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## Political connections and land-related investment in rural Vietnam

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### ABSTRACT

This paper uses household panel data from rural Vietnam to explore the effects of having a relative in a position of political or bureaucratic power. Our results suggest that households increase their investment in land improvements due to such ties. Likely explanations are that connections to office holders strengthen de facto land property rights and access to both credit and transfers. Results also indicate that officials prefer to use informal rather than formal channels of redistribution to relatives.

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### 1. Introduction<sup>1</sup>

This paper investigates the potential effect of family ties between farmers and local government officials on investment in agricultural land improvements. The importance of agricultural investment for economic development is well recognized and has received increased attention in recent years, in part as a result of the ‘food price crises’ in 2007–08 (e.g. de Janvry and Sadoulet, 2008). A number of papers have investigated the effects of land property rights, credit, insurance, infrastructure and other factors on agricultural investment (e.g. Alston et al., 1996, Besley, 1995, Binswanger et al., 1993, Braselle et al., 2002, Carter and Olinto 2003, Do and Iyer 2008, Eswaran and Kotwal 1987, Feder and Onchan 1987, Hornbeck 2010, Jacoby et al., 2002, Jacoby and Mansuri 2008, Rosenzweig and Wolpin 1993). The literature on the political economy of local government in developing countries is also growing fast (e.g. Bardhan and Mookherjee, 2000, 2006, Besley et al., 2007, Ferraz and Finan 2008).

At the same time, few studies have brought the above two strands of literature together by studying the political economy of agricultural investment. An important exception is the contribution by Goldstein and Udry (2008). They investigated the effect of position in traditional, local power hierarchies on following of agricultural land in the Akwapim region of Ghana. Fallow is a major type of investment and Goldstein and Udry show that farmers with traditional political office have stronger property rights than other farmers. They therefore fallow their land much longer than others. We aim to contribute to these insights and do so in a very different context, namely that of rural Vietnam.<sup>2</sup>

Households may be connected with public officials in three different, but not mutually exclusive ways. First, one or more household members may themselves be public officials. Second, a household may have relatives living outside the household who are public officials. Third, friends or other non-family relations of the household may be officials. Our data set contains information on the presence of public officials in each household and on whether household members have relatives or personal friends who are officials. For methodological reasons, we focus on the effects of having relatives outside the household who are officials. This means that we mainly investigate government capture by the extended families of public officials. In other words, we study nepotism in local government.

The reason for focusing on connections with relatives (rather than looking at the effects of officials in the household or connections with non-relatives) is potential endogeneity. Whether a household member takes up work as a public official, and whether the household forms

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<sup>2</sup> Our analysis is also related to a group of papers addressing the economic effects of political connections (e.g. Fisman, 2001, Khwaja and Mian, 2005) and to the literature investigating personal connections between managers and workers within organizations (e.g. Bandiera et al., 2009; Prendergast and Topel, 1996).

and reports connections with non-relatives in government, is simultaneously determined with our main outcome variable, agricultural investment. To illustrate, if a household has invested heavily in the introduction of a new, high-value crop, the incentives for household members to seek employment as officials may be lower than those in other households. The returns from spending time on the farm are higher. A household planning to invest may actively nurture relationships with non-relatives in government in order to obtain approval or assistance for the investment project. Also, households may report an official as a 'friend' exactly because he or she assisted the household with a project, rather than the other way around. Connections with relatives outside the household are arguably more exogenous. A household's investment decisions do little to affect the probability of relatives in other households taking up positions as officials. Clearly, unobserved family characteristics (entrepreneurial spirit, risk and time preferences, etc.) may affect investment as well as the probability of having a relative in the local government. These factors are taken into account through the introduction of household fixed effects in our regressions.

The economic importance of family networks in Vietnam is documented by the survey data used here, as well as by other sources. For example, for more than half of the plots rented out by households in our survey, the tenants are relatives of the landlord. More than 90% of monetary transfers received by households from private sources are from relatives, and more than 70% report relatives as the main source of emergency funding. The 2001 World Values Survey in Vietnam asked respondents about the importance of different 'life domains'. Some 82% of respondents say that the family is 'very important'. Some 57% regard 'work' as being in the same category, while only 22% rank 'friends' as very important (Dalton et al., 2002). A key part of the background for these findings is undoubtedly the enduring influence of Confucianism in Vietnamese society.

So, family ties are important, but are ties to relatives with public offices particularly important and do they matter for agricultural investment? There are several reasons to expect that ties to government officials should matter for investment in land improvements. First, the attractiveness of such investment depends on the security of land property rights. Local government often plays a critical role in determining the strength of land rights. Local officials issue property deeds, decide on land expropriation for infrastructure and other development projects, and implement land use regulation such as 'zoning' laws. Second, investment needs to be financed, and in areas where commercial, financial institutions are not well developed, local government often plays a key role in regulating access to credit. Third, agricultural investment is risky, even when land property rights are secure. New crops may fail or the price of output may drop. Investment is particularly risky when land markets are poorly developed because recovery of investment through sale or rental is prevented. Local governments often control important sources of insurance. Access to credit is one such source, others include access to public sector employment and government transfers.

A priori, it is not clear whether discrimination in favor of relatives leads to efficiency losses. This depends on the motivation of officials. One possibility is that favoritism is driven by a 'taste for discrimination', in the words of Gary Becker (1971). In this case, the official attaches higher weight to the welfare of relatives than to others in his or her maximization problem. This type of behavior, which might be labeled 'true nepotism', generates inefficiencies relative to the goal of maximizing a welfare function that weighs everybody equally. Another possibility is that officials are constrained in their access to information and ability to enforce contracts. For example, administrators of a public lending scheme may not be perfectly informed about the ability and willingness of potential borrowers to repay loans. In this situation, officials may rely on family networks as a form of social capital. Officials may be better informed about the skills and honesty of relatives than those of other people. They may also rely on informal ties for enforcement of contracts. In this case, targeting public resources to relatives of officials might be efficient, helping the official solve an agency problem.

We use household-level panel data from the rural areas of 12 provinces in Vietnam. A bit more than 2000 households were surveyed three times over a period of four years during 2008–12, and it appears from our analysis that households with connections increase their investment in land improvement. We investigate three potential channels through which political/bureaucratic connections may affect investment: property rights, and access to respectively credit and transfers. The results suggest that connections decrease the probability of being expelled from land by the state, and have positive effects on access to informal credit and to both public and private transfers. Another interesting feature of our findings is that officials tend to prefer informal over formal channels of redistribution to relatives. Connections with public officials have no effect on the probability of holding a land title (a formal means of property rights protection) but do affect the probability of having land confiscated by the state. Although effects of connections on public transfers are of the same magnitude as effects on private transfers, connections have a much stronger effect on access to informal than to formal credit. Informal channels of redistribution are more difficult to monitor for those who may hold officials accountable for their conduct (local populations as well as higher levels of government) than formal channels. A preference for using informal channels of redistribution indicates in our assessment that officials seek to hide these transactions from their principals. This supports the view that favoritism is driven by a taste for discrimination, rather than by concerns for efficiency.

These findings stress the significance of informal networks for economic behavior in developing economies. They also suggest the presence of a potential for faster economic development. If households without political or bureaucratic connections could obtain equally strong property rights and access to finance and insurance as the well-connected households, agricultural investment would increase. As a result, rural economic growth would be stimulated.

Section 2 provides background information on land and local government in Vietnam. Section 3 presents the data and defines key variables. Section 4 contains descriptive statistics, and Section 5 investigates whether households gain new connections through marriage or because relatives move into new positions as officials. Section 6 includes the core analysis of connections to officials and land-related investment. Section 7 studies the effects of political/bureaucratic connections on land property rights, while Section 8 analyses the effects of access to credit, and Section 9 focuses on the relationship between connections and access to transfers. Section 10 concludes.

## 2. Background

Vietnamese agriculture is dominated by small, owner-operated farms. Rentals account for only about five percent of agricultural land in our sample, and collective farms play a very minor role. The background for this pattern is the 1987 and 1993 land laws, which followed the Doi Moi reform program initiated at the 1986 Communist Party Congress. The 1987 land law, implemented in 1988 through a directive known as Resolution 10, transferred farming responsibilities from agricultural collectives to households.<sup>3</sup> The 1993 land law went a step further and introduced Land Use Right Certificates (LURCs), also known as Red Books. They entitled holders to 20 years of user rights for annual cropland and 50 years for perennial crop land. LURCs may be traded, rented, mortgaged, exchanged, and bequeathed. For practical purposes, LURCs are therefore quite similar to proper land titles.

Ravallion and van de Walle (2004, 2006, 2008a) show that (i) the process of de-collectivization in the late 1980s and early 1990s was largely equitable and efficient, (ii) subsequent land transactions worked to decrease the inefficiencies that arose from administrative land allocation, and (iii) recent increases in landlessness should be interpreted as a

<sup>3</sup> As described in Pingali and Xuan (1992), steps were taken in this direction as early as 1981.

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