

## LOBBYING, DUP ACTIVITIES AND WELFARE

### A response to Tullock\*

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Professor Tullock (1981), in trying to understand the results in my (1981) paper on lobbying and welfare, has raised issues that require further clarification and analysis. For brevity's sake, I shall concentrate here on the essentials, leaving minor remarks of Tullock's aside.

(1) The specific case of lobbying which I addressed originally was tariff-seeking by protectionist lobbies: so that the tariff would be endogenous. I then showed that one could not argue, in this instance, that an exogenously-specified tariff at  $x\%$  was *necessarily* welfare-superior to an endogenous tariff at  $x\%$ .<sup>1</sup> All other forms of lobbying were excluded, of course.

(2) Tullock argues that this result obtains because he and Krueger (1974) think, whereas I do not, that tariff revenues can be wasted. As it happens, Krueger (1974) made no such assumption. She explicitly compared, in her analysis of the specific case of premium-seeking for import quotas already in place, quotas (with such premium-seeking) with tariffs that had *no* corresponding revenue-seeking or, for that matter, any waste resulting from the government directly expending the tariff revenue. Bhagwati and Srinivasan (1980) were the first to introduce the revenue-seeking concept and to argue that it was wholly inappropriate for Krueger to compare tariffs and quotas on the assumption that the latter gave rise to *full* premium-seeking whereas the former gave rise to *zero* revenue-seeking!

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<sup>1</sup>Incidentally, since this suggested counter-intuitively that lobbying for a tariff was welfare-improving, I also proceeded to show that one *could* decompose the overall loss from the endogenous tariff, vis-a-vis free trade, in an alternative manner which would always sign the 'normal' cost of protection and the lobbying cost agreeably. Tullock seems to have missed this section; it was not present in some of the earlier drafts of my paper which he saw in personal correspondence.

(3) Since Tullock raises the question of wastage resulting from revenues in connection with the impact of tariff seeking, let me first clarify that it is extremely important here to distinguish among three different ways in which revenues can be (wholly or fractionally) wasted. (i) In revenue-seeking, the waste is caused because lobbies seek a share in the revenue disposal and, in competition, the value of the factor services expended in revenue-seeking will equal the revenues lobbied for. (ii) Alternatively, the government may directly spend revenues on purchasing factor services (e.g. in hiring bureaucrats), but the resulting governmental 'output' or consumption is held to be worth less than the revenues. (iii) Finally, the government may directly spend revenues on purchasing goods, in which case one may again regard some or all governmental consumption as wasteful and having zero social value. The first two cases are qualitatively equivalent. But the third is not, since the relationship between the tariff-inclusive goods prices and factor prices ceases to be unique in the first two cases, even with the standard restrictions, when complete specialization can ensue as in the negative-shadow-factor-prices case at issue in my (1980) analysis. Let me distinguish therefore between *case 1* where the revenues cause waste because of revenue-seeking and *case 2* where the waste arises because government spends revenues on goods and this is deemed to have zero value.

### Case 1: Revenue-seeking<sup>2</sup>

Before I turn to what I consider to be Tullock's way of looking at the problem of tariff-seeking, let me stress that I would myself insist that the two different kinds of lobbying — tariff-seeking to impose, say, a protectionist tariff, and revenue-seeking to seek the resulting tariff revenues — be kept distinct. It can, in fact, be shown that *each* of these two lobbying activities can yield the paradoxical conclusion that lobbying may be welfare-improving.

To see this best, consider fig. 1 which shows both tariff-seeking and revenue-seeking. Free trade would be at  $P^*$ , with  $AB$  the production possibility curve.  $\hat{P}$  is where an exogenous tariff would take the economy. An endogenous tariff at the same rate, resulting from lobbying, would take the economy to  $\hat{\hat{P}}$  where the tariff-inclusive price line is tangent to  $A'B'$  which is the production possibility curve *net* of resources used up in tariff-seeking. Since  $\hat{\hat{P}}$  is to the right of  $\hat{P}$ , and the world price ratio in this small economy is  $WP$ , it is clear that the economy is better off. The paradox Tullock is unhappy with is seen.

<sup>2</sup>Or, equivalently, the case where the government spends tariff revenues directly on factor services and these are assumed to amount to socially worthless output or consumption.

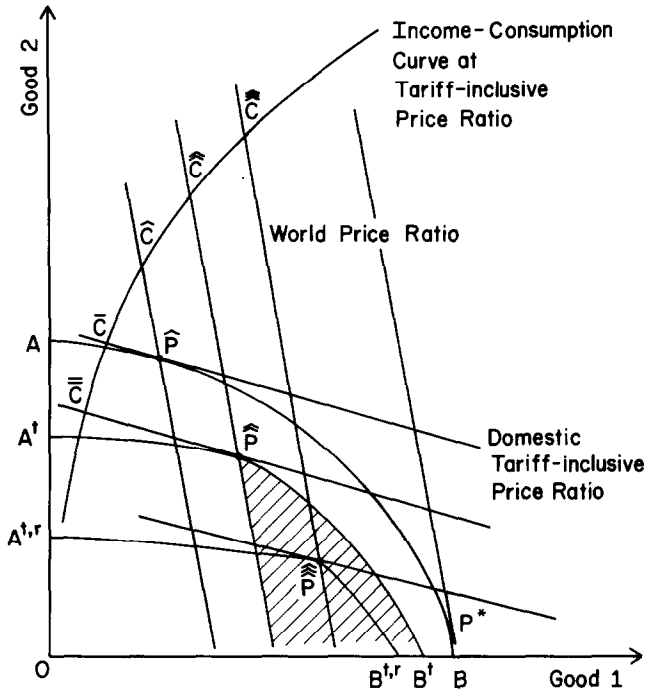


Fig. 1. ( $AB$ : production possibility curve without any lobbying;  $A'B'$ : production possibility curve with tariff-seeking;  $A^{t,r}, B^{t,r}$ : production possibility curve with both tariff-seeking and revenue-seeking.)

Now, introduce revenue-seeking (For simplicity, I assume that the level of tariff-seeking is exogenous to the introduction of revenue-seeking.) The tariff at  $\hat{P}$  yields revenues which trigger lobbying for some of these revenues. Following Bhagwati and Srinivasan (1980), one can solve for the resulting equilibrium. Let this be at  $\hat{P}$  where the tariff-inclusive price line is tangent now to production possibility curve  $A^{t,r}B^{t,r}$  which reflects factor endowments net of those used up in *both* the tariff-seeking and revenue-seeking lobbies. As drawn,  $\hat{P}$  yields a yet further gain, vis-a-vis  $\hat{P}$ . As Bhagwati and Srinivasan (1980) note, in the Komiya-Salter model they use, equilibrium at a point of incomplete specialization such as  $\hat{P}$  implies that *all* revenues are not lobbied for.<sup>3</sup>

On the other hand, as I now read Tullock, he would like to ask a different question: what is the rank-ordering between tariff-seeking (i.e. an *endogenous*

<sup>3</sup>In their fig. 2 (1980, p. 1076), the fraction of the total revenue that is lobbied for and which then equals the market-valued waste of resources is clearly shown for an arbitrary revenue-seeking equilibrium such as  $\hat{P}$  above. This fraction will vary along the Rybczynski line drawn through  $\hat{P}$  and  $\hat{P}$  in fig. 1 above.

tariff) with 100% revenue-seeking and an *exogenous* tariff with 100% revenue-seeking? Must my (1980) conclusion that an endogenous tariff may be welfare-superior to an exogenous tariff at an identical rate, both being considered without any revenue-seeking or other assumption of direct government waste, be reversed if 100% revenue-seeking is admitted as part of this comparison? In fig. 1, therefore, he ought to be comparing (i) an exogenous tariff at  $\hat{P}$  with full revenue-seeking (or equivalently, with the government directly wasting resources through buying factor services towards no socially valuable purpose) *vis-a-vis* (ii) an endogenous tariff at  $\hat{P}$  with full revenue-seeking. If one does that, then Tullock seems to assume that the 'private' economy will operate on the budget line  $\hat{P}\hat{C}$  in case (i) and on the budget line  $\hat{P}\hat{C}$  in case (ii); the latter is then dominated by the former. But, unfortunately, even this cannot be maintained. For, if indeed the Rybczynski line lies in the stripped zone of negative shadow factor prices, full revenue-seeking will simply mean that the economy will specialize completely on good 1. It is then still possible for full revenue-seeking to yield higher welfare than at  $\hat{C}$  in case (i) and at  $\hat{C}$  in case (ii), and, regardless, for the welfare level in case (ii) to exceed that in case (i), thus sustaining my (1980) paradox that an endogenous tariff may be superior to an exogenous tariff at the same rate.<sup>4</sup>

### Case 2: Direct waste on goods

Where instead the government directly spends all revenue, on goods, and the entire resulting governmental consumption is regarded as socially worthless, the endogenous tariff (combined with this assumption) will indeed lead 'private' consumption to  $\hat{C}$  and the exogenous tariff (combined with this assumption) to  $\bar{C}$ . The paradox of the latter being inferior to the former will not arise.

Tullock's contention therefore would be necessarily correct if he made all of the following three assumptions: that the government directly wastes revenues, that all revenues are wasted, and that the waste is occurring wholly through government expenditure on goods rather than factor services.<sup>5</sup> Needless to say, therefore, the possibility of my (1980) paradox is by no means ruled out if 'wastage of revenues' is simply admitted into the analysis. In particular, I should reemphasise that I find it highly improbable that all revenues of the government lead directly or *via* revenue-seeking to fully matching waste of resources any more than I would consider it agreeable to assume that no revenues are so wasted. (Also, I should stress, as I did in

<sup>4</sup>See Bhagwati and Srinivasan (1980, p. 1081, footnote 16).

<sup>5</sup>Tullock has pointed out in private correspondence that his view is that in reality all governmental revenue is not wasted. If so, the conditions for ruling out the paradox at issue are *not* satisfied.

relation to case (1), that it is important to keep tariff-seeking and revenue waste analytically separate. If one does that in case (2), one goes in fig. 1 from  $\hat{C}$  to  $\hat{\hat{C}}$  with tariff-seeking *alone* and with no wastage of revenues assumed. Then one goes from  $\hat{\hat{C}}$  to  $\bar{C}$  when wastage of all revenues through governmental purchase of goods is introduced.)

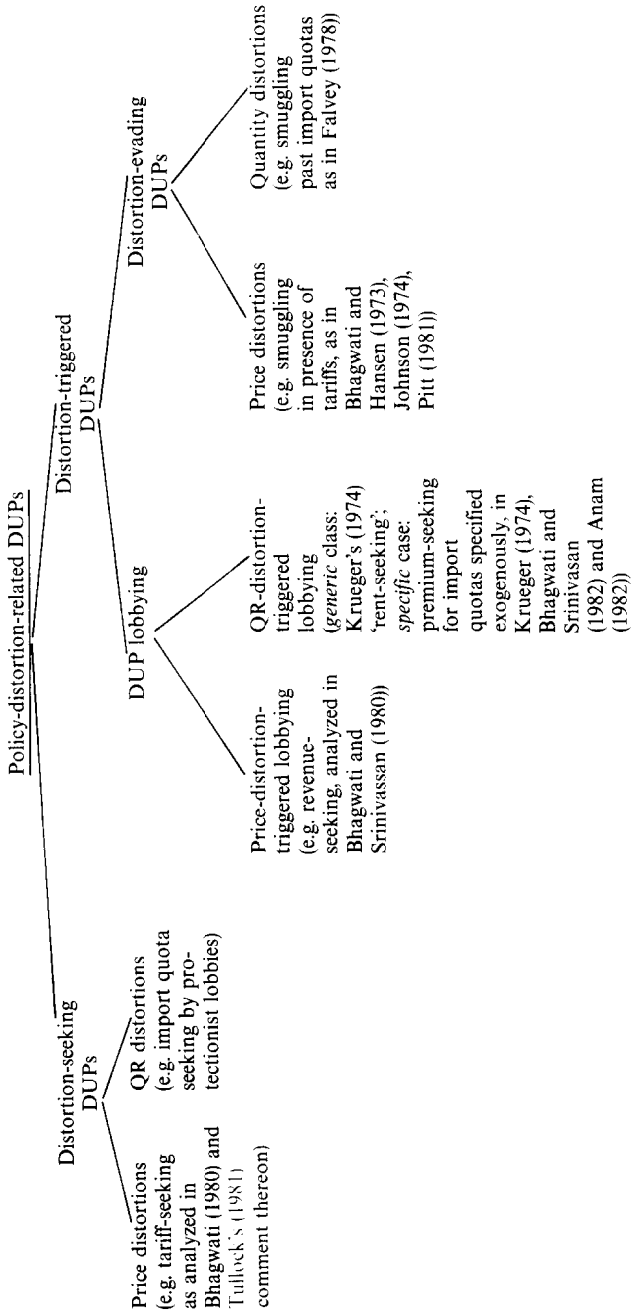
(4) Much of the confusion in this literature on lobbying can be cleared up if we focus on the true nature of the activities being analyzed. In my view, the essential nature of the activities such as lobbying, evasion, etc. is that they are ways of making a profit (or rather, an income) by undertaking activities which are directly unproductive, i.e. they yield 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.<sup>6</sup> Insofar as such activities use real resources, they result in a contraction of the availability set open to the economy. Thus, for example, tariff-seeking lobbying, tariff evasion, and premium-seeking for given import licenses are all privately profitable activities. However, their direct 'output' is simply zero in terms of the flow of goods and services entering a conventional utility function.

Functionally, the DUP activities can be classified as in fig. 2, which is constructed on the assumption that the DUP activities are generated by policy-intervention-imposed distortions — though, they can equally be generated by optimal policy interventions (as when smuggling is around an optimal tariff) or without policy intervention at all (as in Tullock's case of theft). The functional classification in fig. 2 divides the DUP activities into 3 classes: (a) distortion-seeking DUPs, such as tariff-seeking analyzed in my 1980 paper and Tullock's comment thereon; (b) distortion-triggered DUP lobbying, and (c) distortion-evading DUPs. The latter two, of course, immediately imply that the economy *begins* with a distortion that triggers the DUP activity: hence they represent an intrinsically *second-best* problem, with possible paradoxes of the type that Tullock is addressing with puzzlement.

In this schema, Krueger's (1974) generic class of 'rent-seeking' activities comes readily under the category of QR-triggered lobbying, for she is concerned *generically* with lobbying activities that are prompted by the existence of QRs and licenses, whereas her *specific* analysis relates to import quotas. As such, the phrase 'rent-seeking' should apply to simply one, and possibly small, subset of DUP activities in the real world.<sup>7</sup>

<sup>6</sup>The word 'directly' is necessary since, in the inherently second-best cases noted below, DUP activities may be (indirectly) beneficial. See the extended conceptual discussion in Bhagwati (1982).

<sup>7</sup>It is not clear to me that the Marshallian notion of 'rent' is readily extendable to all classes of DUP activities, even if one were willing to overlook the fact that Krueger used the phrase to categorise only the subset of QR-triggered lobbying activities. Furthermore, I have the rather different problem with the focus on rents in thinking about DUP activities, that rents arise also in models where DUP activities are not present at all. Thus, in the traditional models with fixed



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factor supplies in full employment, each factor earns only rents since the minimum supply price of the factors is zero. Thus, focussing on rents does not help to distinguish between DUP and traditional non-DUP activities, which I presume is what one wants to do. Hence, the phrase 'DUP activities' seems the logical candidate, in focussing directly on the relevant essence of such activities.

I also note with pleasure that Tullock does approve of the phrase DUP (pronounced as 'dupe'). As for his fear that it may be too late to have it adopted, I think that this may be too pessimistic. It has already begun to gain currency in the trade-theoretic literature, as in Anam (1982).

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