11
Directly Unproductive Profit-Seeking Activities

In the preceding chapter we outlined a theory for how individuals (or firms) organize themselves into interest groups when there are public goods for the group which may be produced as a result of putting pressure on the government and the legislators. We will now take one more step in our analysis and see what the economic consequences of this behaviour may be. The activities of the interest groups towards securing favours for the members are known as rent seeking or directly unproductive profit-seeking (DUP) activities.

A characteristic of these activities is that interest groups invest resources in securing the public good they want, inflicting costs both on the groups themselves and on society at large. Gordon Tullock has characterized these activities as a ‘negative-sum game’. In the description of Olson’s analysis in the preceding chapter we saw that the public goods would not be produced unless their value for the individuals who try to promote them exceeds the cost incurred by the same individuals. Only privately profitable lobbying is pursued.

For society as a whole, the situation is different. The interest groups invest resources. It is possible that different groups compete and some of them come out as winners with a positive net value for the group. From society’s point of view no new goods or services that would be part of the welfare function of the citizens have been created, however. Instead, resources have been used for redistributing a ‘pie’ that already exists. The point is that the size of that pie has shrunk in the redistribution process as a direct consequence of the activities of the interest groups. The gain for the winning group is more than made up for by what society as a whole loses. ‘Political’ competition of this type usually results in a loss for society.

Directly unproductive profit-seeking activities and their costs

The costs for this type of activity can be seen in different ways. We start with a partial approach. Moreover, let us consider the clearest possible example of this phenomenon: theft. The situation is illustrated in Figure 11.1.
Figure 11.1 The costs of theft

In the figure, MB denotes the potential marginal returns on investing a given quantity of resources (i.e., time and equipment) on criminal activities. MC is the marginal opportunity cost representing the return on the same resources in the best alternative use. We assume that this opportunity cost is constant. The MB curve has a negative slope as the easiest objects for theft are assumed to be exploited first. The distance of the curve from the horizontal axis depends on how much other members of the society (including the public sector) invest in preventive measures. The more policemen society appoints, for example, the closer to the axis the curve would be.

In traditional partial analysis, where a dollar is a dollar no matter who earns it, where redistribution from one group to another does not count but only ‘dead-weight losses’ that do not benefit anybody, theft is a pure transfer from the victim to the thief. There are no welfare effects.

The preceding reasoning seems rather dubious, however, not only from a judicial but also from an economic point of view. The reason for the latter is that theft, and the risk of theft, uses up resources in the society. This may be illustrated in several ways with the aid of Figure 11.1. Let us begin by looking at the thief’s situation. The marginal return on his criminal activity is given by the curve MB (i.e., the curve denoting the marginal product of theft). This benefit has to be compared to his marginal cost (working time, crowbar, mask, hood, sack). The thief’s optimal resource input can be found in the usual way by locating the point where the marginal benefit and the marginal cost coincide (point A). (An additional effort, on the part of society, towards preventing crime would shift the curve to MB’ and the optimal resource input for the thief to point B.) The value of the transfer granted by the thief to himself is given by the area below the MB curve from the origin to A, but from this area we have to deduct his costs, shown by the area below the MC curve between the origin and A.