Positive and Normative Conflicts in the Expanding Domain of Economics: Induced Distortions and Rules

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The current resurgence of interest in questions of methodology has been partly due to the seminal work of McCloskey (1986) who has argued that there is a divergence between formal neoclassical methodology and practice within economics. Often what passes for methodological purity is in fact well-concealed rhetoric. His purpose in identifying the discrepancy between formal methodological rules and professional practice was to argue that economists should recognize explicitly their use of rhetoric and appreciate its value for being a more flexible and effective means of expanding the scope and quality of economic analysis.

Reliance on rigid rules can stultify analytical incisiveness on the pretext of preserving methodological rigor. More seriously, rigid rules can lead to logical inconsistencies which are hidden under a layer of formality which often takes the form of technical (mathematical) precision. This paper identifies some inconsistencies caused by attempts to expand traditional models to cover non-market situations. That such inconsistencies exist has been shown by Nicolaides (1988) who has argued, that despite the appeal of the economic approach to the analysis of non-market situations, there can be no single economic model that explains all market and non-market interactions among individuals.

The logical inconsistencies which are identified in this paper result from the use of traditional normative criteria for the welfare evaluation of such non-market situations. This raises the fundamental question whether there can be any single set of welfare criteria for the evaluation of all market and non-market interactions among individuals.

The paper is divided into two parts. The first part defines the nature of the problem by examining the literature on rent-seeking activities. It identifies the contradictions that arise when traditional models are augmented to explain new phenomena without adequate modification of their normative foundations. Modelling of rent-seeking activities seemed very promising a few years ago, but it has not led to any major empirical results apart from the observation that distortions are induced by special interest groups which in general seek to influence public policies to their advantage. Hence, government intervention is never neutral or completely free of negative side-effects. The second part of the paper argues that there is a conflict between complete empirical explanations of all social activity and normative assessment of that activity.

Part I

Recently the Heckscher-Ohlin trade model was expanded to include such economic phenomena as rent-seeking (RS) and directly-unproductive profit seeking (DUP). It will be argued that a DUP activity cannot be either adequately or consistently as another, non-traded, good. The inclusion of DUP activities undermines the traditional analysis of impediments to trade and other distortions in the economy. It will also be questioned whether it is possible to dissect models into their economic and political parts in the way Bhagwati, Brecher and Srinivasan (1984) propose. The following section examines how RS or DUP activities are defined. In the rest of the paper RS and DUP are used interchangeably.

Definition of DUP Activities

There has been some controversy in the literature about the meaning of DUP activities and how they compare with RS. Bhagwati (1980, 1982, 1983) provides a clear exposition of the differences between DUP and RS activities. Trade economists and public choice theorists (see Buchanan, Tollison and Tullock, 1980) agree that a DUP or a RS activity is in itself wasteful when it attracts scarce resources for the purpose of redistributing income.

It has been noted, however, that wherever there exist other market imperfections the emergence of a seeking activity may cause such a reallocation of resources that social welfare improves (see, for example, Bhagwati 1982). This is a direct consequence of the second-best nature of the initial equilibrium. It arises only when shadow returns to factors are negative. But seeking itself is regarded in the literature as socially detrimental,
wasteful, and therefore unnecessary.

The problem with this definition is that it may not always be possible to determine *ex ante* which non-market activities are completely wasteful. An activity may be assessed *ex post* as DUP but the same activity need not always be DUP. That is, whether a non-market activity is directly unproductive depends on what is thought to have happened in its absence. The nature of a non-market seeking activity is dependent on the context of analysis. For example, there is social waste when resources are expended by a company which maintains a staff of lawyers to manipulate government regulations to its benefit. But, there may be some reduction in welfare losses if the same group of lawyers is successful in convincing or forcing the government to amend proposed tax changes so as to prevent further wasting of scarce resources. Activities are wasteful if resources are expended for the purpose of redistributing a fixed amount of income or output. But there is no reason to expect that there is a neat division between activities aimed at redistribution and activities aimed at generating income.

The difficulty of empirical identification of DUP activities is illustrated in a paper by Mohammad and Whalley (1984) who examine how import quotas are allocated in India. They find that quota applications are evaluated on the basis of "need for imports" which, in turn, encourages producers to "install excess capacity to justify requests for raw material imports" (p. 391). However, Mohammad and Whalley comment that "the over-installation of capacity or excess labor hiring associated with rent-seeking will typically not have a zero marginal product" (p. 392).

Note that in this case producers have an incentive to lobby for changes in bureaucratic rules which suit their production structure as it evolves through time. In this sense, the "economic side" affects the "political side" and vice-versa. It is, thus, neither appropriate nor useful to postulate a permanent dichotomy between politics and economics on an economy-wide basis.

An important aspect which emerges from Mohammad and Whalley's study is that the effects of a seeking activity depend as much on the method by which the activity is carried out as on the target of the activity. RS may waste resources because its objective is the redistribution of income through induced distortions. But the full extent of resource allocation and the caused waste are determined by the method or strategy employed by the seekers in order to reach their objective.

The assumption that DUP activities themselves are competitive seems not to be well founded. This is not a criticism which is directed against the empirical relevancy of that assumption. Rather, it is puzzling and contradictory to explain the induced distortions on the economic side of a model by assuming that economic agents behave competitively on the political side. What is there which prevents them from creating further artificial barriers? Mohammad and Walley's (1984) study can be used again to illustrate this point. The producer who is successful in acquiring a quota could expand his productive capacity to justify further claims for quotas more effectively than his competitors who were initially unsuccessful. The induced state of the economy influences, in turn, the outcome of the political competition. What this implies is that the magnitude of wastefulness changes over time.

If economic agents attempt to influence the outcome of one market by competing in another, why would they not try to change the "rules" in political markets so as to frustrate their competitors? They would have a strong incentive to change the "rules" to influence subsequent stages of the competition for political favors. The assumptions of oligopolistic behavior in one market and competitive behavior in another simply contradict each other.

This last point requires some clarification. It is contradictory to assert that public policies are determined by the expenditure of lobbying groups and at the same time claim that either the rules of lobbying groups are immune to RS or that all groups will have the same amount of resources to spend after repeated rounds of lobbying. The group which would be first to acquire the contested monopoly rights would have more resources to spend, hence greater political power. The only way that there could be complete separation between political and other markets would be for the outcome of political contests to be determined on a purely random basis. But then no one would spend any money to influence them.

This argument does not imply that lobbying in reality does not cause waste. It only means that there is interaction between market and non-market activities which may improve the "efficiency" of the political influence of some groups. This may result in a decline in the wastefulness of their activities. Again there would be less spending on lobbying if policy makers showed particular preferences. This raises the question why the successful groups do not acquire monopoly rights over an increasing number of markets. A plausible answer is provided in the last section of the paper. But in order to answer this question it is first necessary to consider what gives
rise to lobbying in the first place.

Positive Analysis of DUP or RS

In analyzing the effects of DUP activities it is essential to ask why these activities exist. How are they generated? The obvious answer is that they are profitable. This is trivially true and a direct consequence of the basic economic assumption about the rationality that guides economic agents. The interesting question is why are they profitable? Peltzman (1976), Buchanan, Tollison and Tullock (1980), Stigler (1971) and Becker (1983) suggest that information and transaction costs allow only some groups to organize in order to present their opinion and grievances and demand favors from the government (group formation according to Olson's, 1965, theory). Even if the government is civic-minded in a world of incomplete information, it can take action only by considering whatever relevant information is available. The group that succeeds in providing crucial information which also emphasizes its own point of view is likely to be favored. This also holds for seeking activities in the public domain.

The same argument can be made about non-market activities in the private domain. Dilorenzo (1984) constructs a model of dynamic economy in which firms invest in non-market activities because this is how they secure a large enough market share so as to make their R and D worth undertaking. Non-market activities play a normal role in the functioning of the economy.

In explaining the existence of non-market activities in both the public and private domain it becomes necessary to accept that the "real" economy is very different from that postulated by DUP theory. It is ridded with both induced and natural (e.g. incomplete information) distortions. This undermines the credibility of DUP and RS theories in at least two respects. First, the optimum of the economy is unknown and is perhaps unknowable. Second, if the status quo is partly the outcome of previous RS activities then any shift away from it will be resisted. The wastefulness of RS can be derived only with respect to some alternative state of the economy at which real income is estimated to be higher. But the explanation of RS in terms of incomplete information and other imperfections begs the question how the "RS-free" state could be identified and attained. This problem is considered further in part II.

Normative Assessment DUP or RS

The informational scarcity, uncertainty and transaction costs that make non-market activities feasible also cast doubt on the possibility of constructing even in theory, a social welfare function (SWF). Even in the absence of these impediments to exchange, the introduction of seeking activities into the Heckscher-Ohlin model reduces the validity (theoretical and empirical) of relying on a SWF for normative evaluation.

There is general acceptance among trade theorists that a SWF which is not based on interpersonal comparisons can be derived only if compensatory transfers take place. These transfers must satisfy the Hicks-Kaldor-Scitovsky criterion so that an unambiguous ranking of bundles of goods becomes possible. In this way, it is also ensured that free trade is pareto-superior to tariff restricted trade, which, in turn, is superior to no trade (autarky). There is, however, some ambiguity as to the interpretation of the nature of these transfers. Should they be potentially possible only, or should they actually take place? Corden (1984), for example, believes that normative pronouncements can be made by simply requiring that a SWF could, in principle exist.

The explanation of lobbying for tariffs within the Heckscher-Ohlin model identifies the increase in the returns to the factor which is intensively employed in the import-competing industry. If factors are immobile a tariff increases the income of all the factors employed in the protected industry. Here, however, arises a contradiction. Trade theory cannot explain both the existence of tariffs on the grounds and also maintain that transfers do take place, giving rise to a well-behaved SWF. Had transfers taken place in reality, no group would ever demand any tariffs because a subsequent increase in its income would be immediately wiped out by income redistribution so as to compensate the rest of society which suffers a welfare loss. Since a tariff results in a deadweight loss, the amount needed for compensation is greater than the private gain generated by the tariff. Therefore, if tariffs exist as a result of rational private action then transfers do not occur. And, the notion of a SWF based on compensatory transfers is undermined.

It is also puzzling, for example, why economic agents would attempt to capture tariff revenue (e.g. revenue-seeking as in Bhagwati and Srinivasan, 1980) when income is redistributed so as to minimise the reduction in the initial level of incomes. If the revenue is captured by the factor that gains from the tariff, then its action is futile because the government would have to tax it at even a higher rate than before so as to compensate the losers. Moreover, if the revenue-seeking activity reduces national income everybody loses and the
activity is irrational, both socially and individually. But, it also needs to be asked why a government which is assumed to be altruistic with respect to transfers is suddenly selfish with respect to its other policies. If perfect transfers would take place revenue-seeking would not appear.

In textbook analysis monopoly is found to reduce social welfare because consumers could fully compensate the monopolist for charging lower prices. But, the principle of compensation is diametrically opposite to the predictions and assumptions of public choice in whose framework non-market activities are analyzed. Seeking activities exist exactly because no parent-efficient compensation takes place. Not only may a bribe to the monopolist be regarded as unethical (Buchanan, 1980, p.365) and that transfers may not be welfare-neutral (Hartle, 1983, p.540), but it may also be that the political system makes it individually more profitable to bust rather than bribe the monopolist. If compensation is to be individually rational then it must be politically cheaper as well.

It is useful at this point to consider the opinion of one of the founders of the DUP theory. Bhagwati (1982, p.998), in a footnote writes: "A referee has commented that the use of Samuelsonian social indifference curves to evaluate welfare may not be appropriate...on the following grounds: This construction is valid only if lump-sum transfers are being employed to optimize income distribution. In response to any change in this distribution that the seeking activities achieve, the government must recalculate the lump-sum transfers to optimize the Bergsonian welfare function again. This calls the whole process into question. Either the seeking activities will be abandoned, or they will extend into persuading the government to abandon lump-sum transfers. However, the introduction of DUP activities is simply adding new activities to traditionally defined productive activities on the income-generating side of the model, with all of the given factors of production earning competitively determined incomes. In principle, therefore, it is not necessarily implausible to continue the use of Samuelsonian indifference curves as in the traditional analysis without DUP activities".

In Bhagwati’s opinion a DUP activity is not significantly different from other activities, except for being unproductive. This view, however, is incorrect. While the introduction of an additional good or activity leaves the theoretical foundations of the model intact, DUP activities generate individually profitable transfers. A SWF assumes that individuals do not attempt to gain from transfers. Bhagwati seems to believe that traditional models can cope simply by enlarging them in terms of the number of variables which are determined endogenously. But how can models account for the fact that irrespective of how the rules are determined lobbyists will always attempt to subvert political processes to their purposes. DUPs and SWFs cannot coexist.

It was argued above that DUP and RS activities, which seek to induce and oppose transfers, pose an obstacle to actual maximization of social welfare. A critic could retort that the SWF is a theoretical device used by economists to demonstrate how the welfare of a society could be potentially increased. This criticism would be valid if the relevant information needed for constructing a SWF were available. It seems, however, rather contradictory to explain the existence of DUP activities by referring to distortions, including informational scarcity, while claiming that economists or governments are not affected by this scarcity. How does the government know about the preferences of the electorate? If the government is not totally bound by voter's true preferences, would it attempt to generate information of its own so as to change revealed preferences and, hence, change its mandate? Becker (1983) suggests that revealed preferences are rather volatile and amenable to manipulation and Frey and Schneider (1975) find that there is a two-way causality between government actions/reactions and opinion polls.

Finally, a seeking activity may be wasteful without necessarily implying that it is socially undesirable. It may promote non-economic objectives (e.g., determining distribution of income). For instance, some screening processes whose purpose is to provide information are wasteful in the sense that they use productive resources without increasing or improving the output of the economy. However, social welfare may be positively affected especially if the distribution of a given amount of income is aimed at particular needs of the recipients.

**Containing DUP or RS Activities**

Let's grant for a moment that DUP activities are indeed wasteful and unproductive. Their elimination must be, therefore, welfare improving. Posner (1975) suggests that investment in RS activities can be forced to decline by appropriate measures that increase the prices of factors into these activities and by entry barriers that discourage wasteful competition. Tullock (1980) and Corcoran (1984) also argue that an increase in seeking costs will reduce the amount of resources
invested in RS activities. In addition, Tullock (1980) considers how nepotism or bias may have the same effect on seeking. Buchanan (1980) expresses the opinion that RS may be eliminated or reduced as a result of a general legal-constitutional reform. The essence of Buchanan's proposal is very similar to that of centralizing decision making concerning regulation and commercial policy.

On the other hand, however, Bhagwati (1982), Brecher (1982) and Baldwin (1984) write that reduction of DUP activities may be very difficult or impossible in a democracy. Although none of them elaborates further, their statement could be interpreted in two ways.

First, there may be ethical, moral legal or other philosophical reasons for preferring to suffer a loss in resources rather than restrict some basic individual freedoms and rights. This point need not be belabored because it is conjectural. However, whenever DUP activities are tolerated because of ethical reasons, it is also implied that the premises by which these activities are evaluated must be modified accordingly. Again, one has to question the validity of conventionally defined SWFs which do not account for such ethical reasons. It could be argued that conventional SWFs measure "economic" welfare while some other extended SWFs measure "general" welfare. But is there a neat dichotomy between the two kinds of welfare? There is no way of knowing how to evaluate the "optimum" level of the non-market activities without knowing what kind of relationship exists between the two SWFs.

Second, it may not be cost-effective to attempt to reduce DUP activities. Transaction and counterlobbying costs may be greater than the amount that would be saved from the elimination of non-market activities. Actually, social savings may even outweigh the cost of eliminating distortions without implying that distortions will indeed be eliminated. For the same reason that distortions are sought because they are individually profitable, even though society loses, distortions may persist because it is individually unprofitable to eliminate them, even though society gains.

In summary, the presumption that DUP or RS is completely wasteful seems unlikely, given the reasons that give rise to it. Second, even if it is totally wasteful, there emerge conceptual difficulties with the methods of measuring and evaluating its welfare impact and that of other "normal" activities. Paradoxically, expansion of theory to include new activities reduces its credibility and applicability even to the normal market activities. Such an expansion challenges the foundations of traditional theory. It seems unwarranted to explain non-market activities on the basis of informational and transuction costs while assuming that they do not exist as far as proper (goods) markets are concerned.

We are now left with a dilemma. Expansion of traditional models to include non-market activities causes both positive and normative difficulties. Should it, therefore, be inferred that economics cannot say anything about such activities? As a matter of fact another group of economists have independently considered the role of 'non-market activities' and have reached the startling conclusion that the economy operates around its optimum point or path. This raises the question of how natural and induced distortions can be explained and evaluated in welfare terms. Their proposition also raises the question of how rational consumers can be assumed to be. Part II of the paper examines this separate strand in the literature, which has also sought to expand traditional models but has reached a very different conclusion than the literature on rent-seeking.

Part II

Orthodox economic analysis is predicated on two fundamental premises: (a) markets clear, and (b) individuals behave rationally. Criticism of any economic theory or the exposition of new theories must accept and take into account these two premises. Using these two premises, Becker (1976) and McKee and West (1981, 1984, 1987) have argued that government intervention to correct market distortions is both impossible and unnecessary because economies function optimally. Their notion of optimality also includes the (in)ability of the government to intervene or to use second-best instruments. The purpose of this part of the paper is to examine the implications of their criticism on the welfare assessment of apparent distortions and non-market activities.

The following section considers the usefulness of the concepts of rational market-clearing behavior. It then examines how these concepts may be expanded to account for the transaction costs and other possible political or institutional obstacles to the implementation of optimum policies.

Rational Behavior

It would be impossible to study economic events and relationships without assuming that individuals are rational in the sense that they act purposefully, systematically and consistently in relation to their external world. For the purposes of this paper, rationality is broadly interpreted to imply that action has certain objectives
(purposefulness) which are not modified arbitrarily (consistency) and which are sought by considering all possible alternatives, opportunities and consequences (systematic).

These three requirements are similar to the textbook definition of the assumptions that underlie maximising consumer behavior (e.g. complete and transitive preferences). Excellent treatment of the various definitions of rationality axioms and their precise mathematical representation can be found in Elster (1984, 1985).

This section began with a statement that requires elaboration. Why do we have to assume that individual's actions are rational or purposeful in order to analyse them? For one thing, if such actions were random they could be studied only to the extent that over time and at certain level of aggregation they would generate statistical regularities. But, the reason for assuming rationality is deeper than mere expositional convenience.

Consider what it means to make a mistake. If that apparent mistake could be explained ex post then it would not be a mistake. The reason being that it could be attributed to a causal factor which could be in the form of incomplete or incorrect information. There can be no ex post understanding of why a mistake has occurred unless there can be found a causal factor. But, once a causal factor is found then the perceived mistake is in fact the result of constrained action including constraints on ability to reason. Thus, to characterise some action as a mistake is equivalent to admitting incomplete understanding of what caused or motivated it. Perhaps this is the reason why in everyday usage “mistake” implies an unintended or unexpected deviation from the desired objective or course of action.

Therefore attributing errors to the actions of individuals implies ignorance about their motives, ability and particular circumstances. This does not mean that individuals are always correct. It only means that an error is an unexplained event. The identification of instances of erroneous or irrational behavior as a deviation from a particular norm or standard does not mean that it is completely understood.

But, it is not necessary to know everything that motivates each individual in order to be able to construct useful explanations or predictions. For example, in order to explain a rise in the price of a commodity it is sufficient to know that, ceteris paribus, there has been a reduction in its output. In this instance the objective is to determine the consequences of that reduction rather than explain what caused it or why it was not avoided.

Although many phenomena are explainable we cannot hope to explain everything, or we cannot explain everything at the same time. Nicolaides (1988) has argued that there can be no single model of all observed events and behavior. Instead, we rely on many partial models with many exogenous (i.e., unexplained) variables. A single model would not be compatible with the occurrence of mistakes.

**Distortions**

If our understanding of the economy is necessarily partial or compartmentalised, how can we be certain that what we observe is the result of rational behavior which cannot be improved upon because individuals do the best they can anyway? On the one hand, individuals must be assumed to behave rationally given the information available to them. On the other, there is a danger of rationalising everything by claiming informational constraints. In a perfectly competitive economy with the appropriate restrictions on endowments and preferences, it is known ex ante that the resultant market equilibrium is pareto optimum. What happens when individuals function under informational constraints in an economy which is not perfectly competitive?

Recently, McKee and West (1981, 1984, 1987) have argued that such an economy can be expected ex post to reach an optimum state because individuals already do the best they can and governments either cannot or will not remove any apparent distortions. McKee and West do not assume that individuals are perfectly informed. It is sufficient to assume “rational ignorance”. Their decisions are the best they can be under the constraints of available information ability to process it and the cost of acquiring.

The basic premise of the McKee-West approach is that governments are not benevolent despots. They actually induce distortions by extending privileges to powerful lobbies. Hence, they can neither be expected to eliminate such distortions, nor do other groups in the economy find it cost-effective to expend resources to either learn about or influence political decisions.

Ng (1987a,b) has commented that the McKee-West framework refers only to induced or artificial distortions. It does not seem to account for natural imperfections such as public goods or natural monopolies. In response, McKee and West (1987) have argued that governments can also decide not to intervene to correct natural distortions. Hence, the absence of policies can also be interpreted as the result of political bargaining or competition in political markets.
Thus, the essence of McKee and West's arguments is that the status quo cannot be improved upon because individuals always exploit any potential benefits. Any apparent unexploited benefits imply that individuals are somehow constrained either because of hidden costs or because of imperfect information which would be too costly to improve upon. Seemingly distortions are illusionary because they are the result of equilibrium expenditure on lobbying activities in political markets. It would appear, therefore, that despite the claims of the rent-seeking theories, non-market lobbying activities do not worsen welfare because those who seem to lose from them would suffer even greater costs if they attempted to oppose them. McKee and West are correct to criticise traditional second-best theories which evaluate policies against some ideal state of the economy without ever demonstrating how that ideal could be reached (i.e. who would propose the supposedly better policies, how they can be implemented and how they can be protected from opposing interests).

Why Do Policies Change?

If at any given point in time policies are optimal (in the McKee-West sense), who do they change? What causes them to change? The principle of rationality concerns the way information is processed. Public policies may change whenever the information available to lobbying groups changes. Some public policies are determined by coalitions of special interest groups that either support or oppose them. Coalitions are, in turn, formed in response to the policy alternatives that are under consideration. For example, the construction of a road may not only be the result of lobbying by the group that benefits from it directly. It may also have been supported by a conservationist group from a different location which objected to an alternative route through its own area. Thus, to explain the causes of a particular policy (or the absence of it) it is not sufficient to know who benefits from it. It is also essential to know what the alternative proposals were.

Even in an assumed world of rationally ignorant consumers and selfish governments economic conditions and policies have been observed to change. There would be no change (in static terms from a point, in dynamic terms from a path) only if whatever there is to be known is already known and all possible policy alternatives have been considered. Of course, in such a world economists would have a very difficult task justifying their existence. There would be no need to analyse anything because economic agents would know everything they would want to know and no policy could be changed. But, how can policy changes be explained without attributing them only to unpredictable or unintentional exogenous changes (e.g. the effect of solar flares on crop yields)?

McKee and West are wrong to infer, rather implicitly, that because today's status quo of the economy is almost tautologically optimal with respect to yesterday's available information, it will remain so tomorrow. The set of available information can change. Hence, optimality can be assessed only with respect to new information not yet available to economic agents. Given the assumptions about rational ignorance and rational political inaction, McKee and West must demonstrate that the status quo is optimal only if a potential policy change does not benefit at least one group which would be willing to support it and whose lobbying activities would be effective in modifying prevailing policies.

The source of new information could be the analysis by economists of the effects of prevailing policies. Economists do not have to be assumed to be altruistic or civic-minded. They are simply another source of information which may be used by other groups for their own purposes. We would be sure that the status quo is optimal only if no new information could be generated. As long as the information constraints of individuals can change we cannot be certain that pareto optimal policy alternatives could not be formed. In fact if we reason this way we are forced to remain agnostic about the status quo. We cannot make any claims about it because the informational constraints of individuals are impossible to determine because they are unique to each person. Therefore, it cannot be predicted how they might react to newly available information concerning the effects of existing policies and those of potential alternatives. The following section explains why the requirement for knowing the effects of a proposed policy on all individuals before it can be pronounced pareto-efficient is really a dead end.

Normative-Positive Dichotomy

Normative analysis is distinguished from positive analysis in terms of the difference between subjective and objective (empirically testable) statements. The conclusion of the previous section points to another fundamental dichotomy. If we can explain precisely why an existing policy was adopted, then we can also explain why alternative policies were not adopted. But if we can explain why alternatives were not adopted, then we have
also shown that individuals would not find it cost-effective or in their interest to support or seek those alternatives. If everything is explained, then there can be no normative statement apart from accepting that the status quo is optimal.

To put it differently, normative statements can be made only if it is not certain that some alternative would not be chosen. The fundamental dichotomy between normative and positive analysis is that in a world where everything is known, no normative assessment would be possible or that normative assessment is possible only under conditions of imperfect information where the status quo is not completely explainable. In this context, an economist who would criticise an existing policy would have to admit that he/she could not explain precisely what prevented alternative policies from being adopted.

Therefore, normative statements are possible only when not everything is already known. Given that, at least in principle, the status quo can be precisely explained on the basis of informational constraints (rational ignorance), the only way that it can be asserted to be either superior or inferior is with respect to previously unavailable information. This means that welfare evaluation is possible only where there are exogenous changes in the form of an expanding set of information on the functioning of the economy. But it cannot be claimed that newly available information would be sufficient in inducing individuals to seek policy changes.

It is for these reasons that traditional welfare analysis is inappropriate for the use that Bhagwati (1982, 1983) and Ng (1987a,b) make of it. They both claim that non-market activities can be evaluated simply by using an expanded version of welfare functions which would also include the various objectives of governments and the constraints imposed on them by the political system. But, if welfare statements can be made only under conditions of changing information such welfare functions would always be outdated.

**A Synthesis**

In part I it was argued that a major weakness of the theory on RS was its implicit assumption of a dichotomy between perfectly competitive non-market activities and imperfect markets. This dichotomy reduces the credibility of that theory because it cannot explain why RS does not expand to influence other political decisions on the nature of acceptable lobbying activities. In the preceding two sections it was argued that the claim that the status quo is always optimal cannot be proved because of the logical impossibility of normative assessment under conditions of complete information. This section draws together parts I and II.

The starting point is the observation that, even successful, special interest groups do not monopolise all markets. Sugden (1989) provides a possible reason for it. All market and non-market activities take place within a context of social conventions, rules and laws. Sugden shows that interaction among rational and selfish individuals may give rise even to conventions with public-good characteristics. Hence, it is not necessary to drop the postulate of rational behavior in order to explain why some public policies may aim to increase general welfare.

For the purpose of this paper it is not even necessary to claim that there could be policies with such aims. It is sufficient to show that there exist conventions, rules, institutions and laws which (a) impose limits on the discretion of policy makers and (b) determine to some extent how policies are to be formulated and implemented. This implies that even if individuals at large are rationally ignorant (i.e., politically inactive) prevailing rules may facilitate the implementation of pareto-superior policies or prevent pareto-inferior policies. The existence of rules does not make lobbying ineffective. It only means that policy outcomes are not solely determined on the basis of relative expenditure by special interest groups. It also means that not all policy changes have to be directly prompted by those groups. Rules sever the one-to-one relationship between lobbying and policy changes.

Therefore, in a context of rules the welfare evaluation of alternative policies or of the status quo should be done within the scope of those rules. Even if the status quo is optimum with respect to past information it could still be suboptimal with respect to the alternatives that could be determined by the rules. If such alternatives are to be feasible they should not be outside the scope of the rules.

Hence, economists' criticism of the status quo is useless so long as their proposed alternatives are unattainable given the prevailing rules. Welfare analysis that takes into account the constraints imposed by RS and rational ignorance would have to show that pareto-superior alternatives are "rule-feasible".

**Conclusion**

Economic models have been expanding to account for the existence of non-market activities which influence the processes by which economic policies are formulated and implemented. There have emerged two competing approaches to the
welfare assessment of such activities. One presumes to measure their welfare effects, while the other claims that no such measurement is possible.

This paper has argued that neither of these approaches has been able to justify how it can make welfare assessments under conditions of imperfect information. Societies, however, have developed conventions and rules to cope with the problems caused by incomplete information. Welfare analysis, therefore, should take into account the role of these rules and the constraints they impose on the discretion of policy makers.

References