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WORKS OF
GORDON
TULLOCK
VOLUME 5

The Rent-Seeking Society

THE SELECTED WORKS OF GORDON TULLOCK

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Gordon Tullock

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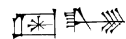
VOLUME 5

The Rent-Seeking Society

GORDON TULLOCK

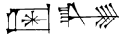
Edited and with an Introduction by

CHARLES K. ROWLEY



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INTRODUCTION

The Rent-Seeking Society brings together the main body of Gordon Tullock's contributions to a field that he pioneered during the late 1960s and early 1970s. Although Anne Krueger coined the name "rent seeking" in 1974, Tullock provided the initial insight in 1967.¹

An important characteristic of competitive market equilibrium is the equality that exists between marginal consumption benefits and marginal production costs. Such an equality implies that competitive markets maximize consumers' surplus over cost. Harberger triangles occur whenever market prices are distorted by taxes, tariffs, or monopolistic practices that drive wedges between marginal benefits and marginal costs, thus cutting off mutually beneficial transactions.

Economists had long thought that welfare losses could be approximated by the magnitude of such triangles. Jules Dupuit is generally credited with the initial insight concerning the notion that welfare effects of price changes could be estimated from demand and supply conditions. Indeed, the welfare loss triangles were known as Marshallian triangles, in honor of the famous Cambridge economist Alfred Marshall, as early as the late nineteenth century.²

Yet before 1954, no one had ever calculated the magnitude of welfare losses from actual distortions within an economy. In 1954 Arnold Harberger proceeded to do so, using a general equilibrium framework in which demand curves were more nearly Hicksian (based on compensating variations) than Marshallian (ignoring the income effects of price changes). In consequence, the welfare loss triangles are now referred to as Harberger triangles.³

Tullock's rent-seeking insight came as a negative reaction to Harberger's 1954 paper in which he measured the welfare loss from monopoly in the United States at a mere 0.1 percent of gross national product. Instinctively

1. Anne O. Krueger, "The Political Economy of the Rent-Seeking Society," *American Economic Review* 64 (1974): 291–303; Gordon Tullock, "The Welfare Costs of Tariffs, Monopolies, and Theft," *Western Economic Journal* 5 (1967): 224–32.

2. A. Jules Dupuit, "De la Mesure de l'utilité des travaux publics," *Annales des Ponts et Chaussées*, 2d ser., 8 (1844); Alfred Marshall, *Principles of Economics* (London: Macmillan, 1890).

3. Arnold C. Harberger, "Monopoly and Resource Allocation," *American Economic Review* 44 (May 1954): 77–87.

Tullock recoiled from the notion that the measured welfare loss from monopoly could be so low. Creatively he set about determining why he felt his instinct was correct.

To this end, Tullock shifted attention away from the welfare triangle to the rectangle depicting the supernormal profits available as the monopolist reduces output below and elevates price above the competitive market equilibrium. If supernormal profits are available from a monopoly position, Tullock argues, surely potential monopolists will expend resources through the political process in a competitive race to secure that monopoly.

If such rent seeking is efficient, in the sense that resources expended equal the present value of monopoly profits, then, Tullock argues, the profit rectangle must be added to the Harberger triangle to identify the full trapezoid of the welfare cost to monopoly. For this insight, economists now identify the profit rectangle as the “Tullock rectangle” in the literature on rent seeking.

The Rent-Seeking Society consists of six parts, each depicting a separate component of the field.

Part I, “Rent Seeking: An Overview,” brings together two papers that focus on problems of defining rent-seeking behavior and outline the nature of the ongoing research program in a suitable historical perspective.

“Rent Seeking: The Problem of Definition” represents Tullock’s proposed restraining order on those economists who view all forms of competitive behavior as rent seeking. As Tullock notes, most forms of competitive behavior are wealth enhancing, even when they result in the elimination of less-efficient firms from the marketplace. Let us restrict the rent-seeking concept, he argues, to only those cases in which individuals and organizations expend resources on lobbying government for special privileges that reduce the wealth of society. In such instances, both the resources expended on lobbying and the special privileges obtained are wasteful of scarce resources, and, further, we know for certain we are dealing with behavior that is harmful to society as a whole.

Rent Seeking is Tullock’s widely acclaimed monograph depicting the intellectual history of the rent-seeking research program and describing the hazards confronted by any scholar who challenges conventional wisdom in public policy, most especially when that challenge threatens strongly entrenched ideological positions. Tullock explains in some detail the nature of Harberger’s 1954 contribution and Harvey Leibenstein’s 1966 modification of that paper in the form of the concept of x -inefficiency (the notion that mo-

nopolies may fail to function on their outer-bound production frontiers because of the absence of strong competitive pressure).⁴ He outlines the nature of his own alternative approach from the perspective of rent seeking and carefully summarizes the sequence of steps that he took during the early 1970s to flesh out the implications of the basic model before Anne Krueger labeled rent seeking, the behavior identified by Tullock's program of research.

Tullock devotes the middle part of the monograph to integrating rent-seeking behavior into a more general public choice model of democratic political markets. The model that he uses will be familiar to those who have read *The Economics of Politics*, volume 4 of this series. For those who have not, suffice it to say that the public choice model is one that implies political market failure when more-powerful interest groups and self-seeking senior bureaucrats rent seek to shift legislative outcomes away from the median preferences of relatively ill-informed voters. By so doing, scarce resources are wasted in the implementation of wealth-reducing policies in clear and costly violations of the Pareto principle.

In the final section of the monograph, Tullock explores an interesting menu of potential constitutional and institutional reforms designed to mitigate the significant welfare costs of the rent-seeking society.

Part 2, "More on Efficient Rent Seeking," contains four contributions in which Tullock elaborates on his famous 1980 article on efficient rent seeking (published in volume 1 of the series).⁵

"Efficient Rent-Seeking Revisited" formalizes and classifies an efficient rent-seeking problem using the example of a true lottery. Tullock assumes that potential rent seekers are permitted to purchase as many tickets as they wish in a rent-seeking lottery. The tickets are placed in a hat. The winning ticket is randomly selected and provides a rent seeker with a predetermined prize. The paper demonstrates that, except for an infinite number of players and constant marginal costs, the market does not clear. The rent seekers in aggregate will lay out sums either in excess of or less than the available prize. In this sense, rent seeking is not efficient.

In "Back to the Bog," "Another Part of the Swamp," and "Still Somewhat

4. Harvey Leibenstein, "Allocative versus X-Efficiency," *American Economic Review* 56 (1966): 392–415.

5. Gordon Tullock, "Efficient Rent Seeking," in *Toward a Theory of the Rent-Seeking Society*, ed. James M. Buchanan, Robert D. Tollison, and Gordon Tullock (College Station: Texas A&M University Press, 1980), 97–112.

Muddy: A Comment,” Tullock plays out his self-appointed role of confounding anyone who claims to have resolved his efficient rent-seeking paradox. These short papers demonstrate the robustness of his original efficient rent-seeking insight.

Part 3, “The Environments of Rent Seeking,” consists of eight papers that together display the wide reach of the rent-seeking concept.

In “Rent Seeking as a Negative-Sum Game,” Tullock explains that when an individual invests in something that will not actually improve, but indeed will more likely lower, productivity, he engages in rent seeking. The “rent” is the income that the individual seeks to secure as a consequence of the special privilege or monopoly power that his investments target. Typically government and its bureaucracy are the focus of such rent-seeking activity. Tullock explains why this type of rent seeking wastes resources overall, even though the successful rent seeker increases his own net wealth. He continues with an explanation of how the existence of privilege and monopoly purchased through government generates attempts by others to avoid the payment of the rents they now confront. Such rent avoidance itself diverts resources from productive to nonproductive activities. Tullock points out the harmful economic consequences that may occur when corporations hire political manipulators, rather than entrepreneurs, as their chief executives, and when they locate high-level executives in Washington specifically to mitigate the harmful consequences of unproductive laws and regulations.

In “Industrial Organization and Rent Seeking in Dictatorships,” Tullock shifts his attention from democracies to evaluate the relevance of rent seeking in dictatorships (in 1986 still the most dominant form of government worldwide). He observes that the dictator typically extracts significant rents from his subjects. The existence of such high rents attracts rent seekers among the high officials, guards, policemen, and military, who endlessly plot for the dictator’s overthrow through coup d’état. The dictator rationally responds by dispensing rents and privileges (as well as killings) in order to disperse coalitions before they are in a position to oust him. The social cost of rent seeking, therefore, is at least as high under dictatorship as under conditions of democracy.

“Transitional Gains and Transfers” attempts to explain why governments rarely transfer the benefits from an exhaustible resource (for example the discovery of oil reserves) efficiently across the citizenry. Instead of providing citizens with a property right in the oil revenues, or making direct cash transfers to existing citizens, governments typically resort to public expenditure pro-

grams that carry high excess burdens, even when they are at all productive. Tullock's explanation rests on an unfortunate combination of ignorance at the highest level of government and of self-seeking by bureaucrats and corporations who stand to gain from such public expenditure programs. In consequence, the transfers of windfall benefits usually are so inefficient that only the initial transitional gain is real.

In "Rents and Rent-Seeking," Tullock sets out to distinguish clearly between what he calls "good rents" and what he calls "bad rent-seeking." Innovations typically attract quasi rents in a competitive private market system. These rents are good rents, even though successful innovations drive the owners of preexisting capital out of business. A situation in which the government seeks to restrict innovations because they damage existing producers is highly undesirable. On the other hand, the seeking of rents through the lobbying of government for special privileges of any sort is also undesirable. Such rent seeking reduces the overall wealth of society.

In "Why Did the Industrial Revolution Occur in England?" Tullock notes that the industrial revolution was well under way, if not completed, before Adam Smith's *Wealth of Nations* had significant influence on government policy. Tullock argues that the conditions for the industrial revolution in England were established as a consequence of the civil war and its aftermath, culminating in the Glorious Revolution of 1688, which made it more difficult for individuals to seek special privileges from crown and church alike.

In "Rent Seeking and Tax Reform," Tullock explores the possibility of reducing through tax reform rent seeking and other kinds of government waste. He argues that efficient tax reform, designed to reduce excess burdens and to close special-interest tax loopholes, is best pursued as a general bargain in which everyone loses some special privilege than by piecemeal methods that will meet fierce, highly specific rent-protection lobbying.

In "Rent-Seeking and the Law," Tullock outlines, for example, the opportunities provided by the American adversary legal system for wasteful rent seeking by attorneys using expert witnesses. He suggests that such a costly system can be justified, by comparison with a civil code system, only if it is substantially more accurate in its outcomes. Tullock notes that American courts are in error in at least one case in eight.

In "Excise Taxation in the Rent-Seeking Society," Tullock notes that taxes imposed on such supposed luxury goods as cigarettes and alcohol do not significantly reduce consumption of either product. They are both products for which demand is price inelastic. Such taxes are imposed, he argues, be-

cause they raise significant tax revenues while avoiding counterlobbying by groups that have been vilified. Considerations of public choice, rather than of sound social policy, dominate excise tax impositions in the rent-seeking society.

Part 4, “The Cost of Rent Seeking,” comprises six papers that address a number of important issues about the cost of rent seeking to society as a whole.

In “The Costs of Rent Seeking: A Metaphysical Problem,” Tullock challenges head-on the implications of rent seeking, one of his most important scholarly contributions. The general normative thrust of the rent-seeking literature before this paper had been that rent-seeking behavior distorted political outcomes from those preferred by the median voter in favor of outcomes favored by concentrated interests and that such distortions were welfare reducing. Tullock further questions this judgment in “The Costs of Rent Seeking.” Given that we accept that the majority of the electorate is rationally ignorant, Tullock asks why should we prefer political outcomes that curry favor to ignorant voters over those that favor the votes of members of a highly informed special-interest group?

In “Rents, Ignorance, and Ideology” and “Efficient Rent Seeking, Diseconomies of Scale, Public Goods, and Morality,” Tullock attempts to explain the small size of the rent-seeking industry. His explanations are the following: that to fool voters, rent seeking typically assumes very inefficient forms, thus providing but small rents to successful lobbyists; that there are diseconomies of scale in lobbying; and that some individuals are endowed with an ethical dislike of rent seeking. For the most part, the small scale of the rent-seeking industry does not imply that the social cost of rent seeking is low. Inefficient rent-seeking mechanisms—for example, quotas rather than tariffs in trade protection or in-kind rather than cash transfers—are extremely costly in terms of resource misallocation.

Finally, in three short papers, “Are Rents Fully Dissipated?” “Where Is the Rectangle?” and “Which Rectangle?” Tullock fine-tunes his thinking on the high cost of rent seeking. He notes that rent-seeking waste is exacerbated by instability in rent-seeking coalitions and results in rotating majorities among groups that seek special privileges. He suggests that the voters themselves are badly—or asymmetrically—informed rent seekers, logrolling among themselves, each in pursuit of an intensely desired special privilege. He further suggests that government subsidies—for example, to farmers—lower the cost of production and thus increase the size of the available Tullock rectangle by comparison with the usual constant-cost welfare loss diagram.

Part 5 is Tullock's short monograph *Exchanges and Contracts*, in which he develops a systematic theory of exchange in political markets, identifying with such exchange serious weaknesses in the form of externalities, rational ignorance, rent seeking, and other transaction costs. Since these political market failures correspond to, in form, and are more insidious, in nature, than the transaction costs typically ascribed to ordinary markets, this monograph succeeds in reestablishing the strong presumption against resorting to politics originally argued by Adam Smith in his masterpiece, *The Wealth of Nations*.⁶ The monograph offers a refreshing free-market perspective to counterbalance the interventionist predilections of most modern neoclassical economists.

In part 6, "Future Directions for Rent-Seeking Research," Tullock focuses on the importance of information in the political marketplace. He notes that in 1600 rent seeking was overwhelmingly the most common way of becoming wealthy. The mercantilist society was a society organized on the basis of rent seeking. The free market ideas advanced by Adam Smith and David Ricardo led to the dismantling in England of the mercantilist system and brought about the industrial revolution. Unfortunately this good information was suppressed from the late nineteenth century, allowing political markets to revert to mercantilism. The future direction of rent-seeking research, Tullock argues, should target modern mercantilism with the objective of returning advanced economies to free markets.

Tullock's original rent-seeking insight and his subsequent extensive follow-up research in this field have opened a major research program in economics and public choice.

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6. Adam Smith, *The Wealth of Nations* (1776; London: Methuen, 1904).

PART I

RENT SEEKING:

AN OVERVIEW

RENT SEEKING

THE PROBLEM OF DEFINITION

Some time ago, I received a paper for comment arguing that the current patent process generated rent seeking. The author's point was that because a patent would be a monopoly, and, in many cases a valuable one, a considerable number of people would engage in attempting to get the patent, and this would be a wasteful duplication of research. In essence, as result of this waste, scientific progress was "too fast."

Most people think it is not possible for scientific progress to be too fast, but most economists would disagree. The realization that too many resources may be invested in something that is in itself desirable is one of the insights provided by economics. In this case, however, oddly enough there may be underinvestment because of competitive research. Thus, the waste might go either way.

In order to see how the research might be undesirably slow, assume that we have a number of people who have decided that some particular patent would be desirable and have undertaken research to achieve it. Each of them, however, realizes that he is not alone; hence, there is only some probability of getting the patent, instead of certainty. Suppose each of them feels that even if he works as fast as possible, he has only a one-in-three chance of being the first person to achieve the goal.

Under these circumstances, he would plan on investing resources of one-third or less of the patent's true value. However, all three of these people will keep their research secret. Under the circumstances, it is certain that there will be duplication, i.e., literally that the different people who are engaging in it will perform the same experiments, undertake the same tests, and so on, and this, if one looks at it from the eye of God, would be wasteful.

Although the various people engaging in this research will invest resources up to, roughly speaking, the value of the patent, much of this resource investment will be duplicative; therefore, the total amount learned might be considerably less than we would achieve if somehow the whole thing had been allocated to one researcher who had then invested the full

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value of the patent. Scientific research can progress too slowly as well as too rapidly. In this case, it might end up costing as much as the efficient pattern while producing a great deal less.

What does this have to do with rent seeking? The answer is that my colleague who sent me the paper thought it was an example of rent seeking, and, indeed, it does look somewhat like it.¹ The paper actually took the view that probably something should be done about the matter in the case of patents, but it did not have any positive recommendations. I personally am a proponent of patents,² but I must admit that there is a resemblance between the two situations.

A resemblance is not confined to patents. Consider the efforts undertaken by producers to sell their products, whether in the form of advertising or simply providing a pleasant environment in which to buy.³ These things tend to be, to some extent, self-cancelling in the same way that one person's secret research tends to duplicate another's.

An example of what can be done in this area is the recent change in the billboards along the interstates. They used to be large and conspicuous. As a result of legislation, they are now rather small plaques attached to an information board put up by the highway department. I do not argue that this is an ideal system, but I have no doubt that it is an improvement. Information of the same sort that the billboards produced is now available at a much lower cost, both to the advertiser and to the driver, who has an unimpeded view of the scenery.

It is not obvious that there is true waste in the sales effort or the invention cases, because it may be that nothing better can be done. In the case of sales effort, I believe something better could be done. I think a heavy tax on advertising would mean that the government could obtain funds, and there would be substantially no cost to the advertisers themselves because everyone's advertising would be cut back by about the same amount. The experience with the restrictions on TV advertising of alcoholic beverages and then

1. Note that in this entire chapter I am ignoring the mathematical difficulties raised by the series of articles beginning with my "Efficient Rent Seeking."

2. See my "Intellectual Property," in *Direct Protection of Innovation*, ed. William Kingston (Dordrecht: Kluwer Academic Publishers, 1987), pp. 171–200; and *The Organization of Inquiry* (Durham: Duke University Press, 1966; and New York: University Press of America, 1987).

3. Expensive restaurants do indeed provide superior food, but they spend much more money on "ambiance."

on cigarettes seems to indicate that the producers of these goods were themselves delighted at what amounted to a cartelization that reduced the total investment in advertising. As far as I know, the people who formerly put up billboards along the highways are satisfied with the present arrangement under which they simply put placards on a large board arranged by the highway department.

It is unlikely that any such tax would go through, because the media themselves are immensely influential in our society and would object to this cut in a large part of their income. We do not know whether society as a whole would gain or lose from this partial conversion of the support of the media from the advertisers to the people who are actually consuming. Surely the readers would have to pay somewhat higher prices, but, on the other hand, the government would have a significant source of revenue.

The problem here is one of definition. Should we regard the competitive research, competitive sales effort, and so on, as equivalent to rent seeking?

Assume here that we have obtained divine guidance: we know everything about some particular set of transactions and can make calculations on the basis of this perfect knowledge. Suppose we examine a simple sales case, not an invention, but a sales case, in which a number of people are trying to sell substantially identical brands of soap. Note, I have said substantially identical. Certainly technological progress has been made in the manufacture of soap, which the advertising and sales process no doubt accelerates. One of the benefits from advertising, I would imagine a quite small one, is the acceleration of technical developments in the product.⁴

We can now, with our divine knowledge, make calculations as to the cost: first, the cost of producing the soap; second, the cost of distribution at minimum cost levels; and third, the cost of informing the purchasers of the soap and its possible superiority over other brands. The sale of the soap in “nice” boxes and the provision of the supermarkets where it is purchased should also here be counted as genuine cost.

I think our divine knowledge would indicate that the customers would be just as well off, and technological progress would go on just as fast. The total cost would be lower if the various parties producing soap were somehow forced to follow an optimal policy of coordination in their advertise-

4. There are a lot of cases in which the soap is simply changed without any improvement, and then the advertisers claim improvement. But, nevertheless, over time there is no doubt that these changes do effect an improvement, even if the improvement is not great.

ments, and so on. The policy coordination, however, would also require divine knowledge because no one now has any idea what an optimal policy would be.

What we can do is work out a humanly possible plan of coordination and inquire whether it would be cheaper than the present system. Undoubtedly it would be, although such a plan might suffer from the fact that there would be substantially no motive for any human being to actually carry it out. Furthermore, there would be many motives for human beings to use the plan as a subtle, or possibly, not-so-subtle, method of cartelizing the industry.

In a way, then, the people who are advertising, and so on, in the soap industry are trying to create monopolistic competitive gains which do, indeed, resemble in a small way the gains obtained by setting up a formal cartel or getting government regulation. Should we call this rent seeking?

As the reader has probably already deduced, my answer is “no.” What I would like, however, is some kind of continuous function in which the costs of competition, and there are costs, were set off against the gains of competition, as opposed to monopolistic activity. For this purpose our divine knowledge, i.e., knowing what would happen if, instead of competition, we had an ideally designed program in which the desires of the consumers were not only known but anticipated by some gigantic super computer, is possibly a useful intellectual construct even though there is no prospect of its being more.

To give an idea of the difficulty, I am dictating this chapter in a room at the Charlottesville Holiday Inn. The bathroom has a note from the management that says: “If you have forgotten or are in the need of essential toiletries (shaving cream, razor, comb, toothbrush, and toothpaste), call our front desk and we will get you a complimentary replacement right away.”

The reason that the management does this is not necessarily that they think their guests are nice people who should be helped. Basically, they are attempting to engage in a little monopolistic competition with the idea that in the future I am more likely to stop at a Holiday Inn than at another hotel. In this case they have chosen, as hotels tend to choose, a very minor advantage because such minor advantages are hard to advertise nationally. Almost the only way people could find out if Quality Courts also do this is through personal experience or word-of-mouth advertising.

This convenience for their customers is also a competitive technique. Is it true that as a result of having this service (which, of course, the customers pay for), the toughness of the competition between them and other hotels is somewhat eased? Will customers pay more for their hotel accommodations

than they would prefer to? I do not know, nor can I think of any way of calculating it. Nevertheless, if we are attempting to determine the costs of competition, this would be part of the problem. I do not even see any way of determining whether the customers would prefer to have this service provided, or have a trifling reduction in their bill.

In competition, it is likely that other hotels will choose to do the same thing. Thus, we might expect sometime in the future that this kind of service is universal for all except the cheapest hotels. Would this be a good or bad thing? I cannot say, but I also do not think that the hotel management themselves have either the appropriate motives or the ability to calculate it. This makes it impossible for them to answer that question any better than I can.

Let us think of the patent case. Suppose, for example, there is some potential new invention that will be worth \$1 million if it is made and if a monopoly is granted to its designer. At the moment, the discovery of this invention would require the solution of 12 problems, and we shall assume that an advance cost estimate for solving each of these problems is \$100,000. Under the circumstances, it clearly is not desirable for people to engage in research for this particular invention. It might be true that, socially, the invention is desirable because the monopolized invention would be worth less to society than a competitive use of the same product, but we will put that aside temporarily.

With time, however, science progresses, and let us assume that after a while, two of the 12 problems have been solved. At this point, one can imagine someone undertaking research to make the invention. One can imagine, that several different companies would undertake that research and that one of them would achieve the patent. Let us assume that if all the estimates of \$100,000 turn out to be true, it is just a question of speed, and Company A spending \$1 million achieves the patent which is worth \$1 million, while Companies B and C each spend \$800,000 and solve eight of the problems but do not achieve the patent. The social loss here seems to be quite severe.

But assume that Companies A, B, and C, instead of taking that particular action, say to themselves: "It is likely that if we start working on that, at least two other people will also start. Their scientists are as good as ours. It is likely that we will not win the race except maybe one time in three, so our laboratories should not begin work on this particular project until there has been further scientific progress." Under these circumstances, all three of them would wait until another set of problems had been solved by someone else. At that point, all three of the laboratories would start working. One of them would beat the other two out and receive something worth \$1 million for an