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WHAT IS RENT SEEKING?

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Q: What is rent seeking?

A: This is an idea which first appeared in the 1970s, but the concept of economic rent, to which it relates, is much older. I ought to deal with that first.

Q: Fine.

A: Economic rent originally applied to the use of land which is in fixed supply: the landlord's remuneration is determined by the highest bidder for the use of that land.

Q: Surely that is true of anything?

A: Yes it is, but an important distinction is made between a productive factor (like labour) whose supply is variable and land, whose supply is fixed.

Q: Go on.

A: It is assumed that labour would refuse to accept work if the rate of pay is too low, whereas land is available to the highest bidder, however low that bid happens to be.

Q: Why is that?

A: A landlord is better off accepting low revenue than no revenue; but, where a worker has other options (including leisure) there is likely to be some minimum payment below which he would not work. That minimum is called a 'transfer earning'.

Q: Transfer? Transfer where?

A: If the wage rate offered is too low, you'd expect the worker to look elsewhere for work.

Q: Or take a break.

A: Certainly. The highest wage that a worker expects to earn elsewhere is the opportunity cost of any time which he decides to allocate to leisure activities; but let us not become side-tracked.

Q: Sorry.

A: A 'transfer earning' is the minimum payment which prevents the transfer of a factor of production to some alternative use. By contrast, 'rent' is a payment to a factor of production that cannot be transferred elsewhere.

Q: So it's all down to whether or not a factor is mobile or immobile?

A: It would be better to say 'whether or not a factor is fixed or variable'. Since the supply of land is fixed, land rent varies with variations in demand. By contrast, the earnings of a factor whose supply is variable are affected by variations in both demand *and* supply.

Q: So rent is determined only by demand.

A: Exactly.

Q: And rent is earned on land.

A: Rent is earned by any factor whose supply is either naturally or artificially in fixed supply.

Q: .Artificially in fixed supply?

A: Yes. For example, local authorities may fix an upper limit to the number of taxis that can operate within their area. Or, there may be requirements for workers to hold certain qualifications: practising dentistry, fitting gas fires ... These limit the supply of such services.

Q: Surely that is done to protect the public.

A: Maybe. That is certainly *one* explanation. Opticians once enjoyed a privilege in the UK to supply spectacles, which now can be supplied by anyone. Has that been for the better or worse?

Q: Hmmm. So rent seeking ...

A: ... is the attempt to raise earnings by restricting supply.

Q: Ahh! Restraints upon trade.

A: You have it!

Q: So taxi owners benefit from restraints upon trade.

A: They may do, although the manner in which licences are allocated is relevant to 'who benefits?' In economics, rent seeking was first applied to international trade and to the rents that can be earned from the sale of import licences.

Q: Import quotas are imposed so that licences to import can be sold?

A: Yes, a 'nice little earner' for the licensing authorities. One study found such rents to comprise over 10 per cent of the GNP of some Third World nations in the 1960s.

Q: And rent seeking is justified by the revenue accruing from the sale of import licences.

A: Not so fast. The imposition of import quotas and the sale of import licences is an illustration not a definition of rent seeking.

Q: Go on.

A: The example shows us that the effect of import quotas is to redistribute wealth from those who have the privilege to sell licences to those who must buy them in order to import goods. No wealth is created and there are costs in administering the system.

Q: Yes, but import licences have the beneficial effect of conserving foreign exchange reserves.

A: Sure, as would the total restriction of trade. So there can be no justification upon the basis of *that* argument.

Q: Hmmmm ...

A: If rent seeking is successful, additional revenue is gained through prices having been forced higher by restrictions upon supply. The rent-seeker wins; the rent-payer loses.

Q: So some special justification would have to be found.

A: Exactly. The general point is that rent seeking is rational and that it leads to an less efficient allocation of economic resources.

Q: Are there other areas where the idea of rent seeking been applied?

A: Yes many but perhaps most notably to the behaviour of politicians and bureaucrats.

Q: Politicians!

A: The economic impact of government decisions encourages lobbying and counter-lobbying (both involving resource costs) between interest groups.

Q: For example?

A: Politicians have been lobbied to retain obsolete schools, hospitals, defence establishments; or to increase expenditure upon education, health services, military services, and so on. And by whom? The lobbyists are generally those who would benefit most directly: teachers, doctors, service chiefs, and so on. You get my point?

Q: I do, but some cases might be justified.

A: Maybe, but that is not the point. The point is that politicians are interested in pleasing voters; and that there are many special interests to please: those of pensioners, trade unionists, motorists, and so on. There is also the general point that voters welcome public expenditure on schools, hospitals and even defence. However, everyone is rather less happy when taxes are levied to finance such expenditure.

Q: The government can borrow ...

A: ... that simply defers the need to raise taxes. An alternative approach would be to require the government to balance its annual budget. This would underscore the cost of such voter-pleasing favours, and thereby offer some protection against rent seeking.

Q: Rent seeking seems to be cover many different areas.

A: Anything that separates benefits from costs, invites resource misallocation, often of a rent seeking kind. Consider an agreement between friends to share a restaurant bill.

Q: Huh?

A: The benefit of any particular meal chosen (say by one person in a group of four) goes to the person who consumes it; but he bears only a quarter of the cost.

Q: Sure, but he also contributes one-quarter of the cost of the other three meals.

A: True, but the person with the omelette subsidizes the person with the steak. More to the point, everyone has an incentive to choose a more expensive meal than if each were paying for his/her own meal separately. Such 'forced' over-indulgence constitutes a misallocation of resources.

Q: And it is rent seeking?

A: It is an unsuccessful attempt at rent seeking. If, on the other hand, three of the group believed that each is to pay for his own meal, then the fourth person can extract a quasi-rent. Do you remember your earlier conclusion, that rent is determined only by demand?

Q: I do.

A: ... and that both demand *and* supply are relevant to other kinds of earnings?

Q: Yes.

A: Well, successful rent seeking at the restaurant occurs because the benefit imparted by the meal (which fuels our demand) rises *pro-rata* with the price of the meal whereas the cost of the meal (supply) rises by only one-quarter of the price of the meal.

Q: Would you fancy a bite to eat?

A: Are you paying?

Q: We'll go Dutch! Can we stop there?

A: Perhaps we should.