POST-REFORM RENT-SEEKING

The continuing 'monopoly rents' generated in the labour market are much more damaging to growth than other forms of rent, says DEEPAK LAL

ILLUSTRATION BY BINAY SINHA

The daily revelation of various scams suggests rent-seeking is alive in India. In fact, one of the puzzles about economic liberalisation was how it could occur in a country, which, for nearly four decades, had created an equilibrium of rent-seeking interests which had mired the economy in the dismal Hindu rate of growth. Many observers saw little hope of a seemingly dysfunctional Indian democracy being able to deliver economic liberalisation. In an important book (*Democratic Politics and Economic Reform in India*, Cambridge, 1999), Rob Jenkins showed how the political players, particularly at the Centre, used both a rearrangement of the previous spoils system, and the various conflicts of interest within the numerous rent-seekers, to both institute and consolidate economic reforms. In terms of my predatory state model (*The Hindu Equilibrium*, Chp.13.2), the improved productivity of the economy resulting from economic liberalisation provided larger rents to the predators. They got an unchanged share of a larger pie. It is these new forms of rent-seeking which are the source of all these scams. But this raises its own puzzle, whereas the earlier pre-1991 form of rent-seeking had led to growth rates well below potential, the new forms of rent-seeking have been accompanied by phenomenal growth rates. What explains these differences in outcomes, and is this new corruption likely to damage growth like the old?

To answer this question it is useful to outline the sources of economic "rent". My UCLA colleague Armen Alchian provides a succinct discussion in *The New Palgrave Dictionary of Economics*. Economic "rent" is the payment for any resource "the supply of which is indestructible (maintainable for ever at no cost) and non-augmentable, and hence invariant to its price. In the jargon of economics, the quantity of present and future supply is completely inelastic with respect to price, a situation graphically represented by a vertical supply line in the usual "Marshallian price-quantity graphs". Land, distinguished by its location, provides one such resource. As at all prices the supply is constant, a tax on land rents does not affect any marginal decision by economic agents, and hence does not affect economic efficiency. It is (in economists' jargon) a lump sum tax.

If in the future, the aggregate supply of such indestructible resources can be increased in response to a higher price, even though the short-run supply is inelastic, there would be "quasi rents" accruing to the resource. An important form of "quasi rents" is what Marshall called "composite quasi-rent". "When two separately owned resources are so specific to each other that the joint rent exceeds the sum of what each would receive if not used together, then that joint rent to the pair was called 'composite quasi-rent'." This is important when the "resources that have been made specific to each other in the sense that the service value of each depends on the other's presence, the joint value of composite quasi-rent might become the object of attempted expropriation by one of the parties, especially by the one owning the resource with controllable flow of high alternative use value". Various institutional and contractual arrangements can be devised for the distribution of these "composite quasi-rents". As with pure economic rent, given the short-run inelasticity in the supply curve of at least the specific resource which does not have "a controllable flow of high alternative use-value", the "taxing" of this specific resource will not affect the efficiency of the economy. The arrangement for the division of the "composite quasi- rents" will represent a purely distributive outcome.

We can now see why the recent scams have not affected the productivity of the economy. Most of the scams involving pure "economic rent", as in the allocation of housing perpetrated by the armed forces in the Adarsh scandal, have no efficiency consequences. Though these may be social losses from the expenditures by "rent-seekers" to acquire these rents through political or administrative means.

Similarly, the scams involving the allocation of the 2G spectrum, the various mining-related scams and those involving infrastructure projects like roads, all relate to the distribution of "composite quasi-rents". These will again affect the distribution of income but have no effect on the productive efficiency of the economy. Again with the proviso of the social losses involved with the expenditure on "rent-seeking".

There is a third category of rents: "monopoly rent". These are created by artificial restrictions on other potential competitors to favour some economic agents. The Indian Licence-Permit Raj with its import quotas, industrial licensing, price controls, etc created these "monopoly rents". As the government intervention creating these rents affect the marginal decisions of consumers and producers, they lead to substantial efficiency losses, in addition to any of the deadweight losses associated with the "rent-seeking". They are equivalent to the levying of distortionary taxes-cum-subsidies, unlike the lump sum taxation associated with various forms of rent-seeking to obtain pure "economic" or "composite quasi" rents.

Economic liberalisation in former highly controlled economies like India (but also China and Russia) reduces or eliminates these monopoly rents. With the boost given to economy-wide productivity by liberalisation, the value of "economic" and "composite quasi" rents will rise. This allows the polity to substitute an even more highly valued source of rents to compensate the losers from the abolition of monopoly rents, but without any damage to the productive efficiency of the economy. This explains the paradox that post-liberalisation rent-seeking has been accompanied by high growth rates in these predatory states, and an increase in the rents garnered, whilst the pre-liberalisation rent-seeking had led to growth rates well below their potential.

There is, however, one continuing major source of "monopoly rents". This is the colonial labour laws creating "monopoly rents" for the small aristocracy of organised labour. By limiting entry and exit, and artificially raising the price of India's most abundant resource, they have damaged labour-intensive industrialisation in India. This situation will be made worse by the minimum wage and other purported labour rights being implemented in the unorganised sector. Much worse, the proposal to introduce minimum wages in the rural employment guarantee scheme will remove the main reason for the efficiency of this poverty-redressing policy: self-targeting. Though the immorality of rent-seeking associated with pure "economic" and "composite quasi" rents may be reprehensible, it is less damaging to growth than the continuing "monopoly rents" generated in the labour market.