

Critical Review on Rent-Seeking Theory

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Abstract: *The purpose of this paper is to review rent-seeking theory which has been developed for over 50 years. Three aspects of rent-seeking are focused on in this paper. As for the types of rents, Public Choice economists focus on monopoly rents and rent-like transfers, recent scholars especially Khan extend the scope and range. As for the actors in Rent-seeking Process, Public Choice economists mainly discuss rent-seekers and partly mentioned rent allocators based on methodological individualism, while recent scholars especially Boyd and Ngo pay more attention to rent-creators and rent allocators from the perspective of historical institutionalism. As for the results of rent seeking, Public Choice economists argue that rent seeking results in social loss and is ultimately growth-retarding, while recent researchers argue that political as well as economic consequences of rent production should be also emphasized.*

Keywords: rent seeking, types of rents, actors in rent-seeking process, results of rent-seeking

Introduction

It is Tullock who first discussed the topic of rent seeking in 1967. In his seminal paper, Tullock (1967) took tariffs and theft as examples to argue the actual welfare loss of monopoly includes not only the Harberger Triangle but also the Tullock Rectangle because individuals or enterprises who intend to obtain the monopoly rents would use the resources that would otherwise have been used in the productive activities. Tullock did not use the concept rent seeking and failed to provide a strict definition in that paper. Krueger (1967) created the expression and developed a simple model of competitive rent-seeking. Buchanan (1980) further distinguishes rent seeking from profit seeking, and defines three levels of rent seeking activity. Tollison (1982) argues that rent seeking theory explores how people compete for artificially contrived transfers, and it involves normative and positive elements. The former focuses on the specification and estimation of the costs of rent-seeking activities to the economy while the latter focuses on explanation of the sources of contrived rents in a society. These conventional economists of rent seeking theory, namely Tullock, Buchanan, Tollison among many others, are usually referred to as the public choice school. The most comprehensive literature of rent-seeking from Public Choice School comes from Buchanan, J., Tollison, R., and Tullock, G. (1980), Lockard, A. and Tullock, G. (2001), Tullock, G. (2005), Congleton, R., Hillman, A. and Konrad, K. (2008), and Congleton, R. and Hillman, A. (2015).

From the studies on rent seeking, three questions should be discussed to articulate a clear definition of it. Put it simply, it involves who seeks what kind of rent and what it results in. The first question discusses the types of rents. It focuses on whether rent seeking is closely connected to government activities. Second, it involves who seeks rents. It discusses the actors who participate in the process of rent seeking. Third, it involves what rent-seeking activities result in. It focuses on whether rent seeking is inevitably inefficient and resource-wasteful.

Types of Rents

As a basic concept, rent is used in Economics for a long time. According to the New Palgrave (Eatwell, J., Newman, P., and Milgate, M. 1987:141), six terms are listed under the heading “rents”, i.e. rents in general, economic rents, quasi-rents (and composite quasi-rents), Ricardian rents, differential rents and monopoly rents. All kinds of these rents except monopoly rent have in common that they are not created by restrictions. They may relate to specific skills or they may arise from natural conditions. All in all, they arise naturally in the price system by shifts in demand and supply curves and such rents are viewed as dissipated quickly because competition will drive them to normal levels. The pursuit of these kinds of rents is equivalent to profit seeking, a normal benefit-pursuing activity. But this is not the case with the type of monopoly rents. Broadly defined, monopoly rents arise from any kind of artificial restriction on potential competitors that allows an increase of the protected company’s wealth. In contrast to rents that attend profit-seeking, monopoly rents usually undermine the efficiency-increasing impact of market forces and may even make price incentives irrelevant in the allocation of resources.

Buchanan (1980) defines rent seeking based on Krueger’s (1967) definition emphasizing that rent seeking is intimately connected to the government activities. He states as follows,

“If supply is arbitrarily restricted and price is allowed to rise to market-clearing levels, rents accrue to those who secure the ‘rights’ to engage in the activity. Governmental licenses, quotas, permits, authorizations, approvals, franchise assignments—each of these closely related terms implies arbitrary and/or artificial scarcity created by government... such scarcity implies the potential emergency of rents, which, in turn, implies rent seeking activity.” (Buchanan, 1980)

In Buchanan’s (1980) definition, rents are used in the narrow sense in which only monopoly rents are included, but in fact he intended to emphasize the relationship to government activity. Just as he put it, “rent seeking activity is directly related to the scope and range of governmental activity in the economy, to the relative size of the public sector.” Actually from the outset, Tullock developed rent seeking theory from a more general view of capturing a transfer, to put it differently in Pius Fischer’s (2006:25) term, i.e. “income without being productive”. In fact, we should add “relate to government activity” after it. In his original paper, although he analyzed theft except tariff and monopoly, theft is just an example to illustrate his idea, and later focused on transfer (Tullock, 1971), and then on aid (Tullock, 1975). As it is stated typically in the first volume of readings on rent-seeking Edited by Buchanan, Tullock and Tullock (1980), “It (rent seeking) is meant to describe the resource-wasting activities of individuals seeking transfers of wealth through the aegis of the state.” A more well-known definition comes from Tullock. “It is this activity of wasting resources in competing for artificially contrived transfers that is called rent seeking” (Tullock, 1982), and rent seeking is described as “the pursuit of profits via the use of government coercion”(Rowley and Tullock, 1988).

Obviously, the public choice economists defined rent seeking with rent in a broader sense emphasizing the relation between rent seeking and government activities. In their definitions, rents include not only monopoly rents but also rent-like transfers if we use the term that Khan has suggested in his study on rent seeking. On the other hand, the political implication of rents and rent seeking on state-market relations is obvious. When state engages in market regulation through limiting entry, creating tariff and so on, conflicts among rent seekers occur and fierce political contentions are involved.

Khan (Khan and Jomo, 2000:21-68) extends the types of rents. Except monopoly rents and rent-like transfer (or rent based on transfer), natural resource rent, Schumpeterian rent, rent for learning, and rent for monitoring (or monitoring and management rent) are included.

Table 1
Relevant growth and efficiency implications of different rents

Type	Efficiency Implications (static NSB)	Growth Implications (NSB over time)	Observations
Monopoly rent	Inefficient	Likely to be growth-reducing	Sometimes difficult to distinguish from Schumpeterian or learning rent
Natural Resource Rent	Efficient	Likely to be growth-enhancing	
Rent-like transfer	Neutral, with possible incentive inefficiencies	Indeterminate: may be growth-enhancing	May be essential for primitive accumulation and to maintain political stability, but may also become inefficient very rapidly
Schumpeterian rent	May be Efficient	Likely to be growth-enhancing	May become monopoly rent if it persists for too long
Rent for learning	Inefficient	May be growth-enhancing	Efficiency may depend on monitoring and enforcement ability of the state
Rent for monitoring	May be efficient	May be growth-enhancing	Efficiency may depend on monitoring and enforcement ability of monitors

Source: Khan and Jomo (2000:68)

It seems that the category of rents by Khan is problematic because its standard is overlapped. Roughly, the first four ones in the table are based on the source of rents but the last two ones are based on the purpose of rents. According to Khan (Khan and Jomo, 2000) subsidy basically is one kind of rents based on transfer, but if it is subsidized to an enterprise to enhance the technology and the enterprise achieves the aim, then it turns out to be a rent for learning.

The point of Khan's theory of course is not the category of rent but the relationship between rent seeking and economic growth. He links rent seeking to right and institution change. In his theory, rent seeking is defined as "the expenditure of resources and effort in creating, maintaining, or transferring rents" (Khan and Jomo, 2000:10). By broadly interpreting rent-seeking as processes which seek to create, maintain or change the rights and institutions on which particular rents are based, he emphasizes the special political and institutional context. As he puts it,

"A more general approach to rent-seeking can incorporate political and institutional variables to explain first, how much effort is actually expended in rent-seeking, and secondly, the types of rights and rents which are created as a result." (Khan and Jomo, 2000:71)

By comparing the input and outcome of rent seeking, he examines the relationship between rent seeking and economic growth, trying to find out the right political and institutional setting that can create and maintain "good" rents. In essence, Khan's approach shares the same of underlying assumption with developmental state theory: economic growth as predicated upon getting the price wrong but the institution right. (Ngo and Wu, 2009:4)

Of course, not all the scholars view rent-seeking as activities related to government activities. Pius Fischer (2006:26) views that "rent-seeking settings cover a continuum from government-related to strictly private settings where the government plays at the most a very passive role." At one end is protection effectuated by government policy, which is the most evident case of government involvement in rent creation; at the other end, rent seeking takes place in private social life depending on the society's subjective definition of property rights and duties. According to Pius Fischer, it even makes sense to define people begging on the

street and knocking on doors as rent seekers, in particular if they have opportunities to work. (Pius Fischer, 2006:26-27)

On the whole, however, most of the theorists have seen rent seeking as activities related to government activities focusing on monopoly rent and rent-like transfers, such as tariff, tax, subsidy, and the like.

Actors in Rent-seeking Process

The second question that who seeks rents is related to actors involving in the rent-seeking process in a much broader sense. The Public Choice Economists analyze different actors based on methodological individualism. Tollock (1993:25-61) in his book named *Rent Seeking* has reviewed the principal actors in the political market for rents, the voters, the media, the interest groups and politicians including legislators and bureaucrats. In this aspect, it is closely connected to interest group theory of government considering a pluralist democratic politics as a theoretical prototype.

In their theory the concept “politics” is understood as an exchange mechanism like a market and rent seeking is viewed as a demand-side as well as a supply-side activity. In a political market, politicians are modeled as providing a brokering function for wealth transfers. Special interest groups capable of effective organization “demand” such transfers. Other more general groups, including many individual voters, incapable of such effective economic organization, “supply” such transfers. In the process, interest groups that both demand and supply transfers, as the principal rent seekers, try to influence government for economic gains while politicians and bureaucrats, as the rent allocators, mediate the competition for rent to maximize their own self-defined interest.

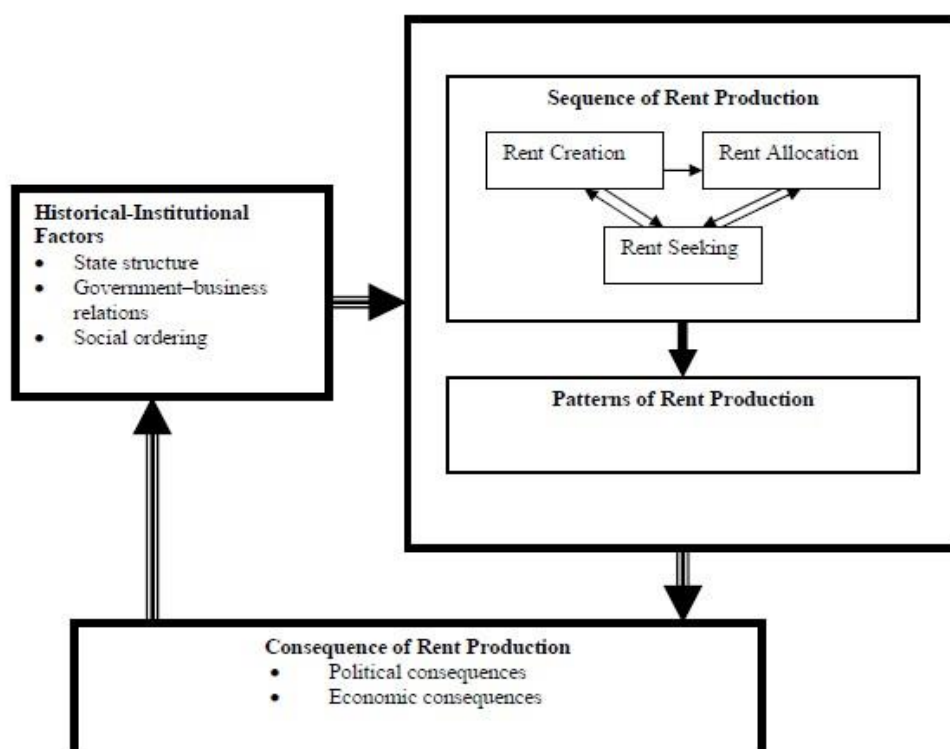
Mchesney (1987) holds a different view about the role that the politicians play. In the model of “rent extraction”, he identifies politicians not as mere brokers but as independent actors getting private actor to respond to their own demands. In this model, politicians are not rent allocators who redistribute wealth in response to competing private demands, but rent seekers who pursue their own self-defined interest.

In a word, in their model of “competitive rent seeking”, Public Choice Economists focus on the rent seekers and rent allocators but only confine them on individuals, say, the voters, the politicians, and the interest groups. The traditional conceptions in politics are never seen, such as state, government, power and authority. From this respective, the rent-seeking theory of the conventional public choice economists is termed by Boyd “the liberal market mode of rent utilization” with a characteristic of political market rent seeking nexus that reflects the particular circumstances of the USA. Boyd also criticizes that in their model the state is absent, replaced by the political market and the political brokers. He argues that it may not matter in respect of the United States which is said to be a typical instance of a stateless-society, but problems arise in the other political economy especially in the so-called state-society (Boyd, 2009).

In the empirical study on rents and rent seeking in the East Asian countries, Boyd has found out that non-market price-setting and non-market resource allocation prevail in these countries. In those processes, rents and rent seeking embedded in the polity every bit as much as the economy of the same political economy. When viewed from the political end of the political economy of rent seeking, the creation of rents, the allocation of rents and rent seeking itself are part of the normal business of politics. It serves political ends, such as the pursuit of power and the rewarding of supporters, as well as ostensible economic ends. Since the politics is generally settled and highly institutionalized, rent seeking is also institutionalized with enduring characteristics and persistent pattern. Boyd term the institutionalization of rent seeking “a mode(s) of rent utilization”. Generally speaking, in the development of a developing country, rents are created and allocated systematically by

political system, related actors try every effort to seek rents, and thus the economy evolves and the social order is maintained through a relatively settled mode of rent utilization under the special political economy of the country. Due to the different formal and informal institutional settings in different political economy, the modes of rent utilization are different in different countries, and furthermore the modes of rent utilization are significant to economic outcomes. Also he discusses the determinants of modes of rent utilization from formal and informal institutional factors. The principal determinants are hypothesized to be the architecture of the state, the mode of social ordering and the government-business relations. (Boyd, 2006, 2008, 2009)

Based on the study of his fellows including Boyd (2009), Ngo and Wu (2009:1-21) suggests a comprehensive framework to analyze the phenomena of rent seeking with emphasis on the institutional supply side of rents. After pointing out that the existing study of rent seeking focuses mainly on the demand side, he proposes an embracing concept of “rent production”, by which he refers to “the whole range of activities connected to the fabrication of economic rent, including its creation, allocation, extraction, redistribution and pursuit” (Ngo and Wu, 2009:10). He conceptualizes the sequence of rent production into three interrelated but separable processes, namely rent creation, rent allocation, and rent seeking. (See Figure 1) He believes that it is possible to trace the sequence of rent production in a specific commodity, industry, policy area, or economic sector by locating the sources of rent creation, the means of rent allocation, and the methods of rent seeking, and so on. Patterns of rent production are differentiated by the combination of different actors, type of rents, means of exchange, and terms of exchange in the whole sequence of rent production. At last the principal determinants of patterns of rent production are three kinds of different historical-institutional factors, namely state structure, government-business relations and social ordering, which obviously are the terms from Boyd’s works.



Source: Ngo and Wu, (2009:17)

Figure 1. Regime of Rent Production

Multiple state and market actors including rent creators, allocators, recipients, and seekers involve in the rent production. In each category, institutional as well as individual actors are included. The government is the main rent creator by virtue of its control over regulatory power and property rights with the power of rent creation and allocation dispersing among competing bureaucratic units. Rent seekers are not only confined to individual actors, say, typically the private entrepreneurs, but also institutional actors, such as state sectors/governmental establishments, industrial sectors, business enterprises and so on. It is worth noting that individual government units can seek rents created by central policies or by other bureaucratic establishments while creating their own rents to be allocated to their hand-picked beneficiaries in the case of China (Ngo and Wu, 2009:10-12).

Ngo and his fellows declare that they try to build “the politics of rent production” (the title of his essay) with an emphasis on “supply side” moving from methodological individualism to a historical–institutional approach examining the historical legacies and political institutions which shape rent production (Ngo and Wu, 2009:4). They argue that the political as well as the economic consequence of rent production should be taken into account. As Boyd (2009) comments, “they signal the shift in emphasis by a new coinage and speak of rent production rather than of rent seeking and which they analyze as a political process with political effects.” In essence, Ngo’s model is not dramatically different from Boyd’s “modes of rent utilization”, because both of them try to advance the analysis of rent seeking activities by integrating rent creation and rent allocation into the conventional model of rent seeking.

Results of Rent Seeking

The third question is what the rent seeking results in. It is a question related to whether rent seeking is inevitably inefficient and resource-wasteful. In order to distinguish rent-seeking with profit-seeking, Buchanan (1980) emphasizes that “the term rent seeking is designed to describe behavior in institutional settings where individual efforts to maximize value generate social waste rather than social surplus.” Tollison (1982) follows the same logic, arguing that “it is this activity of wasting resources in competing for artificially contrived transfers that is called rent seeking”. Most of the economists of public choice school argue that competition for rents generates social waste from society’s point of view because resources that could otherwise be devoted to value-producing activities are engaged in competition for distributive results. Obviously, they take perfectly competitive market as their benchmark, and draw the conclusion from the perspective of opportunity cost. Put it simply, in their analysis, rent seeking activities are basically bad because they are inefficient and harmful to social welfare, and hence growth-retarding to economy. Based on this, they develop some models (Posner, 1975) to calculate the rent seeking cost, i.e. the extent of social waste that rent seeking result in. Furthermore, a lot of empirical studies to calculate the actual rent-seeking cost in different countries come out.

Table 2
Estimates of the Welfare Losses from Rent-seeking

Study	Economy	Year	Welfare loss
Krueger (1974)	India	1964	7% GNP
Krueger (1974)	Turkey	1968	15% GNP (trade sector)
Posner (1975)	United States	various years	3% GNP (regulation)
Cowling and Mueller (1978)	United States	1963–6	13% GCP ^a (private monopoly)
Cowling and Mueller (1978)	United Kingdom	1968–9	7% GCP ^a (private monopoly)
Ross (1984)	Kenya	1980	38% GDP (trade sector)
Mohammad and Whalley (1984)	India	1980–1	25–40% GNP
Laband and Sophocleus (1988)	United States	1985	50% GNP
Lopez and Pagoulatos (1994)	United States	1987	12.5% of domestic consumption

^a GCP = gross corporate product.

Source: Adapted from Tollison (1997, Table 1, P. 514)

However, Buchanan's definition is criticized by Pius, F. (2006) who states as follows in his book.

“Albeit accurate for many rent-seeking situations, the definition is problematic if taken literally, as it classifies any individual maximizing behavior that bears social costs as rent-seeking and labels rent-seeking as always socially wasteful. The crucial point is that even if rent-seeking should be contrasted with profit-seeking, it is more than a negative counterpart.” (Pius, 2006:25)

In fact, Bhagwati (1982) has proposed another expression “Directly Unproductive, Profit-Seeking Activities (DUP)” based on the theory of second best. He classifies DUP activities into four types and rent seeking is only viewed as a subset of DUP. The concept has two different kinds of implications to rent seeking theory. First, what's important here is that it shows some different results that rent-seeking would generate. In the particular situation of initially distorted (type 1) and finally distorted and the one of initially distorted and finally distortion-free (type 2), the social beneficial outcomes would possibly come out, i.e. rent seeking sometimes efficient and welfare-enhancing. This view is much different from the public choice school economists. Second, rent seeking is either exogenous or endogenous to distortion. Distortion-seeking DPUs result in distortion thus generally generates welfare-reducing outcome, but Distortion-triggering DPUs result from distortion and may result in second best situation thus probably generate welfare enhancing outcome.

Khan (Khan and Jomo, 2000:70-144) also discuss outcomes of rent seeking. In their model of rent seeking as process, they examine the net effect of rent seeking by comparing the “output” (net social benefit associated with the rent-outcome) and the “input” (the rent-seeking cost). They argue that outcomes of rent seeking are not always inefficient and growth-reducing, and rent-seeking would generate positive outcome under particular political and institutional context. When he and the others do some empirical studies on rent seeking in several Eastern Asian countries during the period of rapid economic development in the last century, they find that corruption, clientelism and other forms of rent-seeking prevailed in Philippine, Thailand, Malaysia and Indonesia, and point out a great many of other types of rents except monopoly rents existed in these countries on the one hand; on the other hand, the implications of seeking for these rents are complicated. Their studies show that the outcomes of rent-seeking heavily depend on the political and institutional variables and the effects of

rent-seeking on economy are much more complicated than what public choice economists have exhibited. This improves the explanatory ability of rent-seeking theory especially to the reality in developing countries.

However, although Khan has drawn a conclusion different from public choice school theory, Khan's approach still suffers from a serious limitation. As Ngo (Ngo and Wu, 2009:4) criticizes, Khan's approach is still exclusively interested in the economic consequences of rent seeking the same as economists of public choice school do.

Instead, Ngo (Ngo and Wu, 2009) points out that the exclusive concern about the welfare of rent seeking should be changed and the political as well as economic consequences of rent production should be also emphasized. North et al. also view the consequences of rent in a much broader sense. They view rents as well as competition as features of human behavior present in all types of societies. Rents are ubiquitous, and it is the way in which rents are created as well as the nature of competition that differs across the different societies. In their theory, rents come to resemble incentives and rent creation is viewed as the major means for the political system to manipulate to order the political system.

Conclusion

It has been roughly five decades since the term "rent-seeking" became an established expression in economic and political literature. Looking back at the large body of literature, it is not difficult to find out that there exists no single valid definition for rent-seeking that covers the entire domain of activities it refers to. It is so complicated that Pius Fischer (2006:25) has argued that "the choice of any particular rent-seeking definition that outlines its domain and distinguishes itself from other concepts is a matter of preference and opinion". But from what we discussed above, we can see that the domain and focus of rent seeking that different theorists are interested in are relatively obvious.

In general, the Public Choice economists from the outset view rent seeking as a critical pathology of government failure. Individuals or interest groups invest resources to get the government to intervene in market process. It is argued the dynamic costs due to the wasteful investment of resources are much more substantial in addition to statistic deadweight losses. In their point of view, rent seeking is closely relative to the government activities. Monopoly rents and/or rent-like transfers are created as a result of state intervention in the economy. Rent seeking thus constitutes a type of unproductive activity which results in social loss and is ultimately growth-retarding. Therefore, for the public choice economists, to eliminate rent seeking activities is their utmost matter of concern.

Khan link rent seeking to right and institutional change which are intimately connected to the political system. They view rent seeking in a much broader sense as a process to which seek to create, maintain or change the rights and institutions on which particular rents are based. They extend rents into natural resource rent, Schumpeterian rent, rent for learning, and rent for monitoring in addition to monopoly rent and rent-like transfer. Except monopoly rent, the rest kinds of rents do not necessarily result in inefficiency, and may be growth-enhancing (See Table 1.1). What is important in their eyes is the political and institutional context in which the rent seeking occurs. So they put more attention to finding out the "right" political and institutional setting to produce "good" rents.

Like Khan, Boyd (2008) also emphasizes the political and institutional factors concerning rent seeking activities, but advances them in a different way. He uses a new term "modes of rent utilization" to emphasize the institutionalized pattern with enduring characteristics in different political economies focusing their determinants from formal and informal institutional factors. Ngo make a further advance about this approach by putting forward a similar term "rent production" to further integrate rent creation and rent allocation into the conventional theory of rent seeking. They try to embrace "the whole range of activities

connected to the fabrication of economic rent, including its creation, allocation, extraction, redistribution and pursuit” (Ngo and Wu,2009:10) from a historical-institutional approach in order to answer this question “how does a certain set of political institutions shape a specific pattern of rent-creation and rent-seeking practices” (Ngo and Wu,2009:5).

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