The evolution of economic rent seeking

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Abstract

Existing literature has shown that on the one hand, special interest groups can have a growth enhancing effect on an economy. Putnam (1993), for example, argues that lobby groups are conducive to economic performance via building up trust and social ties. But on the other hand, there are various incentives for lobbies to engage in rent-seeking behavior, which hampers growth. According to Olson (1982), for example, special interest groups have an incentive to lobby for socially inefficient policies, which benefit them but are a large cost to society. No matter whether lobby groups were modeled as good or bad for economic performance, previous literature has assumed the nature of special interest groups to be constant over time.

The hypothesis of this paper is that rent-seeking behavior develops through a dynamic relationship between politicians and lobbyists: Initial government support rests on short run economic benefits through adoption of new technologies coming from new ideas. But the lobbies providing the necessary ideas prefer long run support. Assuming that the economic rents coming from a particular idea can be exhausted, then continued spending on a project coming from this idea becomes a cost to society. This indicates that lobby groups initially increase welfare, but that they have an incentive to engage in rent-seeking behavior after economic rents coming from their ideas are extracted.

Examples for this hypothesis are the steel and agricultural industries, which are among the most influential and oldest interest groups in both the US and in Europe. When these groups initially lobbied, governments had good reasons to support them. The large fixed cost of building suitable infrastructure and legal environment initially required government assistance, so that the firms were able to extract the increased rents from the new technologies. Today, the economic rents are extracted, but governments continue supporting these industries.

I use an overlapping generations framework to model the incentives a government might have to keep supporting special interest groups even after economic rents are extracted. The main mechanism is that the government faces a dynamic inconsistency problem: While it wants to get access to the idea of the lobby group in the first period, it would like to stop supporting it in the second period. If offering an idea to the government is costly for the lobby group, then the latter might only do it if it trusts the government to support it also in the second period. In this case, the government can signal trustworthiness by keeping old lobbies around. The model suggests that both benevolent and self-interest oriented governments will keep supporting old lobby groups in equilibrium. Moreover, the majority of the population will not oppose the government's decision even if they do not benefit from the support for these groups.