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Measuring the Social Costs of Rent-Seeking in Agriculture-Based Rural Development Projects in Developing Countries

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ABSTRACT

Identification and measurement of the social costs of rent-seeking (and associated rent-defending and rent-avoiding) in projects in developing countries have been neglected. This is in spite of a voluminous literature on the methodology and practice of project evaluation, and intense scrutiny of project activities by agencies responsible for their funding. The potential for social costs from rent-seeking in such projects is explored in this paper, with some illustrative examples from agriculture-based rural development projects. Other social costs indirectly resulting from rent-seeking activities are also described.

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1. Introduction

The aim in this paper is to outline the potential costs of rent-seeking¹ in agriculture-based rural development projects (ARDPs) in developing countries which stem from government intervention in the economy to improve resource access and use by specific target groups. Targeted beneficiaries of an ARDP are those who would be the legitimate recipients of the benefits bestowed as the product of a normative rural development planning process. They are but one group of people who might have an interest in a project. Other stakeholders include aid and donor agencies, project employees, consultants and various public institutions, who seek a variety of rewards from project operations. All are capable of rent-seeking to boost these rewards.

In perfectly operating rural planning processes, ARDPs will be implemented to the level where their marginal economic and social returns equal the respective economic and social costs of operation (subject to any budgetary constraint), and individual beneficiaries would be prepared to provide their own inputs in ARDP activities to the extent where their marginal costs equal the marginal revenue obtained from the ARDP. To the extent that potential beneficiaries of ARDPs seek to capture returns in excess of the existing value of their own inputs, they would be rent-seeking by earning intra-marginal returns. The social costs they incur in rent-seeking should, in principle, be subtracted from project benefits when measuring the net present value of projects which entail rent-seeking.

Rent-seeking from ARDPs can be categorised according to rent recipients at three levels: the national level (primary rent-seeking); within public bureaucracies (secondary rent-seeking); and by individuals, groups and private organisations within a country (tertiary rent-seeking). In this paper, the primary focus is on tertiary rent-seeking. Fleming identified two phases in tertiary rent-seeking, in terms of attempts to influence (a) the initial selections of ARDPs and their targeted beneficiaries, and (b) the distribution of rewards of an ARDP between groups of targeted beneficiaries once the project has been selected.

The costs of rent-seeking, rent-defending and rent-avoiding² in the planning and implementation of ARDPs vary according to the nature of the rent-seeking. These social costs need to be weighed against the projected net benefits of a project using normal cost-benefit analysis. The most obvious is the waste of resources in the form of both dead-weight losses and Tullock costs.³ But other social costs are also possible. Among them are the misallocation of entrepreneurship, distortions in the accumulation of human capital, greater orientation to short-term gains in the economy, higher transaction costs, lowered investment incentives, over-sized projects, less trust in economic transactions and equity losses.

2. Social Waste from Rent-Seeking, Rent-Defending and Rent-Avoiding

Waste from rent-seeking encompasses dead-weight losses from resource misallocation as well as a whole range of rent-seeking, rent-defending and rent-avoiding activities that dissipate rents. The following discussion focuses particularly on waste from tertiary rent-seeking, rent-defending and rent-avoiding among those who benefit from an ARDP at the micro level, although it could equally well be directed towards primary, secondary and tertiary activities at the meso and macro levels. Emphasis is placed here on the targeted beneficiaries of the project at the micro level because providing benefits to these people is the main rationale of an ARDP.

2.1 Rent-seeking

2.1.1 Estimating the social costs of rent-seeking

Assume a simple two-industry rural economy, with an ARDP introduced in industry A which has the effect of increasing the productivity of many smallholders already in that industry, many of whom can be expected to have resources, especially labour, that are less than fully employed. Figure 1 illustrates the potential for resource waste caused by rent-seeking. The project is expected to shift the industry A supply function to the right, from SA to SA", expanding output from OQ_1 to OQ_3 and increasing economic surplus by JGHM.⁴

Assume for the moment that this increase in economic surplus is achieved, but not all by the targeted beneficiaries. Rent-seekers from industry B are attracted by the subsidies in the project to transfer resources to industry A. As a consequence, targeted beneficiaries only shift supply from SA to SA', increase output from OQ_1 to OQ_2 , and contribute only the cross-hatched area, KGHL, to additional economic surplus. The part of the increased surplus that is contributed by rent-seekers is the horizontal hatched area, JKLM, as they enable the supply function to shift from SA' to SA". There would also be an increase in output from OQ_2 to OQ_3 following their entry to industry A (represented by the shift in supply from SA" to SA"), brought about by the need for rent-seekers to transfer resources into industry A in order to participate in rent-seeking activities. Assume, again for the moment, that the decline in surplus in industry B as a result of this transfer of resources is equivalent to the gain in surplus in industry A (the diagonal cross-hatched area, RJMN).⁵ Rent-seekers are assumed, for convenience,⁶ to displace from the project a number of targeted beneficiaries whose contribution to economic surplus prior to receiving assistance would also have been JKLM, the project assistance captured by the rent-seekers.

[Figure 1 Impact of ARDP rent-seeking on economic surplus in a two-industry rural sector: equal contributions to economic surplus in both industries by rent-seekers.]

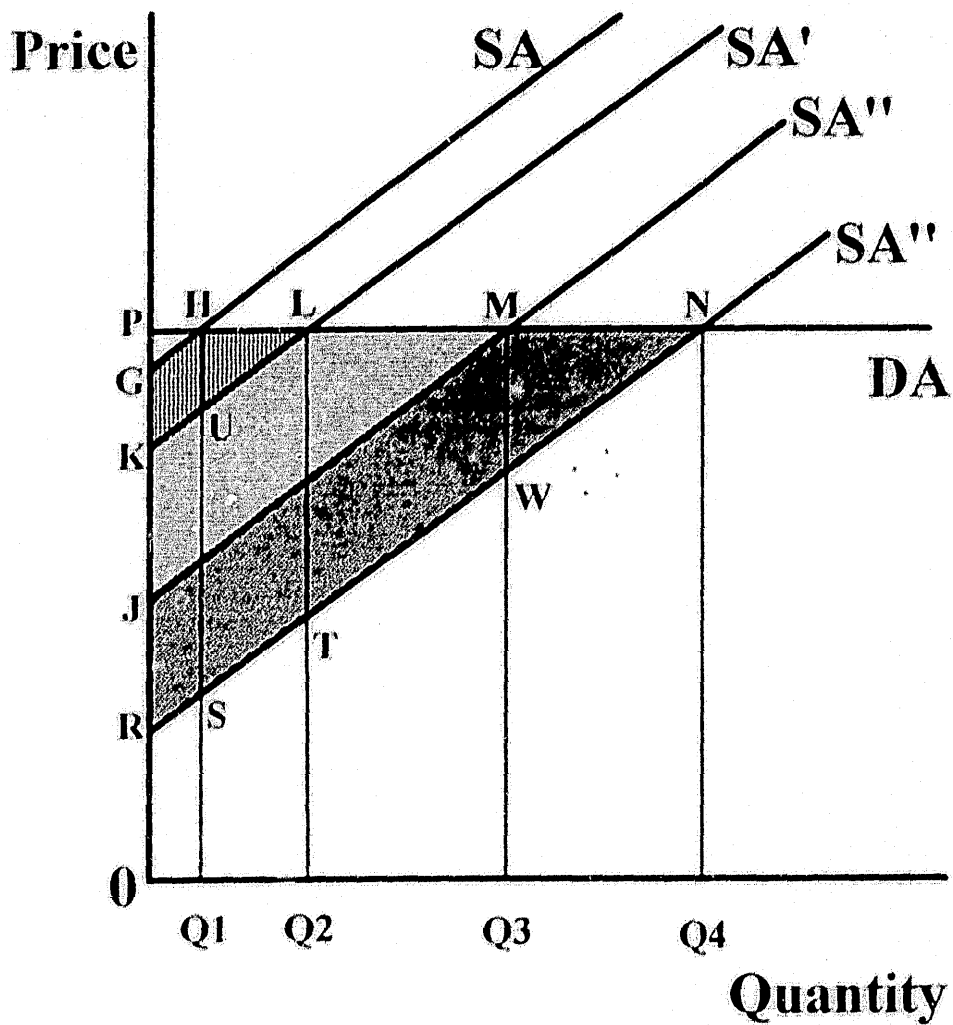


Figure 1 Impact of ARDP rent-seeking on economic surplus in a two-industry rural sector: equal contributions to economic surplus in both industries by rent-seekers.

The net effect on economic surplus can be calculated by subtracting the lost surplus in industry B from the three hatched areas of gained surplus in industry A. This area (JGHM, = KGHL+JKLM) represents the sum of project surplus accruing to project participants and other beneficiaries. It is the maximum potential amount available, or scope, for rent-seeking by producers other than targeted beneficiaries.

All surplus accruing to rent-seekers in excess of surplus loss from the transfer of resources would be rent in that their resources were fully employed prior to use in an ARDP. The surplus accruing to targeted beneficiaries is also rent. Part of the rent would be the additional surplus earned from the ARDP which corrects for existing under-utilisation of resources - or other forms of socially sub-optimal resource use - by these targeted beneficiaries; this amount could also be subject to costs associated with efforts to obtain project funds. The other element of rent present in most ARDPs is where beneficiaries are induced to participate in order to change their behaviour and actions in line with project goals (e.g. fertiliser subsidies or grants to induce farmers to make more productive use of their land and labour).

It is a matter of contention just how much of the net present value of a project should be treated as rent. In principle, all should be regarded as rent where it adds to economic surplus but, to the extent that a project brings about a new economic environment, many post-project benefits might be needed to keep resources in the activities affected by the project. There are also doubts about the ability of rent-seekers, rent-defenders and rent-avoiders accurately to predict the present value of future project net benefits which comprise their rents. In particular, Shafir, Tversky and Diamond (1994) recently cast grave doubts on the ability of people to distinguish between real and nominal prices, and believe money illusion is widespread. A useful approach would be to separate those elements of additional economic surplus deriving directly from various subsidies and grants which are part of the project from surplus gained indirectly through the enabling properties of the project.

The gain in economic surplus would be split between producer and consumer surplus if the demand function were less than perfectly elastic, and the incentives to producers in industry B to seek rents would accordingly be modified. Given the assumption that the project is a price-taker, all additions to economic surplus are producer surplus. The net gain from the ARDP in Harberger efficiency (Harberger, 1954) is represented by the triangles UHL and VLM. As indicated above, no dead-weight loss is assumed to occur with the transfer of resources from industry B to industry A. This assumption is relaxed below.

The net changes in surplus as a result of the ARDP would not be the same for all producers in industry A. Those who benefit from the ARDP in terms of increasing their output capture all increases in producer surplus accruing from the output increase. If the assumption of a perfectly elastic demand for project output were to be dropped, however,

losses in producer surplus due to price decreases would be shared equally among all producers in the industry - ARDP participants and non-participants alike.⁷

So long as the industry demand function is less than infinity, non-ARDP participants in the industry will lose surplus in two ways, shown in Figure 2. First, they will share in the negative impact of a price fall (from P_1 to P_2 in Figure 2) at their initial output level, represented by the surplus loss P_1CBP_2 . Second, as long as their price elasticity of supply is positive, as shown in Figure 2, the price fall would induce them to move back down their supply function (from A to B) to a level of output (OQ_2) below that prevailing before the ARDP (OQ_1). Their surplus loss attributable to this decline would be CAB, and the total surplus loss P_1ABP_2 .

[Figure 2 Impact of an ARDP on non-project participants in an industry.]

If they do not have an equally profitable alternative use of their resources, this effect makes the position of non-ARDP participants akin to that of consumers in the traditional example used to illustrate the effects of rent-seeking: an intervention to restrict output to force up prices. It sows the seeds for rent-defending actions by this group to prevent the erosion of their surplus (see below)

In respect of the consumers' shares of changes in surplus, there is also a possibility that consumer groups could indulge in rent-seeking, using political influence as their resources. This form of rent-seeking almost certainly is less prevalent in ARDPs than producer rent-seeking at the micro level where production-oriented ARDPs are concerned, as consumers tend to lack the ability to band together as a cohesive and articulate group to exert influence. They have admittedly harnessed this power in a number of developing countries, but have used it directly to achieve food subsidies (intervening at the macro level) rather than applied it through mechanisms such as ARDPs. It is in the realm of ARDPs committed to social consumption (health, education, water supply, electricity, communication and information services, and the like) where consumers are more likely to be to the fore as rent-seekers. Their incentives to seek rents in these areas, though, are considerably dampened by the non-rivalry in consumption and non-excludability of these goods and services.

2.1.2 Hampered rent-seeking

The assumption is now relaxed that the rent-seekers originally in industry B who infiltrate the ARDP do not maintain the same level of producer surplus in industry A after they transfer resources into that sector. This assumption is dropped to allow for the possibility of hampered rent-seeking as a form of Tullock rent dissipation. The rents to be gained from the ARDP are sufficient to attract some of these resources away from their most efficient use to a less efficient use. In respect of the additional surplus from the ARDP, two possibilities exist: either rent-seekers introduce greater efficiency into the ARDP than that envisaged by the project planners (call this enhanced rent-seeking) or entry into the ARDP leads to lower levels of technical, size and/or technological efficiency than were

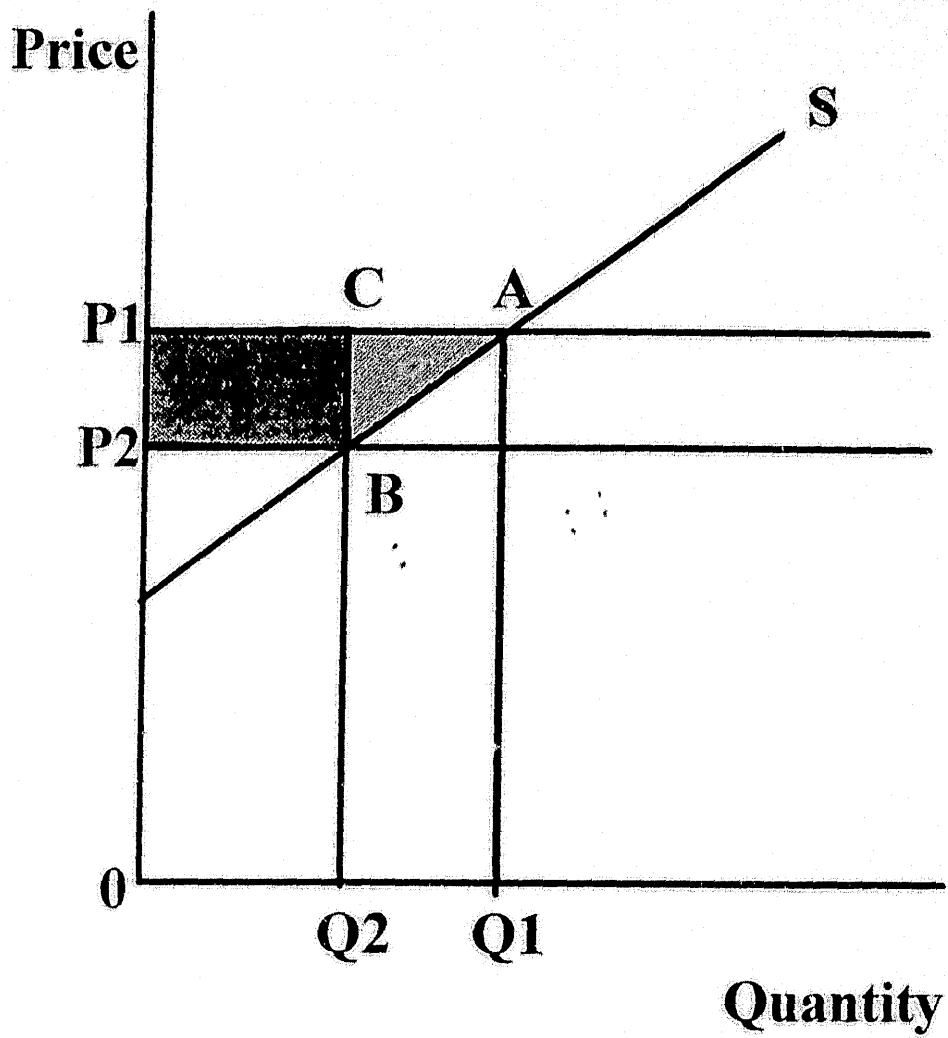


Figure 2 Impact of an ARDP on non-project participants in an industry.

predicted in planning the project. This can follow from the attraction into the industry of people or firms not well equipped to take advantage of the productivity-enhancing services offered by an ARDP. Assuming allocative efficiency prevails in both industries prior to the ARDP, a shift of resources between industries by definition leads to sub-optimal resource allocation through dead-weight losses.⁸

Rent-seeking activities in ARDPs are more prone to hampering than to enhancing. Losses in any of technical, technological and size efficiencies might occur if the resources attracted to industry A in rent-seeking are forced to be used in a situation in which (a) producers operate inside their production frontier, (b) economies of scale in industry B cannot be utilised, or (c) they are applied using a less appropriate technology given the circumstances of their owners.⁹ For example, an ARDP targeted at poor, small farmers - a common approach - might require the use of a highly labour-intensive technology suited to the circumstances of these people, yet the rent-seekers might be medium to large farmers whose resources and circumstances favour a less labour-intensive, more advanced technology. In this event both the diagonal cross-hatched area, JMNR, and the horizontal hatched area, JKLM, in Figure 1 could be reduced, paring producer surplus and dissipating rents. It is an avenue, additional to lobbying and other costs of rent-seeking, to reducing the net social gains of an ARDP. The combined costs, however, cannot exceed JKLM otherwise the rent-seeking is irrational.

Figure 3 shows the effect of using transferred resources in less efficient project activities. The same supply functions are used as in Figure 1 except for the omission of the original supply function and the addition of functions to reflect this efficiency loss. First, there is an upward shift in supply function SAⁿ to SA^o. The efficiency losses are the cross-hatched area JJ'M'M, comprising dead-weight losses of TMM and loss of rent from hampered production of JJ'M'T. Second, there is a corresponding upward shift of SA^m to SA^{oo}. The hatched area, RR'S'S, is the total efficiency loss and comprises (a) RR'S'S (= JJ'M'M) plus (b) the horizontal hatched area, S'N'NS, which is the indirect cost of resource transfer due to lost opportunity to benefit from project activity associated with the hampered rent-seeking.

[Figure 3 Impact of hampered rent-seeking on economic surplus and rents with efficiency losses associated with project activities.]

It is presumed in Figure 3 that Tullock rent dissipation is associated with an inability by rent-seekers from industry B to take full advantage of project activities in industry A. The additional possibility of hampered rent-seeking from efficiency loss directly from the resource transfer is demonstrated in Figure 4. Assuming a parallel supply shift from SA^{oo} to SA^{ooo}, the extent of this effect can be measured by subtracting the area RR'N'N' in Figure 3 from the area, RR''N''N' in Figure 4, = R'R''N''N'. It comprises Tullock rent dissipation plus a small additional dead-weight loss of V'N''N'.

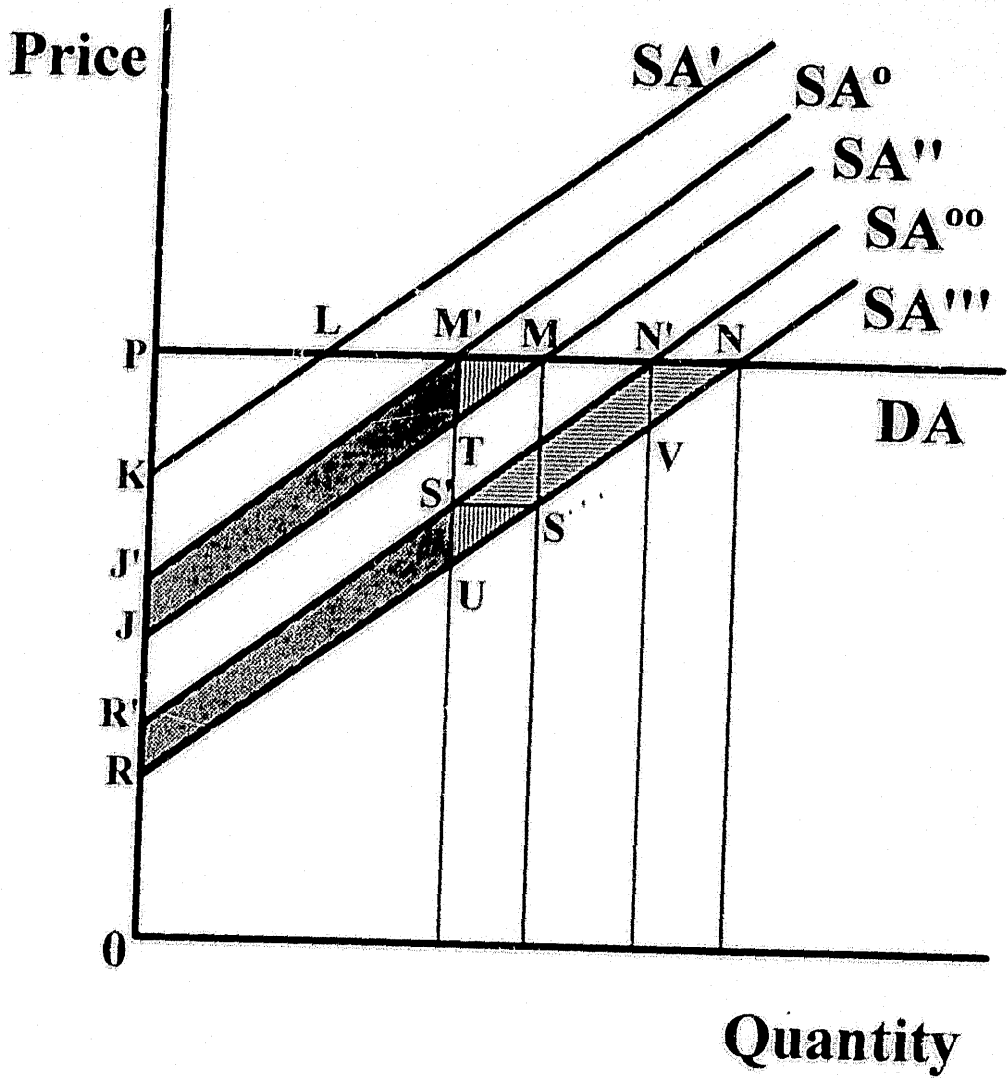


Figure 3 Impact of hampered rent-seeking on economic surplus and rents with efficiency losses associated with project activities.

[Figure 4 Impact of hampered rent-seeking on economic surplus and rents with direct efficiency losses in resource transfer in addition to efficiency losses associated with project activities.]

If the resources transferred by rent-seekers to the ARDP in industry A are more productive than those originally intended to be used by targeted beneficiaries (another possible source of enhanced rent-seeking), SA^{90} would be to the right of SA^m and greater surplus gain would have been achieved than expected through the ARDP. The horizontal hatched area of accumulated surplus loss would then be smaller than the initial losses incurred from the inter-industry resource transfer indicated by the cross-hatched area.

A further potential source of resource misallocation concerns the impact of diminishing returns to agricultural production where these diminishing returns are greater than those in industries from which rent-seeking resources are transferred. Modifying Krueger (1974: 301), 'The value of the rents overstates the increase in [economic surplus derived from an ARDP] ... to the extent that the marginal productivity of labour in agriculture is declining ...'. This can be viewed as another element in hampered rent-seeking.

2.1.3 Factors influencing the extent of rent dissipation

Possible factors influencing the extent of rent dissipation are the existing distortions in the economy, costs of lobbying, degree of competition among rent-seekers, estimation of probabilities of success in capturing rents, risk attitudes, the structure of groups seeking rents, power relations between groups and those making rents available (especially politicians and bureaus responsible for distributing aid funds for projects), extent of defensive transactions to control rent-seeking activity, and degree of rent dissipation that occurs prior to project planning.

Existing distortions. Blomqvist and Mohammad (1986) presented a strong case why the losses from rent-seeking can differ from the value of the rents because of corruption and other distortions in the economy.¹⁰ A special case is where bureaucrats compete for a limited number of positions to adjudicate on, or in other ways obtain the power to influence, project selection. Rent-seeking thereby increases the social costs of existing distortions. On the other hand, it could be argued that existing distortions impede the implementation of an ARDP to such an extent that a bit of bribery helps 'grease the wheels' of bureaucratic activity, reducing social costs. As it implies treating the symptoms of rent-seeking rather than its causes, this line of argument is dubious at best and is more likely to entrench rent-seeking, increasing its social costs, than alleviate the problem of bureaucratic impediments.

Costs of lobbying and other rent-seeking activities. On the surface, increasing the cost of rent-seeking should be a useful measure to discourage potential rent-seekers. Evidence from Appelbaum and Katz (1987), however, dispels this notion or at least makes it a dubious tactic. Even if Gallagher (1991: 62-3) is correct that high rent-seeking costs

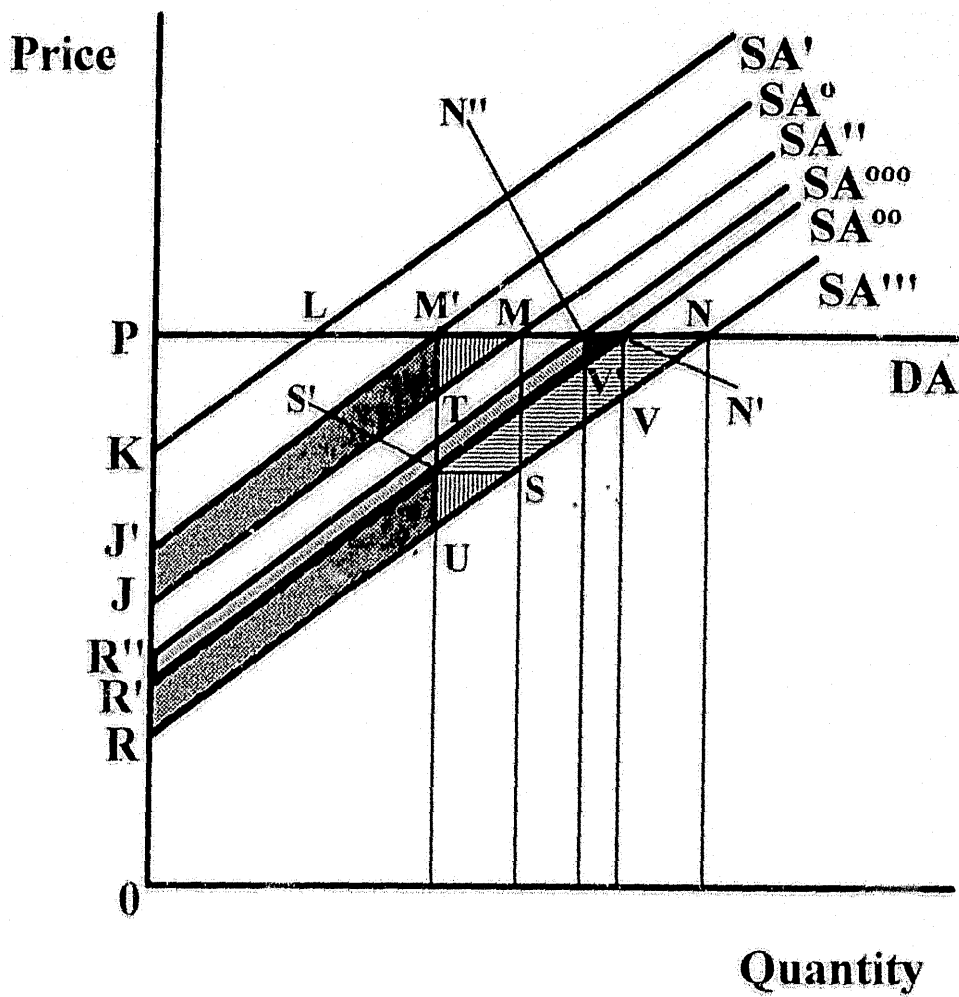


Figure 4 Impact of hampered rent-seeking on economic surplus and rents with direct efficiency losses in addition to efficiency losses associated with project activities.

discourage rent-seeking, the costs of those remaining will be increased and may outweigh the reduced cost of rent-seeking brought about by reduced rent-seeking activity. Existing rent-seekers might especially be forced to dissipate more of their rents if there are substantial entry costs to rent-seeking, such as the costs of group formation.

Degree of competition. With perfect rent dissipation (Wenders, 1987), rents would be totally dissipated by competitive rent-seeking efforts and hence all represent social costs. In practice, conditions for perfect rent dissipation rarely exist; therefore, only portions of these areas would be dissipated by rent-seeking activities so that not all Tullock rents would result in social costs. This seems to be an argument for making rent-seeking less competitive (Tullock, 1980); yet, as Ekelund and Tollison (1981) contended, competitive rent-seeking discourages potential rent-seekers. Blomqvist and Mohammad (1986) reckoned that the estimated social losses from the dissipation of rents are sensitive to the rent-seeking mechanisms put in place and the 'precise rules of the rent-seeking game'.

Competition for rents is supposed to increase with increases in the number of groups of rent-seekers. Nitzan (1991) concluded that dissipation of rents is positively related to the number of participating groups except where rent is precisely distributed according to the relative effort put into rent-seeking by each group. Dissipation is limited by imperfect competition when the number of rent-seekers is small (Tullock, 1980). Tullock (1989: 7) gave two reasons why he thinks the rent-seeking market in USA does not work in a very competitive way: the restrictions on competition on the supply side and absence of a large rent-seeking industry on the demand side. The extent of competition on the supply side in USA is restricted by the nature of the democratic political system. In developing countries, the money distributed to ARDPs provides at least some competition on the supply side in secondary rent-seeking within and between the bureaus and among politicians with a role in aid distribution. Azhar (1993) argued that bureaus compete with one another for control over national resources because 'the larger the jurisdiction of a bureau, ... the greater its power (discretionary as well as nondiscretionary), prestige, and influence'. But the limitations in competition are probably not too different from those described by Tullock for USA. On the demand side, it is an empirical question just how large the rent-seeking industry is, but one observation is worth making as a counterpoint to Tullock's contention. Much of the rent-seeking that takes place (probably as much in USA as in developing countries) is done through informal networks, and is very difficult to observe and measure (Pecorino, 1992).

Risk. Rent-seeking has its risk in that resources can be allocated to it yet the probability of gaining the level of rent sought is less than unity. Where the chances of receiving the full rent are less than perfect, risk-neutral rent-seekers would presumably invest resources up to the point where costs equal a subjectively estimated certainty equivalent amount of rent. Individual rent-seeking costs and hence extent of dissipation, would be expected to vary inversely with degree of risk aversion (Hillman and Katz, 1984; Fabella, 1992). The relatively poor farm and other rural households (especially those of landless labourers) that are the focus of most ARDPs are probably, on average, more risk-averse than other rent-seekers in ARDPs and thus less likely to compete for and dissipate rents. They would also

be expected to have a keen understanding of the low probability of success of capturing rents.

The above line of reasoning is based on an assumption that all resources invested in rent-seeking are those of the rent-seeker. In secondary rent-seeking, this is not guaranteed. Individuals within bureaus involved in funding and operating ARDPs can use institutional resources to fund their rent-seeking activities. A common example is the time taken off work by a bureaucrat to lobby other influential bureaucrats who can bring about changes in ways in which project aid monies are spent. This would show up in low productivity in the public service, but can be passed off easily enough as typical bureaucratic inefficiency or inertia.

As for individual rent-seekers, the more risk-averse a group of rent-seekers the lower the level of activity they would be expected to undertake in rent-seeking. The more clearly understood the probabilities, the higher the level of rent dissipation whereas dissipation is lower in more imperfectly discriminating rent-seeking contests between groups (Nitzan, 1991: 1522). Groups of targeted beneficiaries tend to be at least mildly risk averse, prompting them to avoid spending on rent-seeking which is by its nature a risky assignment.

Structure of groups. The nature of groups can also influence this source of rent dissipation. Appelbaum and Katz (1987) reported that groups compete with each other by spending resources on rent-seeking in order to improve their probabilities of gaining a project. Large rent-seeking groups discourage rent-seeking and lower rent dissipation. According to Nitzan (1991: 1522), 'the extent of rent dissipation is positively related to the number of contesting groups and is inversely related to the degree of "egalitarianism" in distributing the rents' among group members.

Power relations. Relations between groups in rent-seeking are complex, as are the impacts on social costs. As stated above, competition for rents is meant to encourage rent dissipation, but free-riding also discourages rent-seeking activity and can be overcome by cooperation between groups. Hence, the extent of cooperative behaviour between groups can also vary positively with rent dissipation (Grads'cin, 1993: 1241).

Groups vary in their capacity to compete for rents. In particular, willingness to rent-seek varies positively with income (Gallagher, 1991: 77). Nitzan (1991) concluded that wealth can influence outlays on rent-seeking. Given the relative poverty of the targeted beneficiaries of ARDPs, groups of them are unlikely to outlay as many resources on rent-seeking as other relatively wealthy interest groups. Hence, the propensity of the typical targeted project beneficiaries to seek rents is especially likely to be low. This is not just because these people are typically poor, restricting their ability to spend. They also lack the power to participate in project planning and management, and influence those responsible for making decisions about the disbursement of aid funds. It probably explains the phenomenon of small farm households adopting strongly rent-seeking attitudes to ARDPs yet putting negligible effort into the practice of rent-seeking (Raurela, 1995).

Defensive transactions. Defensive transactions effected by bureaus concerned with development and project planning can reduce the extent of rent-seeking through external control. The extent depends most obviously on the effectiveness of these controls; experiences to date do not offer much confidence in rural areas of developing countries. These transactions themselves have costs to set against rents.

Rent-seeking at different planning levels. The amount of aid funds earmarked for ARDPs can be substantially eroded by the time they reach ARDP planners as a result of rent-seeking at the macro and meso levels. This rent-seeking will have its own costs, and add to the dissipation of rents that occurs at the micro level. National governments, for example, need an expanded bureaucracy to deal with the myriad of missions from international agencies and to compete in the international arena for aid funds from international and bilateral donors. An example of the latter is the exploitation of geopolitical resources which is not costless.¹¹

2.2 Rent-defending and rent-avoiding

Defence of rents in relation to ARDPs is possible in all stages of rent-seeking, but its presence in secondary and tertiary rent-seeking is the focus of attention here. Consider a particular ARDP in which a group of rural inhabitants have been identified as the target of thorough planning processes. Now, allow for other groups to attempt to appropriate any rents accruing to this group by influencing relevant personnel in the planning hierarchy. Groups within targeted beneficiaries can compete among themselves to deflect rents (Wenders, 1987: 457) in second-phase tertiary rent-seeking. Such attempts to alter the distribution of benefits among targeted beneficiaries of a project can generate rent-defending activities by those who stand to lose their share of project rents reflected by gains in producer surplus.

Secondary rent-seeking also offers potential for rent-defending as well as rent-seeking in ARDPs. It is usually rife among public bureaus competing for the right to control and manage the distribution of rents in such projects. On the surface, the department of agriculture (national and provincial) is the bureau most obviously at the centre of ARDP planning and management other than the organisation of the project itself. In practice, this bureau seldom has much power and influence. It is generally on the periphery of influence among line agencies while line agencies themselves are much less influential than those responsible for 'the civil administration in the day-to-day affairs of ordinary citizens' (Azhar, 1993: 121). Consequently, line agencies, and the department of agriculture in particular, find themselves defending their rents from ARDPs from the hegemony of powerful sections of the civil service (Azhar, 1993: 122).

Rent-defending activities would also be expected from non-ARDP participants (see Figure 2) as groups of producers outside the targeted beneficiaries could either lobby to prevent the project or alter its form, or pursue rent-seeking activities to deflect rents to themselves

in first-phase tertiary rent-seeking. These producers would lose from an ARDP to the extent that they do not share in increases in producer surplus derived from output expansion but share in the price-depressing effects of this expansion wherever the industry faces a downward-sloping demand function. Where an ARDP has a major impact on market prices in an industry, non-ARDP producers stand to lose substantial shares of producer surplus if price is depressed by the additional output generated by the ARDP. It sows the seeds for rent-preventing actions by this group to prevent the erosion of their surplus

In theory, rent-defending and rent-avoiding costs could match rent-seeking costs such that, at the limit when all rents are dissipated, waste from rent-seeking could be double the rent available to tertiary rent-seekers at the micro level. This cracks of double-counting; yet, according to Wenders (1987: 457), something akin to the prisoners' dilemma makes such an outcome possible as neither the rent-seeker nor rent-defender/avoider is aware of the decisions made by the others and is prepared to let the other take rent from them. It would seem that the scope for such a situation to arise is limited by at least some knowledge by the rent-seeker and rent-defender/avoider of each other's decisions and activities, and consequent threat of retaliation. This puts a cap on the levels of both rent-seeking and rent-defending/avoiding and hence on the extent of dissipation of rents by the defenders/avoiders

2.3 Conclusion

The material presented in this section gives an idea of the scope for incurring social waste from rent-seeking in ARDPs. Waste does not begin with the planning of an ARDP but with the initial procurement of the aid funds that are normally used to finance it.

It is conceivable that, at the extreme, the total increase in economic surplus generated by an ARDP is wholly dissipated (or more) by rent-seeking and retaliatory rent-defending and rent-avoiding activities. It is even possible that there is a net loss of surplus arising from an ARDP in which rent-seeking is rampant and leads to rent dissipation and distortions in resource use. The true extent of social waste is an empirical issue, which means measurement of waste for each ARDP, but it is notoriously difficult to carry out the necessary quantitative analyses.

3. Other Potential Social Costs

3.1 Misallocation of entrepreneurship and distortions in the accumulation of human capital

Sturzenegger and Tommasi (1994) contended that poor economic growth rates in developing countries can be attributed in part to the misallocation of entrepreneurial

resources that do not generate growth. Misallocation of entrepreneurial resources occurs in enabling projects, such as many ARDPs, where entrepreneurs opt for the more certain returns from rent-seeking in projects rather than seek profits from more uncertain but also more valuable, often export-based, economic activities. Murphy, Shleifer and Vishny (1993) observed that rent-seeking tends to attract the most talented among rent-seekers while Lu (1994) found that competitive rent-seeking wastes entrepreneurial resources.

Bureaucratic positions that endow power to decide over the allocation of aid rents can attract numerous applicants, well beyond the positions available (Krueger, 1974: 293), even to the point of biasing education expenditures. Assuming a particular post-secondary education is needed to obtain such a position of power, and that this level of education is subsidised by the state (as it typically is), endeavours by rent-seekers to get a subsidised tertiary education will lead to higher potential waste from rent-seeking to the extent of the subsidies incurred above levels in the absence of rent-seeking (Blomqvist and Mohammad, 1986: 177).

Gallagher (1991) pointed to the importance of human capital in economic growth and the possibility that, if human capital investment is distorted by rent-seeking, it could damage growth prospects. An increased economic growth rate achieved through the accumulation of human capital is a crucial element of most ARDPs. If people were to seek advancement through an ARDP as a means of helping their chances of getting an urban job, resources would have been diverted away from rural growth.

3.2 'Short-termism'

Rent-seeking from ARDPs encourages short-termism at the expense of socially more desirable long-term development activities generated by projects. This is a paradox as a principal aim of most ARDPs is to establish useful activities sustainable in the long term that would not emerge without government intervention through a development project. Rent-seeking can lead to a reduced sustainability of project activities by concentrating efforts on extracting benefits rather than strengthening productive capacity that can survive the completion of a project.

3.3 Diminution of trust in rural economic activities and higher transaction costs in project planning and management

Increases in transaction costs associated with operating an ARDP are likely to occur as rent-seeking becomes more pervasive, not just in ARDPs themselves but also in general development bureaus, and the extent of higher level moral behaviour diminishes.¹² Those organisations responsible for project planning and management, as well as external funding agencies, need to put more time and money into activities such as monitoring, control, reporting and evaluation.

According to Becker (1994), bribery and other forms of illegal rent-seeking do considerable damage to economic life. If, as hypothesised above, there is a link between politicised ARDPs and illegal rent-seeking, the former could be having a negative impact on economic growth as well as reducing trust in ARDPs. Kamath (1993: 215) referred to the negative impact of rent-seeking in the sugar and cement industries in India which he described as a 'monumental distortion of incentives away from honesty and trust in daily economic transactions, away from improved and appropriate technology and quality, and the reduction of prices, towards a high-cost, low-efficiency economy'. As improved technology and lower prices are commonly major goals of ARDPs, allowing rent-seeking to bring about a similar lowering of standards in rural economic life risks destruction of the very things governments are trying to achieve through ARDPs.

3.4 Discouragement of investment

A common feature of ARDPs is their substantial investment component. Given development concerns about low levels of investment in rural areas of developing countries, this is obviously a good thing as long as that investment is in socially desirable forms of capital, which is usually assured by the criteria applied to assess proposed ARDPs. Introduce rent-seeking, however, and the positive social impact of ARDPs through their investments can be diminished. Gallagher (1991) demonstrated that rent-seeking can reduce incentives for private investment elsewhere in the economy.

3.5 Bias towards oversized ARDPs

ARDPs, like all projects, are subject to welfare loss in that rent-seeking biases them towards being larger than is desirable. This occurs because of the rationing process involved in the non-price allocation rules used for selection of projects (e.g. Deacon and Sonstelie, 1989). Rent-seekers compete for project funds and attempt to capture as many of these funds as feasible from one project proposal. Aiming for one large project now is preferable to the alternative of having to wait and seek future rents from new project proposals a number of times in the future because it saves time queuing for projects for which success in application is uncertain. Hence, project beneficiaries would be expected to make their initial proposals as costly as possible subject to limits imposed by proposal guidelines. As Deacon and Sonstelie (1989) pointed out, welfare losses occur when rent-seekers economise on waiting costs (and, one could add, uncertainty about the occurrence of future events).

3.6 Rent-seeking and equity

Rent-seeking is likely to aggravate existing rural inequities through greater maldistribution of income. Successful rent-seekers are more often among the wealthier members of society. Consider the common case of an ARDP that is introduced to increase the output

of those farm households, usually among the poorer members of rural societies, with substantially under-employed labour resources. To the extent that fully-employed rent-seekers from outside this sector take project resources from these people, some households will remain under-employed whereas they would have become more fully employed if they, rather than rent-seekers, had participated in the project.

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Endnotes

- ¹ Rent-seeking is defined by Tollison (1982, p. 578) as 'expenditure of scarce resources to capture an artificially created transfer'. Tullock's (1989, p. vii) definition is 'the use of resources in actually lowering total product although benefiting some minority'. Perhaps economic surplus is a preferable measure to total product.
- ² Rent-defending is a set of activities parallel to rent-seeking, with equal potential to lead to social loss through rent-seeking (Wenders (1987, p. 456). As the name implies, it entails the defence of their rents by persons or groups from those seeking to appropriate them. Rent avoidance implies activities similar to rent-defending except prevention of the creation of rent, rather than capture of existing rent, is at issue.
- ³ Rent-seeking costs, or Tullock costs (Tullock 1980), are the benefits achieved through rent-seeking which are dissipated by the resources expended to capture those benefits. Rent-defending and rent-avoiding costs are costs incurred in defending rents from capture by rent-seekers and avoiding the setting of rents, respectively.
- ⁴ Assuming a perfectly elastic demand function for project output.
- ⁵ For simplicity here, it is assumed that producers in both industries and that these rent-seekers are able to maintain the same level of productivity in industry A after they transfer resources into that sector so that the decline in output in industry B equals the increase in output in industry A, from OQ_3 to OQ_4 , and they face similar demand and supply functions. If the latter assumption is dropped, it paves the way for small gains or losses in the surplus accruing to these rent-seekers depending on the demand and supply functions in each industry. A more price inelastic demand in industry A would lead to a reduction in surplus to rent-seekers arising from their transfer of resources, other things being equal.
- ⁶ Such equivalence is unlikely in practice. It is to be relaxed below.
- ⁷ The exception to this rule would be where some ARDP participants respond more quickly than others (often the wealthier producers who are likely to be among the rent-seeking contingent). These producers would be the first to increase output and, for a time, not suffer price falls to the same extent as those whose output increases lag behind.
- ⁸ Hampered rent-seeking occurs where rent-seeking causes resources to be used in a less efficient manner than they were prior to the rent-seeking activity (Tullock 1989, pp. 13-14).
- ⁹ This notion is consistent with the observation made by Tullock (1989, pp. 13-17) that rent-seeking often entails the use of an inefficient technology for rent-seekers to enable rents to be earned.

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- ¹⁰ It is conceivable that rent-seeking can cause welfare gains if the outcome of rent-seeking is a reduction in existing distortions (Blomqvist and Mohammad 1986, p. 163).
- ¹¹ The presence in New York of relatively costly missions to the United Nations from very small developing countries is probably at least partly explained by a need to exercise their votes to support the international positions taken by the major suppliers of their aid funds.
- ¹² These costs could be construed as rent-dissipating costs, in a similar manner to Posner's (1975, p. 808) reference to policing costs as a form of rent dissipation caused by theft.