

RENTSEEKING

"Rent"

- 1) Income paid to factor which is nonreproducible/fixed supply,
e.g. land, natural resources
(distinct from quasi-rent to capital)
- 2) Supernormal profit or factor income to
monopoly, cartel, ...
firm, labor union, guild, ...
requires barrier to entry
which can be created by govt. regulation (e.g.
occupational licensing, import controls,
restricted corporate charters...)
- 3) Transfers, Expropriation
e.g. theft, protection money, "predation"
taxes (not spent to buy goods/services at
competitive prices but)
given as transfers
paid in above-market prices
(overpaid bureaucrats)

RENTSEEKING (cont.)

(2)

In models with perfect competition, symmetric info, social-planner govt., complete property rights, etc., all efforts of agents to boost income (trade leisure for income, allocate time/effort) tend to raise aggregate social Y or Y/L by

- increase output of goods/services
- reallocate inputs/output to higher-valued stuff

but if

- imperfect property rights over nonreproducible factors
- monopolies/transfers/expropriation
e.g. by manipulating government

then efforts to boost income by "rentseeking"

can lower aggregate Y
even if they boost agents' income

RENTSEEKING (cont.)

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How rentseeking can reduce Y

- 1) Effort spent rentseeking is not making stuff
- 2) " " defending against rentseeking ----
- 3) Creation of monopolies
- 4) Discourage activities especially vulnerable to predation, e.g. capital investment

Society suffers from deadweight loss of monopoly, underinvestment etc.

plus opportunity cost of efforts devoted to rentseeking & defense against...

Idea first applied to rich economies (Tullock, 1967) understanding regulation in US, Britain

but "particular applicability for developing countries, where government interventions are frequently all-embracing" (Anne Krueger, 1974)

and to situations where "government" breaks down: anarchy

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Production, Protection, Predation (Romer 3.11)

Model of transfers/expropriation/predation

e.g. bandits, kleptocratic govt., taxes → transfers

Implies

1) Possible multiple equilibria:

high output, low rentseeking vs.
low output, high rentseeking.

2) Even if one equilibrium, small changes in conditions (parameters) can have big effects on output/rentseeking.

So, across countries,

Jamaica is not Sweden because...

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Production, Predation, ... (cont.)

Assumptions

Agents have 1 unit resources (time)

To maximize income, choose to be

- producer, makes output
 - predator/rentseeker, takes output from producers.
- ↑ (fraction of population R)

If choose producer, choose:

f protecting against predation

$(1-f)$ production time = output \leftarrow (simple prodn $f \cdot 1$)

Total output in economy: $(1-R)(1-f)$
person

R : opportunity cost of rent seeking

f : " " " defense against ...

Key function: fraction of output $(1-f)$
producer loses to predators

$L(F, R)$

$L_{FF} \geq 0$ diminishing marginal benefits

$L_{FR} \leq 0$ diminishes less if $R \uparrow$

$L_{RR} \leq 0$? less to steal?

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Production, Predation, ... (cont.)

Incomes

Producer's $[1 - L(f, R)](1 - f)$

Predator's $\frac{(1 - R)L(f, R)(1 - f)}{R}$ \leftarrow (total taken from producers)
 \leftarrow (number of predators)

How to derive results

Given exact form of $L(f, R)$,
model must determine f^* , R^* , $Y = (1 - R)(1 - f)$

Two conditions:

- 1) Producer's Income = Predator's, given f
- 2) Producer chooses f to max producer's income, given R

$$F, \text{ o.c. } - [1 - L(f, R)] - (1 - f)L_f(f, R) = 0$$

Two equations, two unknowns.

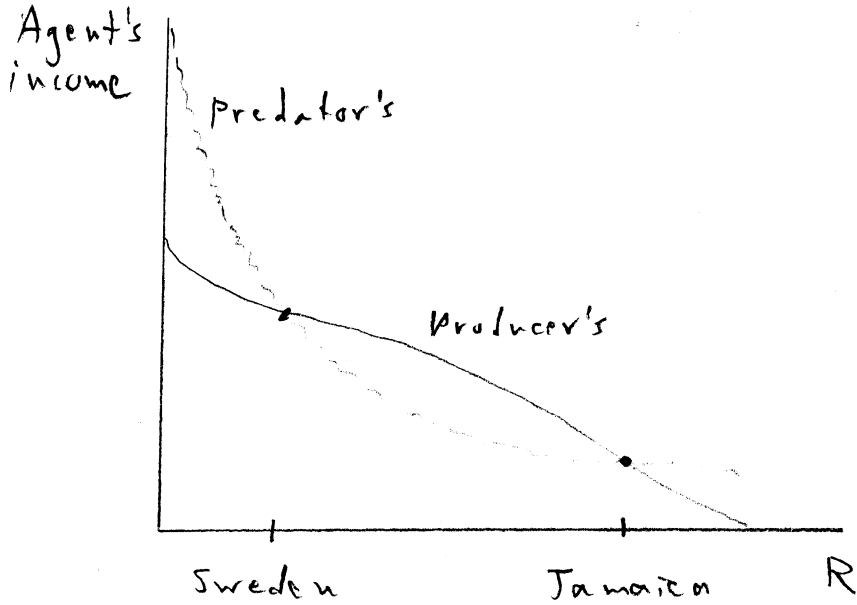
Note: $R \uparrow$ reduces
producer's income because $f \uparrow$ / more stolen
predator's income because $f \uparrow$ & more thieves

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Production, Predation, ... (cont.)

1) Possible multiple equilibria



2) Big effects of small parameter change

Example: change that reduces predator's income, doesn't change producer's, at given F, A

Raises income because $R \downarrow$
& $F \downarrow$ because $R \downarrow$