

EMERGENCE AND PERSISTENCE OF INEFFICIENT STATES

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Abstract

We present a theory of the emergence and persistence of inefficient states based on patronage politics. The society consists of rich and poor. The rich are initially in power, but expect to transition to democracy, which will choose redistributive policies. Taxation requires the employment of bureaucrats. By choosing an inefficient state structure, the rich may be able to use patronage and capture democratic politics, so reducing the amount of redistribution in democracy. Moreover, the inefficient state creates its own constituency and tends to persist over time. Intuitively, an inefficient state structure creates more rents for bureaucrats than would an efficient one. When the poor come to power in democracy, they will reform the structure of the state to make it more efficient so that higher taxes can be collected at lower cost and with lower rents for bureaucrats. Anticipating this, when the society starts out with an inefficient organization of the state, bureaucrats support the rich, who set lower taxes but also provide rents to bureaucrats. We obtain that the rich-bureaucrats coalition may also expand the size of bureaucracy “excessively” so as to generate enough political support. The model shows that an equilibrium with an inefficient state is more likely to arise when there is greater income inequality, when bureaucratic rents take intermediate values, and when individuals are sufficiently forward-looking. (JEL: P16, H11, H26, H41)