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RENT-SEEKING

RENT-SEEKING AND PUBLIC POLICY

SANJAY PATNAIK¹

Introduction

Firms and industries across the world regularly engage with political and government players in order to obtain economic rents through a variety of elaborate strategic tools. Scholars in political economy and economics refer to this behavior as rent-seeking, while scholars in business and management often call it non-market strategy or corporate political strategy. The usual goal of these rent-seeking efforts is to secure benefits from the government that would ultimately allow the rent-seekers to improve or maintain their economic position. Examples are plentiful in a variety of institutional settings across the world and include classic cases (e.g., agricultural protection). As Mueller (2003) points out, rent-seeking usually imposes welfare losses on society, which can be substantial depending on the type of rent-seeking behavior that takes place, as well as the political system it occurs in. However, despite the prevalence of rent-seeking and the increasingly salient participation of firms in the political process, rent-seeking behavior and its costs to society often do not receive as much public scrutiny when new policies are developed as they should. This can be quite problematic for a country's political process and economic development, particularly because rent-seeking by its very definition distorts the efficient use of resources.

Why rent-seeking matters

One of the main characteristics of rent-seeking is that it can be defined as the re-allocation of resources to rent-seekers. For example, if a government decides to award subsidies to farmers to grow a certain crop, those funds will not be available for other uses that might be

more efficient given the overall composition of the economy. Similarly, if a government institutes trade protection as a response to pressure from a certain industry (e.g., through tariffs), prices for consumers are likely to be higher than without the tariffs in place. Within this view, the rent-seeking process can be described as a game where multiple interest groups compete with each other to influence government players to their benefit. As a result, the outcomes of those processes often reflect which group is more skilled at the rent-seeking game rather than an optimal allocation of resources. Not surprisingly, these outcomes can alter the competitive landscape and consumer behavior in fundamental ways and often persist for a long time as they become entrenched. Recently, we have seen how rent-seeking behavior by interest groups can impede important structural reforms in countries that need to modernize their economies and make them more competitive. In several Euro countries, for instance, governments have struggled to implement reforms against the opposition of groups that are receiving rents through the status quo (e.g., through preferential tax treatment, regulations that eliminate competition, etc.). Another case of rent-seeking that becomes salient regularly during negotiations for free trade agreements is when countries are reluctant to eliminate protective measures for their agricultural sectors, partially as a result of successful rent-seeking by those sectors. As these cases illustrate and my own research shows, one of the key characteristics of rent-seeking is that it can be found in many different political systems.² Moreover, it occurs in a broad variety of different policy arenas (e.g., environmental policy, food safety regulations, etc.), making it an important issue for policy makers regardless of the political structure they operate in.

Rent-seeking and public policy

Since rent-seeking efforts by firms and industries are likely to emerge whenever there are economic benefits to be reaped from governmental and political players, it is imperative for well-functioning democracies to protect their institutions and policy makers from too much pres-



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sure from rent-seekers. If rent-seeking behavior is not kept in check within the confines of a balanced political system, not only will welfare losses for society increase, but the system will inherently become less democratic as the rent-seekers' influence rises. Not surprisingly, in countries with a low quality of institutions, rent-seeking often devolves into its illegal and most destructive form: corruption. In very corrupt countries, the rent-seekers through a variety of illegal means (e.g., bribery, coercion, etc.) are able to capture disproportionately large rents. This often keeps those countries in a low-level equilibrium as the limited economic resources available are mostly channeled to the rent-seekers rather than utilized more efficiently.

However, even when considering modern democratic countries, the costs imposed by rent-seeking – both indirectly through welfare losses and directly through the costs rent-seekers have to expend to secure their rents (Mueller 2003)³ – rarely receive the public attention they warrant. For example, for years, the US and several EU countries have provided government support that was found to be against WTO rules to airplane manufacturers Boeing and Airbus, respectively (Rooney 2012). The question that arises is why public funds are used to support those companies instead of other sectors/firms? What makes the aerospace industry special compared to other industries or compared to putting those funds to different uses? Were the subsidies awarded because the often cited benefits of supporting those firms (e.g., the provision of jobs, potential national interests, etc.) outweigh the costs of the government subsidies? Or were they awarded because those two companies have been more successful in influencing political decision makers in their respective home jurisdictions? The public often receives little justification for the decisions to distribute those rents to private entities, which to some degree is a testament to the success of the strategies rent-seekers are employing (such non-market strategies are subject to a growing stream of research in applied economics and strategic management).

Another example can be found in the area of environmental policy. We are currently seeing strong rent-seeking efforts by fossil fuel companies to impede the regulation of greenhouse gases within the broader context of tackling climate change. Unfortunately, many of those efforts have been quite successful in derailing or weakening proposed legislation to curb the emissions of greenhouse gases, particularly in the United States.

³ Such expenditure includes, for example, spending on formal lobbyists, PR campaigns, political campaigns, etc..

This not only steers public policy away from policies that would benefit society at large, but undermines credibility in the respective political system as it becomes captured by more powerful interest groups.

Limiting the negative effects of rent-seeking

While the previous sections listed a lot of negative examples of rent-seeking, this should by no means imply that all interactions among firms, industry groups and government actors are detrimental to society. There is a legitimate role for information exchanges between firms and political actors, as many of the policy makers do not have all the necessary expertise to make decisions that affect a wide variety of stakeholders. However, it is imperative for democratic systems that those interactions are transparent and that they lead to policy outcomes geared towards maximizing overall economic welfare rather than only benefitting the groups that engage in rent-seeking. I believe that steps can be taken to reduce those rent-seeking efforts that are damaging to societal welfare, while at the same time allowing for productive and useful interactions between firms and political actors.

First, it would be essential for policy makers to take the costs of rent-seeking more explicitly into consideration when designing policies. Different policy alternatives should therefore also be evaluated based on (1) their potential vulnerability to rent-seeking, (2) the direct costs incurred by groups seeking to influence those policies and (3) the expected welfare losses if some of the rent-seeking were to be successful. (1) implies that a new policy could be implemented and designed in a way that restricts the ability of rent-seekers to influence the policy to their benefit. (2) implies that when policy makers compare different policy tools on the basis of their costs and benefits, the expected expenditures incurred by potential rent-seekers to influence the policy should factor into these calculations. Finally, (3) implies that if policy makers do make the conscious decision to award rents to certain interest groups (e.g., for political reasons, reasons of national interest, etc.), the expected welfare losses incurred should be included in the cost-benefit analysis. This would result in a more comprehensive evaluation of the actual costs of certain policies.

Second, it would be imperative to introduce much greater transparency into any interactions between firms and political/government actors. While there are some rules (e.g., laws requiring the disclosure of official lobbying

activities in the US) that allow the public to trace some of these interactions, many of the existing regulations leave room for rent-seeking efforts that are hidden from the public's view. By expanding existing disclosure laws and tightening the rules on how firms can engage with government actors, rent-seeking efforts could be limited as policy makers would be more sensitive to public concerns when responding to rent-seekers.

Conclusion

This article – which is by no means all-encompassing – provides a brief overview of important considerations with regard to rent-seeking and public policy. The topic of rent-seeking is very interesting both from the view of academics and practitioners. Many topics within the area of rent-seeking have yet to be explored further and the potential richness of studying rent-seeking in different contexts around the world promises interesting and rewarding results.

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