Rent-seeking and X-inefficiency

PATRICK A. McNUTT*
Department of Economics, University College, Galway, Ireland

Accepted 11 June 1991

Abstract. This paper discusses the social cost of monopoly with special attention given to the geometric representation of that social cost, notably rent-seeking and X-inefficiency. The possibility of an overlap between these two measures is examined. In particular the paper addresses a problem of measure identification which highlights the need to reconsider the normative microfoundations of rent-seeking.

1. Introduction

Public choice scholars continue to address the normative analysis of rent-seeking within a partial equilibrium framework. Within the same framework X-inefficiency can be described. The issue under review in this paper is whether or not these two measures of the social cost of monopoly overlap. We contend that they do.

This paper is an extension to the arguments outlined in three papers which have appeared in this journal — namely Congleton (1988: 182) who concludes that “the social cost of rent-seeking is the Harberger triangle plus the opportunity cost of scarce economic resources utilised in rent-seeking activities”, Formby, Keeler and Thistle (1988: 123; hereafter FKT) who “have shown that X-efficiency and rent-seeking theory have significantly different implications for economic welfare”, and Naughton and Frantz (1991: 264; hereafter NF), who in a critical comment on FKT’s treatment of X-inefficiency, concluded “that a priori one cannot without assurance”, compare the social costs of X-inefficiency and rent-seeking.

Although social costs are associated with rent-seeking activity the literature on rent-seeking per se is neither clear on the apportionment of such costs nor on the extent of their magnitude. Positive estimates on the social cost of rent-seeking differ widely across the literature as reported in McNutt (1991). The development of the efficient rents hypothesis represents an attempt to explain incomplete dissipation of rents. Many authors including Buchanan (1980) and

* Director, Centre in Economics and Law, University College Galway. The author acknowledges helpful comments from Roger Congleton and encouragement from Gordon Tullock. The usual disclaimer applies.
Tirole (1988) have suggested a typology of rent-seeking costs. For example Buchanan's "third party distortions" and Tirole's "administrative costs" would not be regarded as socially wasteful expenditures. The absence of any reconfiguration of the geometric explanation of the social costs of rent-seeking in the light of such normative developments is a problem for public choice theorists. In addition, the parallel treatment of X-inefficiency and rent-seeking only exacerbates this problem. This is clearly evident by the absence of a common interpretation of the geometric areas of social cost in the partial analysis of the three papers outlined.

2. Geometric areas

The essence of the social cost of monopoly within which both X-inefficiency and rent-seeking evolved, is that a price above the long run perfectly competitive price represents a transfer of resources from the consumer to the producer. Quite simply if the monopoly price PM in Figure 1 is realised the trapezoid PMGAP1 is divided into Tullock's rectangle PMGEP1 and a Harberger triangle GEA. The rectangle is the amount that completely dissipates the monopoly rent. In calculating these geometric measures we are assuming that the demand curve is linear.

Congleton (1988) has suggested that the social cost of rent-seeking is the opportunity costs of the real resources used in rent-seeking behaviour. Indeed Tirole's "strategic costs" of rent-seeking would include the expenditure of real resources for either long term R & D expenditure or in order to erect entry barriers. The opportunity cost of these resources would amount to the social cost of the rent-seeking activity. We demonstrate that Congleton's particular treatment of an opportunity cost argument within a partial equilibrium model leads to an interesting result, namely, that the traditional [geometric] social cost of