

Rent Seeking Behavior in the Indian Economy

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Abstract -

Rent seeking Behaviour, is an economic concept, that occurs when an entity seeks to gain added wealth without any reciprocal contribution of productivity. The concept is devised from Adam Smith's ideologies. Here, rent refers to wealth derived from potentially unethical sources or means. Such income is low risk and is easier to obtain. Rent-seeking widely impacts our society in multiple ways. The following research paper aims to analyse the impact of Rent Seeking in the economy from an Indian perspective.

Keywords: *Rent, Wealth, Unemployment, Caste, Game theory, Gender, Entrepreneurship*

1. INTRODUCTION

Rent Seeking is a part of Economics and Public choice theory, it's a behavior that is aimed to increase one's wealth without creating new wealth for others. In other words, it describes the tendency of some people to seek profits without doing any actual work. Once the process starts, society faces 3 different kinds of Cost, they are Direct cost, Moral cost and Opportunity costs. Many economies have characteristics including lack of development, slow growth, shaky property rights, income inequality, and pervasive rent-seeking. One effect of such rent-seeking is the misallocation of resources in the economy as productive resources are redirected to appropriative activities. By diminishing total incentives and opportunities for production and investment, rent-seeking practices like corruption and tax farming can slow growth, thus economists view this practice as detrimental to the economy. It reduces economic efficiency and can have long term impacts of increased inequality, lost government revenues, and decreased competition. However, some economists are of the view that the practice may be beneficial during an economic slowdown or recession.

In this research paper, multiple researches have been analyzed to evaluate the impact of Rent seeking on several aspects of the Indian economy.

Objectives:

- 1) To analyze rent-seeking behavior in India
- 2) To determine the varied impacts of rent-seeking on the Indian economy based on the following perspectives:
 - a. Unemployment
 - b. Capital markets - monopolistic competition
 - c. Gender
 - d. Social Welfare - Impact on Indian Citizens
 - e. Impact on resource distribution
- 3) Evaluating the cost of rent seeking in India

2. Body of Paper

Rent seeking is a form of economic activity in which individuals seek to protect their wealth from the risk of being seized by the state. In 'Rent Seeking', Shankha Chakraborty reported that lack of development, stagnant growth, insecure property rights, income inequality, and widespread rent-seeking are common features of many economies. The researchers show that in the absence of credit markets, only wealthy agents can overcome the non-convexity in rent seeking. In the absence of credit markets, a higher initial wealth is of greater value to rent seekers than to producers. The wealthy population avoid tax from rent seekers by becoming rent seekers themselves. The academic rent seeking literature is relatively new, developing from articles and research papers by Gordon Tullock, Ann Kruger, and Richard Posner published over a roughly ten-year period in the 1960s and 1970s. Early rent analysis looked for concrete measures of social costs through public policies and monopolies. Tullock, Kruger, and Posner argue that the tools used to establish, maintain, or eliminate trade restrictions and monopolies are part of the social cost of these policies, but have previously been overlooked. Gordon Tullock's 1967 article "The Welfare Costs of Tariffs, Monopolies, and Theft" is often considered a precursor to this literature.

Unproductive for business, rent-seeking is a concept that includes the use of resources and, sometimes, the use of unlawful measures in order to gain special rights. And in doing so, they do more harm to others' interests than good, as their incomes are less than what they lose out on.

Here, multiple research papers have been analysed to form a conclusive analysis of the impact on important aspects of society and Economy. We also discuss the different models and tools used by researchers to assess this impact.

1. Impact on Employment

The research papers analysed establish a direct relationship between the role of public sector and the scope of employment in an Economy. They are directly proportional to each other. Here, the jobs are rent yielding in nature. This was concluded based on a comparison of multiple countries based on their public and private sector employment scenario.

The paper also define the role of the state in job creation. Governments, especially in India are constantly used the pressure to create jobs and increase employment. This is also evident from the studies of Jha (1980) as well as Bhagwati and Desai (1970), Chaudhuri (1978) and Bardhan (1984). This theme is echoed elsewhere; for evidence of 'pressure to create jobs at any cost' in an atmosphere of 'parasitism on the state' in India. However, today's government is not simply a provider of social welfare. Today, it goes beyond that to inculcate political power and stability. It is now an organizer of political support to stay in power (Bates, 1983). For the government, rent-seeking is a costless way to gain political support. The practice of rent-seeking is more prevalent in developing countries than the developed ones mainly due to high bureaucracy, low public accountability, and high inequality which are common characteristics of an underdeveloped economy.

In the labor market, rent-seeking takes various forms - pressure to raise wages and lobbying for the creation of more wealth-yielding jobs. Here, we analyze the relationship between government role, rent-seeking, and employment from the Harris-Todaro model.

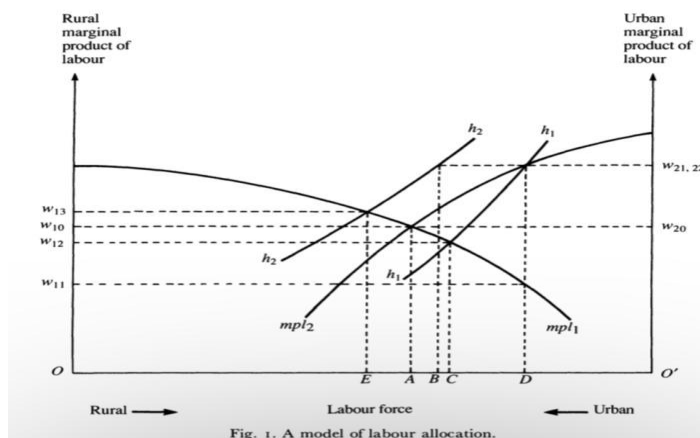
In the given graph, labor supply is depicted on the horizontal axis, with rural employment being measured from the left-hand origin O and urban employment from the right-hand origin O' . On the vertical axis are measured marginal products and wages. The marginal product curves of the rural sector and the urban modern sector (sectors 1 and 2 respectively) are mpl_1 and mpl_2 . In competitive equilibrium, a common wage rate ($w_{10} = w_{20}$) is established and employment in sectors 1 and 2 is respectively OA and $O'A$. A single wage applies to private, productive public and non-productive public components of the modern sector. An exogenous rise in the modern sector wage to w_{21} creates a misallocation of labor, with rural employment expanding to OD and modern sector employment contracting to $O'D$; the wage gap becomes $w_1 - w_2$. A **probabilistic migration relationship** then creates urban unemployment. Given the simplest probability function expressed by the hyperbola h_1h_2 , modern sector employment remains $O'D$, urban unemployment is CD , and rural employment contracts to OC , its corresponding marginal product being w_{12} .

Next, introduce a government response to unemployment. Government creates employment in an unproductive 'sink' (sector 3), which in turn generates more migration and unemployment, and so on, until a new static equilibrium is reached when there is no tendency for either sink employment or urban unemployment to alter. Urban sector demand is now the sum of the labour demands of sectors 2 and 3. In the new equilibrium, sector 2 employment is $O'D$, sector 3 employment is BD , urban unemployment is EB , and labour in sector 1 is residually determined as OE . The marginal products of labour in the sectors 1, 2 and 3 are respectively w_{13} , w_{23} , and by assumption to be explained below, w_{23} . The loss of output due to government response is shown by the area under mpl_1 between E and C . Thus, we analyse the static effect of the theory.

2. Impact on Gender - The Logit Model

In the studies analysed, it has been indicated that gender is a significant factor in explaining rent-seeking, and that there exists a relation between women's participation in the labour force, elective positions and corruption levels. The studies use corruption as a central indicator between rent seeking and gender equality. Economies with more women employed in government organisations have less corruption. Secondly, economies with more evidence of rent seeking could have higher levels of corruption. Here, we analyse the logit model to understand the relationship. In this model, we assume that women representatives are a potential agency for reducing corruption.

Based on widely prevalent patterns of rent seeking practices in local government, The general framework of the Logit model is expressed as follows:



CASE 1: Representatives in collusion with officials and other agents make private gains mainly through accepting commissions and bribes while carrying out developmental work.

The multiple agents involved in corrupt transactions in the panchayat are representatives (p), officials (o), politicians other than panchayat representatives (r), and contractors (c) in carrying out any activity. This network could be established as follows:

$$Cn1 = [p + o + r + c] \dots\dots\dots(1)$$

CASE 2: bribes are accepted to extend illegal services to individual clients by using the official position, which takes several forms. Consider the agent who may be an elected representative of the panchayats and works as a broker (p) for personal favours or illegal services and speeding up bureaucratic procedures for a client. The same agent may also network with a professional broker (b) in association with an officer (o) to fulfil the client’s needs. This network can be established as follows:

$$Cn = [p + b + o] \dots\dots\dots (2)$$

In both the cases mentioned above the possibility of the involvement of other intermediary agents is greater in the case of women representatives which is indicated by Pw. Therefore

$$Cn2 = [Pw + b + o] \dots\dots\dots (3)$$

The assumption that women make a difference to the level of corruption in local government considers women as the agency. If pw indicates the participation of women in elective positions, their potential to influence the corrupt practices (Cij) with networking of the ith situation of the jth agent may be expressed by the following equation:

$$Cij = Vij + Eij \text{ -----}(4)$$

Now that the model has been demonstrated, the research papers analysed showcased the same Logit model is used to estimate the factors affecting the attitude towards corruption across states in India.

3. Impact on Public Welfare:

In India, people spend Crores of rupees to hold jobs that give them the exclusive right to charge for water while also allowing them to distribute purportedly free water to farmers. Compared to the annual remuneration for the position, public service positions in many developing nations are expensive to acquire. According to casual observation, it appears that in many nations, it is typical for politicians and government officials to own enterprises owned by themselves or their families and to use their positions of power to defend these

companies against fraud and other types of expropriation. Additionally, there is a growing amount of focus on the link between wealth and rent-seeking when there is inadequate protection for property rights.

Agents who engage in rent-seeking activities share the same tastes and skills and only differ in terms of their starting salaries. We suppose that agents can engage in either rent-seeking or production, the two main economic sectors. Rent-seeking necessitates the payment of an upfront fee. Rent seekers can save a chosen amount of their original income (by hoarding) and appropriate a piece of the surplus produced by productive economic activity by paying this cost, preserving their riches against expropriation by others. We demonstrate that, depending on the initial wealth distribution in society, a single interior equilibrium with rent-seeking exists for a particular range of parameter values.

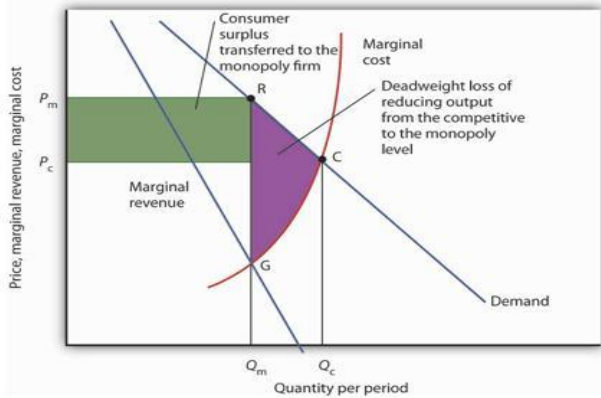
Even with the possibility of fierce competition in rent-seeking, the relevance of rents is still in doubt. A welfare cost is associated with competitive rent seeking for import licenses in addition to the welfare cost associated with achieving the same amount of imports through tariffs. The impacts of tariffs on trade, output, and welfare are well established, but in this case, the focus is on the increased expense of aggressive rent-seeking. The argument is developed using a straightforward model. Free trade is initially a presumption.

4. Impact on the competition: Monopoly as an effect of rent-seeking behavior:

Rent-seeking practices leads to monopolies in the economy which hinders the process of growth and economic development. It focuses on the benefits of the few due to which masses have to suffer, which in the end gets reflected in the economic position of a country. If the capital market, the goods market, and labor market controls are implemented and rent-seeking costs are added to external controls, annual welfare costs range from 35-40 percent of GNP. Welfare losses brought on by rent-seeking are likely to be more severe than losses resulting from more conventional price-distorting effects in the context of an economy of a poor country.

The fact that prices in a monopoly exceed marginal costs suggests that the monopoly solution violates the basic condition of economic efficiency, i.e., the price system faced by decision-makers at all prices and benefits of their choice. Efficiency requires that consumers face a price equal to marginal cost. Because a monopoly charges a price higher than the marginal cost, consumers will consume less of the monopoly firm's goods or services than would be economically viable. To contrast, the effects of perfect competition with the inefficiencies of monopoly outcomes,

Imagine a perfectly competitive industry whose solution is illustrated in the below picture “Perfect, Monopolistic, and Efficient Competition.” The industry's short-run supply curve is the sum of the individual marginal cost curves; it can be thought of as the industry's marginal cost curve.



A perfectly competitive industry reaches equilibrium at point C, with price P_c and quantity Q_c competing with each other. The marginal cost curve can be viewed as the supply curve of a perfectly competitive industry. A perfectly competitive industry produces a quantity of Q_c and sells its output for P_c . The monopolist limits output to Q_m and raises the price to P_m . The reorganization of a perfectly competitive industry into a monopoly leads to heavy losses to society due to the potential for GRC. It also transfers part of the consumer surplus obtained in the case of competition to the monopolist. Now suppose all the firms in the industry merge and a government restriction prohibits the entry of any new firms.

Our perfectly competitive industry is now a monopoly. Assume the monopoly continues to have the same marginal cost and demand curves as the competitive industry. The monopolist faces the same market demand curve from which he derives his marginal revenue curve. It maximizes profit at exit Q_m and calculates price P_m . Lower productivity and higher prices than competitive solutions. The company will benefit from the transition from a proprietary solution in Q_m to a competitive solution in Q_c .

The benefit to the consumer will be due to the area under the demand curve between Q_m and Q_c ; this is the Q_mRCQ_c region. Of course, the increase in output has a price to pay. Since the marginal cost curve measures the cost of each additional unit, we can consider the area under the marginal cost curve over a given output range when measuring the total cost of output.

So, the total cost of increasing output from Q_m to Q_c is the area under the marginal cost curve over that range - the area Q_mGCQ_c . Subtracting this cost to the gain gives us the net

benefit of moving from a monopoly to a competitive solution; this is the gray area of the RCMP. This is the potential benefit of switching to an effective solution. The GRC zone is for weight loss.

5. Game theory of Rent-Seeking Behaviour - Impact on Resource Distribution

Now, we evaluate the game model analysis of tripartite rent-seeking behaviors to have a deeper insight into the situation – Under this Model, it is assumed that the unit and contractor under supervision have two options: choose rent-seeking or not; in reference to their decisions, the owner has two options as well: monitor them or do not monitor; and there are two outcomes of monitoring: discover rent-seeking behaviors or do not discover them. Rent-seeking practices will be exposed, and appropriate sanctions will be applied.

Conclusions are obtained from the examination of the behaviors of the three subjects in accordance with game analysis, equilibrium solution, and example analysis. The optimal rent-seeking probability is directly related to the owner's monitoring cost and inversely proportional to the owner's monitoring probability and penalty coefficient. Owners should intensify internal management while minimizing expenditures, monitor and verify such actions more effectively, and increase the severity of punishment in order to effectively lower the likelihood of rent-seeking activities occurring and increase their likelihood of occurring on purpose.

In this study the authors investigate why rent-seeking—broadly defined as any form of resource redistribution—is detrimental to economic development. To begin, activities that attempt to increase their own rent typically display extremely natural increasing returns. Second, there is a high probability that rent-seeking, particularly public rent-seeking by government officials, will be more detrimental to creative activities than regular output.

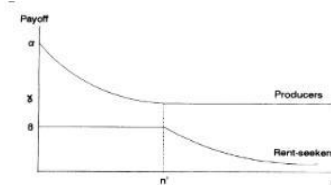


FIGURE 1. PAYOFFS TO PRODUCTION AND RENT-SEEKING, $\beta < \gamma$

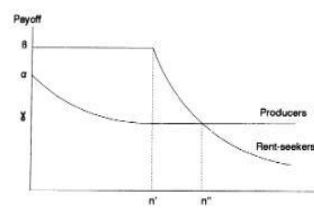


FIGURE 2. PAYOFFS TO PRODUCTION AND RENT-SEEKING, $\beta > \alpha$

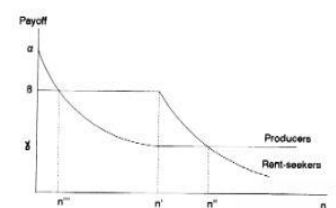


FIGURE 3. PAYOFFS TO PRODUCTION AND RENT-SEEKING, $\gamma < \beta < \alpha$

Analysis and Findings

In the Harris-Todaro model of endogenous government policy the reduction of public sector surplus labor requires an exogenous change in the balance of political pressures, so altering the government response function. The model can thus provide a theoretical justification for external intervention in policy-making. A combination of external leverage by multilateral lenders and the need to deal with macroeconomic destabilization has recently caused numerous countries to attempt to curb public sector employment. On comparing this to foreign research papers, similar impacts have been observed in countries like Ghana and Turkey but in both countries, the reforms are resisted by vested interests. The phenomenon of public sector surplus labor has been most obvious under populist, highly interventionist leaders. It may be more insidious in a milder form, however, because its effects, which may take several years to become evident, are less attributable. Recognition of the ill effects of surplus labor may not be sufficient to reverse policies.

Now, analyzing the Logit model in relation to the Rent seeking behavior we observe 3 common patterns were observed. First, the attitude of a representative towards corruption was not affected by Gender. Secondly, there was no difference in corruption between panchayats led by male and female presidents. Lastly, the involvement of women in corruption networks and in accepting bribes and commissions has been indirect. The tax base in underdeveloped societies are generated by the losers in the rent-seeking game who work towards value-producing activities but at a low rate of returns e.g. - shopkeepers, cultivators, carpenters, construction workers, agricultural laborers, and so forth. Tax revenues should target education resources to the poor, particularly if wealth and skills are uncorrelated. Considering wealth and abilities are perfectly correlated, it may be possible for the rent-seeking equilibrium to disappear. It may be worth targeting higher education to the rich to eliminate rent-seeking.

As the public has to forcefully give out more and more money, the expenses are increasing. Money supply in the economy increases and if the government is the rent seeker, then their revenue at the end of the day is increasing at a very high rate

Tools and techniques - Research Methodology

The literature curation of relevant material including research papers, articles, case studies, publications and reports was acquired from the following database and sources:

1. Google Scholar
2. EBSCO Host
3. Sci-Hub
4. Science Direct

The search strategy involved using specific areas of research relevant to the topic. The aim has been to identify a network and target publications to conduct the bibliometric analysis. Our main focus has been on India-centric papers, preferably written by Indian authors. These papers evaluated several aspects and ways in which the economy is impacted by Rent-seeking. Each paper presented a different dynamic in order to give us a holistic view. From the finalized literature search, we have obtained a few leading cited authors and a keyword network obtained from the keywords used in each of the contributing articles. It is evident that V Vijay Lakshmi, A Gleb, JB Knight, Roby Ranjan, and Shankha Chakraborty are the key authors.

These papers were thoroughly reviewed and examined to prepare the research paper. Later, this research was translated into a literature review. Next, the review was analysed to draw inferences and conclusions. We also examined the papers for limitations and defined the scope of our paper.

The data evaluated by the researchers has been used for analysis. Hence, the data used is secondary in nature. However, majority of the research is qualitative in nature.

Limitations

1. In the Harris-Todaro model, the paper has only evaluated the static effects of the theory. The dynamic effects, which present a more practical picture are beyond the scope of this paper.
2. The Equations of the Harris-Todaro model have not been discussed and lie beyond the scope of this paper.
3. It is beyond the scope of this paper to express the impact of rent-seeking on public welfare in quantitative terms. Our evaluation is only on qualitative measures.
4. The analysis of gender could be invalidated if a woman is co-opted into the corruption network, which is the base assumption on which the model is based.
5. Majority of the analysis is qualitative in nature and not quantitative.

3. CONCLUSIONS

In this paper, we analyzed the impact of rent-seeking behavior on various aspects of the economy.

In terms of employment, Rent seeking can create a sink effect, on the accumulation of unproductive labor. This can restrict the growth of the economy. Fiscal resources further support the sink and its investment claims, which ultimately diverts

resources from the productive sector. The creation of sheltered employment results in increased rent-seeking, migration, and unemployment. The experiments conducted to examine the sensitivity of the model to its various assumptions suggest that the main conclusion is robust.

Analyzing the impact on public welfare, it is clear that for many years, it has become common for the public to pay for something that no one owns. People who are dominant example government officials usually try to introduce laws that would actually benefit the government and not the country.

Throwing light on the creation of a monopoly, we can infer that the consumer and the producer both lose potential resources when we have a monopolist economic structure. During the producer's monopoly, the prices are in accordance with the producer's greed which in turn exploits the consumer. Thus, rent-seeking practices encourage monopolies and this further leads to a deadweight loss in an economy.

Rent-seeking also affects resource redistribution since there is a clear lack of a really fair, just, and open competitive environment because of several problems, including the defective law, regulation systems, excessive industry protection, local safeguards, administrative involvement, and regional segmentation. In this study, the focus is on an even more general type of increasing returns to rent-seeking, one that results not from the basic design of rent-seeking technology per se but from the interplay between rent-seeking and productive pursuits.

Two reasons why countries with profitable rent-seeking technologies, such as easy corruption, inadequate laws, and liberal legal systems, can experience economic hardship have been proposed in this research. To begin, we contended that extremely high levels of rent-seeking may be self-sustaining because such activity is characterized by very natural increasing returns. Second, we suggested that the rate of innovation may be drastically decreased by public rent-seeking in particular.

Entrepreneurship is the value-creating force in a competitive market order where the potential for rents provides the incentive for resource owners to seek out more efficient allocations of their resources. Roby Rajan in his paper focuses on state and local rent seeking rather than on the rent seeking that arises from state controls. Once the rents are captured, there is a lifetime guarantee of payments. This has created a situation where political tycoons continually find it profitable to increase transactions costs. The creation of the nation-state of India was accompanied by the preservation of incentives for continuing caste-based interest groups centred on rent-seeking activities.

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