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The Political Economy of Rent-Seeking Behavior and the Connection with Unearned Income and Inequality¹

Rant Arayışı Davranışının Ekonomi Politikliği ve Kazanılmamış Gelir ve Eşitsizlikle Bağlantısı

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Abstract

For decades, inequality has been one of the most critical problems that we must tackle, and studies of income (or wealth) inequality are the source of much research. When we deal with the sources of unequal income distribution, and if a factor is unproductive but only reasonable in accumulating wealth, it has a diverting impact on income. In this line, rent-seeking activities are a structure suitable for this content. Rent-seeking aims to gain without contributing to the number of goods and services and shows the characteristic of unearned income. Unearned income is the return from income investment, not from physical and mental effort. In other words, rent-seeking behavior is a struggle to get a larger share of wealth. Taking larger shares is linked to declining shares and leads to inequality within society. In the context of the political economy of rent-seeking behavior, we examine various approaches. In addition, we illustrate how rent-seeking is related to unearned income and inequality.

Keywords: Rent-Seeking, Unearned Income, Inequality, Political Economy

Öz

Eşitsizlik onlarca yıldır ele alınması gereken en önemli sorunlardan biri olagelmış ve gelir (veya servet) eşitsizliğine ilişkin çalışmalar pek çok araştırmannın kaynağını oluşturmuştur. Gelir dağılımındaki eşitsizliğin kaynaklarına bakıldığında, bir faktör verimsiz ve ancak yalnızca servet birikimi için makulse, geliri saptırıcı bir etkiye sahip olmaktadır. Bu doğrultuda rant arama faaliyetleri, saptırıcı içeriğe uygun bir yapıdadır. Rant arayışında mal ve hizmet miktarına katkı sunulmaksızın kazanç

amaçlanmakta ve bu yönüyle hak edilmemiş (kazanılmamış) gelir özelliği göstermektedir. Kazanılmamış gelir fiziksel ve zihinsel çaba karşılığında değil, gelire yapılan yatırım kaynaklı gelirin getirisidir. Başka bir açıdan rant arama davranışı, servetten daha fazla pay alma mücadelesini ifade etmektedir. Daha büyük pay almak, payların azalmasıyla bağlantılıdır ve bir tarafın daha fazla pay alması, toplumda gelir eşitsizliğine yol açar. Bu yazıda, rant kollama davranışının ekonomi politiği bağlamında çeşitli yaklaşımlar incelenecektir. Ayrıca rant arayışının kazanılmamış gelir ve eşitsizlikle nasıl ilişkili olduğu gösterilmektedir.

Anahtar Kelimeler: Rant Arama, Kazanılmamış Gelir, Eşitsizlik, Politik Ekonomi

Introduction

The problematic nature of pure public interest also became a field of study for rent-seeking behavior. In this scheme of work, the term rent-seeking was coined by Tullock (1967) and Krueger (1974). Their works are the first articles of this period with Posner (1975). (Farooq, 2019, p. 112; Laband and Sophocleus, 1988, p. 274; Linster, 1991, p. 421). When we search the literature, since rent-seeking generates effortless and excessive gains, it might be a kind of unearned income and a source of income inequality. Besides this, rent-seeking disturbs resource allocation, causes inefficiencies in the market, and unfair gains. This behavior might exist in developing countries, developed countries, and various sectors. Moreover, rent-seeking behavior has conceptualization and measurement difficulties in the struggle of this kind of behavior. In this vein, we construct this study by first giving various descriptions of rent-seeking behavior, later the differences between profit-seeking and rent-seeking behaviors, and the logic of unearned income and dynamics of rent-seeking behaviors. The last two chapters illustrate the link between rent-seeking and inequality and sectoral examples of rent-seeking behaviors.

The Rent-Seeking Behavior Concept

The widespread and robust presence of rent-seeking behavior and culture in the modern world in its increasing complexity, often associated with the rentier economy, requires a better comprehension. As with rent-seeking behavior, the term is not in the usual sense of the word, namely, rent for property, cars, or equipment. Nor is it in the sense of paying a factor for land as one of the four factors of production. In this context, rent is used in a unique economic sense (Farooq, 2019, p. 112).

Before focusing on the rent-seeking term, we can look at the initial usage area of the term. Early on, a landlord receives payment only for ownership. However, there are no productive actions on the land, and thus, there becomes an unnecessary increase in its value. Later, this term is for monopoly gains due to similar ownership and power. The gains turn to the monopoly rents due to overcharging payment claims for her/his products, and the results are damaging to the common sources/values (Stiglitz, 2016).

When we think about or compare the distribution effect of monopoly rents and rent-seeking activities, generally, in economic terminology, monopoly rents have an easily understood context since a monopolist controls the market because of being a unique producer of a good or service. Thus, the monopolist causes a redistribution of income from consumers to their company. Nevertheless, rent-seeking behavior is so straight for the income distribution. Posner (1975) states that monopoly does not have a distributive impact on income. In contrast, rent-seeking scatters the monopoly rents and turns potential allocations into societal costs. When we evaluate monopoly rents within the rent-seeking community, monopoly has an infinitesimal impact on income distribution (Tollison, 2012, p. 79).

If we continue with the definitions, the first definition of rent (Marshall, 1949) is,

“payments to assets that exceed the competitive price (i.e., payments that exceed what is required to bring about the employment of the asset)” (Dencker and Fang, 2016, p. 468).

But the second rent-related definition has another side of the coin. Stiglitz (2016) explains rent-seeking as

“getting an income not as a reward for creating wealth but by grabbing a larger share of the wealth that would have been produced anyway”.

If getting rent motivates the actions, it becomes a rent-seeking behavior and has unfair consequences. The self-interested nature of individuals reveals the public choice theory, and the theory expresses that the primary motivation of human behavior (whether they are voters, politicians, lobbyists, or bureaucrats) builds rent-seeking behavior (Farooq, 2019, p. 116; Gordon, 2023; Shaw, 2023).

According to the theory, a rent-seeker tries to be wealthier without

creating new wealth, only getting existing one and also “grabbing” the definition by Stiglitz (2016). Unfortunately, this struggle brings side effects for the rest of society for the sake of rent-seekers’s financial gain without adding any value to the economy. Not only individuals but also companies, groups, and lobbies try to get these favors (Hillman, 2013, p. 307). Related favors might include many benefits, such as special grants, subsidies, tariff protection, monopoly profits, quota rents from import restrictions, and profits from exclusive rights to extract a natural resource (Gordon, 2023; Chaturvedi, 2016, p. 3). If political figures and governmental bureaucrats tend to assign rents, there might be a struggle among the retrospective and prospective seekers for the rents. The seekers put effort into taking favors from the government, not to produce goods/ services (Gordon, 2023).. In this process, Hillman (2013) says,

“The time, effort, initiative, and resources used in contesting rents are lost to productive contribution to a society’s output.”

Profit-seeking vs Rent-seeking Behavior

Rent-seeking behavior is undesirable because of the economic and social losses it causes. Besides that, not every earnings-seeking behavior does not have a rent-seeking pattern. At this point, it will be helpful to understand the difference between profit and rent. From the perspective of Buchanan (1972; 1980) and Ricketts (1987), while selfishness is the key driver of both, profit-seeking activities result in social gains, but rent-seeking is a reduction in social prosperity. Furthermore, profit maximizer (enterprising) is compatible with property rights, but rent-seekers look like challengers for the rights (Brooks et al., 1990, pp. 431-32).

On the other hand, Farooq (2019) compares economic profit and economic rents. He expresses that economic profit stimulates other firms to enter the market, whereas economic loss has a contractionary effect on the firms in the competitive environment. During the process, fair competition will benefit society, consumers, and producers incentivized by profit-seeking motives. Even if economic rent cannot be abolished or diminished by legal regulations, it is unfair and unearned income that prevents fair competition (p. 113).

Similarly, entrepreneurship encourages resource owners to search for more efficient resource allocation. The existence of positive returns encourages competitors to enter some activities, while negative returns cause some resource owners to exit their activities. Thus, returns return to normal levels over time (Rajan, 1988, pp. 165-66). In the Schumpeterian

Model, the entrepreneur is also an innovator and gets the profits from innovative activities (Baumol, 2004, p. 9). Leibenstein (1968) insists on the unique and critical role of entrepreneurship in the development process (p. 72). Entrepreneur, as he puts it (p. 74);

"search and discover economic opportunities, evaluate economic opportunities, marshal the financial resources necessary for the enterprise, make time-binding arrangements, take ultimate responsibility for management, be the ultimate uncertainty and risk bearer, provide and be responsible for the motivational system within the firm, search and discover new economic information, translate new information into new markets, techniques, and goods, and provide leadership for the workgroup."

On the other side of the issue, Dejardin (2011) refers to Tollison's (1997) description of rent-seeking behavior as a social cost of resource deviation and gives some kinds of this behavior;

"corruption, stealing, bribery, as well as seeking abusive judicial compensation or protection-seeking with the express purpose of limiting economic competition and promoting particular interest. Rent-seeking can originate from both the public and private sectors."

Laband and Sophocleus (1988) claim that profit-seeking and rent-seeking have parallel motivations, such as favoring the investor when an investor takes advantage of an asset that happens at the expense of others. In this respect, these considerations and outcomes are logical and expected. Although profit-seekers generate socially valuable output, rent-seekers do not. Even if there is no cost of transactions, rent-seeking is socially wasteful. In Olson's (1982) words, rent-seeking might ultimately hinder a nation's economy (p. 274). With the scope of rent-seeking, the most criticized sides of rent-seeking behaviors are related social losses such as increasing inequalities, inefficiency, inadequate economic functioning, transferring income to unproductive channels, waste of resources (Chakraborty and Dabla-Norris, 2006, p. 29; Farooq, 2019, p. 116; Gordon, 2023; Hillman, 2013, p. 307; Palk and Muralidhar, 2018, p. 782; Stiglitz, 2016).

The Logic of Unearned Income

Regarding rent activities, the rent-seeker gain is mainly harmful to

society and the economy. However, we do not directly mention that income classification belongs to it. Suppose rent is an income without any effort. In that case, only a transfer from others, King (1976) states that there is a general agreement that rent-seeking activities belong to the unearned income category. At this point, we must clarify the distinction between earned and unearned income. "Earn" links to putting effort and means getting a gain or compensation from labor-related work or service. When we concentrate on "unearned income," the term cuts the connection with effort but makes a connection with the ownership of a property. In other words, unearned income is a change in ownership of an income already earned by someone (King, 1976, pp. 251-2). There is another distinction considering how people feel about income. Earned income may make one feel more deserved but act less pro-social than unearned income. However, the source of income can affect what we spend the money on and how we consume it (Ambler and Godlonton, 2021, pp. 33-34).

Henry George and his colleagues separated the income, whether from using the soil in a pure state or from land improvements, albeit artificial. The former is an example of unearned income since an increase in land value only comes from a rise in demand. King (1976) insists that the work for clarification is challenging and needs sensitive determination and detection. On this line, labor is the main factor for the evaluation. Thus, our income is an earned income if it includes labor but unearned if we gain from interest or a rise in property value. A Marxian puts interest and illogical gains into the same basket. Likewise, George analyzes 'unearned increment' and asserts that value increases due to the rise in demand, not the owner's efforts, are also in the unearned income category. For instance, all speculative or chance gains are under the unearned income (pp. 251-5).

Similar acceptance is made by Taleghani (1983) and Naqvi, stating that "any automatic increase without productive labor" for interest revenue (Haneef, 1995, p. 101 in Farooq, 2019, p. 112). Haneef (1995) put it into the unearned income classification as Henry George. Farooq (2019) argues that we can hardly make the unearned income concept detailed under the scope and implications. Also, rent-seeking behavior is relevant to this unearned income (p. 112). Moreover, this relevance is not only because of definitional belonging but also the economic and societal outcomes. Unearned income and, thus, rent-seeking behavior is like transferring a gain or wealth from consumers to the corporations' owners. Also, this transferring mechanism occurs from their interlocutors without their

awareness of them to the seekers/earners. Additionally, the volume of gain allocation might become massive amounts. In this context, this kind of action looks like persecution/exploitation (Farooq, 2019, p. 114).

The Dynamics of Rent-Seeking Behavior

In terms of Gordon (2023), while any recompense above the production cost of a good that we coin as 'rent,' 'rent-seeking' is not beneficial in any way. Gordon declares rent-seeking is a redistribution of resources causing an inefficient economy and leading to unproductive resource allocation, reduction in government returns, rising income disparity, diminishing rate of national output, reducing prosperity accumulation, and disturbing competition.

McCormick, Shughart, and Tollison (1984, p. 1075) liken rent-seeking behavior to a kind of vascular disease 'arteriosclerosis' and characterize it as sunk costs that permanently deprive the economy. In addition, even though competition returns, with the distribution of monopoly profits, the investment in question becomes no longer possible with current production facilities (Laband and Sophocleus, 1988, p. 270). In addition, rent increases harm the free-market economy and cause a decrease in growth rates. It tries to stretch the system's rules so that the capitalists can compensate more, and it opens the door not only to income inequality but also to other types of inequality. In straightforward terms, any business that earns financial returns without adding value to the economy is in pursuit of rent (Palk and Muralidhar, 2018, p. 781).

One more lousy side of rent-seeking makes a connection to lobbyists and corruption. The lobbying activities of a rent-seeker need to build connections within the government, and this could be a very costly action. For instance, the cost of rent-seeking behavior for natural resources may include exclusive mining operations, drilling or distribution rights, and the enactment of appropriate legislation. (Blanes i Vidal et al., 2012 in Chaturvedi, 2016, p. 4). Chaturvedi (2016, 4) affirms that;

“for every piece of legislation enacted to unfairly favor rentiers, there is an increased burden on the rest of the population. Each of these inefficient transactions imposes a fee that is distortionary in nature.”

On the other side of the renters, there is a situation where corruption occurs for the sake of public interest. Lobbyists, as rentiers, earn rewards because of their rent-seeking activities and ensure that public sector rent-

seekers get a share. Similarly, in the case of corruption, there is a costly contract covered by taxes so that there is a wealth transfer without any contribution to economic value.

Congleton et al. (2008) argue that rent-seeking is similar to theft in terms of its role in the distribution of income and wealth, as it transfers/distributes existing wealth rather than generating new wealth. Similarly, theft is an income transfer that does not affect the national output and is only a transfer/grabbing. The social cost of theft arises from using resources for defense expenditures to protect against thieves rather than employing more efficient investments and objectives. The social loss caused by inefficient resource allocation similarly occurs in rent-seeking activities (pp. 2-3).

The Links Between Rent-Seeking and Inequality

Most economies have common significant problems such as inefficient development, slow growth, insecurity in wealth rights, unequal income distribution, and general rent-seeking tendencies. Rent-seeking impacts the economy by deflecting productive resources to activities that cause resource misappropriation. Rent-seeking activities such as corruption and tax farming might decrease growth by reducing global inducements and chances for production and investment. Widespread rent-seeking and precarious property rights are also associated with significant inequalities in income and wealth. Olson (1965) argued that corruption and rent-seeking are more likely in unequal societies (Chakraborty and Dabla-Norris, 2006, pp. 28-29).

Does the increase in the level of inequality affect rent-seeking, or does rent-seeking have an impact on income distribution and cause the inequality trap? The literature suggests that the causality between inequality and rent-seeking is a bidirectional model. The channels through which inequality leads to rent-seeking behavior are more likely to make society vulnerable to such behavior. In other words, unequal societies are more prone to rent-seeking behavior. On the other hand, rent-seeking also causes wealth distribution to become more skewed and unequal. Thus, this interaction produces the inequality trap (Acemoglu and Robinson, 2006; Banerjee et al., 2001 in Chaturvedi, 2016, p. 2).

In economies with high inequality, the wealthy may have sufficient resources and incentives to maintain their economic position (Acemoglu and Robinson, 2006; Banerjee et al., 2001 in Chaturvedi, 2016, p. 2). For this purpose, it provides benefits in providing sufficient resources and

power, such as a high level of distributional inequality, bargaining power, influence, and personal connections (Chaturvedi, 2016, p. 2). Corrupted judicial processes with lobbying activities also contribute to this process and may lead to action favoring the capitalist. With the decrease in trust, the increase in rent-seeking behaviors, which can be called the pursuit of everyone's interests, results from a rise in inequalities (Glaeser et al., 2003 in Chaturvedi, 2016, p. 2). In this context, Grossman (1991, 1994) demonstrates how inequality diverts resources from productive activities, encouraging the poor to predatory activities and the rich to defense investments (Chakraborty and Dabla-Norris, 2006, p. 31).

Rent-seeking, as a part of unearned income, is closely related to wage inequality. Rent-seeking gains earned from all kinds of resources, such as opportunities, power, and privileges, disturb the balance of wages, creating unequal income distribution. These sources, like patents and copyrights, give owners both monopoly power (and monopoly rents) and motivation for rent-seeking behavior (Baker, 2016 in Appelbaum, 2017, p. 514). Earnings from rent-seeking behavior are different forms of regressive redistribution in which income moves from the bottom to the top of the pyramid and involves costs. However, lobbying activities take place on a broad scale, not only for the private sector but also for the public sector. The level of public wages due to union activities is generally higher than that of the private sector. The resulting wage differences are due to the type of contract, task structure, and union rents (Chaturvedi, 2016, p. 4). Stiglitz and Bilmes (2012) evaluate the correlation between rent-seeking and rising income disparity as a zero-sum game by nature. In other words, correlation is like two pans of the scale. Since the number of resources allocated is limited, if one party wins, the other will inevitably lose (Appelbaum, 2017, p. 515).

Rent-seeking Behavior in Sectors

Stiglitz (2016) emphasizes that rent-seeking behaviors in the financial sector are serious. He explains this argument through the high levels of compensation paid to those in managerial positions after the financial crisis. If we determine wages according to marginal productivity, these payments were not at a height. Stiglitz also explains this link with increasing tax rates applied to the highest percentage of income earners. If the incomes of this group were from earned income, the tax increase would have reduced their GDP by discouraging their work. However, it did not lead to any decrease in GDP. Khwaja and Mian (2011) point out the variety of rent-seeking activities from private to public and from

developing to developed countries in the financial sector (p.580). Most studies focus on the role of the public sector rather than market players searching for rent-seeking gains in developing countries. On the other hand, in developed countries, the state's role is ignored, and the private sector is the dynamic of the sector's progress. Rent-seeking behavior on the part of politicians and bureaucrats is more likely to result from soft budget constraints or direct political/bureaucratic influence on state banks (p.582). When we look at market players in the financial sector, we cannot easily detect such behavior because it cannot be isolated from other activities. Private sector players lead to rent-seeking behavior through manipulations of prices and stocks, organizational patterns, particularly managerial issues, and insider information for equity markets (pp. 583-4).

Income/wage inequality is not only a consequence of rent-seeking motivated behavior, but abundant natural sources also lead to such rent-seeking based inequality. Rent-seeking takes place with the privilege of access to resources and makes the path easier for seekers than generating wealth. In contrast zero-sum game in wage inequality, this game results in a negative-sum game causing a reduction in growth rates for the country. Tax allowances applied for resources are the advantage of only owners, whereas policymakers could use the amount of taxation for socially beneficial fields such as education, health, and disadvantaged groups (Stiglitz, 2016). Moreover, Stiglitz (2016) argues that taxes on the rent of natural resources do not destroy them, meaning there is no adverse incentive effect on them. On the contrary, abundant natural resources can accompany high inequality rates in host countries. Because a few individuals or companies obtain these resources, they are the only ones who use their rent at the expense of others. Deacon and Rode (2015) explain this using the resource curse phenomenon. This phenomenon (or Dutch Disease) refers to the slower rate of growth accompanied by abundant natural sources. In the process, the weak institutional structure might make the resources a curse; when wealth is concentrated in minerals, political power seeks to establish control over mining, and institutions evolve to maintain their existing power. In contrast, relatively effective institutions turn the process against rent-seeking in favor of the community (pp. 3-4).

Sectoral potential for rent-seeking behaviors differs depending upon the structure of the sector. We might add another sample of rent-seeker activities: data brokers. Data brokers collect personnel information through different channels and sell the information for the marketing

purpose of commodities, services, or political thoughts to third parties (Reviglio, 2022, p. 3). However, they earn without bearing any cost or making productive output. Likewise, data brokers force private agents to accept individual information even if they are unaware of the data collection because of data mining techniques (Palk and Muralidhar, 2018, p. 785; Reviglio, 2022, p. 11). Thus, brokers cause data inequality compared to other competitors and wealth transfer without any increase in the acceptor's income in contrast to profit-seeking activities (Palk and Muralidhar, 2018, p. 786).

Conclusion

Throughout human history, countries have faced and tried to solve common issues such as low growth rates, inefficient resource allocation, unfairness in remuneration, rent-seeking, corruption, and bribery. In this paper, we demonstrate a political economy aspect of rent-seeking behavior via unearned income and inequality from a theoretical perspective. Rent-seeking is not only a physical impact on the national economy but also a security concern of society. The unearned income structure of rent-seeking behavior produces inequality, and inequality also increases rent-seeking activity. Preventing or reducing this gain-oriented behavior is significant for a more prosperous and fair life for all citizens.

Since difficulties in the measurement and identification are valid for rent-seeking, preventing or diminishing rent-seeking gains is complicated. Although we give some sector samples where rent-seeking prevails, we cannot claim that any sector or work area stays away from such issues. The causes of this complication are how much any action/sector might consist of rent-seeking activities and which regulations and implications might be effective against this behavior.

The detection needs technical calculation and statistical datasets. Unfortunately, data availability and accessibility are strictly low. Additionally, the literature is mainly theoretical or based on mathematical modeling. Econometric analysis, such as Laband & Sophocleu (1987) and Vasilev (2013), is scarce. In this regard, further studies could focus on econometrical methods measuring the degree of rent-seeking behavior. Also, sectoral studies could be helpful for this purpose. On the legal side of reducing such activities, an effective bureaucratic structure, solid institutional infrastructure, and ethical working perspective could facilitate the process (Park et al., 2005, pp. 46-47; Vasilev, 2013; p. 846).

Declaration

In all processes of the article, TESAM's research and publication ethics principles were followed.

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