

Rent Seeking Opportunities retard Economic Growth. Better institutional democracy and reduction in corruption lead to sustainable economic development

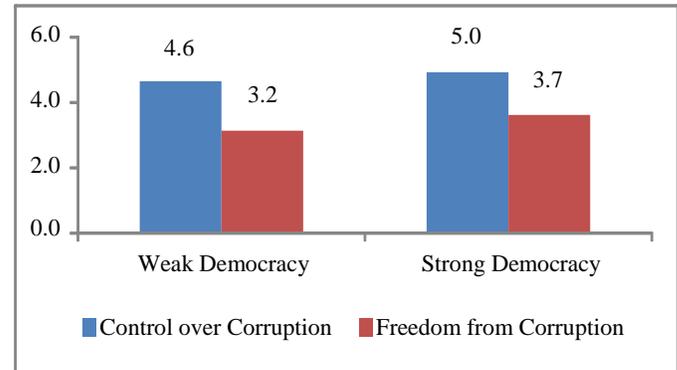
Rent seeking activity (RSA) is envisaged as any activity through which public power is exercised for private gains. This may involve misuse of public resources, any attempted capture and commodification of state, social or commercial authority by politicians, public officials, elites and private interests. The severity of problem exists in the developing countries where the rule of law is weak, checks and balances are ineffective and public sector management is poor. Government officials such as legislators, executing and enforcing agencies, members of the armed services, the police force, judges, public sector managers and employees are involved in rent seeking activities. Private agents influence politicians and bureaucrats to make policies in their favour by lobbying, sponsoring, bribery and exploiting patronage relations to seek maximum rent.

Using a panel of 52 developing/transitional countries, this study has offered an empirical assessment of the overall macroeconomic consequences of institutional frameworks that restrict opportunities for RSA. The study is focussed on middle income countries, which are on the path of economic development but still in a transitional phase. In these countries we find considerable heterogeneity in opportunities for RSA. When we look across these countries we find that the rule of law is not equally effective, property rights are not equally well-defined, democratic rights are not equally extensive. Individuals and organisations that have political or administrative authority will not find that authority equally restricted by checks and balances. Unrestricted authority is an opportunity for rent-seeking behaviour that may redirect resources, violate regulations, and focus effort on wealth redistribution (“bribery”).

Mankiw-Romer-Weil (MRW) conditional convergence model, with path-dependence is used for the empirical analysis. Opportunities for Rent Seeking activities are captured by democracy index and index for the perceived extent of corruption. To capture the impact of human capital health and education are used. However, in conformity to the literature health is more relevant than education as a measure of human capital development in the MRW model. The dynamic nature of this modelling framework led us to use a GMM approach to estimation and the extent of cross-sectional variation led us to prefer the “System GMM” estimator.

Estimation shows that RSA retards economic growth, in that democratic institutions, which are inimical to RSA, are growth enhancing. We also find that reduction in the perceived extent of corrupt practices can be growth-enhancing, but only if supported by well-developed democratic institutions.

Weak vs. Strong Democracy and Corruption Control Measures



Furthermore, study finds interesting results when we split our panel into “strong democracy” and “weak democracy” panels. In the “weakly democratic” countries we find an absence of path dependence; the growth experience thus appears fragile and uncertain in the sense that random disturbances have relatively high persistence, compared to the countries with an institutional framework that is more supportive of growth.

Interestingly, physical capital investment is insignificant to growth in RSA-prone countries because relatively high incidence of RSA in countries where institutional frameworks do not constrain such behaviour may make fixed capital formation an unreliable contributor to growth since (i) corruption of commercial and public sector decision making processes may lead to relatively unproductive investment decisions and (ii) data series for fixed capital formation do not recognize the possibly high incidence of “leakage”, in which funds have been corruptly diverted away from their declared purpose but are still recorded as representing fixed capital formation.

Following policy implications are drawn from the study based on the empirical findings.

- Governance institutions which are not overtly “economic” in their focus may nevertheless be integral to economic development.
- Institutional democracy in and of itself is associated with more sustainable economic development for transition economies and additionally, within the more democratic countries, a reduced incidence of (perceived) corruption is associated with faster growth.

Iqbal, N. & V. Daly (2013), “Rent Seeking Opportunities and Economic Growth in Transitional Economies” PIDE Working Paper (Forthcoming)