The Welfare Costs of Rent-Seeking: A Methodologically Individualist and Subjectivist Revision

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30 March 2015

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***This is a draft; a revised version is forthcoming in the* Journal of Philosophical Economics.**

Abstract: Gordon Tullock is acknowledged for being the first to recognize the true costs of rent-seeking as including not only the Harberger triangle but also the Tullock rectangle. This rectangle does not constitute merely a lossless transfer of wealth, but it causes a misallocation of resources as rent-seekers invest resources in lobbying. However, a close reading of Tullock's writings show that his arguments are formulated in a holistic fashion, speaking of what is efficient or inefficient for society. Rent-seeking is inefficient because it reduces societal welfare. But according to a methodologically individualist and subjectivist economics, such a claim is invalid. We must distinguish between positive economic fact and normative moral philosophy. We call for a reconstruction of utility and welfare economics based on methodological individualism and subjectivism with implications for the theories of monopoly and competition: practices which Neoclassical perfect-competition theory considers to be evidence of rent-seeking should instead be deemed as indications of genuine competition. Political economy should be concerned with ascertaining which institutions will best enable individuals to pursue their individually subjective ends – or else economists should be explicit about their normative preferences and political philosophies.

Keywords: Tullock; rent-seeking; interest groups; efficiency; subjectivism; methodology
JEL codes: B31; B41; D61; D63; D72

Gordon Tullock is famous for his pioneering the concept of rent-seeking (Tullock 1967) even though the term itself is owed to Krueger (1974). Tullock's simple claim was this: previous economic analysis of monopolies had argued that the allocational rectangle was a mere transfer of wealth from one party to another which occasioned no loss to society (Tullock 1967: 225 in Tullock 2004: 170; Tullock [1987] 2004: 237; Tullock 1998; Tullock 2003: 2). The only true social loss was the "Harberger triangle" of deadweight loss, whose magnitude was calculated to be quite small (Tullock 2003: 2f.). Therefore, the social cost of monopolies was almost negligible. Tullock "simply shifted attention from the welfare triangle to the profit rectangle and asked what self-seeking entrepreneurs would do to access such a profit rectangle from the zero profit environment of a competitive market" (Tullock 1998). His answer was that the "Tullock rectangle" of transfer itself occasioned social losses of its own. Potential recipients of monopoly privilege or regulatory protection would invest resources in lobbying to obtain that protection, theoretically investing up to the capitalized probability-discounted value of the potential protection to be obtained. Furthermore, potential victims of the monopoly would engage in a similar calculus, investing in counter-lobbying, potentially investing a value up to the capitalized cost which would be imposed on them. Potential beneficiaries and victims will invest to the point where expected marginal returns equal expected marginal costs. Thus rent-seeking is "defined as the outlay of resources by individuals and organizations in the pursuit of rents created by government" (Tullock 1998). These investments in lobbying and counter-lobbying resources are a pure social waste with no productive value to society and society loses not only the value of the Harberger triangle but also of the Tullock rectangle. In short, the costs of protectionism include not only the deadweight loss of the protection itself, but also the value of all the lobbying resources which are invested in securing and forestalling this protection. These investments in lobbying are of no productive value and constitute pure social waste.

Note that one cannot say that rent-seeking is negative sum because investments are necessarily duplicated. When multiple firms each invest in lobbying to secure a single privilege, only one firm can be successful, and all the other firms will have wasted their investments. Perhaps it is this duplication which

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explains why rent-seeking reduces welfare. But in fact, each firm will invest not according to the maximum realizable rent obtainable but the rent discounted by the probability of its successful acquisition. Similarly, the potential victims of rent-seeking will invest in counter-lobbying, up to the cost being potentially imposed on them discounted by the probability of their counter-lobbying being successful. In other words, the investment in lobbying (and counter-lobbying) is based not just on capitalized expectation of cost and benefit – because transfers are continual and not one-time – but also discounted by probability – because lobbying efforts have less than a guaranteed chance of success. The more firms competing for a single rent, the lower the probability any given firm will obtain it, and the less any one firm will be willing to invest. Because this depends on expected not actual probabilities, we cannot predict *a priori* whether rent-seeking investment will be efficiently based on correct estimations of probabilities.[2] But assuming probability estimations are unbiased and errors are random rather than systematic, we should expect that the probability-discount on investment will prevent the wasteful-duplication aspect of investment in obtaining rents. The total probability of obtaining the rent is equal to approximately 1 (100%), and so the total investment in lobbying by all firms collectively should tend to equal the total value of the rent, which each individual firm investing an amount equal to the rent discounted by that firm's individual probability of obtaining it. Therefore, Tullock says ([1987] 2004: 239),

> In almost all existing lotteries, of course, the total investment of resources by the gamblers is considerably greater than the total payoff, whereas here it is still assumed that the total resources committed to rent seeking equal the total monopoly profits.

But an important shortcoming in Tullock's argument is that he evaluates things from the perspective of "society." From that holistic standpoint, lobbying produces waste and loss. But from a methodologically individualist and subjective standpoint, it is not clear what is or is not a genuine waste or loss. "One man's trash is a another man's treasure"; *de gustibus non est disputandum*. Only by speaking in the name of "society" is it possible to declare what is socially wasteful. But if one cannot speak for society, then one cannot declare that investment in lobbying is a net loss. Instead, we must evaluate things from the perspective of individual economic actors. We will find that while the positive side of Tullock's analysis of rent-seeking – the discovery that actors will invest in lobbying – is a perfectly legitimate illustration of "that which is seen and that which is not seen" (to borrow from Bastiat), the normative side of Tullock's analysis – his criticism of rent-seeking – dubiously involves methodological holism and illegitimate imputations value of objective value. A normative criticism of rent-seeking which avoids methodological holism and eschews speaking in the name of "society" will have to be conducted on methodological grounds different than Tullock's.

It is possible, however, that Tullock was already well aware of these criticisms. As Tullock himself made clear (Tullock 1971: 375), "my work in expanding economics into new areas was, in a real sense, begun by my reading of *Human Action*" by Ludwig von Mises (1949). Furthermore, the underlying methodological claims of this present paper are all essentially put forth in *Cost and Choice* by Tullock's colleague, James Buchanan (1969).[3] Therefore, this paper is not so presumptuous to claim that Tullock was unaware of these criticisms. It seems more likely that Tullock intended to take the essentials of Neoclassical welfare analysis for granted in his analyses of rent-seeking in order to show that even according to the accepted Neoclassical standards, rent-seeking was more costly than had been realized. In other words, Tullock wanted to fight a battle only on one front, not two, and Tullock did not want to unnecessarily provoke a second dispute concerning the Neoclassical methodology itself. Indeed, as it was, Tullock had a very difficult time publishing his original 1967 "Welfare Costs of Tariffs, Monopolies, and Theft" (see Tullock 1998, 2003: 5 for the full story), and had he argued against the Neoclassical methodology too, his 1967 article would have been even less publishable. Consequently, the argument is not that Tullock was ignorant of the claims this essay makes, nor even that he would have disagreed with them. Our claim is only that in taking Neoclassical methodology for granted in his analysis of rent-seeking, Tullock neglected to say everything that he could have, and his criticism of rent-seeking was therefore incomplete. Even if Tullock had very good reasons for confining his analysis, there are still things he left unsaid, and it is to these we turn. If our guess is correct that Tullock's original 1967 article deliberately eschewed contesting Neoclassical methodology in order to avoid provoking unnecessary controversy, then today, now that Tullock's rent-seeking concept is no longer controversial, perhaps the time is ripe for us to complete what he perhaps left unfinished. Tullock's original article took Neoclassical methodology for granted, but now we may extend his criticism of rent-seeking to account for the radical methodological individualism and subjectivism of

Mises's *Human Action* (1949) and Buchanan's *Cost and Choice* (1969). Our objective is not to dethrone Tullock's analysis of rent-seeking, but only to refine it in a spirit of admiration.

While this analysis will focus on a methodologically individualist and subjectivist reformulation of Tullock's concept of rent-seeking, our conclusions will have broader implications for economic methodology. A reconstruction of utility and welfare economics based on methodological individualism and subjectivism has implications not only for rent-seeking but also for monopoly theory. Many practices which Neoclassical static-equilibrium theory considers to be evidence of imperfect or monopolistic competition, are better understood as genuinely competitive activities in an environment of ignorance, uncertainty, and subjectivism. These activities are neither acts of rent-seeking nor are their abnormal returns instances of monopoly rent. An economic methodology reconstructed on individualism and subjectivism should focus on the gains from trade and voluntary cooperation, and the losses from interfering with consensual market interaction. Rent seeking should therefore be understood as activities which interfere with voluntary market activities. Alternatively, one's definition of rent-seeking should be based on an explicitly normative declaration of which activities are and are not considered desirable according to one's political philosophy. As value is individually subjective, there is no non-arbitrary way to declare what benefits "society". Therefore, one should speak either of what enables individuals to pursue their individual ends or else what promotes those things which one personally considers morally desirable. Economics can help us determine what *is* but not what *ought* to be.

I. What is "Society" and its Welfare?

We begin by observing that Tullock repeatedly speaks of unproductive investments which do not produce wealth for society. The problem is that "society" does not exist as an economic actor; only individuals act. Therefore, we cannot speak scientifically of a loss to society unless literally every member of society suffers a loss, or at least does not gain. But where even a single member of society benefits, then we can no longer speak of an investment as wasted or socially unproductive. For example, Tullock speaks of "revenues raised by [a] tax [which] are completely wasted, building tunnels, for example, which go nowhere" (Tullock 1967: 225 in Tullock 2004: 171). According to Tullock, "no one benefits from the expenditure" and "the whole economy is poorer not just by the triangle, but by the whole amount of wasted resources" (Tullock 1967: 226 in Tullock 2004: 171). But this is not at all true. The construction industry and the workers it employs have certainly benefited from the government's use of tax revenue to purchase tunnels to nowhere, and they are not complaining about society – of which they are members – being any worse off than before. This industry is the recipient of a government transfer, and within the boundaries of positive economics, it is impossible to say whether society is rendered better or worse off than before by a transfer of wealth from one person or group to another. A methodologically individualist and subjectivist economics makes it impossible to make judgments about societal efficiency.

More generally, Tullock's criticism is that traditional economic theory "assumes that the monopoly is created in a costless manner, perhaps by an act of God, whereas in fact real resources are used to created monopolies" (Tullock 1987 [2004]: 237). Similarly, Tullock argues that investment in lobbying is "wasteful from the standpoint of society as a whole; they are spent not in increasing wealth, but in attempts to transfer or resist transfer of wealth" (Tullock 1967: 228 in Tullock 2004: 174). But the recipients of those real resources do not regard the cost as a cost at all, but instead as a beneficial transfer to themselves. Similarly, when Tullock argues that "[t]he problem is that the possibility of a transfer leads people to invest resources in either obtaining the transfer or preventing it" and that "from the society standpoint the resources invested in the conflict between the two groups are entirely wasted" (Tullock [1971b] 2004: 191), we respond that the lobbying industry, in which the resources are invested, certainly does not regard these resources as being wasted. For that industry, these allegedly wasted resources constitute a beneficial transfer of wealth. Investment in lobbying is a waste only from the perspective of the victims of transfers and rent-seeking, but not from the perspective of the victors, and certainly not from the perspective of the lobbyists themselves. In fact, the lobbyists would appear to benefit regardless of whether their patrons eventually win or lose. Assuming a given lobbyist has a good enough success record that he is regarded as basically competent and hireable, then he will be happy as long as firms continue to hire him to lobby on their behalf. In any given particular case, whether he succeeds or fails, he will be satisfied as long as he is paid. For the professional lobbyist, the rent-seeking society promotes his own full-employment. Lawyers probably tend to regard the growth of the legal code similarly: more laws mean more clients. Lobbyists and lawyers – who, don't forget, *are* members of society – are probably shedding few tears at the prospect of reliable employment, no matter how many others deplore their professions as "unproductive."[4]

II. Transfers as Investments and Investments as Transfers

Notice that we have considered investment in lobbying as equivalent to a transfer to lobbyists. This brings us to our next criticism: that Tullock makes an artificial distinction between transfers and investments. According to Tullock, rent-seeking occasions losses because not only is wealth transferred costlessly from one group to another, but resources are invested wastefully as well. In his words (Tullock 1967: 231 in Tullock 2004: 177),

> theft itself is a pure transfer, and has no welfare cost, but the existence of theft as a potential activity results in very substantial diversion of resources to fields where they essentially offset each other and produce no positive product. The problem with income transfers is not that they directly inflict welfare losses, but that they lead people to employ resources in attempting to obtain or prevent such transfers.

Similarly, he states (Tullock 1967: 230 in Tullock 2004: 176),

> Transfers themselves cost society nothing, but for the people engaging in them they are just like any other activity, and this means that large resources may be invested in attempting to make or prevent transfers.

And again (Tullock [1971b] 2004: 193):

> The transfer itself may be costless, but the prospect of the transfer leads individuals and groups to invest resources in either attempting to obtain a transfer or to resist a transfer away from themselves. These resources represent net social waste.

In other words, the problem with theft is not the pure transfer of wealth from the victim to the thief, but rather the fact that victims invest in locks and thieves in lock-picking equipment. Tullock assumes that from a societal perspective, this investment in lobbyists and theft-related equipment is wasteful and decreases total national wealth. By contrast, pure transfers are costless. But in fact, every investment is a transfer and every transfer is an investment. Suppose, for example, the automobile industry obtains a subsidy at taxpayer expense. And suppose that the process of obtaining the subsidy was costless, with no investment in lobbying whatsoever. We might say then that the subsidy constitutes a pure transfer without any wasteful investment. But in fact, this tax-and-subsidy will still alter the allocation of resources. For example, suppose the recipients of the subsidy – members of the automobile industry – live in a geographic region where wine is preferred to beer relatively more than in the rest of the country. When the beer-preferring taxpayers are taxed to provide a subsidy to the wine-preferring members of the automobile industry, the pattern of production and consumption of wine relative to beer will change. We should expect production and investment in beer to decline and that in wine to increase, even though the tax was assessed on say income and the subsidy was a pure transfer to the automobile industry. Although the subsidy was a pure transfer, the recipients of the subsidy still have to spend their newly-obtained money somewhere. Even if they spend their entire subsidy on consumption, this will still indirectly affect investment and production. Even a pure transfer entails reallocation of resources and changes in the societal pattern of investment. If rent-seeking is costly only because it alters the pattern of investment, then even a pure transfer would have to be regarded as costly insofar as the recipients of the transfer have different subjective tastes and preferences for consumption compared to those who paid the tax.

The reverse is true as well: every investment in production is a transfer. Tullock criticizes the fact that in an environment of rent-seeking, there will be unproductive investment in lobbying. But such investments are nothing other than pure transfers to lobbyists. Just as the construction industry is not sorry to build tunnels to nowhere, lobbyists do not complain about the salaries they receive to make their pitches in Washington. Likewise, the manufacturers of padlocks and lock-picking tools do not lament how the pervasiveness of theft alters patterns of investment. Societal wealth has not necessarily been diminished in absolute terms but merely transferred from consumers to lobbyists and to manufacturers of lock-related equipment. From the perspective of lobbyists and lock-industry manufacturers, personal wealth has in fact been increased, not decreased. Lobbyists and the lock industry perceive an increased demand for their products and services no differently than brewers would respond to a shift in consumer preferences from wine to beer. In fact, every alteration of investment and production is just a form of wealth-transfer to the members of the recipient industry. One cannot argue, as Tullock has, that rent-seeking is costly because it occasions malinvestments or misallocations of resources above and beyond the innocuous pure transfers of wealth. In fact, every investment is a transfer and every transfer is an investment.

III. Return to Society

From the methodologically individualist and subjectivist perspective, Tullock's primary mistake is that he attempts to measure value and productivity from the perspective of "society."[5] For example, in one discussion of rent-seeking, while criticizing investment in lobbying services, he claims that "[n]o improvement in efficiency in society is expected from such a transfer" (Tullock [1971b] 2004: 188). He continues that when those who would suffer a loss from rent-seeking, respond by investing in counter-lobbying, the two investments largely cancel and "it is clear that the action as a whole has not benefited 'society'" (Tullock [1971b] 2004: 190). In a later reflection on his earlier work, Tullock recapitulated that "Irrespective of which party wins the struggle, the resources invested in the struggle are wasted and society as a whole is worse off" (Tullock 1998, commenting on Tullock [1971b] (2004)). While Tullock is correct that there is indeed a sort of Prisoner's Dilemma at work (Tullock [1971b] 2004: 185), nevertheless, it is not meaningful to speak of what benefits or costs society. While the majority of citizens may be distressed, the lobbying industry, which benefits from this investment, is not complaining, and lobbyists are every bit as much members of society as anybody else. Therefore, it is not true that "from the social standpoint the resources invested in the conflict between the two groups are entirely wasted" (Tullock [1971b]: 2004: 191), because the lobbyists who receive the transfer of wealth receive a benefit but do not suffer a loss. The positive economist cannot make any argument for why the "social standpoint" should discount the welfare of lobbyists more than anybody else. As Murray N. Rothbard has noted (1982: 59 n.8),

> Social efficiency is a meaningless concept because efficiency is how effectively one employs means to reach given ends. But with more than one individual, who determines the ends toward which the means are to be employed? The ends of different individuals are bound to conflict,making any added or weighted concept of social efficiency absurd.

The same criticism should be applied to Tullock when he says (1967: 230 in Tullock 200: 176) that theft

> would be extremely costly to the society in spite of the fact that the activity of theft only involves transfers. The cost to society would be the investments of capital and labor in the activity of theft and in protection against theft.

But it is not true that society homogeneously suffers a loss. Every investment in padlocks is nothing but a transfer to the members of the lock-manufacturing industry. Moreover, there is no positive economic reason why padlocks are a morally less valuable or worthy investment than anything else. The positive economist cannot say that investment in locks is a more or less wasteful investment than an investment in anything else. After all, it is merely a transfer of wealth from one manufacturing sector to another.

Even rent-seeking to remove harmful restrictions – e.g. lobbying for free-trade – cannot be judged efficient or desirable on value-free grounds because removal of inefficient restrictions entails transitional losses (DiLorenzo 1988: 319). For example, if a tariff is repealed, consumers will benefit but the formerly-protected industry will suffer losses, and there is no non-normative way to weigh subjective costs and benefits against each other (Ricketts 1987: 462).

Furthermore, Tullock hypothesizes that "society" might choose to accept Kaldor-Hicks improvement in lieu of insisting solely on Pareto improvements (Tullock [1971b] 2004: 183). But society does not make such choices; only individuals choose and act. It is not scientifically meaningful to speak of what benefits or costs society unless every single member of society is united in sharing the benefit or cost together (or at least, as long as some members are not affected). But as long as any member of society experiences a benefit from another's loss or a loss from another's benefit, it is impossible to speak of what benefits or costs society. Tullock should not speak of lobbying and theft-deterrence as socially wasteful because the members of those industries receive transfers and society's loss is their gain. Hence, society as a unitary entity does not really homogeneously lose after all.

IV. Value is Subjective

There is also the problem of subjective value. According to Tullock (1987 [2004]: 239, 243), again discussing lobbyists, there is

> a considerable waste of resources in general, both because these highly intelligent people could otherwise be doing something of higher productivity and because the economy's use of resources has been further distorted by the creation of the monopoly. . . . [T]he large-scale lobbying industry is truthfully a major social cost [because] . . . these highly talented people could produce more in some other activity.

But what does it mean that “these highly intelligent people could otherwise be doing something of higher productivity”? According to whom? From whose perspective? The perspective of society? In fact, value is subjective, and the positive economist cannot say what is more or less productive than anything else. As E. C. Pasour, Jr. notes (1987: 130), “Since individuals base choices on data that are inherently subjective, the economist can identify waste in the actions of other people only by imposing his own standard of value.”. This is a normative judgment, and we might just as well say that society suffers loss when religiously observant Jews refrain from work on the Jewish Sabbath and that societal efficiency would be enhanced by the abolition of the Jewish religion. This may well be true from the perspective of gentiles and anti-religious Jews, but from the Jewish viewpoint, this would entail a welfare-loss. But if the positive economist cannot legitimately say that religiously observant Jews “could otherwise be doing something of higher productivity” on the Jewish Sabbath, then he or she cannot criticize investment in lobbyists either. This is the cost of acknowledging the essentially subjective nature of economic value.

V. Rent-Seeking as Immoral, not Inefficient

What then, from the perspective of a thoroughgoing methodologically individualist and subjectivist economics, is the true cost of rent-seeking, the real reason why it should be criticized? It is that the consumers who must pay the taxes and higher prices, find their welfare reduced. When the government offers a subsidy to a rent-seeking interest, it means that somebody else must have involuntarily paid a tax. (Of course, the subsidy and tax may be indirect, in the form of e.g. a regulation which restricts competition.) Every form of rent-seeking is merely a transfer of wealth, but the victims of that wealth-transfer regard it as worthy of serious resentment and criticism. Similarly, every form of regulation which has beneficiaries and victims, aggrieves its victims. For example, any form of licensure harms those who have to pay the cost of obtaining a license. The ethical or normative problem is not that “society” suffers a loss or that economic efficiency is impaired, because such losses or inefficiencies are not really scientifically ascertainable or verifiable (Rothbard [1956] 2011). The problem is that somebody – anybody – suffers an unjustifiable loss, no matter the magnitude; the objection is moral, not economic – deontological, not utilitarian nor consequentialist (cf. Rothbard 1982: 61f.).

Even if it were true that transfers of wealth did not affect GDP or societal wealth, it would still matter to the specific parties involved who was the donor and who was the recipient (Block 1977 and Hoppe 2004 discussing Coase). When somebody is forced to surrender wealth to another, his concern is not with whether GDP is affected or whether “society” finds its efficiency impaired, but instead, he cares primarily about what this does to his own personal well-being. Similarly, the problem with government grants of monopoly privilege is not that they reduce societal efficiency or welfare in any calculable fashion, because in fact, the supply and demand curves are simply not given for anyone to measure. Instead, all we can say about monopoly grants of privilege are that they render supply more inelastic, violating the moral right of potential competitors to compete, and violating the right of consumers to seek alternative providers of satisfaction (Leoni 2009 [1965], Pasour 1987: 126). It is morally wrong to prevent consumers from seeking the most effective means of satisfying their desires if they do not unjustifiably harm others in the process. Likewise, it is unjust to prevent one producer from seeking to satisfy consumers better than his or her competitors can.

Hence, at the heart of nearly any criticism of rent-seeking lies the intuitive moral belief that coercion is wrong, that the privileged or powerful do not have a right to use political power to profit at the expense of others. But as E. C. Pasour, Jr. notes (1987: 131-135), this depends on a normative judgment concerning the proper role of the state.[6] For example, "resources expended by teachers to enact (or preserve) a system of public education would be wasteful if education were not a proper function of the state" (Pasour 1987: 131). Conversely, if public education is legitimate, then the activities of teachers' unions are much less likely to constitute rent-seeking at all. "If education is a proper role of the state, the use of resources devoted to lobbying efforts to improve schools and teachers' salaries would not necessarily be wasteful" (Pasour 1987: 132).[7] Not only is an assessment of the precise costs of rent-seeking essentially subjective, but even a judgment of whether a particular activity constitutes rent-seeking at all relies on a subjective opinion of political philosophy and the legitimate role of the state. "[I]n the absence of a consensus on these issues, there is no objective basis for identifying which lobbying efforts are wasteful and which are beneficial" (Pasour 1987: 132) and "[o]ne person's waste is another's cherished activity" (DiLorenzo 1988: 330).

The hidden normative presumptions that lie behind pronouncements of economic efficiency or inefficiency become more apparent if we reexamine the case mentioned earlier of rent-seeking to repeal a trade restriction (DiLorenzo 1988: 319, Ricketts 1987: 462). As Murray N. Rothbard notes ([1956] 2011: 314f.),

> If X number of individuals gain, and Y number lose, from a change, any weighing to sum up in a "social" conclusion would necessarily imply an ethical judgment on the relative importance of the two groups. … Suppose, for example, that two social changes take place, each of which causes 99 percent of the people to gain in utility and one percent to lose. Surely no assumption about the interpersonal comparison of utility can suffice to establish an ethical judgment, divorced from the content of the change itself. If, for example, one change was the enslavement of the one percent by the 99 percent, and the other was the removal of a governmental subsidy to the one percent, there is apt to be a great deal of difference in our ethical pronouncements on the two cases, even if the assumed "social utility" in the two cases is approximately the same.

In both cases – the 1% being enslaved to the 99% or the 1% losing their subsidy which had cost the 99% – the mathematical magnitude of utility is identical. From a utilitarian calculus of societal welfare, the two cases are identical. What changes is not mathematical figures but moral desert. If one considers only enslavement and not subsidy-repeal to be a form of rent-seeking, the reason is because of subjective, normative considerations not related to value-free economic science. Furthermore, if one were to advocate only Pareto improvements on positive economic grounds, then one would have to oppose not only the enslavement of the 1% to the 99% but also the repeal of the subsidy. For subsidy-repeal entails transitional losses to the formerly-protected industry and is therefore not Pareto efficient. One may advocate for repeal nevertheless only on normative grounds that this subsidy is morally illegitimate. Even if one insists that the subsidy is economically inefficient judged by the baseline of welfare prior to the establishment of the subsidy, the choice of this as the baseline is itself normatively-based. The choice of an ideal assignment to be used as a benchmark is itself subjective.

VI. Monopoly, Entrepreneurship, and X-Efficiency

There is another cost of monopoly to which Tullock did not credit as much as he could have.[8] In one retrospective, Tullock takes note of Harvey Leibenstein's X-efficiency (Tullock 2003: 3 citing Leibenstein 1966), but Tullock is not satisfied with this (2003: 4). Leibeinstein argued that the costs of monopoly are not just the static inefficiency of producing lower quantity at a higher price, but also the dynamic inefficiency of the fact that the protected industry does not strive as much to improve product quality and reduce the cost of production.[9] According to Tullock, it is hard to believe that a monopolist would rest on their laurels and not make as much profit as they could by cutting costs, and so he rejects Leibenstein's answer (Tullock 2003: 4).

But X-efficiency deserves more consideration. Neoclassical welfare analysis assumes that all profits are due to monopoly and constitute permanent welfare-loss (Pasour 1987: 124). But if market competition is understood not as a static outcome but as a dynamic process (Pasour 1987: 124, DiLorenzo 1988: 321; cf. Ricketts 1987: 460), then competitively-earned profits are merely transitory and they indicate that value has been created where none existed before, either by lowering costs of production or else by creating a new product or service which consumers value more than any preexisting alternative (Holcombe 2014). Profits are transitory, not permanent, because they encourage imitation; profits are a common-pool resource which are depleted and bid away by new entrants in a competitive marketplace (Holcombe 2014). According to Israel Kirzner's model of entrepreneurship, entrepreneurs will be constantly on the lookout for new opportunities to make profits (Kirzner

1973; Kirzner 1997; Littlechild 2009 [1978]; Boettke 2012: 213-225, 281-285, 291f.). Every market failure is a profit opportunity, an externality to be internalized.

But the act of being constantly alert for new profit opportunities is itself costly and tiring. It is reasonable to suppose that a monopolist, protected from competition, will find it simply not worth his effort to strenuously explore new ways to produce higher-quality products at lower prices. Much less will he attempt to invent totally new, unprecedented products. Yes, he could make higher profits by doing so. But leisure is also an economic good, and it is reasonable to suppose that without the spur of competition, he will invest relatively more in leisure and relatively less in entrepreneurial alertness.[10] Tullock's assumption that even a monopolist would pursue X-efficiency and cut costs to achieve maximum profits, assumes that businessmen do not value leisure as a commodity. In fact, with his monopoly profits, he is making a handsome enough living as it is, and he does not need to engage in the tiresome and exhausting effort of entrepreneurship just to increase the magnitude of his already abnormally high profits. When the monopolist is sheltered by competition, his passivity and laxity means only that he makes lower profits than he otherwise could, but he still makes positive profits. It is only when there is competition that his positive profits can turn negative and he is forced to engage in entrepreneurship just to stay in the black. As Randall G. Holcombe has recently observed (2014: 390f.) concerning entrepreneurship in a competitive market,

> Because some entrepreneurs are looking for innovations that can increase their profits, all business people must be. . . . [A]ll business people have to [innovate], or they will continue to fall behind their entrepreneurial competitors until their normal profits turn into losses. The profit potential that gives some firms the incentive to be entrepreneurial and innovate requires that all firms do so, in order to remain competitive with their entrepreneurial rivals.

With the advent of competition, the monopolist can no longer rest content with laziness that earns him abnormally high profits. Instead, laziness earns him bankruptcy, and relentless innovation and creativity, no matter how exhausting, is the only way for him to even stay in business at all.

Furthermore, understanding competition as a dynamic process rather than a static outcome undermines efforts to perceive rent-seeking in non-political market practices such as advertising and product differentiation (Pasour 1987: 124-126, DiLorenzo 1988: 321; cf. Ricketts 1987: 520). According to the perfect competition model, advertising and product differentiation are evidence of monopoly. But if competition is a dynamic process and if knowledge is imperfect, then advertising and product differentiation constitute efforts to better serve consumer demands in an environment of subjectivity, uncertainty, and ignorance, where neither producers nor consumers are sure what consumers want.[11] Many market practices are “only evidence of social waste, however, if one compares real-world markets with the perfectly competitive ideal where information is costless” (DiLorenzo 1988: 323). And if profits are transitory and not permanent, then they constitute not an inefficient monopoly rent but a reward for entrepreneurship and innovation which benefits consumers.

Similar considerations militate against the theory of natural monopoly. Let us grant, for the sake of argument, that in some industries, there are increasing returns to scale such that a monopolist alone would obtain the most efficient economy of scale. But it does not follow that therefore, we should favor a monopoly, because economy of scale is not the only desirable form of efficiency. We should also seek X-efficiency or the promotion of Kirznerian entrepreneurship. A competitive utility might operate at an inferior economy of scale but more than make up for this by promoting innovation and creativity. According to Walter J. Primeaux, Jr. (1985: 128),

> X-efficiency means that if it does exist, competition could lead to lower costs than a monopoly in any business by improving incentives to operate efficiently. Moreover, to the extent that inefficiency exists in a monopoly electric utility firm, the inefficiency may be so large as to overcome or offset any economies of scale gained from monopoly.

Furthermore, the Misesian problem of economic calculation under socialism and the Hayekian challenge concerning “the use of knowledge in society,” means that it is impossible to scientifically rate-regulate a natural monopoly or public utility. As Nina W. Cornell and Douglas W. Webbink note (1985: 44 n. 16),

> The requirements on an economic regulatory agency that tries to do its job properly according to traditional public utility regulatory concepts are not very different from the requirements on a central planning agency in a socialist or communist country.

Historically, competition in supposedly naturally-monopolistic industries was not abnormal (DiLorenzo 1996), and Leibenstein's concept of X-efficiency – rejected by Tullock – deserves a reconsideration. It may be that the benefits of innovation and creativity motivated by competition in naturally-monopolistic utilities will outweigh the costs of achieving less than perfect economy-of-scale – especially when the ideal outcome is unknown, for competition is a discovery procedure (Hayek 1968).

VII. The Transitional Gains Trap

Now, it should be noted that in one place, Tullock suggests that the the welfare cost of rent-seeking is something else entirely from what he has been quoted so far as having primarily said. In his original article on rent-seeking, he notes (1967: 226 in 2004: 172, body & n. 8) briefly that,

> The owners of the resources now engaged in inefficiently producing the commodity receive no more than they would have received had the tariff never been introduced and they had been employed in other industries. There might be sizable but temporary rents to the first-comers when the industry was first established.

This adumbrates the argument he would later make about the transitional gains trap, how the rents from rent-seeking are eventually dissipated until the recipients are no better off than they were before, while their victims are definitely worse off (Tullock 1975). For example, when a taxicab medallion system is first instituted by granting all current taxicab drivers a medallion and forbidding all new entrance into the industry, the first recipients of the new medallions benefit from the restriction on competition. But when the original recipients are all dead and the current generation's taxicab drivers must purchase their medallions, the rents they obtain from higher fares are dissipated when those rents are capitalized into the cost of the medallion which they must purchase. Similarly, the rents from farm-price supports are capitalized into the value of farmland. In such a situation, it is indeed possible for the positive economist to pronounce that rent-seeking is “bad” because some people are hurt and *nobody* benefits. Since there is nobody who receives any benefit from the intervention, the positive economist can state that the intervention is undesirable and “bad” as a Pareto non-improvement (or Pareto loss). But notice that the dissipation of rents takes place only after the passage of some time. As long as the rents have not been dissipated yet, then there is still at least one person who benefits, and the positive economist cannot declare that “society” has been harmed, nor can he state that rent-seeking is “bad” on account of its welfare costs. At the moment the rents are being granted by the government, the economist cannot declare the grant to be “bad.” Even if the economist knows that in the future, the rents will be dissipated and render the rent-seeking “bad,” he cannot criticize this normatively because this involves a subjective imputation of value based on his own personal time-preference. If the economist declares that rent-seeking is “bad” in the present because the rents will be dissipated in the future, others may respond, “in the long run, we're all dead.” In any case, if the reason why rent-seeking is worthy of censure is that the transitional gains trap causes rents to be dissipated, then one should notice that this fact is given only two sentences in Tullock's original article (1967), and even less mention in many of his other articles on rent-seeking (excepting Tullock 1975). If rent-dissipation is *the* correct reason why rent-seeking should be criticized, then this still means that most of Tullock's writings on the subject fail to deliver. The rest of Tullock's statements on the subject still neglect to account suitably for methodological individualism and subjectivism, as has been shown – even if in one or two places, he did make the most correct argument. Even if an author considered holistically as a person is correct, if some of his specific statements are dubious, then this should not escape notice.

VIII. Conclusion

Hopefully, this paper is not perceived as being unfairly pedantic at Tullock's expense. In fact, the author himself is probably guilty as well of speaking of government interventions which “cost society” or which “make all of us poorer”. People often say that the automobile has made “all of us” better off, even though it actually harmed buggy manufacturers and horse-breeders. People often have a tendency to speak in lazy shorthand which is approximately true but which conceal scientific inaccuracies.[12] These sentiments are essentially accurate even though technically, they are not quite true, and a laborious reformulation is sometimes necessary to make them accord with technical economic fact. It is something like how every morning, the sun rises in the sky even though no, it really doesn't. For everyday purposes, it is true enough that taxes are involuntary and that the sun rises. For scientific purposes, some more precise restatement is necessary. Which formulation is preferable depends on the context and the audience.

It is in that spirit which I criticize Tullock. It is perfectly true that rent-seeking results in reallocations of resources and alterations in patterns of investment which are economically meaningful and significant. It is the economist's task to perceive "that which is seen and that which is not seen," and Tullock has most proficiently highlighted the fact that rent-seeking results in increased investment in lobbying in the same way that theft causes increased investment in locks, lock-picks, and police. The problem is only that Tullock is not quite right in diagnosing what makes rent-seeking normatively "wrong." Economics tells us where wealth comes from and where it goes, and for this, one is indebted to Tullock's incisive analysis of rent-seeking and how it affects patterns of investment. But economics cannot tell us anything about where wealth *ought* to come from or where it *ought* to go. For that, one must turn to moral philosophy.

The moral problem with rent-seeking is not that it alters allocations of resources *per se.* Pure transfers of wealth affect the allocation of resources as well, even when there is no investment in lobbying. And in any case, it is scientifically illegitimate to speak of what benefits or costs "society" – much less can one derive any moral or normative conclusions from that methodologically holistic analysis. Furthermore, the economist cannot legitimately pronounce normative criticism on the reallocation of resources, but he or she may only point out in a value-neutral way what those allocational effects are so that others may pass philosophical or ethical judgment. If there is any positive economic criticism to be made of rent-seeking it is that it benefits nobody in the end, due to the transitional gains trap or dissipation of rents. But even that argument involves an appeal to subjective time-preference, for one must argue that rent-seeking should be opposed in the present because of something it does in the future.

At the very least, one should specify whether one's baseline for comparison is the "ideal" or the "status quo" distribution of property rights (Ricketts 1987: 464). For example, if one defends the repeal of a protectionist tariff and criticizes the tariff's defenders as rent-seekers, then one is apparently choosing as a baseline the ideal situation where the protectionism does *not* exist, not the status quo situation where it *does* exist. If the baseline were the status quo, then repeal of the tariff would entail transitional losses to the protected industry. The repeal would therefore not be Pareto-efficient, and one could not defend the repeal on positive economic grounds, but only by making the normative claim that tariffs are undesirable or unjustified. Either way, however, the choice of any baseline is a normative, value-laden decision; the choice between the ideal and the status quo as a baseline cannot be based on value-free economics.

Rent-seeking should primarily be criticized because it allocates resources differently than consumers and producers themselves would have under a regime of legitimate freedom. All mutually-voluntary transactions are mutually beneficial and produce mutual welfare gains, and the problem with rent-seeking is that it violates consumer sovereignty (Rothbard [1956] 2011). Alternatively, rent-seeking is illegitimate because people as subjective individuals – not economists – do not consider lobbyists to be "productive" and morally deserving of their wealth. As Peter Lewin has remarked, "Sans a reliable utility calculus – the ability or willingness to make interpersonal utility comparisons – the notion of 'economic efficiency' cannot be sustained without an ethical component. What we should mean then when we say that rent seeking is inefficient is that we judge those activities to be 'undesirable' - not part of the kind of society in which we want to live."[13] At the heart of all this is an unspoken, intuitive conviction that it is morally wrong to use political power to enrich oneself at the expense of others. The wrongness of rent-seeking depends on one's political philosophy, making this a question of ethics, not economics (Pasour 1987: 137).

More generally, this suggests the need for a "reconstruction of utility and welfare economics" (Rothbard [1956] 2011). Economists should recognize that cost and value are subjective concepts and that the subjective utilities of consumers and producers cannot be compared (Pasour 1987: 131). Therefore, "utilitarian approaches do not present a way of determining which activities are wasteful" (Pasour 1987: 131). "[A]s in other cases of alleged inefficiency, rent-seeking waste can be identified only by substituting the observer's own standard of value" (Pasour 1987: 131).

Such a reconstruction of welfare analysis would affect not only assessments of rent-seeking but also monopoly and competition. The Neoclassical static-equilibrium model assumes perfect knowledge, and therefore, profits are judged to be permanent and indicative of monopoly in a state of equilibrium. But "[a] real world market will always appear inefficient when measured against the norm of perfect competition (Pasour

1987: 132), and the challenge is to find an appropriate benchmark for meaningful comparison. Improper comparison with an unrealistic ideal constitutes Demsetz's nirvana fallacy (Pasour 1987: 130).

In contrast to the Neoclassical model of perfect competition, if knowledge is imperfect and subjective, then profits indicate temporary returns to entrepreneurial innovations in a state of disequilibrium. These profits are the rewards for entrepreneurs who satisfy consumer demands at lower cost or with higher quality or with totally new products which never existed before. But these profits are temporary because they attract new competition (Kirzner 1973; Kirzner 1997; Littlechild 2009 [1978]; Boettke 2012: 213-225, 281-285, 291f.; Pasour 1987: 124-126; Holcombe 2014).

Moreover, because the supply, demand, and cost curves needed to evaluate monopoly are not objectively given in reality, economists cannot hold reality up against an abstract perfectly competitive ideal which does not exist for comparison. Therefore, all economists can say is that monopoly grants of privilege render supply relatively more inelastic, thus violating both the rights of producers to compete and the rights of consumers to seek competitive suppliers (Leoni 2009 [1965]). Furthermore, that government-enforced monopoly prevents mutually-beneficial transactions from occurring which would have otherwise occurred, and therefore, potential gains from trade are prevented (Pasour 1987: 126, Rothbard [1956] 2011). According to this understanding – that all mutually-beneficial transactions are wealth-maximizing and that all barriers to trade harm those who would have cooperated with each other (Rothbard [1956] 2011) – properly, “the focus of economic analysis is on the institutional framework that provides the greatest opportunity for individuals to pursue their own diverse ends through decentralized coordination of their activities” (Pasour 1985: 529 citing Coase 1974).[14]

Tullock may have been aware of our arguments and even agreed with them, deliberately eschewing their expression only to make his arguments more palatable. If so, then all this paper has done is to use this opportunity to elucidate what Tullock left unsaid. But whether Tullock would have agreed with these claims or not, this paper has extended his analysis of rent-seeking to account for the contributions by his inspiration – Mises's *Human Action* (1949) – and by his colleague – Buchanan's *Cost and Choice* (1969). It is hoped that Tullock would have appreciated this criticism which is meant, after all, only to subtly refine his pioneering contribution, not to fundamentally controvert it.

Acknowledgments

The author thanks Peter Lewin for commenting on several drafts of this paper, and David R. Henderson for helpful conversation. The author began thinking about this topic after some remarks made by Prof. Leo Krasnozhon in his course on Public Choice at Loyola University, New Orleans. All errors belong to the author alone.

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[1] In many respects, this article repeats the shared argument of Ricketts (1987), Pasour (1987), and DiLorenzo (1988). However, those papers do not seem to be cited in any general surveys of rent-seeking or public choice, and so the argument deserves to be repeated. This present article pursues this argument in a different fashion, with a different mode of presentation, and so it may find a different reception. In fact, the first draft of this article was written before the author read Ricketts (1987), Pasour (1987), and DiLorenzo (1988), so this article constitutes an independent discovery of their conclusions.

[2] Pasour (1987: 128-129) argues there is radical uncertainty concerning both the size of the rent and the probability of obtaining it, and therefore, we have no way of knowing whether the total investment in rent-seeking by all parties concerned will be less than, equal to, or greater than the rent itself, thus "raising questions as to the usefulness of probability theory in analyzing choice."

[3] Ricketts (1987: 458) notes "that a subjectivist approach to economics,as represented by much of Buchanan's work, makes it impossible to distinguish rent seeking, as conventionally defined, from entrepreneurship."

[4] As James Ostrowski has noted (2006: 11, 2010: 77), once you understand economics,

> you will no longer be mystified by the so-called waste of your tax dollars. They may be wasted from your point of view, but they are not wasted from the point of view of those who spend your tax dollars: the bureaucrats and politicians and their infinite list of clients. Just as you will spend your funds on your highest and most urgent needs and wants, they too are now spending your tax dollars on their own needs and wants. You may moan and groan about the Defense Department paying $1,000 for a toilet seat, but the manufacturer of that toilet seat was laughing all the way to the bank.

[5] But as was remarked earlier, this was probably not really a mistake by Tullock, but instead a conscious decision on his part to avoid contesting more of the Neoclassical analysis than was necessary for him to make his point.

[6] Cf. DiLorenzo (1988: 319) that one's judgment of rent-seeking "must be based on one's normative views of the 'appropriate' system of property rights." And again (DiLorenzo 1988: 320), "the use of the pejorative word 'wasteful' to describe rent-seeking behavior is not based on sound theoretical grounds. It is based on implicit value judgements [sic] embodied in neoclassical economics regarding the legitimate role of the state and the 'correct' structure of property rights." This is because it is impossible to specify what constitutes unjustifiable aggression and justified self-defense without first defining legitimate property rights. If A confiscates a watch from the hand of B, whether A has aggressed against B depends on whether the watch really belongs to A or to B.

[7] If a policy is bad, then rent-seeking in favor of that policy is automatically bad. But if a policy is desirable, then lobbying may or may not be inefficient depending on whether there is a less costly way to obtain this same policy. Whether or the policy could have been obtained at less cost – and therefore, whether lobbying for good policy is wasteful – depends on the baseline one adopts for assessing cost (Pasour 1985: 527). For example, "[r]esources used in this way [to lobby for even desirable policies] will appear to be wasted, however, if the real world is compared with an ideal polity where no information or transactions costs are required to initiate or maintain the appropriate functions of the state" (Pasour 1987: 132). Therefore, whether a given act of lobbying is wasteful depends not only on one's subjective view concerning whether the policy is desirable in itself (Pasour 1987: 131) but also on the baseline one adopts for assessing opportunity cost of achieving a given policy outcome by one method or another (Pasour 1985: 527, 1987: 132; cf. DiLorenzo 1988: 319). Furthermore, whether lobbying is productive or wasteful depends on the actual consequences the policy will have, not whether the lobbying interest was motivated by the prospect of personal gain (Pasour 1985: 527, 1987: 130).

[8] Again, the claim is not that Tullock was ignorant of these arguments, not even that he would necessarily disagree with them. We claim only that Tullock did not voice these arguments when he perhaps could have.

[9] For a recent, lucid summary of how competition spurs innovation, see Holcombe 2014.

[10] One anonymous referee objected that this statement "seems to treat the Kirznerian property of alertness as being a resource or particular form of search, the use of which is costly. … [But] alertness is meant to have exactly the opposite qualities, being that element of individual economic activity not amenable to capture purely through maximization within a given means-ends framework." Perhaps Kirznerian alertness deserves a fuller reevaluation elsewhere, for unless Kirznerian alertness is meant to capture only spontaneous "eureka" moments where an entrepreneur conceives of a new idea without any effort whatsoever, then alertness should entail some cost. As Pasour (1987: 126) notes, "a social policy which arbitrarily confiscates the returns due to entrepreneurial alertness will inevitably discourage such alertness in the future." But this implies that alertness is costly. For if the marginal cost of alertness were exactly zero, then confiscating anything less than 100% of all profits would still leave a positive net return on alertness. Only if alertness entails a cost can the net return to alertness become negative, when so much profit is confiscated that the cost of alertness exceeds the net profit that is retained after confiscation. If the cost of alertness is zero, then confiscating profits will leave a net return of zero if all profits are confiscated or a positive net return if less than 100% of profits are confiscated, but never a negative net return. Indeed, Pasour speaks (1987: 126) of "the cost inherent in the uncertainty and innovation associated with attempts to obtain such profits" through entrepreneurial activity.

[11] The best entrepreneur is one who invents a product which even the consumer did not know he or she wanted. If the first inventor of the automobile had polled consumers, they would have asked for a better horse. Likewise, before the invention of the first personal computer, the consumer would have said he or she wanted a better typewriter.

[12] I owe this point to David R. Henderson, who said to me in personal conversation, “You’re right to be critical of Tullock’s formulation. He is comparing dollar values of gains and losses and he jumps from that to an unfounded conclusion. I sometimes find myself saying that carelessly, as when I say that free trade is good for America.”

[13] Quoting Peter Lewin from personal conversation.

[14] Similarly, “political economy is concerned instead 'with a framework of institutions and rules within which people can effectively cooperate in pursuing their own diverse ends through decentralized coordination of their activities'” (DiLorenzo 1988: 328 quoting Yeager 1976: 560).