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A Review of Rent-seekers, Profits, Wages and Inequality, The Top 20%, 2019 by Péter Mihályi and Iván Szelényi

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Abstract: The authors, Péter Mihályi and Iván Szelényi, set themselves the ambitious task of formulating an alternative discourse about inequality in which the extent of inequality per se is not the problem but rather where inequalities stem from? Herein lies their fundamental divergence with Piketty (2014) for whom the excessive growth of "profits" is assumed to be the source of inequalities. The problem with mainstream economics and Piketty is that "profit" and "rent" are lumped together. A critical distinction between the two is warranted to grasp the relationship between inequalities, innovation and economic growth. In line with Kornai's criticism of Piketty (2016), the authors insist on the source of inequality. Are they engendered by wages and profits earned on competitive markets or are they originated from rents due to imposed restrictions on market competition? In contrast with Piketty, the general assumption of the authors is that higher profits and wages often add to the annual growth or national income. Rents on the other hand lower annual growth. Although some forms of rent may even be useful, excessive rents breeds economic stagnation.

Keywords: Inequalities, rents, profits, wages, patrimonial capitalism, political capitalism

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A Review of

Title: *Rent-seekers, Profits, Wages and Inequality, The Top 20%*, 2019, Palgrave Macmillan, 156 pages, ISBN 978-3-030-03845-8

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The authors, Péter Mihályi and Iván Szelényi, set themselves the ambitious task of formulating an alternative discourse about inequality in which the extent of inequality per se is not the problem but rather where inequalities stem from? Herein lies their fundamental divergence with Piketty (2014) for whom the excessive growth of "profits" is assumed to be the source of inequalities. The problem with mainstream economics and Piketty is that "profit" and "rent" are lumped together. A critical distinction between the two is warranted to grasp the relationship between inequalities, innovation and economic growth. In line with Kornai's criticism of Piketty (2016), the authors insist on the source of inequality. Are they engendered by wages and profits earned on competitive markets or are they originated from rents due to imposed restrictions on market competition? In contrast with Piketty, the general assumption of the authors is that higher profits and wages often add to the annual growth or national income. Rents on the other hand lower annual growth. Although some forms of rent may even be useful, excessive rents breeds economic stagnation. The book's major arguments may be summarized in five points.

The first point elaborated both in introductory and conclusive chapters (Chapters 1 and 7) is that societies predominantly oriented towards rent-seeking are economically stagnating and socially unstable, whereas societies founded on competitive free markets are economically dynamic, and socially relatively stable. Rent-generated inequalities undermine the meritocratic legitimacy of liberal capitalism and enhance a patrimonial capitalism. Historically speaking, rent has been dominant (if not exclusive) source of income in pre-capitalist economies. A distinctive feature of capitalist economies is that they are driven by profit and wage maximizing behavior. However, there is a diversity of capitalisms. The authors argue that Piketty's strong point is that he correctly identifies the importance of rent-seeking in nowadays capitalism though he conflates it with "profit" in his two-class model of wage versus profit. The authors interpret contemporary capitalism as a "re-feudalization" ("patrimonial capitalism" in Piketty's terminology) rather than a return to "classical" capitalism of pre-twentieth century, especially to the pre-1930 epoch as Piketty seems to imply. "Unlike Piketty, we do not believe that the largest part of present-day inequalities can be derived from the "fundamental law of capitalism"." (Mihályi and Szelényi 2019, p. 36). Furthermore, growing levels of inequalities do not necessarily provoke social and political instability. People may accept more inequalities as long as their prospects for a better life seem secure. This can be explained by the fact that it is rather the *perceived level of inequality* than its actual level that motivates people to oppose the existing social and political order.

The second point is the authors' classification of rents. After a chapter on historical background of Classical Economic on rent (Chapter 2), they describe thirteen types of rents in Chapter 3 that can be classified into two broader categories: "scarcity rents" and "solidarity rents". According to the authors, the former is the concept of David Ricardo that has been generalized by Max Weber (1921/ 1978) and the sociologist Sorensen (2000). The latter is the authors' own addition. According to Sorensen (2000), "Rents are payments to assets that exceed the competitive price or the price sufficient to cover costs and therefore exceeding what is sufficient to bring about the employment of the asset"." (As cited by authors) (Ibid, p. 45).

To put it differently, scarcity rent is an income gained from restrictions of market competition. Solidarity rents, as conceptualized by the authors, capture all forms of rents related either to market failures or to an improvement in market competition. Among the latter are included rents generated by nation states (for example trade protection, immigration control), collective bargaining (local and national trade unions), state induced welfare entitlements (like healthcare and pensions), and charitable institutions (aid and other forms of assistance) (Ibid, p. 65). Scarcity rents stemming from governments' intervention and political bodies are often referred to as corruption. Such type of rent-seeking is practiced not only in Africa and other developing countries but also in all capitalist countries. The authors mention Liberal critiques of President Trump as being suspect of using his administration political power to generate incomes for himself, his daughter and son-in-law. The book devotes a whole chapter to stages of rent-seeking under post-communism (Chapter 5). This fascinating chapter substantiates three different stages in Russia, China, Hungary, and other post-socialist systems: 1) market capture by political elites; 2) state capture by oligarchs and 3) capture of oligarchs by autocratic rulers. This provides a theoretical explanation for autocratic tendencies or illiberalism: "The three most powerful figures of our present world, Vladimir Putin, President Xi and Donald Trump are deeply committed to the idea of illiberalism (though Trump has to deal with a fairly powerful liberal institutions, the judiciary, the two houses of the Congress and surviving strong commitment to individual liberty even aiming some members of his own party)." (Ibid, p. 84).

The third point is that the authors argue that focusing on the wealth of the top 1.0% or 0.1% as Piketty suggests, is a mistake. They explain that these elite groups are not long-lasting and not necessarily hereditary, while the top 20% of the society or "upper middle class" have become a "new nobility", a "dominant rank or estate". Chapter 4 identifies three mechanisms through which this new nobility has emerged: 1) elite education; 2) inheritance of wealth, and 3) assortative mating. Elite education notably in Ivy League Colleges provides a cultural capital for the reproduction of the "patrimonial upper middle class" (Ibid, p. 75). Inheritance of wealth in terms of valuable real estates, house condos, and works of art is particularly high in case of the upper middle class (Ibid, pp. 78-80). Finally, there is some credible evidence that graduates from elite schools tend to form families from similar institutions especially Ivy League. Spouses often achieve privileged positions in privileged institutions and gain high incomes including some rents over and above their market salaries.

The fourth point is about rent-securing by the nation-states and rent-destruction by globalization (Chapter 6). The authors view globalization as an important, praiseworthy new stage of the world economy. “What is unfolding in front of our eyes is arguably *the greatest emancipatory achievement of humankind since the Enlightenment*.” (Ibid, p. 128). The book underlines the positive aspects of international movement of capital and labor (migration) leading to cross country equalization of incomes, while the within country inequalities rose both in the core economies and in the emerging countries. The higher global competition undermines the privileged position of workers in core countries and their “rents”. Moreover, globalization is also a source of rent-generation for multinational firms. The final upshot is that drawing a demarcation line between rent, and income earned as profits or wages/salaries on competitive markets is very difficult. Incomes of capital owners as well as skilled and less skilled workers stem partially from rents.

The fifth point concerns policy implications building upon a discriminatory impact of tax on rents versus tax on wages and profits (Chapter 7). Tax on earned income (profits and wages) tends to have an inflationary effect whereas tax on rents (unearned incomes) does not. The authors contend that “Tax the 1 percent” is “populist demagoguery. There is no way how one can generate enough public income just taxing the wealthiest 1% and in addition, the wealthiest 1% may make socially productive investments and we may not want to discourage such investments…the fairest tax system is a tax on inheritance and capital gain”. (Ibid, p. 132).

To sum up, the book is a truly multidisciplinary work on political economy of inequalities based upon a synthetic work of a Weberian sociologist (Iván Szelényi) and an institutionalist economist (Péter Mihályi) following Kornaien systemic approach. Capitalist economies are analyzed as a whole social, economic, and political system. The authors correctly argue against mainstream economics by introducing a distinction between rents and profits. This theoretical distinction is important in analyzing new tendencies of contemporary capitalism towards patrimonialism and illiberalism. Re-feudalization of capitalist economies and post-communist societies has strong political implications for all supporters of liberal democracy who are opposed to such tendencies. All the merits of the book notwithstanding, it suffers from three fundamental shortcomings.

The first major shortcoming is theoretical. The authors construct their theoretical framework on rents on the basis of sociological works of Weber and Sorenson: “Aage Sorenson (2000) in his path-breaking article generalizes Ricardo’s theory of Rent.” (Ibid, p. 44). Without denying the interesting passages in the above-mentioned sociological works, the authors’ review of literature on rent is clearly incomplete. Unfortunately, Alfred Marshall (1920/1961) is passingly cited two times (Ibid, pp. 60, 64), and the Public Choice economists (Tullock, Kreuger, and Congleton) are cited once in the introductory part (Ibid, p. 11) without any further discussion of their theoretical contribution to the field? The founders of ‘Directly Unproductive, Profit-Seeking’ (DUP) (Bhagwati and Srinivasan 1980; Bhagwati 1982) as well as Oliver Willimason (1985) on quasi-rents related to asset specificity are totally ignored (for a detailed survey see Vahabi, 2016, pp. 311-318 and the new special issue of *Public Choice*, Mitchell 2019). Accordingly, Table 1 on “An overview of rent theories” (Ibid, p. 49) also excludes the bulk of economic literature on rents by Alfred Marshall, Public Choice economists and the founders of DUP activities. A more comprehensive review could shun many inaccuracies in formulating issues related to rent, and would cast light on the process of rent-dissipation (called “rent-destruction” in the book). For example, Sorensen’s (2000, pp. 1541-1542, 1547-8) idea of rents based on “natural abilities and talents" or "genetic endowments" (for example, height for basketball players) is totally meaningless outside a specific social or institutional structure, and we do not find any trace of it in David Ricardo or Tullock (1967). Moreover, according to transactional approach, quasi-rents may stem from asset specificity leading to bilateral monopolies (Williamson 1985). Impersonal markets are often appropriate governance structures for generic assets and not idiosyncratic ones. The quasi-rents measure the difference between the value of an idiosyncratic asset within a particular relationship compared to its alternative options outside contractual relationships. In these cases, quasi-rents are part of productive and allocative efficiencies (Vahabi 2011) and cannot be classified according to broad categories of 'scarcity or solidarity rents'. Interestingly Sorensen (2000, pp. 1545-1547) refers to "composite assets or rents on *asset specificity*" and quotes Marshall, Becker, Kreuger and Summers, but not Williamson (1985). The authors have incompletely cited this type of rent in Sorensen (2000) under the title of "composite rent" (Ibid, pp. 45-46) and have not noticed the significance of *asset specificity*. Similarly, "efficiency wage" theories demonstrate the reasons for payment of wages/salaries above and beyond market salaries in many corporations. The efficiency wage in the presence of asymmetry of information between employees and employers is a way to elicit the optimal level of effort from employees. This again is not reducible to 'scarcity or solidarity rents'. Surprisingly, the authors do not consider "asset specificity" as a specific form of quasi-rent: "it is not clear whether these two types of incomes are really "rent"." (Ibid, p. 46).

The second major shortcoming of the book is that global finance and its relationship with rents and profits are completely disregarded. Piketty's contention with regard to present-day inequalities as manifestations of "fundamental law of capitalism" is derived from higher return on financial assets compared to the annual economic growth rate. The authors exclude from their field of investigation the financial sector and its role as a driving force of globalization. If they had integrated this important element, could they have maintained their unconditional optimism about globalization?

Finally, Piketty is not alone in stressing the polarization between the 1% (or 0.1%) elites and masses. This distinction is also germane for understanding illiberalism or what has been called by Holcombe (2018) "political capitalism" following Weber (1921/1978). Taxing the 1% fortunes is not a demagoguery initiative if we follow a tendency towards a policy of non-progressive income tax since the end of seventies in developed countries (Piketty 2014, 2018). The recent "yellow jackets" demonstrations in France for fiscal justice following the abolition of "Solidarity Tax on Wealth" (ISF) and the attempt to excise tax on gasoline is a salient illustration of taxing the wealthiest in provoking social and political instability. In fact, the inability of Liberal elites to grasp this polarization has already contributed to the crisis of liberal democracy, and the ascendancy of right populism (illiberal tendencies) everywhere in the world including the United States and France.

The importance of a multidisciplinary book on a particularly complicated topic such as contemporary capitalism cannot be grasped only by its additions to our knowledge but also by its quality to raise controversial issues and provocative claims deserving deeper investigations. This is similar to providing an original spicy food combining different culinary cultures. Péter Mihályi and Iván Szelényi have prepared such a palatable intellectual dish, and it would be a pity not to indulge oneself in tasting it.

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