



Excessive public employment and rent-seeking traps[☆]

Esteban Jaimovich^{a,b,*,1}, Juan Pablo Rud^{c,2}

^a University of Surrey, United Kingdom

^b Collegio Carlo Alberto, Italy

^c Royal Holloway, University of London, United Kingdom



ARTICLE INFO

Article history:

Received 20 December 2011

Received in revised form 25 July 2013

Accepted 16 September 2013

JEL classification:

O10

J24

H11

H83

Keywords:

Rent seeking

Occupational choice

Public service motivation

ABSTRACT

We propose a model where the size of the public sector and aggregate output are interrelated through the occupational choice of agents who differ in their skill level and degree of public-mindedness. When the public sector attracts bureaucrats with low degree of public service motivation, they will use their position to rent seek by employing an excessive number of unskilled workers. This leads to an equilibrium with relatively high unskilled wages, which lowers profits and deters entrepreneurship. Conversely, an equilibrium with a lean public sector and greater private economic activity arises when public service motivated agents populate the state bureaucracy. These agents exert high effort and employ a limited number of unskilled workers. Our model also shows that a bloated public sector with high wages may be supported by the unskilled agents.

© 2013 Elsevier B.V. All rights reserved.

1. Introduction

Low quality and oversized public sectors are often perceived as an inefficient use of budgetary resources that, if redressed, could improve public service delivery or help reduce poverty. It is no surprise then that two of the biggest institutional lenders to developing countries, The IMF and the World Bank, have actively promoted the inclusion of governance and corruption issues on the development agenda since the late 90s.³ The concern with public sector mismanagement goes, however, deeper than just an issue of wasting budgetary resources: poor bureaucratic quality appears to be so important because it may also largely distort the operation of markets. Indeed, cross-country studies show that corruption

and rent seeking in the public bureaucracies can severely hurt private investment and are associated with lower income per head, [Keefer and Knack \(1997\)](#), [Knack and Keefer \(1995\)](#) and [Mauro \(1995\)](#).⁴

In this paper, we argue that an oversized and inefficient public sector might also affect the economy's performance in a different way, by misallocating human resources through its participation in labor markets. In particular, we suggest that the quality of the public bureaucracy determines the demand of unskilled workers by the public sector, which in turn affects the equilibrium wage. When unskilled wages are inflated by excessive public sector demand, profits will be reduced and the private sector will lose attractiveness to potential entrepreneurs.

We focus on one particular aspect regarding the quality of bureaucrats that has attracted growing interest over the past few years: whether or not they exhibit the appropriate ethics or motivation for their jobs.⁵ Commonplace in this literature is the presumption that monetary payoffs are not the only type of reward that individuals pursue and the idea that pro-social behavior cannot be perfectly monitored by monetary incentives. In such a context, it proves desirable that bureaucrats display a sense of mission and commitment towards the society they must serve. Such a sense of social mission has long been

[☆] We thank Maristella Botticini, Lucio Castro, Allan Drazen, Rocco Macchiavello, Ignacio Monzon, Alessio Moro, Andy Newman, Nicola Pavoni, Patrizio Tirelli and two anonymous referees for useful comments and suggestions, as well as seminar participants at Bocconi University, Collegio Carlo Alberto, CSEF, Essex, Inter-American Development Bank, Royal Holloway, University of Milan-Bicocca, University of Namur, University of Pavia, Microfoundations of Development Workshop at LSE, Far East Econometric Society Conference 2009, European Economic Association 2009, NEUDC 2009, Royal Economic Society 2010, and BREAD Summer Workshop in Development 2010.

* Corresponding author.

E-mail addresses: e.jaimovich@surrey.ac.uk (E. Jaimovich), juan.rud@rhul.ac.uk (J.P. Rud).

¹ Mailing address: School of Economics, Guildford GU2 7XH, United Kingdom.

² Mailing address: Department of Economics, Egham, Surrey TW20 0EX, United Kingdom.

³ See for example, "Good Governance: The IMF's Role" (1998).

⁴ This negative relationship is also highlighted by comparative studies that look at different regions in Italy [Alesina et al. \(2001\)](#) and [Putnam \(1993\)](#).

⁵ See [Benabou and Tirole \(2006\)](#), [Besley and Ghatak \(2005\)](#), [Bond and Glode \(2011\)](#), [Delfgaauw and Dur \(2008, 2010\)](#), [Francois \(2000\)](#), [Ghatak and Mueller \(2011\)](#), [Macchiavello \(2008\)](#), [Murdock \(2002\)](#) and [Prendergast \(2007\)](#).

explored by the public administration literature, which refers to it as *public service motivation*, and a large number of survey-based studies provide evidence of its relevance in explaining the efficiency of public offices.⁶

In Sections 3 and 4, we propose an occupational choice model with heterogeneous agents and two different sectors: the *public sector* managed by bureaucrats and the *private sector* managed by entrepreneurs. There are two dimensions of heterogeneity among individuals. The first is the level of skills, which is assumed to be publicly observable (e.g. education). Only highly skilled individuals may become entrepreneurs or may be appointed state bureaucrats. The second source of heterogeneity is the individuals' intrinsic public service motivation, which is assumed to be private information. The advantage of filling the state bureaucracy with public service motivated agents is that they are less inclined to rent seek.

In our model, bureaucrats and entrepreneurs need unskilled workers to carry out their productive activities, and must compete for the same pool of workers in the (competitive) labor market. Entrepreneurial activities yield profits, which are a decreasing function of the labor cost. Bureaucrats earn a salary fixed by the central administration. In addition, bureaucrats enjoy (some) discretionary power over the public budget. As a result, they could find ways to abuse this power in order to extract rents from the society.

An important issue in our model is then *how* rent seeking materializes in the economy. In that regard, we argue that several among the main channels used by bureaucrats to generate and extract rents require somehow oversizing public employment. For example, bureaucrats may bloat the public sector with excessive workers so as to extract different kinds of perks from some of them. Alternatively, overemployment may be the result of the creation of (unnecessary) jobs as a mean to directly appropriate income from it or to channel transfers to certain desired groups of people. Indirect sources of rents may also lead to an oversized public sector: for example, overmanning may be the result of clientelistic practices by state bureaucrats, as public jobs are somehow exchanged for political support (Robinson and Verdier, 2002).

Within this framework, we show that markets might coordinate activities in two different types of equilibria, depending on who self-select into the state bureaucracy. First, there is an equilibrium in which only public service motivated agents become bureaucrats. These agents keep an efficient public sector, which employs the lowest possible number of workers, subject to providing all public goods demanded by the economy. In turn, a lean public sector disciplines wages in the labor market, sustaining high entrepreneurial profits, which attracts agents whose main concern is their own income (profit-driven agents) into entrepreneurship. A different equilibrium arises when profit-driven agents control high-rank positions in the public sector and use their discretionary power to extract rents by overhiring public workers. The ensuing bloated public sector inflates aggregate labor demand, pushing up the equilibrium wage. This situation becomes also self-sustained because low profits deter skilled profit-driven agents from entering the entrepreneurial sector.

Bureaucratic rent seeking is clearly inefficient in our model. A crucial question that arises is then whether individuals may put in place an institutional setup that precludes such rent seeking. At the end of Section 5 we argue against this possibility. In particular, we show that oversized public sectors may actually find the support of the unskilled fraction of the society. The reason for this is that unskilled workers *indirectly* benefit from bureaucratic rent seeking by seeing their (equilibrium) market wages inflated as a result of public sector overmanning.

There are a number of past articles that have embedded models of endogenous rent-seeking behavior into general equilibrium frameworks. Notable examples are Acemoglu and Verdier (1998, 2000) and

Murphy et al. (1991). Murphy et al. (1991) studied how the choice between entrepreneurship and rent-seeking activities by the most talented individuals determines technical change and growth. Acemoglu and Verdier (1998) focused on the effects of property rights enforcement in a context of entrepreneurial opportunistic behavior. Acemoglu and Verdier (2000) dealt with the level of optimal bureaucratic intervention when the central (benevolent) government is confronted with both market failures and potential bureaucratic corruption. None of these articles has centered their attention on the interaction between the size, skill composition and efficiency of the public sector, together with its ensuing effects on the level of entrepreneurship, which are the main themes of our paper.

A closely related article is Macchiavello (2008), which also studies the possibility of multiple equilibria in an occupational choice model with public service motivated agents. His paper looks, however, at a public sector whose size and educational composition is exogenously fixed. Instead, our model highlights the importance of accounting for skills (or educational) differences, since the wage distortion becomes a crucial feature in explaining the following two phenomena: i) why a bloated public sector may adversely affect profits and entrepreneurship; ii) why a fraction of the society (the working class) may be willing to support rent-seeking bureaucrats who sustain a large and inefficient state apparatus. The latter point above contributes also to the political economy literature that has sought to endogenize the emergence and persistence of inefficient state institutions [e.g., Acemoglu et al. (2011) and Hassler et al. (2003)], by suggesting an additional channel that could generate political support for institutions that depress aggregate productivity.⁷

Our paper also relates to the growing literature on the quality of bureaucrats and politicians, e.g. Besley (2004), Bond (2008), Caselli and Morelli (2004), Matozzi and Merlo (2008) and Messner and Polborn (2004). A key aspect of all this literature is that it studies the process of self-selection into bureaucratic and political jobs within a partial equilibrium approach: in particular, it assumes that the returns in the private sector are exogenous and remain unaffected by who end up in the public sector. By contrast, in our model, the interplay between self-selection into public bureaucracy and the returns to private entrepreneurship lies at the heart of our theory and its main predictions.

Finally, occupational choice models in the development literature have so far mostly studied the long-run consequences of financial markets imperfections.⁸ In particular, Ghatak et al. (2007), Aney et al. (2011) and Jaimovich (2011) have focused on how financial markets imperfections may interact with the inability of markets to allocate agents to the occupations for which they are comparatively best suited. Our paper sheds light on how imperfections in the sorting of bureaucrats may also result in market distortions which preclude full development of the entrepreneurial sector, even in the absence of credit market imperfections.

2. Public sector overmanning and rent seeking

The mechanism we propose in this paper mostly applies to urbanized developing countries, regions or even cities, where labor markets are not fragmented and state capacity has somewhat developed. Anecdotal evidence of public sector overmanning in developing regions is

⁷ More recently, an interesting political economy mechanism complementary to our story has been proposed by Aney et al. (2011) within an occupational choice framework with credit market frictions. Their model leads to a class structure that distorts institutions by removing incentives to vote for surplus-maximizing policies.

⁸ E.g., Aghion and Bolton (1997), Banerjee and Newman (1993), Ghatak et al. (2001) and Lloyd-Ellis and Bernhardt (2000).

⁶ See discussion in Francois (2000) and references therein (pp. 275 and 276).

Download English Version:

<https://daneshyari.com/en/article/5094520>

Download Persian Version:

<https://daneshyari.com/article/5094520>

[Daneshyari.com](https://daneshyari.com)