Const Polit Econ (2017) 28:62–78
DOI 10.1007/s10602-016-9228-4

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ORIGINAL PAPER

Political incentives for rent creation

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Published online: 25 October 2016
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Abstract Rent-seeking is often depicted as a contest in which rent-seekers compete for a prize—the rent. In the process of rent-seeking, much or perhaps all of the rent is dissipated through the costs the contestants incur to compete. Rent dissipation is inconsistent with the incentives of both the rent-seekers and those who create the rents. Policymakers have an incentive to create rents only if they gain from the process, and their gain comes from sharing any surplus that goes to those who obtain the rents. A surplus can be created through a barrier to entry into rent-seeking. When institutions that generate barriers to entry into rent-seeking break down, rent-seeking competitions can occur in which all rents are dissipated, but this should be a special case rather than the general rule in rent-seeking.

Keywords Rent seeking · Rent dissipation · Transitional gains · Rent extraction · Elite theory

JEL Classification D02 · D72 · H11

1 Introduction

Rent-seekers, in the framework developed by Tullock (1967) and Krueger (1974), expend resources to try to convince policymakers to transfer resources from others to the rent-seekers. Those transfers are the rents, and rent-seekers expend real resources

I am grateful to Roger Congleton, Russell Sobel, Todd Zywicki, two referees from this journal, and participants in the 2016 annual meeting of the Public Choice Society for insightful comments. Remaining shortcomings are the responsibility of the author.

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to try to obtain those rents, perhaps equaling or even exceeding the rents that are transferred. The theoretical literature on rent-seeking has depicted it as a contest in which rent-seekers devote resources toward winning a rent, typically with the rent going to the highest bidder.[1] Congleton and Hillman (2015), for example, devote eight chapters in their edited volume on rent-seeking to the theory of rent-seeking, and all eight of those chapters refer to rent-seeking as a contest.[2] Hillman (2015: 10–11) notes that it is common to assume that the value of the resources dissipated as a welfare loss in rent-seeking equals the total amount of rents generated, based on the theory of rent-seeking, but notes (p. 11), "The possibility of under- or over-dissipation compromises the assumption that observed rents indicate social losses. Nonetheless, against the background of the murky processes of rent seeking, at best all we usually have to go on for evaluating losses from rent seeking are observed rents." Aidt (2016: 143) says that the two core ideas in the rent-seeking literature are that rent-seeking activities "involve unproductive use of real resources and cause a social loss" and that "Rent-seeking costs are, by and large, unobserved but by applying contest theory and assumptions about the behavior of rent seekers, the size of the social cost can be inferred from the value of the contestable rent."

The depiction of rent-seeking as a contest in which rents are dissipated as welfare losses places both rent-seekers and the policy makers who create those rents in an unrealistic setting that does not account for the institutional structure within which rent-seeking takes place, and that unrealistically depicts the incentives of the rent-granting policymakers. This paper looks at the incentives of those involved in the rent-seeking process and considers the institutional framework within which rent-seeking occurs. In the traditional model in which rents may be completely dissipated (or even over-dissipated!), there would appear to be little incentive for rent-seekers to enter a rent-seeking contest, and even less of an incentive for the policy makers to grant those rents.[3] However, if institutions can limit the dissipation of rents, a surplus will be created which can then be shared between the rent-seekers and the rent-granters.

The possibility that rents might not be dissipated completely has been considered in the literature before by Tullock (1980), Corcoran and Karels (1985), Higgins et al. (1985), and Dugan and Snyder (1993), among others. One reason is that inframarginal rent seekers might face lower costs of competing. Another reason is that there may be certain qualifications for receiving the rent, creating a barrier to entry, although this pushes the problem back one stage, because rent-seekers will compete to have rents available for the qualifications they have. For example, only tobacco farmers can receive tobacco subsidies, but this may encourage corn farmers to seek rents that go only to corn farmers. Tullock (1980) notes that if the marginal cost of rent seeking is higher than the average costs, rents will not be completely dissipated. Congleton (1980, 1984) demonstrates that the different ways in which

[1] In some models, rents may not go to the highest bidder for various reasons, but in most cases the literature does depict rent-seeking as a contest that the highest bidder wins.

[2] Five of the eight chapters refer to rent-seeking as a contest in their titles, and the other three clearly depict rent-seeking as a contest in their models.

[3] Congleton (1988) notes that the standard rent-seeking model understates the welfare loss of rent-seeking in the complete dissipation case because it does not consider the potential productivity gains that might have been realized had those dissipated resources been invested in productive activity.

rents can be divided and different ways that the decision as to who gets the rents is made can affect the amount of dissipation that occurs.

Applebaum and Katz (1987) develop a model in which the amount of the rent is set by a regulator that is motivated to take some of the gain, which is one of the few cases in which the motivation of the rent creator is considered. When considering the motivation of those who create the rents, it is apparent that their incentive is to create rents only when they have something to gain, and the clearest way for rent creators to gain is for them to limit competition for the rents so that there is a surplus that can be divided between the rent recipient and the rent creator. Rent creators have the incentive to design a system that has as little dissipation as possible—ideally, no dissipation which, following the ideas of Becker (1983), maximizes the joint gain to both the rent recipient and the rent creator.

The idea that rents may not be completely dissipated is not new, but even here most of the literature focuses on the characteristics and behavior of the rent seekers rather than the rent creators. It looks at how different types of rent-seeking contests affect the amount of dissipation, but rarely takes another step back to note that those who create the rents often can design the process by which rents are awarded, and have the incentive to do so in a manner that maximizes the benefit that goes to the creators of the rents. Buchanan (1990) notes that whereas economics typically examines the way people choose subject to constraints, constitutional economics studies the choice among constraints. This paper takes a constitutional approach by looking at the way rent-seeking institutions are designed and chosen, rather than taking those institutions as given.

2 Rent creation and rent dissipation

The monopolies granted by Queen Elizabeth I (1533–1603) and King James I (1566–1625) of England are early examples of rent creation. The crown granted patents for common goods like salt, starch, and playing cards, nominally to promote domestic industry and create a more self-sufficient economy. The patent system became a revenue-generating mechanism for the crown because the government could tax the patent holders to recover some of the monopoly rents for its own use (Bloxam 1957; Dent 2009).[4] This example illustrates the motivation for the rent creator—the crown—to grant the patents that generated the monopoly rents. The crown creates the rents and benefits by taxing away some of the rents for its own use. The theoretical framework within which complete dissipation of the rents occurs does not fit this example, because if the rents were completely dissipated, there would be no surplus going to the rent recipients out of which the granter of the rents could be paid. Even partial dissipation takes away from the potential benefits that can accrue to both the rent recipient and the rent creator. Congleton and Lee (2007) provide a good analysis of the incentives for government to create monopolies that generate rents in this way. The rent seekers would have little

[4] Perceived abuses of the patent system led Parliament to pass the Statute of Monopolies in 1624 which repealed all existing patents and monopolies and limited future patents to novel inventions.

incentive to pursue the rents if there was no net gain to them, and the rent granters would have no incentive to grant them if they gained nothing from creating the rent.

Looking at the incentives of both the rent-seekers and the rent granters, the rent-seeking process provides them with the maximum benefit if they are able to create a barrier to entry into rent-seeking to prevent it from becoming a competition. That way, the entire amount of the rent is available for division between the rent seeker and the rent granter. Rent-seeking losses, sometimes referred to as Tullock costs, are due to competition for rents, so if a barrier to entry into competition for a rent can be erected such that there is only one rent-seeker, those losses will be completely eliminated. The optimal strategy for the rent creator is to limit competition for rents as much as possible.

In a monarchy or a dictatorship, this could be accomplished by limiting the grant of rents only to people who are close associates of the autocrat—friends and family—or to those who offer an explicit payment to the autocrat in exchange for the opportunity to capture a rent. One function of designating some people as members of a royal class could be to restrict competition for rents to so they are limited to that elite group, which creates a barrier to entry for others. An autocrat would have little to gain from responding to rent-seeking expenditures like lobbying. Indeed, the autocrat should want the rent to go to the party that generates the greatest surplus, which would be someone who undertakes no socially wasteful rent-seeking expenditures.[5]

The creator of the rent has every incentive to prevent rent-seeking from becoming a contest by creating a barrier to entry into rent-seeking and granting rent-generating opportunities to those who can generate the greatest surplus, to maximize the amount of the surplus going to the rent creator. Conversely, the creator of the rent has no incentive to create it if all of the rent is dissipated so there is no surplus left to share with the creator. One question the rent-seeking as a contest model leaves open is what incentive anyone would have to create a contest that generates net social costs, and no net gains to either the creator of the contest or the contestants. The literature on rent-seeking contests focuses on the behavior of the contestants, given that there is a contest, and does not look at the incentives of those who create the contests.

3 Rent seekers

Look at the rent-seeking contest from the standpoint of the rent-seekers. If rents are fully dissipated, as Hillman (2015) notes is the case in much of the literature, there appears to be little incentive to engage in rent-seeking. The zero profit expectation when all rents are dissipated has sometimes been compared with the complete dissipation of economic profits in the neoclassical model of competitive

[5] Nti (1999) develops a model in which different contestants place different values on the rent and looks at the incentives facing the contestants. In this case, the rent creator should grant the rent to the individual who values it the most, because that maximizes the amount that the rent recipient and the rent creator can divide, consistent with Becker's (1983) framework. Still, the joint benefit is maximized when the rent-seeking costs are minimized.

equilibrium. Ex ante, everyone expects to receive a normal rate of return. But the rent-seeking model is different from the neoclassical competitive model in that regard. All firms earn a normal return in a neoclassical competitive equilibrium, whereas in the model of complete rent dissipation the winners earn an above-normal return while other contestants lose.[6] Risk-loving rent-seekers can even generate over-dissipation in equilibrium, as Jindapon and Whaley (2015) note, but as with many depictions of rent-seeking contests, this makes rent-seeking appear as even more of a gamble rather than a good business decision.

The distinction between the expected competitive returns in the neoclassical model of perfect competition and rent seeking is worth emphasizing. In the neoclassical competitive model, everyone gets the normal return, so in a competitive equilibrium nobody loses. In a rent-seeking contest, rents are won by some, but others lose because they expend resources to compete for a rent, but do not win the rent. Firms in the model of competitive equilibrium are not gambling as are those who enter rent-seeking contests. The two models—competitive markets and competitive rent-seeking—are not equivalent.

It might be that some contestants are more likely to win than others. Dari-Mattiacci and Parisi (2014) examine the case where there is an increasing return to rent-seeking effort. If some contestants are more likely to win than others, the consistent losers should drop out of the contest, leaving only those who are consistent winners. This points toward the case, illustrated by the examples of the monopolies granted by the British crown, in which rent seeking is limited to net winners, who are able to share their surplus rents with the political parties who granted them. Rent-seekers have an incentive to seek rents when institutions are designed to give them a positive payoff.

It is easy to understand why rent-seekers would enter a contest in which entrants are, on average, net winners. It is more difficult to develop assumptions about rent-seeking behavior that would give people an incentive to enter a rent-seeking contest with complete dissipation, which is a gamble, or a contest with over-dissipation in which entrants would expect to come out losers. The expected behavior in situations where there is substantial dissipation of rents has been examined extensively in the literature on rent-seeking contests, and the point here is only to note that there is are good reasons to think that rent-seekers would prefer institutions in which they anticipate that the rents they receive are greater than any costs they incur to acquire the rents. This is obvious. What is not obvious—in the literature on rent-seeking contests, at least—is that the rent-seekers have some say over the institutions that produce rents. They are in a position to lobby and bargain with rent creators to design institutions for their mutual benefit. This is left out of the rent seeking as a

[6] A referee points out that firms often make losses in the short run because of risky projects that do not pan out, or R&D expenditures that do not result in profitable projects. Of course this is true in the real world, but in neoclassical competitive equilibrium, firms produce homogeneous products using a given production function, which rules out risky projects and R&D (all firms produce the same product using the same production technology). More relevant, in neoclassical competitive equilibrium, all firms earn a normal rate of return. The neoclassical competitive model is useful as an example because people refer to the equilibrium result that above-normal and below-normal profits are eliminated as analogous to the competitive rent-seeking result in which the rents are completely dissipated, when in fact the results are not analogous.

contest literature, which takes the nature of the contest as given, or sometimes compares different types of contests without noting that rent creators can choose how the contest is designed.

This as a constitutional issue, as Buchanan (1990) framed it. Rather than analyze how rent seekers will act within the parameters of a given rent-seeking contest, a constitutional analysis of rent seeking examines how those parameters are chosen by those who create the rents. Rent seeking contests do not just appear exogenously. They are designed through the political process.

4 Rent creators

Models of rent-seeking contests focus on the competitors for the rents, rather than looking at the incentives facing those who create them. Rent creators have no incentive to create a contest in which the rents are dissipated. Why design a contest that has net social costs, and that reduces or eliminates any benefit to the contest's designers? The theory of rent-seeking should begin with the assumption that the creators of rents design rent-seeking institutions so that they—the creators—benefit. Net benefits are maximized when rent dissipation is minimized.

Becker (1983) depicts the legislature as a political marketplace in which competition among pressure groups leads to public policies that maximize the political support going to members of the legislature. In considering a tariff, for example, legislators weigh the marginal political benefit from supporters of the tariff against the marginal political cost from opponents and choose the tariff level at which the political support gained by the proponents just equals the political support lost from the opponents at the margin. The payoff to the legislature is the political support they maximize. Rents could be dissipated in a rent-seeking competition among pressure groups, but as Wittman (1989, 1995) notes, all parties have an incentive to prevent dissipation, so they have a larger surplus available to split among themselves. Becker and Wittman emphasize that regardless of the specific policy goals of political decision makers, they always have an incentive to achieve them in the least-cost manner, to maximize the benefits that are produced. This would mean awarding rents in a way that minimizes rent dissipation. Specific institutions designed to minimize rent dissipation are discussed below. The first step is to recognize that rent creators have an incentive to design rent-generating institutions to minimize dissipation.

One classroom rent-seeking game goes something like this. The instructor invites all students to bid to win $20. The instructor passes out envelopes and tells students to place any amount of money they want in their envelopes, write their names on the envelopes, and pass them up to the instructor. The instructor awards the $20 to the highest bidder—the student who put the most in her envelope—and keeps all of the money in the envelopes. The total amount collected will often exceed the $20 rent that is awarded to the winner. This game can be profitable for the instructor, but note that as described, there is no rent dissipation. The game is designed so that all of the rents go to the instructor. In a complete dissipation game, the instructor would send all the bids into a shredder, and then off to a dumpster to make sure any loose

change is unrecoverable. Is it more likely that the designer of a rent-seeking game would design the first type of game, in which all the bids went to the game's creator, or the second, in which all the rent-seeking expenditures were dissipated?

Focusing on the incentives facing those who create rents, rather than just assuming there is a rent-seeking contest open to everyone, suggests that rent-seeking institutions will be designed to minimize rent dissipation, so that the rent creator will be in a position to capture back some of the rents. This can be done by creating a barrier to entry into rent-seeking.

5 Barriers to entry into rent-seeking

Interest group theories of politics conclude that concentrated special interests are able to gain benefits for themselves at the expense of the general public. Olson (1965) explains why concentrated special interests are able to effectively organize, creating a group of insiders who are able to impose costs on outsiders. One way to look at this process is within the Coase (1960) framework of transaction costs. Some people are in the low-transaction cost group and can strike bargains with policy makers to receive rents. Most people are in the high-transaction cost group and are not able to strike such bargains. When looking at legislative activity, Buchanan and Tullock (1962) note the efficiency advantages of logrolling, but this type of political exchange can only occur when transaction costs are low enough to allow it, which is true among legislators and lobbyists. High transaction costs keep most citizens from engaging in these types of bargains, which is why special interests are able to receive rents that are paid for by transfers from others. This division of the population into low-transaction cost and high-transaction cost groups creates a barrier to entry into rent-seeking. The barrier to entry limits competition for rents, which then limits rent dissipation. The idea of a low transaction cost group that is able to obtain rents at the expense of a high transaction cost group that cannot bargain to prevent the transfer is already embodied in the interest group theories which are a well-recognized component of public choice.

This idea of transaction costs limiting entry into rent-seeking competitions can be found in elite theory that is well-established in political science and sociology. The division of the population into elites and masses has been developed by Bentley (1908), Truman (1951), and Mills (1956), and more recently has been extended by Bartels (2008), Hacker and Pierson (2010), and Gilens (2012). Economists also have commented on the division between elites and masses. Stiglitz (2012) uses the Occupy Wall Street movement to discuss rent-seeking and, referring to the influence of the 1 %, says (2012: 59) "It's one thing to win a 'fair' game. It's quite another to be able to write the rules of the game—and write them in ways that enhance one's prospects of winning. And it's even worse if you can choose your own referees." Stockman (2013) offers a similar message, referring to the system as crony capitalism. Looking at the influence of the elite, Stockman (2013: 169) says that people "…fail to recognize that the state bears an inherent flaw that dwarfs the imperfection purported to afflict the free market; namely, that policies undertaken in the name of the public good inexorably become captured by special interests and

crony capitalists who appropriate resources from society's commons for their own private ends."

Elite theory suggests that there are cronies—the 1 %—who have access to rents unavailable to others. The creation of such a barrier to entry is easy to envision in an autocracy, because it is to the autocrat's advantage to do so. Even in democratic societies, Holcombe (2015) notes that some individuals have more access to the political process than others, and that creates a barrier to entry keeping the masses from entering rent-seeking competitions. Downs (1957) observes that voters tend to be rationally ignorant, and the reasoning behind this rational ignorance is significant. Citizens are rationally ignorant because they believe they have no political influence. As Olson (1965) notes, an incentive to free ride keeps the masses from effectively organizing, giving undue influence to concentrated special interests. This limits entry into rent seeking, which creates a surplus that can be divided between the creators of the rents and the initial recipients of the rents.

Regardless of the mechanisms through which rent creators can design barriers to entry, the larger point is that those who create rents have every incentive to limit entry by whatever means are available to them, so they can profit. Otherwise, there is no incentive for those with the power to do so to create policies that generate rents.

6 Transitional gains and rent extraction

Tullock (1975) offers an insightful analysis of the long-run impacts of rent creation. Successful rent-seekers are able to receive above-normal returns for a period of time because of a government-granted barrier to entry, but over time those returns become capitalized into the assets that are used to produce them. The initial creation of the rent produces a transitional gain which becomes capitalized into an asset, dissipating the gain from rent-seeking. If the regulation that initially created the rent were to be reversed, there would be a transitional loss.

McChesney (1987, 1997) describes what he labels rent extraction, in which policymakers threaten to impose costs on groups unless they pay up to keep those policy changes from occurring. No new rents are created; rather, payment is made to policymakers to retain the status quo. Rent extraction is closely related to Tullock's transitional gains trap. In the abstract, policymakers could threaten to impose all kinds of costs on anyone, and in fact often do. For example, look at the large range of excise taxes imposed by the federal, state, and local governments. Policymakers could choose any industry and threaten to place an excise tax on their products, prompting those in the industry to engage in lobbying to pay off the policymakers to not impose the tax. Despite this being a common occurrence, singling out one particular group to bear costs not imposed on others could be politically difficult if those costs would violate a sense of fairness perceived by a majority of legislators' constituents. However, it may be politically less costly to threaten to remove a policy benefit that had been granted previously be the legislature.

Combining the insights of Tullock (1975) with the insights of McChesney (1987, 1997) shows that the transitional gains trap is more of a trap than Tullock

depicted. Tullock's trap is that removing the policy that created the transitional gain will create a transitional loss for current owners of those assets. McChesney's framework shows that because those groups are now dependent on the policy for their incomes, policymakers are in a position to continue to extort payments from them to maintain the policies. Rent extraction is one mechanism by which rent creation can benefit the rent creators.

7 Regulatory capture

Stigler's (1971) framework of regulatory capture has a close relationship to the rent-seeking literature, because it depicts regulated firms as capturing those who are regulating them, so that the regulation works to the benefit of the regulated firms, at the expense of the general public. Rents are transferred via regulation from one group to another. The regulated firms are the rent-seekers who receive rents because of regulation.

Not everybody can compete to capture a regulatory agency, so there is a barrier to entry. Firms must be in a position to benefit from regulatory capture, and must have the political connections to be able to negotiate that regulatory benefit. Most people are not in that position, so there is a barrier to entry that generates a surplus that can be shared with rent creators.

Jarrell (1978) describes the history of electric utility regulation, which was demanded by the utilities themselves to shield them from competition, and offers a good historical example of the way that rents are generated through public policy in actual practice. Electric utilities were not natural monopolies, in which the larger firms put the smaller ones out of business until only one firm remained. Rather, utilities cooperated with each other, approaching the government and asking to be able to be combined into a single monopoly and regulated, capturing the regulatory apparatus in the process.

The capture theory of regulation describes a setting in which the rents gained by those who are regulated could not be claimed by most people; firms must be in a position to negotiate to get them. The theory of regulatory capture describes a framework in which there is a barrier to entry that makes the generation of rents profitable for both the recipients of the rents and those who create the rents, as Applebaum and Katz (1987) describe.

Stigler (1971: 5) notes that rent recipients often prefer regulatory protection to a direct payment of money because it is often difficult to limit entry into rent-seeking for cash transfers. He says, "We have already sketched the main explanation for the fact that an industry with power to obtain governmental favors usually does not use their power to get money: unless the list of beneficiaries can be limited by an acceptable device, whatever amount of subsidies the industry can obtain will be dissipated among a growing number of rivals." Stigler is explaining why regulation often brings with it a barrier to entry into rent-seeking.

8 Institutions that prevent rent dissipation

The design of rent-seeking institutions in such a way that they benefit rent creators will depend on other characteristics of political institutions beyond just the institutions that create rents. The British Crown set up a system in which they granted monopolies that they were then able to tax. Rent creators would have to expect to retain their hold on political power for an extended period of time for this to be a good strategy, as would be the case with a monarchy. Otherwise, if those holding political power were replaced, their replacements would collect the benefits rather than those who created the rents. The more rapid the turnover in those who hold political power, the more the rent creators would want to charge in advance for rent creation, so they could get their payoffs regardless of whether they were able to maintain power.

In the United States benefits come in both forms: up-front payments combined with on-going charges to maintain the rent. Up-front payments often come in the form of political contributions, although as noted below can take other forms as well. In what Schweizer (2013: 16) refers to as a tollbooth, legislators will only listen to a lobbyist's request for rents if they receive a "donation" to a political campaign or political action committee (PAC) up front. Schweizer (2013: 61) quotes John Hofmeister, former president of Shell Oil, who says "If you want access or to raise something with them that concerns you, they check to see if you are a donor before they meet with you." The only way it would pay a rent seeker to engage in this process is if the expected rent is greater than the amount the rent seeker pays for access. As this will not be the case for those who do not have the political connections to obtain a rent, the "tollbooth" creates one barrier to entry into the rent-seeking process.

Hofmeister's observation applies regardless of whether the concern is the desire to create a new rent or to avoid bearing a legislatively created cost—rent extraction. Rent creation may be more comfortable for legislators to deal with than rent extraction, because rent extraction creates a conflict that lobbyists hope to resolve, whereas rent creation offers the opportunity for mutual benefit between the lobbyist and legislator. The creation of the rent produces a transitional gain that allows legislators to continue charging to maintain it even after the rent-seekers have already passed through the tollbooth to acquire it in the first place.

Explicit payment for favorable legislative treatment would be illegal corruption, but the system has evolved such that insiders know how the game is played without rent seekers having to explicitly offer payment or rent creators having to explicitly ask for it. Rent creators design institutions to make sure they will benefit before a rent is created. Legislators seek monetary donations to their reelection campaigns and PACs from interested parties as legislation that interest groups desire is coming up for consideration. Schweizer (2013: 16) notes, "Donations are solicited days before a vote is scheduled to take place. If the tribute offered by those who want the bill to pass is not large enough, the vote will be delayed."

When major votes are approaching that will be important to many lobbyists, legislators schedule receptions to meet with groups of lobbyists, and invite them to

attend. Schweizer (2013: 60), again quotes Hofmeister, who says, 'If you are invited, you are expected to be there. There is an implicit aspect of the request that makes that clear. And when you get there, you better show up with a check. … You are standing in the room, and there is a glass bowl in the center. You are supposed to place your check in the bowl. Someone who works for the politician is watching from the corner to make sure everyone puts a check in the bowl. Its public. If you don't—they are going to come and ask you why. That's the expectation.'"

Rent seekers must pay up front simply to be able to make a credible request to receive a rent, which creates a barrier to entry. They must have the ability to pay, perhaps with money but also with the offer of voter support. These are transfers to rent-creators, not Tullock costs. The rent seekers also must have an expectation of receiving a rent to be willing to pay up front. Insiders know how the system works, so they can participate. Outsiders do not, creating a barrier to entry that excludes many from the ability to capture rents.

There is some discussion of lobbyists wining and dining legislators, wasting resources on activities that have little value to either side. Because political fundraising is not permitted in legislative offices, the purpose of those meetings is not to provide unwanted food and drink to legislators, but to provide meetings in which transactions can be made with little outside scrutiny. It is the meeting, not the meal, that provides value to both sides. The benefit to the legislator is not the meal, but the opportunity to extract a payment from the lobbyist.

Institutions are also designed so that once a rent is created, the rent-creators can continue to share in the proceeds. Schweizer (2013: 30–31) discusses tax extenders as an example. "Tax extenders temporarily reauthorize tax breaks that have not been made permanent in the law. … Why doesn't Congress just make these tax deductions permanent? … Making them permanent would take away the ability of the Permanent Political Class to return again and again to wealthy industries for largess to keep the credits on the books. … Washington has been using tax extenders to extort donations for more than thirty years."

This applies to rents that come in any form, not just tax breaks, because Congress can always reconsider existing laws that generate rents. The ethanol mandate requiring that 10 % of motor fuels be ethanol, or the sugar program that keeps domestic sugar prices well above world prices, can persist only because the rent recipients who benefit from those programs continue to support the legislators who can reconsider those programs. Rent creators demand payment up-front, and then they demand continuing payments to maintain the flow of rents. The transitional gains trap puts rent recipients in a difficult position in that they must keep paying to avoid a transitional loss.

Payments to political campaigns and PACs appear beneficial to politicians' political careers, but payments to rent creators often offer more personal benefits. Schweizer (2013: 19) observes that "political extortion can often involve a web of family members, who extract from the target on several levels: campaign contributions and favors for the politicians, jobs for the politicians' children, and lobbying contracts for their spouses." Schweizer (2013: 75) says, "During the 2008 and 2010 election cycles, eighty-two members of Congress had their family members on the campaign payroll or hired them as 'consultants.'" Schweizer (2013:

74) documents another case of a legislator who lent money to her political campaign and rather than having the campaign pay it back, charged the campaign 18 % interest on the money for nearly two decades. There are not many ways to earn an essentially risk-free 18 % a year on investments, but this legislator found one not available to most people. There are easy ways for politicians to transfer cash “contributions” to family, friends, and themselves.

This often goes beyond just laundering cash through their own campaigns. When a lobbyist shows up with a request, a legislator might recommend to the lobbyist a relative who could be a good hire for the lobbyist’s client. If the relative gets the job with the rent-seeker, this could facilitate the rent being created. Exchanges like this are not made explicitly, but participants understand how the system works, and those with connections—those in the low-transaction cost group—benefit from the connections that create a barrier to entry to outsiders.

Rent creators go beyond just legislators. Schweizer (2013: 17) explains that regulations are often complex and vague, making it difficult to tell whether one is actually in compliance. Legislative staffers and executive branch bureaucrats who write those regulations routinely leave those government positions to work in consulting firms, offering regulated firms advice on compliance. Those former government workers wrote the regulations, their argument goes, so they are in a good position to advise firms on compliance. And because those consultants have connections to their former cronies in government, they are in a good position to use those connections for the benefit of their clients. With vaguely worded regulations, an interpretation from a well-connected former staffer can carry more weight than the exact same interpretation from someone without personal connections. Similarly, making campaign contributions to key legislators helps to keep firms from running afoul of regulations. Schweizer (2013: 48) observes, “There is no explicit quid pro quo here. It is all unspoken. Friends help friends get elected by raising money. And friends who get elected don’t like friends who helped them raise money going to jail.”

This section draws heavily on the actual facts describing how the political process works, as described by Schweizer (2013). Schweizer’s book provides excellent background for public choice scholars. It is not public choice theory; it is a description of the way that politics actually works. Advances in public choice can be made by providing a theoretical foundation for the process Schweizer observes, rather than abstract theory unconnected to actual political events. The idea that rent creators have no incentive to create rents unless there is something in it for them is straightforward. How do rent creators benefit? This section has described some of the ways that rent creators design institutions so that they benefit from the rents they create.

Looking at the way institutions are designed to channel benefits to rent creators, the channels involve implicit agreements rather than explicit exchanges. Explicit exchanges would constitute corruption, and as Aidt (2016) notes, there is a fuzzy line between rent creation and corruption, as the examples in this section illustrate. Schweizer (2013) explains how policymakers can turn extracted rents into personal benefits, which he labels extortion. Schweizer’s book is extensively footnoted and

referenced, and is worth reading as an actual description of the political process that public choice attempts to describe in theory.

9 Erosion of barriers to entry in rent production

Those who grant the rents have the incentive to erect barriers to entry into rent-seeking for their own benefit, but this system of generating political profits can break down is if barriers to entry into rent production are eroded. A centralized system of rent production can limit who can produce rents, whereas a decentralized system opens the door for many rent producers. For example, if the central administration has complete control over who can get an import license, the producer of that rent can limit the competition by only giving licenses to close associates. If import licenses can be granted by dozens of customs houses in multiple ports of entry, rent-seekers can approach a second (or third) customs house if they are turned down by the first. The multiple customs houses will be competing with each other in the granting of rents to rent-seekers, which will reduce the payoff they can demand for granting the rent.

Turnover among those who can grant rents can also erode barriers to entry, giving government officials an incentive to extract what they can before they are replaced by others. Those with short time horizons will be less interested in minimizing rent dissipation, as Levi (1989) noted. In Olson's (2000) framework, those who anticipate longer tenures view themselves as stationary bandits who have more of an incentive to minimize rent dissipation, whereas those with shorter time horizons will act more like roving bandits who will take all they can and care little about rent dissipation.

Thus, the most important barrier to entry to limit the dissipation of rents may be the barrier to entry that limits who is in a position to create rents. The rent creator must establish a barrier to entry in the ability to create rents, or competition to receive rents can occur, which would result in rent dissipation. Such barriers are rarely included in rent-seeking models. Lake and Linask (2015) present a rent-seeking model of tariffs and quotas in the spirit of Tullock and Krueger in which entry into the rent-seeking contest is open, which dissipates rents. Higgins et al. (1985: 255) say "It is unsatisfactory to imagine, for example, that the franchisor sets the number of contestants," but if the franchisor is creating the rents, it has every incentive to do so.

10 Competitive rent-seeking: the Tullock–Krueger model

Some evidence that there is not always a barrier to entry into rent-seeking is presented by Krueger (1974), who described the Turkish and Indian economies at the time she was writing. In the economies she described, the institutional barriers to entry broke down, turning rent-seeking into a competition that completely dissipated rents. Thus, based on her first-hand observations she assumed that rent-seeking costs were equal to the amount of the rents generated. This is the case that

the literature depicting rent-seeking as a contest describes. The possibility of complete dissipation is supported by Krueger's examples, so one could not conclude that institutional barriers to rent-seeking always prevent rent dissipation. However, Krueger singles out those poor economies with low-quality institutions that encourage rent-seeking, in contrast to developed economies that do not appear to have the same degree of rent-seeking welfare losses. Rent-seeking as a competition that completely dissipates the rents—the case that Krueger (1974) described—is the extreme case in which policy makers have been unable to maintain the barriers to entry into the creation of rents that would prevent free entry into rent-seeking. While Krueger's description appears to fit those particular cases, the rent-seeking literature may have latched on to those extreme cases and portrayed them as typical rent-seeking institutions when, in fact, they are extreme examples. There is a good reason why Krueger, an American economist, used Turkey and India as her examples rather than the United States.

The value in studying competitive rent-seeking lies in trying to understand what institutional features allow it to occur. What institutions facilitate this complete rent dissipation in in some countries when it does not occur in others? Kolko (1963) examines Progressive era regulation in the United States and challenges the conventional wisdom by concluding that it was done in cooperation with the economic elite, to preserve their elite status and protect them from entrants into their industries, consistent with Stigler's (1971) capture theory. Kolko (1965) and White (2011) describe the Progressive era regulation of the railroads in more detail, illustrating how they were able to steer public policy to benefit themselves and capture rents, just as Jarrell (1978) does when describing the regulation of electric utilities. These historical accounts document cases in which rents are not dissipated, which should benefit both the rent recipients and rent creators.

The theory of rent-seeking competitions in which all rents are dissipated does not describe the institutional features that allow this dissipation to occur. It describes the competition among the rent seekers, but not the behavior of the rent creators. Complete dissipation can occur, as Krueger (1974) describes, but there are good arguments, backed by persuasive case studies, to show that often it does not. The creators of rents have an incentive to design an institutional framework that erects a barrier to entry to limit rent dissipation and provide a positive return to rent seekers and to themselves.

11 Conclusion

In the article that gave rent-seeking its name, Krueger (1974) took an institutional approach, describing an institutional structure in which all of the rents generated were dissipated in rent-seeking costs. The literature since then has focused heavily on theoretical models of rent-seeking competitions with little in the way of institutional foundations. Krueger's assumption of complete dissipation has dominated the development of rent-seeking theory. Models in which all rents, or even most rents, are dissipated do not square well with the incentives facing participants in the rent-seeking process. Most models depict rent-seeking as a

competition and focus on the behavior of the competitors, but do not look at the incentives of those who design the public policies that generate the rents. Policymakers have an incentive to create rents only if they have something to gain from doing so.

Buchanan (1990) noted that whereas economics typically studies the way individuals choose subject to constraints, constitutional economics studies the choice among constraints. The bulk of the literature on rent-seeking competitions does not take a constitutional approach. It takes institutions as given and looks at how competitors act subject to those institutional constraints. Taking a constitutional approach recognizes that rent-seeking institutions are a product of the political process, and those who create rents have the incentive to design rent-creating institutions such they they—the creators—benefit from the creation of rents.

Policymakers benefit most from creating rents when they limit the competition for them, which minimizes the rent-seeking costs and leaves the largest surplus available to be divided between the rent recipients and the rent creators. The case of complete dissipation is best viewed as the extreme case in which the institutional structure has broken down and allows no way for those who create the rents to capture any benefit from them. There may be a transitional gain, to use Tullock's (1975) term, until entrepreneurial rent-seekers learn how to work the system to gain those rents, along the lines of Baumol (1990, 1993). Over time, the system degenerates into one that contains an increasing amount of inefficiencies, following Olson (1982), until rent-seeking competitions erode all rents.

A significant research question is why extreme rent dissipation happens in some cases but not in others. Looking at the incentives of those who create the rents, there are good reasons to think that a substantial dissipation of the rents would be the exception rather than the rule, a conclusion that is supported with a strong theoretical foundation and a variety of case studies.

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