



Sustainable Development Policy Institute

Working Paper Series no: W-67

**Rent-seeking: A Comparative
Analysis**

Foqia Sadiq Khan

24 October 2001



**Rent-seeking:
A Comparative Analysis**

Foqia Sadiq Khan

Working Paper Series # 67
2001

All rights reserved. No part of this paper may be reproduced or transmitted in any form or by any means, electronic or mechanical, including photocopying, recording or information storage and retrieval system, without prior written permission of the publisher.

A publication of the Sustainable Development Policy Institute (SDPI).

The opinions expressed in the papers are solely those of the authors, and publishing them does not in any way constitute an endorsement of the opinion by the SDPI.

Sustainable Development Policy Institute is an independent, non-profit research institute on sustainable development.



WP- 067- 002- 060- 2001- 016

© 2001 by the Sustainable Development Policy Institute

Mailing Address: PO Box 2342, Islamabad, Pakistan.
Telephone ++ (92-51) 2278134, 2278136, 2277146, 2270674-76
Fax ++(92-51) 2278135, URL:www.sdpi.org

Table of Contents

Summary 1

I. Directly Unproductive Profit-making (DUP) Approach 1

II. Public Choice Approach 4

III. Political Economy Approach..... 6

IV. Structural Level versus Exchange Level of Rent-seeking 9

V. Conclusion 10

VI. References..... 10

The Sustainable Development Policy Institute is an independent, non-profit, non-government policy research institute, meant to provide expert advice to the government (at all levels), public interest and political organizations, and the mass media. It is administered by an independent Board of Governors.

Board of Governors:

Dr Amir Muhammad
Chairman of the Board

Ms. Shahnaz Wazir Ali
Education Specialist - MSU

Dr Abdul Aleem Chaudhry
Director, Punjab Wildlife Research Centre

Dr. Pervez Hoodbhoy
Professor, Quaid-e-Azam University

Mr. Irtiza Husain
Director, Pakistan Petroleum Ltd

Mr. Javed Jabbar
President, MNJ Communications Pvt. Limited

Mr. Malik Muhammad Saeed Khan
Member, Planning Commission

Mr. Shamsul Mulk
Former Chairman, WAPDA

Ms Khawar Mumtaz
Coordinator, Shirkat Gah

Mr. Mohammad Rafiq
Head of Programmes, IUCN-Pakistan

Dr Zeba A. Sathar
Deputy Resident Representative, Population Council

Dr Shahrukh Rafi Khan
Executive Director, SDPI

Under the Working Paper Series, the SDPI publishes research papers written either by the regular staff of the Institute or affiliated researchers. These papers present preliminary research findings either directly related to sustainable development or connected with governance, policy-making and other social science issues which affect sustainable and just development. These tentative findings are meant to stimulate discussion and critical comment.

Rent-seeking: A Comparative Analysis

Foqia Sadiq Khan

Summary

The paper thrashes out main theoretical trends in the literature on rent-seeking and corruption. In the early phase of capitalist development, concerns were raised about the rents charged by private sector monopolists. Keynesian economists focused on the role of government to regulate the economy and government's role was increased to control the seemingly unlimited influence of monopolies in 1930s. However, Krueger and Tullock were among the first few people in 1960s and 1970s to bring forward the inefficiency of government regulation because it leads to rent-seeking. The initial insights on rent-seeking based on neo-classical economics are called directly unproductive profit-making (DUP) approach. The first section of this paper focuses on DUP. It examines the loss of resources spent on rent-seeking activities which otherwise, could have been used in other productive sectors of economy. The second section of the paper addresses the public choice approach. The public choice approach analyses the monopoly of the public sector in the context of lobbying and suggests that there is a linkage between limiting the size/power of government and reducing wasteful rent-seeking activities. The third section of the paper introduces the political economy approach to rent-seeking based on Mushtaq Khan's writings. The political economy approach says the concept related to rent-seeking can be explained by looking at broader sociological and political realities. He uses "patron-client" framework to explain the state-social groups' relationship and their linkage to rent-seeking. In the last section, the paper points towards a distinction between a structural approach to conceptualise rent-seeking and an exchange-based approach.

The concept of rent has been used in various ways in economic literature. Pareto defines rent as "a payment to a factor in excess of what is necessary to keep to its present employment", while Ricardo views rent as "the difference between what a factor receives and the payment which would be necessary to entice it into employment".¹ Asad Sayeed has defined rent as "above 'normal' profits arising out of any form of monopolisation of pricing".² However, Ricardo's conceptualisation of rent in the 1930s was in the context of profits generated by private sector monopolies. His frame of reference was essentially the private sector. In the 1970s rent analysis shifted its focus towards public sector distortions. Here, rent is defined as a price that a public sector monopolist charges for private gain at a higher price than that prevalent in the market. Hence, the term "rent-seeking" was coined. Rent-seeking refers to the profit generation behaviour of public sector agents for personal gains by (mis)using the discretion of government's monopoly.

However, like all other concepts rent-seeking is not a homogenous concept either. The interpretation of the concept and its application varies. This paper evaluates different approaches to rent-seeking, i.e. a) directly unproductive profit-making, b) public choice, and c) political economy:

1. Directly Unproductive Profit-making (DUP) Approach

Anne Krueger was the first to explore the process of rent-seeking. She applied her rent-seeking model to the realm of international trade and analysed the impact of restrictive quotas on implicit welfare loss in India and Turkey. Government's control over import licensing creates a public monopoly. If

1 David W. Pearce (ed.), *Macmillan Dictionary of Modern Economics*, London: Macmillan Press Ltd., 1992, p. 120.

2 Asad Sayeed gave this definition in his comments as referee for this paper.

there is competition for licences under quota, then an agent of public sector can abuse discretion to earn rents for private gain by selectively distributing premium-fetching import licences to the private sector claimants. Rent seeking is unproductive because people withdraw resources from some productive sector of the economy and utilise them as bribes or pay-offs to get much needed import licences instead of using them as investment in some productive activity. Government revenue, estimated to be gained with the application of government control policies (such as import licensing) is outweighed by illegal rents paid by claimants to the public sector agents. “Empirical evidence suggests that the value of rents associated with import licenses can be relatively large, and it has been shown that the welfare cost of quantitative restrictions equals that of their tariff equivalents plus the value of the rents.”³

Government’s monopoly creates a dead-weight loss by taking away potential resources and social value from other sectors where these rents could have been used as investment had it not been for the public sector monopoly. Hence, governmental control leads to economic inefficiency instead of growth. This approach implies that economies with less government control are less susceptible to rent-seeking, and by implication, are much more likely to be economically efficient. Implicit welfare loss of the government’s control makes rent-seeking an unproductive and profit-making exercise. “One can conceive of a continuum between a system of no restrictions and a perfectly restricted system. With no restrictions, entrepreneurs would seek to achieve windfall gains by adopting new technology, anticipating market shifts correctly, and so on. With perfect restrictions, regulations would be all-pervasive that rent-seeking would be the only route to gain. In such a system, entrepreneurs would devote all their time and resources to capturing windfall rents.”⁴ Krueger’s concept of rent-seeking falls in the purview of the directly unproductive profit-making (DUP) approach.

She argues that in common perception the market mechanism is based on the price system that favours the rich and influential. It implies that government needs to intervene more to protect the public interest, “if the market mechanism is suspect, the inevitable temptation is to resort to greater and greater intervention, thereby increasing the amount of economic activity devoted to rent seeking. As such, a political ‘vicious circle’ may develop. People perceive that the market mechanism does not function in a way compatible with socially approved goals because of competitive rent seeking. A political consensus therefore emerges to intervene further in the market, rent seeking increases, and further intervention results.”⁵ Public sector is institutionalised to regulate the market, yet another watchdog is needed to monitor the public sector. For example, in Pakistan many anti-corruption departments have emerged; such as the Public Accounts Committee, Federal Ombudsman, Provincial Ombudsman, Prime Minister’s Inspection Team, Chief Minister’s Inspection Team, Directorate of Anti-Corruption, and *Ehtesab* (Accountability) Bureau.⁶ Most of them are primarily constituted to check corruption in the public sector, while the *raison d’être* of the public sector is to monitor the excesses of the private sector. Political scientists may call it another layer of checks and balances. Krueger would attribute it to distortion in the market function due to unnecessary intervention of the public sector.

Jagdish Bhagwati in his well-known paper on “Directly Unproductive Profit-seeking Activities” formally coined DUP to present a theory of the welfare consequences of corrupt activities in 1980s. Bhagwati’s attempt to study tariffs and trade relations is an effort to understand the theoretical basis of “lobbying for protection, competing for a share of industrial and import licences, inducing

3 Anne Krueger, “The Political Economy of the Rent-Seeking Society”, *American Economic Review* 64 (June 1974) pp. 291-303.

4 Ibid.

5 Ibid.

6 Saba G. Khattak *et al.* “Perspectives on Corruption in Pakistan: A Pilot Study”, *Monograph Series*, Sustainable Development Policy Institute, Islamabad, 1999, p. 12.

legislatures to enact monopolistic barriers to domestic entry, utilising resources to evade ‘price’ or ‘command’ governmental regulations, etc.” activities. For Bhagwati, rent-seeking is a way of earning profit by getting involved in directly unproductive activities that lead to “pecuniary returns but do not produce goods or services that enter a utility function directly or indirectly via increased production or availability to the economy of goods that enter a utility function.” He lists tariff-seeking lobbying, tariff evasion and premium-seeking for import licences as DUP activities because they are used for personal or pecuniary income while their productive output is zero in terms of their utility function and they lead to distortions in the economy.⁷

Shyam Kamath⁸ has studied Indian sugar and cement industries and introduced the concept of *suppressed markets*. Government controls operate as a market, however, the rent potentiality of government controls suppresses the mechanisms of free market. Suppression of free markets by government controls leads to distortions. He criticises the price-theoretic basis of tax, tariff and regulation evasion because it does not take into account the diversion in economic behaviour that results from command regulations. Therefore, he calls it *suppressed markets* by replacing market mechanisms, “any market where market forces are severely constrained or prevented from operating and where individual maximising behaviour manifests itself in the circumvention of the artificially imposed constraints can be classified as a suppressed market”. Rent-seeking is the expenditure of scarce resources to capture an artificially created transfer and such an activity generates social waste rather than social surplus as free markets do. Rent-seeking is a result of distorted political policies that replace market allocation by other *suppressed* allocation mechanism.⁹

DUP approach has emerged as a result of its analysis of the economics of international trade. It has made a significant contribution in terms of re-interpreting Ricardian concepts of monopoly rents in the context of public sector. It showed the fallacy of the concept of government being a watch-dog over private business. Government regulation creates possibilities of rent-seeking (corruption) even if the purpose is to prevent a monopoly in the private sector to earn surplus rent. They also show that the rationale for government intervention to overcome market failure does not work, because government failure is more pervasive and damaging than market failure.

DUP’s methodology is based on a neo-classical model of Krueger, Bhagwati and Kamath base their analyses on the *efficiency* of free market, anything that interferes with the free flow of goods and services (in this case government regulation) distorts and suppresses the inherent growth potential of free market. DUP approach also shows that the rationale for government intervention of overcoming the market failure has not worked, because government failure is more pervasive and damaging than market failure. Chang and Khan have posed a relevant question to address the concerns raised by DUP approach; i.e. if we buy these arguments then how can we explain the success of government intervention in South Korea that led to growth? Khan says, even in the case of South Asia, a more corrupt Pakistan has had a higher economic growth than less corrupt India.¹⁰

DUP approach needs to be analysed in the context of market-failure versus government failure debate. Krueger and Bhagwati agree that market failure occurs and it necessitates the need for government intervention. However, they argue that government failure is more damaging due to rent-seeking.¹¹

7 Jagdish Bhagwati, “Directly Unproductive, Profit-seeking (DUP) Activities”, *Journal of Political Economy* 90 (October 1982), pp. 988-1002.

8 Shyam Kamath, *The Political Economy of Suppressed Markets* (Delhi: Oxford University Press, 1992), pp. 1-2.

9 Ibid.

10 Ha-Joon Chang, *The Political Economy of Industrial Policy* (Basingstoke: Macmillan, 1996). Mushtaq Khan, “Patron-Client Networks and the Economic Effects of Corruption in Asia”, Proceeding of the workshop on ‘Corruption and Development’ organised by the Institute for Development Studies, University of Sussex, 1998, pp. 15-39.

11 Based on Asad Sayeed’s comments as a reviewer of this paper.

Therefore, they view government intervention as detrimental to overall growth and development. DUP successfully challenges the efficacy of government regulations but its insight does not go beyond that. It does not address the broad political and sociological aspects of market failure and government intervention.

II. Public Choice Approach

Weberian theory of bureaucracy has been reinterpreted on the assumption of public choice. Due to the lack of definitive notions of public interest, bureaucrats are vested with discretionary powers and they utilise those powers for self-seeking ends of profit-making. In the public sector, increase in an organisation's revenue does not motivate its employees to increase their output. Public sector officials display a maximisation behaviour rather than bridging the gap between the organisation's revenues and costs.¹² It provides a supply side perspective to the rent-seeking theory and explains why public sector employees might be motivated to indulge in rent-seeking.

Gordon Tullock is the leading proponent of public choice approach on rent-seeking. Although Krueger later coined the phrase in 1974, Tullock had started writing on the *welfare costs of tariffs* in 1967. Transfer and exchange of goods and services involves a social cost.¹³ When government takes the responsibility away from the free market to direct the transfer of goods and services, it inflicts an opportunity cost on society. Various interest groups engage themselves in lobbying and counter-lobbying activities to extract profits by misusing the public sector regulatory authority. A need was felt to analyse the politics of group interests and its relationship with government regulation. It developed into the public choice approach.¹⁴

Buchanan, Tollison and Tullock formally employed the precepts of public choice to describe rent-seeking in 1980s. They focused on social waste generated by lobbying activities of political groups to accrue benefits by influencing the functions of public regulation. One major limitation of this approach is that it mainly analyses the group politics in the United States and its relevance to the study of other democracies/societies is a shot in the dark.

Rent-seeking in the public choice approach is employed to "describe behaviour in institutional settings where individual efforts to maximise value generate social waste rather than social surplus."¹⁵ Both the public choice and DUP regard loss of welfare as a basic criterion to evaluate rent-seeking. Yet public choice is somewhat different. It focuses on the "economic behaviour in the political, bureaucratic and regulatory marketplace".¹⁶ Public choice operates in an organisational-institutional setting, while DUP focuses on distortions created by public sector monopolies in the free market. Institutional economists regard market as an institution. Therefore, DUP is also an institutional approach. However, in public choice approach, market does not

12 Charles Rowley and Robert Elgin, "Government and its Bureaucracy: A Bilateral Bargaining Versus a Principal-Agent Approach", *The Political Economy of Rent-Seeking*, *ibid*, pp. 267-69.

13 Coase introduced the notion of transaction costs in his seminal articles much earlier (Ronald H. Coase, "The Nature of the Firm", *Economica*, 4, 1937, pp. 386-405 and Coase, "The Problem of Social Cost", *Journal of Law and Economics*, 3, 1960, pp. 1-44). He explored the linkage between specificity of property rights and economic efficiency through transaction costs. These costs are borne by transacting parties due to lack of delineation of property rights. If property rights are well-defined, then transaction cost will be negligible and individuals will get incentives to be efficient.

14 Charles Rowley, "Rent-Seeking Versus Directly Unproductive Profit-Seeking Activities", in C.K. Rowley, R.D. Tollison, G. Tullock (eds.), *The Political Economy of Rent-Seeking* (Boston: Kluwer Academic Publishers, 1988), p. 18.

15 James Buchanan, "Reform in the Rent-Seeking Society," in J.M. Buchanan, R.D. Tollison and G. Tullock (eds.), *Toward a Theory of the Rent-Seeking Society* (Texas: Texas A & M University Press, 1980), p. 4.

16 Charles Rowley and Gordon Tullock, "Introduction", *The Political Economy of Rent-Seeking*, p.4.

appear to be an instrumental mechanism. The focus is slightly shifted from distortions in the free market mechanism to the politics of public regulation.

Public choice approach views rent-seeking as a political bargaining process, whereby various interest groups try to seek/protect their rents in the realm of public sector regulation. The analysis has shifted from self-motivated public sector individuals to concession-seekers as organised lobby groups. It is interesting to note how business corporations lobby to promote their interests in the US. One study on interest groups quotes corporations to be having a 45.7 % share in interest group community who retain a lobbyist in Washington, D.C while the share of trade union, professional associations and citizen groups is 17.9 %, 6.9 % and 4.1 % respectively. This study also attributes the increase in lobbying groups in Washington to the large size of the government. While citizens groups have tried to organise marginalised groups to campaign for their rights, the corporations strong lobby groups sprung up to get information about government's policies and to protect their corporate interests in the wake of public regulatory institutions. The study further says that the increase in corporations' lobbying group "was also fuelled by the competitive nature of business lobbying. The reason for this political competition is that legislation and regulatory decisions never seem to apply uniformly to all businesses; rather they effect one type of business or industry more than others do. Financial services are one area where growing competition and limited steps toward deregulation have transformed the lobbying scene. Insurance companies, brokerage houses, investment banks, and retail banks have all made efforts to encroach on one another's turf. So many new players have entered the picture that policymaking has become even more complex".¹⁷

Public choice approach conceptualises it as a process whereby "detailed institutional knowledge is necessary concerning all actors in the regulation market, their goals and reward cost-structures, and the information environment within which they operate."¹⁸ The underlying hypotheses of the public choice approach seem to be grappling with the problems of interest group lobbying and limitations of the political institutions. The public choice approach considers rent-seeking as taking place primarily through a political process and recommends limiting the size of the government as the best way to reduce rent-seeking.¹⁹

The public choice approach has made an important contribution in the literature on rent-seeking by presenting an institutional analysis of governmental regulation and its linkage with social welfare loss. It argues for reduction in the size of government as well as its regulatory role. However, it does not discuss how transfer of resources is linked to the distribution of rights. For example, if corporations have many more resources to lobby effectively, does that mean that the large segment of population who cannot organise themselves as effective pressure groups should lose out in competition for public resources? Would reduction in the size and regulatory role of government solve the problem? The public choice approach ascertains the political nature of rent-seeking, yet it does not evaluate the impact of initial allocation of property rights on various segments of the society in the case of minimum government and least possible government intervention.

Douglass North as a new institutional economist, has used the Coasian concept of transaction costs to come up with a theory of property rights. North explains inefficient allocation of property rights (proportional to high transaction costs) with regards to institutional change. His criticism of public choice approach of rent-seeking is that approaches such as public choice essentially "take a rent-seeking view of government; that is, they view the government as nothing but an

17 Kenneth Janda *et al.* *The Challenge of Democracy: Government in America* (Boston: Houghton Mifflin Company, 1992), pp. 366-368.

18 Rowley, "Rent-Seeking Versus Directly Unproductive Profit-Seeking Activities", *ibid.*, pp. 15-21.

19 *Ibid.*

extortionist body. The dilemma comes out of a traditional public choice school that continues to view the government as nothing but a mechanism for redistributing income and that implicitly uses a zero transactions cost model to measure the amount of rent-seeking. Certainly this approach is in direct conflict with the property rights literature, which recognises that government specification and enforcement of property rights is the basic underpinning of efficient property rights and consequently of economic growth.”²⁰

Public choice approach analyses institutional basis of rent-seeking in terms of formal political organisations while the focus of the new institutional economics is on property rights. New institutional economics²¹ seems to view rent-seeking as an appropriation of certain attributes of property rights. Public choice approach fails to explain the impact of the initial allocation of resources on the emergence of interest group lobbying and competition for exchange, transfer and transactions.

The public choice literature is based on the “predatory” theory of the state. This means that they apply individual/firm level utility (profit) maximising assumptions of neo-classical theory to public sector organisations. They consider the state and its organisations as nothing more than revenue maximising agents. While they have managed to identify the supply side process of rent-seeking, their conception of the state is problematic.²²

III. Political Economy Approach

DUP and public choice approaches to rent-seeking analyse the linkages between government policies and economy, they do not take into account the process of state formation and emergence of class structures. A theory of state is implicit in these approaches: the individual utility maximising concept is lumped onto the state. However, such a conception of state does not go beyond the welfare loss calculus or interest groups politics. Hence, the theory of state is rather ahistorical and timeless; it lacks an analysis of social groups.²³ State is assumed to be an abstract unit.

DUP approach does not explain why government regulations retard efficiency in some countries and not in others. Whether the causality lies in government regulation vis-à-vis free trade equation or it is rooted in a rather complex composition of state and its relationship with social groups and the allocation of property rights. Public choice approach is embedded in the context of Western (American) democracies and seems to be limited to formal political organisations. How can it be applied to study the diverse political structures in the developing world? We need to bridge the gap between economics and politics by employing a political economy approach to rent-seeking. For this paper we are primarily using Mushtaq Khan’s analysis of rent-seeking in the context of post-colonial states.

State is not a unitary entity composed of homogenous interest groups. State represents a multiplicity of interests and groups, therefore, policies of any government of a state cannot be devoid from the nature of that state itself. “*The state* is not a thing... it does not, as such, exist. What *the state* stands for is a number of particular institutions which, together, constitute its

20 Quoted in Rowley, *ibid*, p. 21.

21 New Institutional Economics (NIE) is introduced here only as a critique of the public choice approach. A detailed NIE analysis of rent-seeking is not done in this paper.

22 Based on Asad Sayeed’s comments as a reviewer of this paper.

23 Helen Shapiro, “Rent-Seeking or Rent-Redistribution? Automobile Firms and the Brazilian State 1956-68”, F. D. McCarth (ed.) *Problems of Developing Countries in the 1990s*. World Bank Discussion Papers. The World Bank, Washington, D.C.

reality, and which interact as parts of what may be called the state system.” Property rights are specified in the capitalist countries and usually state bureaucracy and politicians define the interests of state in terms of economic growth.²⁴ We need to analyse how the interests of bureaucracy and political leadership are linked with the interests of *the state*. Samuels and Mercurio challenge the perceived *neutrality* of the state in the neo-classical model and bring social groups analysis into focus, “the state is a principal vehicle for achieving values and interests. The state is thus an object of control, and an arena in which conflicts of values and interests are worked out. The question is: Who uses government to set the initial assignment of rights to commodities and resources. Who uses government to define effective commodities and resources? Who subsequently uses government to change rights through law? And, who uses government to alter commodity and resource prices to garner net revenues, i.e. income?”²⁵

Though even in developed societies, state primarily acts in the interests of dominant classes, yet it is quite different from developing societies. The post-colonial state in developing countries does not enjoy the credibility of being a protector of public interest and is believed to be promoting certain privileged classes in the process of class formation. To understand the composition of dominant classes, it is important to understand the historical genesis of the state. Hamza Alavi evaluates the “relative autonomy” (neutrality) of the post-colonial state in the Subcontinent in relationship with the “the indigenous bourgeoisie, the metropolitan bourgeoisie, and the landed classes” and therefore, state’s *autonomy* is determined by a class matrix.²⁶ The same dominant social classes represent the state in civil and military bureaucracy who are controlling the agricultural and industrial set up of a post-colonial state. If government’s policies favour certain dominant groups at the cost of others, it may well be a result of the inter-locking of class interests.

In a relatively non-class analysis, Olson reaches a similar conclusion; individuals are not likely to organise themselves in large collective groups because of free-rider problems. There is a stronger incentive to organise in small groups (we can re-interpret it as social classes) and these coalitions of self-interested individuals accrue most of the benefits to their own members rather than distributing them across the board.²⁷

However, both Alavi and Olson do not capture the dynamics of class/groups formations in post-colonial states. The dominant classes are not static entities; new social groups emerge with time. Class structure and social groups need to be conceptualised in a more dynamic way. Emerging classes struggle to attune some attributes of property rights in their favour while entrenched dominant classes struggle to preserve their hold. A dynamic model of state-social class explains the perpetuation of rent-seeking in developing countries.

Khan, in his analysis of corruption,²⁸ has reviewed the economic effects of patron-client networks. Rent-seeking analysis cannot be isolated from the stage of a country’s capitalistic development. There is a contestation of various classes/interest groups in the transitory phase. Economists have mostly analysed the economic determinants of rent-seeking (price-theory and social welfare loss) while economic variables alone cannot explain or differentiate among various forms of rent-seeking unless accompanied by political processes, “this approach raises fundamental dilemmas for policy

24 Mushtaq Khan, “Clientelism, Corruption and Capitalist Development,” Unpublished Ph.D. thesis, University of Cambridge, 1989, p. 164.

25 Warren Samuels and W. J. Mercurio, “A Critique of Rent-Seeking Theory”. In D.C. Colander (ed.) *Neoclassical Political Economy*. (Cambridge: Ballinger, 1984), p. 58.

26 Ibid, pp. 164-172.

27 Mancur Olson, *The Rise and Decline of Nations* (New Haven: Yale University Press, 1982).

28 Rent-seeking deals with corruption in the public sector only. For the sake of continuity, this paper uses the terms “corruption” and “rent-seeking” interchangeably.

approaches to corruption. The public face of corruption is clearly unacceptable and in the long run it may destroy the limited legitimacy of some developing country states. On the other hand, the visible face of corruption is often an integral part of processes of accumulation and social compromise which are no less ugly in themselves.”²⁹

Different arrangements of patron-client networks explain the *differential* impact of rent-seeking across countries. Non-specificity of property rights in developing countries translates into differences of bargaining power of patrons and clients. A comparative economic analysis of the Indian Subcontinent and Southeast Asia has looked into the nature of policies that lead to rent-seeking activities³⁰ Khan reverses the order of analysis; a sociological analysis of class structure explains the differential impact of policies that lead to rent-seeking. Political power of the “intermediate ‘non-capitalist classes’” has resulted in a locked allocation of rights in the Indian Subcontinent. A weak patron (state) -- strong client (intermediate classes) relationship has developed and led to the stagnation of economic growth. In South Korea intermediate classes had no discernible impact due to the historical weakness of intermediate classes in that region; therefore it led to a strong patron (state) -- weak client (intermediate classes) relationship.³¹

Khan’s analysis of rent-seeking is a comment on the political socio-economy of post-colonial states. The economics-driven concepts do not capture the complexity of social reality. Rent-seeking is not only a loss in social welfare by the manipulation, corruption or exploitation of government’s power to regulate, it is also a movement of various social classes and groups along the state’s path towards capitalist development and redistribution of initial allocation of property rights. Therefore, it is not enough to ask whether rent-seeking leads to an increase or decrease in economic efficiency without considering the underlying politico-social realities of the transitory phases of developing countries and their impact on reallocation of property rights.

IV. Structural Level versus Exchange Level of Rent-seeking³²

This article makes an attempt to conceptually bring forward the two broad perspectives in the existing literature vis-à-vis rent-seeking;

1. rent-seeking as a structural concept;
2. and rent-seeking as an exchange-based concept.

The political economy approach of rent-seeking looks at the structural attenuation of property rights on the basis of inter-subjective relationship of the state with social classes mediated by institutions. Thus, it explains the structural basis of rent-seeking. Patron-client networks based on non-capitalist intermediate classes in the Indian Subcontinent are involved in rent-seeking at a structural level (re-appropriation of property rights) on the basis of their political power. It is the rent-seeking at structural level that determines the scope of exchange measures. Hence, if we broadly conceptualise

29 Mushtaq Khan, “Patron-Client Networks and the Economic Effects of Corruption in Asia”, *ibid.*

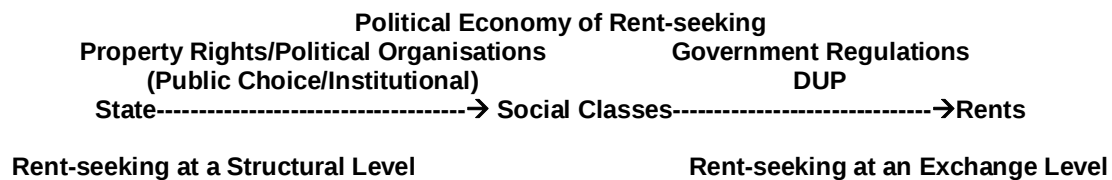
30 Import-substitution policy adopted by India led to inefficient premium-seeking while export-oriented policies adopted by South Korea have achieved economic growth despite rent-seeking.

31 *Ibid.*

See also, M. Khan, “State Failure in Weak States: A Critique of New Institutional Explanations”, J. Harriss, J. Hunter and C.M. Lewis (eds.) *The New Institutional Economics and Third World Development* (London: Routledge, 1993), pp. 71-86.

32 This distinction is based on the author’s formalisation of ideas on rent-seeking. Particular thanks are due to Tommy Murphy (M.Phil. candidate in Development Studies, University of Cambridge, 1998-99) for clearing the tension between the two levels of rent-seeking during a class discussion. Moreover, this paper does not use the structural level and the allocative level of rent-seeking as mutually exclusive binary distinctions. The distinction has been made to capture the complexities related to the concept. The model is based on the assumption that these levels interact in an inter-subjective dynamic way.

rent-seeking at a political level, it seems “all politics is rent-seeking.”³³ Even the Western formal democracies do not have truly representative democracies, politics at the state and government level reflects the interests of dominant social classes and groups. That is why public choice approach focuses on lobbying and policies resulting from such interest group politics. Though, it seems to have missed the point; allocation of resources is a political process, it will achieve a social equilibrium by balancing out individual/group actors in a political setting across economic classes. Public choice approach aptly captures the political process involved in rent-seeking, however it still limits it to that “social welfare loss” grid. It does not point out the social welfare loss results in the re-arrangement of social and political equilibrium among classes and social groups. This paper explains why government intervention produces *differential* impact on economy in various countries. Krueger’s estimation of “efficiency loss” resulting from premium-seeking behaviour of importers only captures the exchange side of the picture. This paper makes an effort to point out: allocative distortions are a result of government intervention and often lead to rent-seeking and loss of social welfare, however, the very “loss of social welfare” denotes a political and social structural rearrangement of the state and social classes. Therefore, a “social welfare loss” may result in a different sort of socio-political equilibrium.



V. Conclusion

The aim of this article is to thrash out main theoretical trends in the literature on rent-seeking and corruption. The early phase of capitalist development led to an era of monopolies and economists started questioning the “loss of welfare” due to rents charged by monopolists in the private sector. Keynesian economics focused on the role of government to regulate the economy. A need was felt to “control” the seemingly unlimited influence of monopolies. Western democratic governments took the responsibility to protect their citizens against the unfair rents of monopolies by getting involved in regulation in 1930s. However, Krueger and Tullock were among the first few people to bust the efficacy of government regulation in 1960s and 1970s. Their empirical research particularly focused on developing countries. The politics of government intervention created its own process of generating rents, hence the term “rent-seeking” was coined to refer to corruption in the public sector.

The initial insights on rent-seeking were limited to what now is called directly unproductive profit-making approach. Krueger and Bhagwati conceptualised rent-seeking in the context of international trade on the basis of neo-classical economics’ price-theoretic approach. It examines the loss of resources spent on rent-seeking activities which otherwise could have been used in productive sectors of economy. The public choice school also focuses on monopolies and rents in the public sector. Public choice approach accepts the political underpinnings of the rent-seeking processes, however it suggests that there is a strong correlation between limiting the size/power of government and reducing wasteful rent-seeking activities. Both DUP and public choice approaches fail to take into account the property rights distribution and its linkage to political economy of rent-seeking. Mushtaq Khan employs a political economy perspective approach to explain the phenomenon of rent-seeking. According to him, economic realities cannot be explained by economic explanations alone. Rent-seeking is an economic concept, though it can be comprehensively explained by looking at political and sociological realities. He uses the “patron-client” framework to explain the state-social groups

33 A phrase coined by Dr. David Lehmann, Director Development Studies Committee, University of Cambridge, 1999 over this paper.

relationship and their linkage to rent-seeking and explains “loss in social welfare” has led to economic stagnation in the Indian Subcontinent due to the inter-locking of interests of strong non-capitalist intermediate classes, while it did not lead to a similar inefficiency in South Korea because of historical composition and political power of intermediate classes. In the last section, the paper points towards a distinction between a structural approach to conceptualise rent-seeking and an exchange-based approach. It also makes a case to analyse rent-seeking in the context of broader socio-political realities informed by social groups and class theories in the context of reassignment of property rights.

VI. References

- Alatas, S. H. (1990). *Corruption: Its Nature, Causes and Functions*. Avebury.
- Bardhan, P. (1997). “The Role of Governance in Economic Development: A Political Economy Approach”. OECD Development Centre, Paris.
- Buchanan, J (1980). “Reform in the Rent-Seeking Society”. in J.M. Buchanan, R.D. Tollison and G. Tullock (eds.). *Toward a Theory of the Rent-Seeking Society*. Texas A & M University Press.
- Bugwati, J. (1982) “Directly Unproductive, Profit-seeking (DUP) Activities”. *Journal of Political Economy* 90.
- Chang, H-J. (1996). *The Political Economy of Industrial Policy*. Macmillan.
- Coase, R (1937). “The Nature of the Firm”. *Economica* 4.
- _____. (1960). “The Problem of Social Cost”. *Journal of Law and Economics* 3.
- _____. (1992). “The New Institutional Structure of Production”. *The American Economic Review*, 82.
- Gambetta, D. (1993). *The Sicilian Mafia*. Harvard University Press.
- Galtung, F. (1998). “Criteria for Sustainable Corruption Control”. Paper presented at the ‘Workshop on Corruption and Development’ organised by the Institute for Development Studies, University of Sussex.
- North, D. (1990). *Institutions, Institutional Change and Economic Performance*. Cambridge University Press.
- Nye, J. (1967). “Corruption and Political Development: A Cost-Benefit Analysis”. *American Political Science Review* 61.
- Olson, M. (1982). *The Rise and Decline of Nations*. Yale University Press.
- Janda, K. et al. (1992) *The Challenge of Democracy: Government in America*. Houghton Mifflin Company.
- Kamath, S. (1992). *The Political Economy of Suppressed Markets*. Oxford University Press.
- Khan, M. (1989). “Clientelism, Corruption and Capitalist Development”. Unpublished Ph.D. thesis, University of Cambridge.
- Khan, M. (1993). “State Failure in Weak States: A Critique of New Institutional Explanations”. J. Harriss, J. Hunter and C.M. Lewis (eds.) *The New Institutional Economics and Third World Development*. Routledge.
- Khan, M. (1998). “Patron-Client Networks and the Economic Effects of Corruption in Asia”. Proceeding of the workshop on ‘Corruption and Development’ organised by the Institute for Development Studies, University of Sussex.
- Khattak, S.G. et al. (1999). “Perspectives on Corruption in Pakistan: A Pilot Project”. *Monograph Series*. Sustainable Development Policy Institute, Islamabad.
- Klitgaard, R. (1988). *Controlling Corruption*. University of California Press.
- Krueger, A. (1974) “The Political Economy of the Rent-Seeking Society”. *American Economic Review* 64.
- Pearce, D. (ed). (1992). *Macmillan Dictionary of Modern Economics*. Macmillan University Press.
- Rowley, C. (1988). “Rent-Seeking Versus Directly Unproductive Profit-Seeking Activities”. in C.K. Rowley, R.D. Tollison, G. Tullock (eds.). *The Political Economy of Rent-Seeking*. Kluwer Academic Publishers.

- Rowley, C and Robert Elgin (1988). "Government and its Bureaucracy: A Bilateral Bargaining Versus a Principal-Agent Approach". *The Political Economy of Rent-Seeking*. _____
- Samuels, J. (1992). *Essays on the Economic Role of Government*. The Macmillan Press Ltd.
- Samuels, J., and Mercuro, N. (1984). "A Critique of Rent-Seeking Theory". In D.C. Colander (ed.) *Neoclassical Political Economy*. Ballinger.
- Shapiro, H. "Rent-Seeking or Rent-Redistribution? Automobile Firms and the Brazilian State 1956-68". F. D. McCarthy (ed.) *Problems of Developing Countries in the 1990s*. World Bank Discussion Papers. The World Bank, Washington, D.C.
- Shleifer, A and P. Vishny (1993). "Corruption," *Quarterly Journal of Economics* 108.
- Tullock, G. (1989). *The Economics of Special Privilege and Rent-Seeking*. Kluwer Academic Publishers.

SDPI is an independent non-profit research Institute
on Sustainable development

Mailing Address: PO Box 2342, Islamabad Pakistan

Street Address: 3rd Floor, Taimoor Chamber, 10-D West,
Fazal-ul-Haq Road, Blue Area, Islamabad.

Telephone: +(92-51) 2277146
2278134 2278136 2270674-6

Fax: +(92-51) 2278135

URL: www.sdpi.org e-mail: main@sdpi.org