

Individual Economic Ignorance versus Social Production Functions and Precarious Enlightenment:

Comment on Tullock's View of
Rent Seeking in Dictatorships

by

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1. *Tullock's Argument*

Dictatorship is and has been the dominant form of government and myth has it that this form of government has one thing going for it: it is efficient compared to democracies in which a multitude of wills paralyzes decision making. Not so, said TULLOCK [1986]. Dictators commonly grant monopolies (i.e. they provide a great deal of rent-seeking opportunities) to various of their citizens which is economically inefficient. But if they have dictatorial powers, why do they increase rather than reduce economic inefficiency?

Tullock tackled this question by first ruling out the halfwit hypotheses: dictators are almost always intelligent people. Next, he drew the appropriate conclusion that, if stupidity is ruled out, offering rent-seeking opportunities must be the result of purposive action on the part of the dictator. What can the purpose be?

He suggested two likely purposes for granting monopolies. First, revenue raising: people apply for a particular monopoly and the dictator will grant it to the highest bidder, thus raising revenue (much of which will be diverted to the personal account of the dictator). Second, raising political support for the dictator to stay in office: a dictator is in constant fear of being overthrown and he needs to be continuously concerned about gaining and keeping the loyalty and trust of those who could possibly become dangerous. The granted monopolies will provide these people with a good reason to remain loyal to the dictator (but it does not mean that they are efficient managers of the enterprises with which they have been entrusted; in all likelihood they will be quite inefficient).

Although granting monopolies seems to serve important purposes, it still is a puzzle to Tullock why dictators almost always revert to *this* means for achieving their goals. If they would not grant monopolies but instead allow free competition and impose taxes, they would have a more efficient way to raise revenue. If they would not grant monopolies but hire efficient man-

agers, tax away the (then much higher) profits and use the money to pay off their political cronies, they would have a much more efficient way to raise political support. Thus, why do dictators shun the tax alternative?

Tullock's answer is surprisingly simple: there is a great deal of *economic ignorance* on the part of the dictator and on the part of the protégés who greatly overestimate their own managerial capacities. While Tullock admits that this answer is not very certain, he does think that it is necessary to explain why dictators do not opt for the tax alternative.

2. Some Doubts

My critique of Tullock's analyses of dictators is no attempt to address myself directly to the theory of rent seeking. Tullock has put rent seeking as a topic on the agenda of political economy (cf. TULLOCK [1967]) and he continued to put his stamp on the further development of rent-seeking theory (cf. TULLOCK [1980]). Rather, I will argue from the point of view of a sociologist who is more than favorably inclined toward the new political economy (see LINDENBERG [1985]) but who thinks that this discipline would gain a lot by paying still more attention to the social context and to institutions.

While I can accept the idea that economic ignorance has something to do with rent seeking, I find it hard to believe that we should think of single ignorant individuals whose replacement would change the whole system. The view Tullock offers us of the alternatives of a dictator is virtually context free, and it personalizes social structure and institutions. The dictator supposedly has the choice between granting monopolies and „the tax alternative“ and the efficiency of managers is supposedly simply a matter of their competence. A different person would make a large profit no matter what the context within which she has to operate. From this view, the puzzle naturally arises why dictators do not choose the „better“ alternative, and the solution must be something personal (if it's not stupidity, it's ignorance). I have my doubts about this view and, as an example of what I have in mind, I would like to make a brief excursion to pre-revolutionary France.

In a fifteen years span, from 1774 to 1789, there were eight ministers of finance, each totally or partially undoing the policy efforts of the previous one. Some (or most?) of these ministers were neither naïve nor economically ignorant and yet they were not able to translate their economic insights into stable institutional change towards efficiency. Let us have a brief look at some of them.

In 1774, *Turgot*, by the standards of his time certainly a good economist, began his office as finance minister of the heavily indebted France with the resolve to establish clever economic reform (abolishing duties and protective tariffs, doing away with privileged trade corporations, replacing the *corvée* by an extra tax on revenues, and reducing the number of venal offices). He

lasted only two years, when he was replaced under pressure of the business community.

Cluny, Turgot's successor, very pointedly recalled Turgot's reform that had directly touched privilege: he reinstated the *corvée*. Yet he was unable to improve the financial state of France. This feat was (temporarily) accomplished by *Necker* who replaced him in 1776.

Necker showed himself to be a genius in restoring confidence in the government and thus to contract new loans. But he thought he could do so only by also reimposing duties and tariffs because there was much popular unrest and a widespread belief that duties on grain would increase the bread supply. Necker was too clever not to know that this belief was mistaken; yet he deemed it necessary to support the myth in order to calm people down and to create a new atmosphere of confidence¹.

None of these three ministers of finance were in any obvious way economically ignorant. Turgot who may have been the most advanced economist of the lot did not succeed in implementing his superior insights. He was chased away by the (ignorant?) business community. Necker, playing up to popular misconceptions, succeeded in raising enormous sums of public loans.

3. Systematic Effects of Privilege

It seems to me that the crucial question with regard to systematic effects of privilege can be stated as follows: what produces a system in which the transaction costs for an agreement that ignores privilege are considerably higher than for agreements that acknowledge privilege?

3.1 Social Production Functions

Privilege is of course present in any society to some degree. But on the basis of my own studies on revolutions², I would like to suggest that the important point is not the presence of privilege per se but the degree to which the individual and the state are systematically related on the basis of privilege. Such a relationship exists when state finance is *institutionalized* on the basis of privilege.

The degree to which a society has such a system of state finance depends

¹ A fascinating story of economic insight, systematic ignorance and the tenacity of certain aspects of the system can be seen in Kaplan's description of the fate of liberal reform 1763–64 and the following bread crisis in France (KAPLAN [1976]).

² The project on state finance and revolutions (especially the French and Russian revolutions) has been described in LINDENBERG [1982] and some of the results have been described in LINDENBERG [1984b] and HART [1984]. An extensive report will be forthcoming.

to a large extent on the way the state was formed. France, for instance, developed from early on fiscal immunity and many feudal rights (monopolies) for the nobility as concessions for military (cavalry) service. England's military core was a remnant from Saxon times: the militia; and it was sufficiently protected by natural borders that its only use for cavalry was for campaigns on the continent. As a result, the process of state formation was much less based on privilege in England than in France. Once state finance is based on privilege, it is very difficult to change without withdrawing property rights (i.e. privileges) from the elite, a move that destabilizes the whole society.

For our purposes, the important point is that in such a system privilege produces both status and income. In fancier language, one can say that the social production functions for status and income (cf. LINDENBERG [1984a]) both depend heavily on privilege. For pre-revolutionary France, Alexis DE TOCQUEVILLE [1955] described these relationships with humorous detail. Obviously, being exempted from paying taxes was not just a matter of money for the nobility, it was a matter of honor. And the rich bourgeois living in town had „only one ambition: that of securing an official post of some kind ... no sooner did he find himself in possession of a small capital sum than he expended it on buying an official post instead of investing it in business“ (DE TOCQUEVILLE [1955], p.91). Even in the lower strata of society, daily life was shot through with concerns for privilege. “Each group was differentiated from the rest by its right to petty privileges [and] they were constantly wrangling over questions of precedence ... When a group was not given the precedence it claimed in the general assembly of notables, it ceased to attend, preferring to withdraw from public affairs altogether rather than to stomach such an affront to its dignity” (DE TOCQUEVILLE [1955], p.95)

What Tullock calls the “tax alternative” supposedly at the disposal of the dictator is nothing less than a radical change of social structure, i.e. of the social production functions for status and income. How would the dictator do it? This question is all the more compelling if one considers that in such a society the *agency problem* in the widest sense of the word (cf. WHITE [1983]) can only be solved on the basis of privilege. In order to get things done you need other people who, in turn, function on the basis of the prevailing social production functions. They want privilege as part of their payment. And even if you get managers from a country with different social production functions (Tullock's so-called efficient managers from abroad), he or she still has to operate in a society in which people want privilege as part of their payment. The irony is that the manager from abroad will be able to solve the agency problem better playing up to privilege than operating on the basis of the so-called efficient alternative. This is Necker's story.

3.2 *Precairous Enlightenment*

Economic ignorance in a society in which social production functions are based on privilege is so to speak built in because transactions costs for moving away from privilege are high and because people have a tendency to chose beliefs that are rewarding and therefore self-serving.

According to the Oxford English Dictionary, the removal of someone's ignorance is enlightenment. In order to bring the systemic aspect of self-serving beliefs into better relief, it is useful to distinguish between two forms, viz. *robust* and *precairous* enlightenment, analogous to the difference between coordination and a prisoner's dilemma in game theory. Once you have learned how to drive a car, your enlightenment in this matter is likely to be robust. You have no incentive to distort or to deviate from what you have learned. Once you have learned how the economy can be run most efficiently, the enlightenment is in all likelihood precarious because you individually would like to be an exception with special privileges. For this reason, Adam Smith did not trust the business man to defend what is best for the economy. He instructed the public to be wary of special claims coming from a sector of the business community. In fact, a market society needs continuous market enlightenment in order to counteract the tendency of self-serving beliefs to increase the transactions costs for appropriate market policies.

BROUGH and KIMENYI [1986] are authors quoted by Tullock as having proposed the economic ignorance solution for manager. They say that when the rewards of the managerial position itself (not just the monetary gain) are aspired, political cronies of dictators "usually overestimate their capabilities and assume that they can attain at least the same levels of profits as the experienced managers do." (BROUGH and KIMENYI [1986], p. 42) A footnote belonging to this quote refers to psychological work on self-serving attributions, i.e. to the idea that even if the cronies knew better, they would adapt their beliefs to what they perceive to be the most rewarding course of action. Their enlightenment is precarious. This is a far cry from personal economic ignorance; and it depends on the desirability of the managerial position above and beyond the monetary rewards associated with it (i.e. on the status rewards attached to privilege). The assumption that the "tax alternative" is there for the choosing implies, wrongly, that status rewards do not matter or that they are unconnected to privilege.

4. *Dictatorship and Democracy*

Towards the end of his paper, Tullock compares rent seeking in dictatorships and democracies and he comes to the conclusion that the difference is not great. For him, the methods for obtaining the special privileges differ in

appearance, but not in essence. This conclusion is completely unconnected to the first part of his paper. There is no word about the reason heads of government would not opt for "the tax solution". Economic ignorance is not invoked anymore. Why?

Tullock is too evenhanded to make democracy look good by default. Obviously, there are rent-seeking opportunities in democracies too, in the form of overpaid officials, special regulatory restrictions, subsidies and the like, each kind involving many people. Yet, he cannot quite claim personal economic ignorance for western democracies. As a result, he just disconnected the two arguments.

Unable to use the economic ignorance argument for western democracies, Tullock had no basis left for the comparison of western democracies and dictatorships. Consequently, he detected little difference. I submit that when we look at the transactions costs for agreements that explicitly do not involve privilege, we will detect a considerable difference between dictatorships and western democracies. Low transactions costs regarding competitive arrangements will, in turn, considerably reduce the impact of self-serving economic ignorance (i.e. precarious enlightenment).

In short, rent-seeking theory would profit from considering social production functions and the concomitant transactions costs.

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