

Regulations, risk, and rent seeking behaviour

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Aim of the paper

- This paper studies how political uncertainty affects rent seeking, and what level of political uncertainty is “optimal” for society.
- We find that under some conditions, a higher level of political uncertainty might be beneficial to society, because it discourages rent seeking.
- The findings can be applied to various regulatory relationship in the areas of environmental regulations and regulations of resource extraction.

Background

- Fisheries: Overcapacity => buy-back schemes. Fishermen will know the government's objective and strategy, anticipate new buy-back schemes, and invest in capacity. Also: Quotas based on current/past catches
- Contradicts the government's goal
- Fishermen's actions will increase the overcapacity/overfishing, and hence the need for new schemes

Background

- What if government's objectives and strategies were less clear and easy to understand?
- Would this uncertainty discourage rent seeking and "strategic behaviour", and make agents focus on their business?

Litterature/theory

- Kydland/Prescott +++: Governments should stick to (objective) rules, limit their own possibilities to deviate
- Large theoretical litterature on rent seeking (Lockard, Tullock). Main result: Firms will undertake rent seeking behaviour/lobbyism/strategic behaviour to maximize their expected utility, i.e., spend resources on rent seeking as long as the expected utility of the investment is positive

Model

- Introduction of political risk:
- I_{PU} is some kind of index measuring the relevant political risk. This affects the risk in the decision problem (via the standard deviation/variance), but not the expected value.
- Hence: The political risk will affect the rent seeking

Model

The costs that the regulator minimizes are given by

$$C(I_{PU}) = n \cdot x^*(I_{PU}) + n \cdot \Pi(I_{PU})$$

$\Pi(I_{PU})$ is the risk premium, convex and increasing in I_{PU} , and x is the optimal rent seeking for agents, given the level of political uncertainty

Results

- First order condition for optimal risk level:
A marginal increase in the risk premium is equal to the marginal reduction in the costs from lobby activity. Hence, it will in some cases be optimal to choose a political risk level higher than 0.

Results

- Otherwise: Quite intuitive results.
 - The more risk averse agents are, the less risk is optimal
 - The more rent seeking decreases with increased political risk, the more "beneficial" is political risk (all else equal)

Implications

- Assume that policy makers want to minimize total costs:
 - Cost from risk (lost utility)
 - Cost from rent seeking
- Can governments decide the value of I_{PU} ?
 - If uncertainty is too high – reduce it (better legal system, "Kydland rules", rhetorics)
 - If uncertainty is too low? More difficult, but drastical changes unlikely to be desirable. Changes in legislation and/or rhetorics to emphasize future flexibility
 - In general: Government predictability is usually good – but sometimes uncertainty is useful. Still likely to be the exception, and not the rule!