Knowing the Right Person in the Right Place: Political Connections and Resistance to Change

Giorgio Bellettini
University of Bologna and CESifo

Carlotta Berti Ceroni
University of Bologna

Giovanni Prarolo
University of Bologna

Abstract
We use a political economy model of Schumpeterian growth with entry to investigate how an incumbent politician can strategically use the level of red tape to acquire incumbency advantage. By setting sufficiently high red tape, the politician induces the incumbent firm in the intermediate sector to invest in political connections, which are valued also by voters, who recognize that bureaucratic costs can be reduced by connected firms. Within this framework, we study the Markov perfect equilibria of an infinitely repeated game among politicians, firms, and voters, and show that all equilibria are characterized by investments in political connections and the re-election of the incumbent politician. Political connections may prevent entry of advanced competitors and cause the economy to lag behind the technological frontier. Our model provides a possible explanation for the persistence of inefficient democracies and political barriers to technology development, where these reflect shared rather than conflicting interests. (JEL: O31, O33, O40, D72, D73)

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E-mail: giorgio.bellettini@unibo.it (Bellettini); carlotta.berticeroni@unibo.it (Berti Ceroni); giovanni.prarolo@unibo.it (Prarolo)

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