that politicians in the United States receive from rent-seeking groups comes not in the form of elaborate dinners or direct cash payments, but in the form of specialized votes. The special interest group which makes it clear that it has a sizeable number of voters who will ignore all other considerations and vote solely in terms of whether their congressman has or has not backed, let us say a cotton textile tariff, inflicts an injury on the economy as a whole, but can we say that these votes are in fact costly?

In a democracy, the government is supposed to be controlled by the votes cast. If the voters vote for something which economists think is not in fact desirable, can we call it a cost? Can we follow the Benthamite assumption that their judgement is better than any other judgement here? Note that, once again, Bentham's judgement did not turn on any argument that they were right, but on the argument that individuals knew more about their own utility than anyone else. It should of course also be pointed out that Bentham would be horrified by a cotton textile tariff.

This whole problem turns on deep metaphysical views as to what the government is supposedly doing. Most economists think of government as an organization for internalizing externalities. It makes it possible for us to reach a higher level of satisfaction than we could without it. From that standpoint the cotton textile tariff clearly is undesirable. We might argue that the government as a whole is highly desirable even if it does enact tariffs on cotton textiles,

but still, we can say that the cotton textile tariff is simply wrong.

If on the other hand we, and once again as most economists do, believe that the people should get what they choose, the cotton textile tariff is right and desirable. Add on the prospect that if the voters stop voting in terms of their special interest and began voting in terms of the public interest, their motives for becoming well informed would be extremely weak and hence their decisions would have almost a random relationship to that public interest. Then the problem becomes even more difficult.

Let me add on a final item of difficulty and then resign the problem to my readers. The final item concerns the fact that pressure groups very commonly deliberately spread misinformation among the voters. Thus, a regulation may be so designed that it benefits some participants in a given industry but not in others, but it would be sold on the theory that it benefits 'the industry'. To take an example, when the AAA was introduced in the 1930s it benefited the owners of agricultural land a great deal and injured hired labor in agriculture a great deal. I suspect that most hired laborers would have favored congressmen who voted for this bill, because they thought it was good for 'agriculture'. Certainly they were encouraged to do so by the farm groups' propaganda.

This, however, is within the group, outside you also have this kind of misinformation. The widespread view among the citizenry that protective tariffs are beneficial not just to the industry that is protected but to everybody, is an example. Suppose that someone votes for something which he mistakenly thinks will benefit him because he is a member of a special interest group, but it will not. Is this a 'cost'? Suppose that a citizen whose only connection with the cotton textile industry is to buy clothes, is convinced that at the very least a congressman voting for a protective tariff on textiles is doing nothing which injures him and perhaps doing something that benefits him. Once again, is this a cost?

The problem here is how much weight we should give to people's ill considered views as to what should be done. The argument for giving them overwhelming weight in private decisions is not only Benthamite, but favored by practically all other economists. For public decisions the argument is not nearly as strong.

There is another problem. We have no objection to people making their market decisions in terms of their own selfish well-being. Once again, in the case of the government it is not so obvious that we should feel that way. On the other hand, it is not at all obvious that we shouldn't.

I sub-titled this article 'A metaphysical question.' Metaphysics, in this case, is not meant in strict technical terms, but in the sense of a rather confusing problem. Further, it is a problem of great importance, particularly for the analysis of rent seeking. This essay certainly does not solve it. Can the readers do better?

Notes

1. The advice came from the Department of State which simply misunderstood economics.
2. The bankers didn't want them.
3. We need not worry about the problem of comparing utility between persons. Science-fiction, after all, is science-fiction.
4. With the infinite time somehow having zero cost to him.
5. I knew a wealthy man whose foundation provided financial support for tournaments between professional bridge players. I thought this was a total waste of money, but he didn't. The Internal Revenue Service ruled that it was a charitable contribution.
6. I've just been informed that a senior professor in one of the states which produces textiles is in the process of being driven from his university because he wrote a paper in which he said that textile tariffs were a bad idea.

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