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Harmful rents and rent-seeking

Query

What approaches are there to identify policy-induced harmful rents, what are their respective strengths and weaknesses, and how have donors used them?

Content

Caveat

The identification of policy-induced harmful rents has been approached mainly from a theoretical perspective. There is a lack of information on how donors have used those theoretical approaches.

Summary

The analysis of rents and rent-seeking has been dominated by an economic perspective focused on assessing rents according to their impact on efficiency and economic growth. Contrary to a political approach to rent-seeking, which tends to assume the negative impact of rents and their potential to derive from corrupt activities, economists classify rents as growth-retarding or growth-enhancing. The classification of rents as "harmful" or "not harmful" does not respond to the characteristics of the different types of rents but, rather, on the conditions and incentives that make them have a positive or negative impact on the economy.

The reflection on rents have evolved from a neoclassical economic approach of rents framed in an ideal competitive market to more realistic perspectives incorporating political elements influencing rents and rent-seeking, such as institutional frameworks and power structures. The identification of harmful rent-seeking tendencies is challenging due to their dependency on the circumstances in each case. Nevertheless, the literature identifies certain conditions with explanatory power to influence the outcome of rent-seeking as either positive or negative. Among those conditions are the state-market relationship, the influence of institutions and the social order, rent-seeking competition, collective action dynamics and the agency in pursuing rent-seeking. The impact of these aspects is assessed

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in relation to the level of rent-seeking cost and to the value of the rent-outcome resulting from rent-seeking expenditure.

An increasing acknowledgment of the presence of rents in every economic and political system is leading the reflection on rents and rent-seeking towards the question of how to manage rents to ensure they have a positive impact. Conditions, such as a political context free from political constraints and government capabilities like their learning and policy experimentation capacity, are among the considered necessary aspects for successful rent management. The transformation of the relationship between the public and the private sectors towards collaboration, mutual learning and accountability through tools such as integrity pacts is crucial in this regard.

1. Understanding rents

In economics, the term “rent” is defined as an income that is higher than the minimum that an individual or a company would have accepted given alternative opportunities (Khan 2000b). Rents might take different forms, such as monopoly profits, import and export quotas, extra income from subsidies or from owning scarce resources, agricultural price supports, occupational licensing, transfers operated through political mechanisms, or short-term super-profits made by innovators before competition enters their sector. These excess incomes are generated through the creation, maintenance or transfer of rights (Khan 2000a). The fact that rents involve extra income implies the existence of strong motivations and incentives to maintain those rents. The activities seeking to create, maintain or change the rights and institutions on which particular rents are based is known as rent-seeking (Khan 2000a).

In the literature, both rents and rent-seeking activities have been mainly analysed from an economic perspective, in terms of their impact on efficiency and economic growth. However, the limitations of that approach and the need to distinguish between rents in different sectors have motivated the introduction of political elements in the analysis.

Economic approaches to rents

The economic analysis of rents has been dominated by two main traditions: classical and neoclassical economics. Neoclassical economic theory has analysed rents in terms of their efficiency in relation to a model of perfect market competition, where the income that recipients in an industry would accept and the income that they would need to produce their goods or provide their services are equal (Buchanan, Robert and Tullock 1980). The efficiency of rents is assessed by looking at the immediate net social benefit (the difference between the social value of the output and its costs) associated with the rent and comparing it with the net social benefit achieved in its absence (Khan 2000b). For example, monopoly rents, created by entry barriers that allow firms in protected markets to charge higher prices for their products, are inefficient because they reduce the utility or social benefit of the product by producing less for a higher price. However, in a perfectly competitive market, where the prices cannot be manipulated by companies and are determined solely by the equilibrium between supply and demand, the social benefit is maximised. Thus, according to neoclassic economics, institutions and rights protecting rents should be removed to achieve efficiency and good economic performance.

Classical economics has focused the analysis of rents on their impact on economic growth, assessed by looking at the growth of output (or net social benefit over time) when there is rent compared to the growth achieved in its absence (Khan 2000b). Following the example of monopoly rents, if monopolies reduce the net social benefit, this can result in lower levels of investment in the economy, which will, subsequently, have an adverse effect on economic growth. In this sense, monopoly rents are potentially growth-reducing. According to Khan (2000b), this would happen when the monopoly is permanent; if it is temporary, monopoly rents might motivate investments and incentives for technical progress.

These economic approaches to rents have been criticised for not responding to a reality in which there is a great diversity of aspects affecting the effect of those rents on the economy (Khan 2000b).

Not all industries and sectors have the same conditions. On the one hand, certain types of rents can play an important role in helping particular sectors to exist and grow. For instance, in cases of scarce common natural resources, such as fishing waters, the allocation of rents – for instance, through the creation of private property rights – would prevent the overuse and free exploitation of the resource to the point that it might be extinguished (Khan 2000b). Another example is the green industrial sector since the development of renewable energies technologies requires private investment, and governments can do this by providing opportunities for above-average profits on investment (Schmitz, Johnson and Altenburg 2013).

Along these lines, more recent economic analysis suggests that rents may be essential to ensure that markets work by creating incentives in the fields of information generation and monitoring (Stiglitz 1996). On the other hand, Murphy, Shleifer and Vishny (1993) point out the negative effects of rent-seeking to innovation hampering, thus, economic growth. According to these authors, innovation is specially damaged by rent-seeking because innovators are dependent on government goods, such as permits, licences or import quotes, and they are not usually part of the government "elite". Furthermore, innovative projects are long-term and risky, making them vulnerable to heavy bribes and expropriation, and, since they are usually credit-constrained, they cannot find the cash to pay bribes easily.

Political variables in the analysis of rents and rent-seeking

Conventional rent-seeking theories (Tullock 1967; Krueger 1974; Posner 1975) have mainly focused on the social costs of the resources used for rent-seeking activities and have paid very little attention to the value and diversity of rents produced by rent-seeking activities. Khan (2000c) argues that rent-seeking should be understood as a process where its effect on society depends on the rent-seeking cost and on the value of the rents or rights produced by the rent-seeking expenditure. Both the input cost and the output rent are determined by political and institutional variables. Borrowing from the disciplines of institutional economics and political economy, two main political variables have been incorporated in the analysis of rents and rent-seeking activities: institutional frameworks and power structures. The understanding of these variables helps to explain why the impact of rent-seeking varies across countries and sectors.

Regarding the institutional framework, economists have compared rent allocation in democratic and autocratic regimes and find that, at a pure analytical level, institutions have indeterminate effects on rent-seeking and that there are other conditions determining the high or low cost of rent-seeking (Khan 2000c; Congleton 1980). The rapid economic growth of some Asian countries suggests that the rent-seeking costs, independent of the political regime, also depend on the level of fragmentation in the society and the strength of redistributive fractions. For example, where social fractions are weak and the power is centralised, the institutions in an authoritarian regime might produce low rent-seeking costs (Khan 2000c). Where social fractions are strong and the power of the state to suppress them is weak, democratic institutions might be necessary to achieve low rent-seeking costs (Khan 2000c). This is explained by the fact that the free flow of information in a democracy makes the process easier and faster (North 1990), and because democratic institutions are likely to awaken lower levels of conflict from excluded groups and, therefore, lower secondary rent-seeking costs (Khan 2000c).

Regarding the distribution of power, the outcomes of rent-seeking activities often depend on who is more powerful and can inflict the biggest costs on others during the competition for rents. In developing countries, a significant part of the rent-seeking cost and the distribution of rents take place within patron-client networks. In these contexts, to maintain the organisational power of patrons is crucial to win rent-seeking contests (Khan 2000c). This organisational power is preserved through a circular flow whereby part of the income from rents created for patrons will provide the resources for inputs of later rent-seeking expenditures on clients.

Crony capitalism, practiced in both developed and developing countries, for example, presents a more horizontal distribution of power in rent-seeking. Crony capitalism involves an exchange through which governments guarantee asset holders that their rights will be protected and, as long as their assets are protected, asset holders will continue to invest, allowing economic growth (Haber 2002). According to Haber (2002), in the absence of limited governments (those bound to respect political and economic rights through self-enforcing institutions), crony capitalism is the solution for governments to keep their commitment and do not use their power to abrogate rights.

Harmful rents and harmful rent-seeking processes

The rent-seeking literature has generally assumed that rents are always harmful. Evidence from developing countries in Africa and Asia, where rent-seeking is high and economic performance is poor, have influenced a negative perception of rent-seeking activities as wasteful expenditures to create or protect value-reducing rents (Khan 2000a). However, the economic growth of South East Asian countries in the last decades contradicts this argument and shows a more complex reality in which rents can be good or bad depending on the conditions that determine their value and the rent-seeking cost. From an economic perspective, rents can be both growth-reducing or growth-enhancing.

Following Khan (2000b), different types of rents have different growth implications. For example, the growth implication of monopoly rents varies depending on the market, technologies and companies involved. On the one hand, if monopolies reduce the net social product, this can result in lower investments in the economy and, therefore, in lower growth. On the other hand, the accumulation of profits by monopolistic companies may motivate more investment if deficiencies in capital markets make it difficult for smaller producers to raise capital collectively. Rents on natural resources, in contrast, often signal efficiency in resource allocation and may be a precondition for growth. They signal efficiency because by maintaining scarcity rents through the creation of property rights they prevent the overexploitation of the natural resource.

The efficiency and growth implication of politically organised transfers vary across countries. For instance, in developing countries, the state does not only redistribute income but is also involved in creating property rights. The outcome of these property rights can vary from the creation of the first generation of capitalists in a developing society, to tremendous wastage and theft (Khan 2000b). In developed countries, income from production is frequently lost or supplemented as a result of transfers through taxes and subsidies. Schumpeterian rents, which reward innovation in finding and using information, can, on the other hand, enhance both efficiency and growth in specific circumstances. Rents for learning can play a crucial role in facilitating the process of learning in developing countries.

In qualifying rents, it is important to distinguish between rents and rent-seeking activities. The rent-seeking activity might be negative (for example, bribery), but it might preserve a growth-enhancing rent (for example, a Schumpeterian supporting innovation); or even if the rent-seeking activity has a positive value (for example, lobbying), the outcome-rent might be negative (for example, a growth-reducing monopoly rent). It is worth keeping in mind, however, that sometimes rent-seeking activities, even positive ones, can lead to corruption. A corrupt government can, for example, choose to keep a rent deemed as positive in order to increase the opportunities to demand bribes (Khan 2000a).

Regardless of the outcome and costs of rent-seeking, these activities can also be classified as legal (lobbying, contributions to political parties, advertisement) or illegal (bribery and coercion). The potential for rent-seeking motivations to lead to potentially corrupt forms, such as crony capitalism, state capture or revolving doors, has been a matter of concern in the literature (Dal Bo 2006; Boehm 2007; Carpenter and Moss 2014; Razo 2015; Wu 2005).

2. Identifying harmful rents and rent-seeking tendencies

The identification of harmful rent-seeking tendencies is challenging due to the confluence of different conditions and incentives that might alter the outcome of rent-seeking activities in each case. The following are conditions identified in the literature with explanatory power regarding the potential outcome of rent-seeking as positive or negative.

The role of the state in the economy

The implications of the state's involvement in the economy on economic growth has been debated in the literature. Initially, the debate revolved around the size of state involvement (usually measured as the share of government spending as a proportion of GDP). The proponents of "small" government argue that limiting the influence of the state in the economy would reduce the amount of resources that governments can allocate in a discretionary manner to support particular interests, allowing the free market to allocate resources more efficiently to foster economic growth (Shleifer and Vishny 1998: Rose-Ackerman 2000). The defendants of "big" government, on the contrary, argue that, due to the existence of market failures, the market cannot ensure an optimal allocation of resources by itself, and state intervention is therefore necessary to fix such failures. Despite the efforts to link big government with higher corruption, empirical evidence contradicts "small" government proponents (La Porta et. al 2000; Hopkin and Rodriguez-Pose 2007).

The lack of empirical evidence linking the size of government involvement with fostering economic growth led the debate towards the nature of government spending. Discretionary spending, for example, creates resources for corruption, since it is decided by a small number of officials and can be channelled to specific groups; and much of welfare spending is impartially and automatically distributed to large groups of the population. Empirical studies show how the potential of corruption in certain sectors might affect the structure and size of the government budget (Delavallade 2006). For example, Tanzi and Davoodi (1998) find that the composition of government spending favours large-scale capital investment in infrastructure because such projects facilitate the collection of bribes for public officials. Although government expenditure in these sectors will increase, the productivity of the resources does not. The discrepancy between the amount of public investment and the outcome is also found in the education sector where several studies show no statistical correlation between public spending on education and literacy rates (Harbison and Hanushek 1992; Anand and Ravallion 1993; Rajkumar and Swaroop 2008). In this sense, Mauro (1998) concludes that education is unattractive for rent-seeking, because the provision of education does not require high technology inputs that could be provided by oligopolistic suppliers.

Competition

Market competition is often seen as an anti-corruption tool because bribes are harder to sustain in a competitive market (Emerson 2006; Rose-Ackerman 1988 in Bliss and Di Tella 1997). The understanding is that when officials and companies are exposed to competitive pressures and operate under a common set of market rules, the incentives for corruption are reduced. There is also the assumption that uncompetitive markets facilitate collusive deals because there is no incentive to cut costs where companies and officials depend on each other, rather than on the market or the electoral arena, for their survival (Rose-Ackerman 1978).

When domestic markets are opened up to competition, public officials are forced to stop demanding bribes, because their electoral future depends on domestic firms staying in business to provide employment for the electorate and revenues for the state. Opposing arguments state that competition does not necessarily reduce corruption (Straub 2005; Bliss and Di Tella 1997), but, rather, corruption is absorbed into the system (Warner 2007). The effect of competition on corruption depends on the nature of corruption and on the reasons for competition, among other factors (Alexeev and Song 2013). Alexeev and Song (2013) argue that, unlike rent extraction, corruption that reduces firms' cost is likely to be promoted by market competition. Moreover, some argue that the opportunities that capitalism offers to companies to increase profits and market share is an incentive for companies to seek the maximum assistance from governments to secure those benefits and to pay the lowest possible revenues and taxes (Wolff 2014).

Institutions and the social order

The social order and institutional setting in a society plays an important role in the likelihood of achieving benefits through personal connections and power or through economic productivity. North, Wallis and Weingast (2009) distinguish between limited-access orders (or natural states) and open-access orders. In limited-access orders, personal relationships among powerful individuals form the basis for social organisation, and rent-creation and limited access creates order and stability. In open-access orders, impersonal categories of individuals – citizens – interact, creating the foundation of the social order. The authors show why the same institutions – such as markets, civil society, fiscal incentives and mobile factors of production, elections and competitive parties – produce different outcomes in limited-access and open-access societies.

In natural states, there is no open access to organisations, resulting in a weak civil society; and they impose restrictions on the competitive party process, making the existence of an opposition difficult. Benefits are provided according to personal relations and political interests, which limits the capacity of governments to sustain programmes that share widely the benefits of the market economy in ways complementary to markets. As a result, natural states are subject to policies that create macroeconomic imbalances and budgetary crises. They do not rely on broad taxes on the economy and inhibit market competition.

In contrast, open-access orders ensure that governments provide services and benefits to citizens and groups on an impersonal basis, without considering personal or political connections. Political officials are subjected to competition, which limits their ability to cement their advantage through rent-creation. Governments are, therefore, more transparent and everyone knows how laws and regulations are produced.

According to Mungiu-Pippidi (2016), the key institutional change necessary to make societies able to control corruption requires a shift from particularism to ethical universalism. Particularism limits the access to resources favouring some and discriminating others, which results in an unfair allocation. On the contrary, ethical universalistic treatment of citizens is delivered impersonally by a state free from private interests. Mungiu-Pippidi (2016) distinguishes between competitive particularism and neopatrimonialism. Both are varieties of systems that distribute goods in a preferential way, but each of them requires different anti-corruption strategies. The predatory nature of the leaders in a neopatrimonial regime might mean that assisting them with tough anti-corruption laws bolsters the ruler’s prestige and endanger their political critics. According to Mungiu-Pippidi (2016) the assistance required in this case should be focused on building demand for good governance, empowering citizens and fostering collective action. In contrast, competitive particularism settings, where there is pluralism and freedom, need collective action capacity and to hold the government accountable. In this case, donors could help plausible principals to build a good-governance coalition and support rising demands for ethical universalism.

Bueno de Mesquita et al. (2003) analyse how institutions create incentives for leaders to pursue good and bad public policy with the ultimate purpose of holding office. According to the authors, a key explanatory factor in this regard is the size of the group of people (winning coalition) that keep the leader in power. The way leaders maintain their coalitions of supporters is by taxing and spending in ways that allocates mixes of public and private goods. The mix, and the amount spent, depend on the size of the winning coalition and of the “selectorate”.

They conclude that a larger selectorate and winning coalitions in democratic institutions promote productive economic activities, whereas the small coalitions of authoritarian governments promote kleptocracy. Hamilton (2013) shows that, in high-income democracies, a higher ratio of electorally-dependent decision-makers to non-electorally-dependent decision-makers is associated with less rent extraction. This is because electorally accountable and career-concerned office holders would be incentivised to minimise their short-term rent extractions and voters would be able to re-elect competent incumbents.

Acemoglu and Robinson (2012) refer to “extractive” and “inclusive” institutions. Extractive institutions produce limited prosperity and distribute it into the hands of a small elite. They profit from being in a position where they can extract benefits from others rather than engaging in productive activity. The limited growth produced by extractive institutions requires political centralisation; such growth is unsustainable and it does not focus on technological progress. Inclusive institutions, on the other hand, are based on constraints on the exercise of power and on a pluralistic distribution of political power enshrined in the rule of law. The authors argue that inclusive political institutions tend to support inclusive economic institutions, which leads to a more equal distribution of income, empowers society, limits the benefits of usurping political power, and reduces the incentives of extractive attitudes.

Collective action and interest group politics

Rent-seeking activities often involve competition between groups to get favours and privileged rights (Krueger 1974). The study of interest group politics has had as a reference the collective action theory developed by Olson (1965). According to Olson, the incentives for group action diminish as group size increases, so larger groups are less able to act in their common interests than smaller ones. The incentives to act in larger groups decrease because the individuals within them are less likely to get benefits from their efforts. According to Olson, when the group works to provide a public good, the likelihood of individuals trying to benefit from the efforts of the others without making any contribution (the free-rider problem) increases. The smaller the group, the larger the benefit and, consequently, the larger the incentives to act in their interest.

According to North, Wallis and Weingast (2009), Olson’s theory fails to recognise the capacity of creating interests contrary to privilege and rent-creation attempts as well as the ability of political institutions to reflect the interests of unorganised groups.

Regarding the competition among groups for political influence to protect their interests, Becker (1983) argues that the influence and outcome of the collective action depend upon how efficient groups are to produce political pressure and upon the group’s size. The efficiency of the group is measured in terms of its capacity to control free-riding. Another aspect that may influence the way groups compete is the lack of knowledge on how far competing groups are willing to go to gain privileges and protect their interests. This uncertainty can raise a situation comparable to a prisoner’s dilemma: in a competition between companies that could be won with the payment of bribes, where it is unknown if the other companies pay bribes or not, the dominant strategy for any company, from a purely rational self-interest perspective, will be to pay bribes too.

Rent-seeking agency

According to Khan (2000c), the conditions under which rent-seeking results in the creation of socially valuable rents and rights, as opposed to socially damaging rents and rights, can depend on who is seeking the rent and how. He distinguishes between three scenarios:

1) individuals or groups privately negotiate changes to rights without involving the state
2) individuals or groups take the initiative in seeking rents, but it is the state which creates and transfers rights
3) the state leads initiatives to create and change rights according to its own agenda

For the purpose of this analysis, which is mainly focused on understanding rents created by the state, we will focus on the second and third scenarios, which are further discussed in the following sections.

Rent-seeking by groups of individuals

Under scenario number two, individuals and groups try to influence the state by spending resources in bribing, lobbying or using political pressure. According to Khan (2000c), ensuring value-enhancing outcomes requires that influence is proportional to the absolute value of gains and losses. In the same way, in order to block value-reducing outcomes, losers should have more influencing power when the value of their loss is higher than the value obtained by the winners.

There are thus, two main conditions that are conducive to the creation of socially valuable rents in this scenario:

1) the spending power of rent-seekers must be proportional to the size of their gains
2) the political power of the rent-seekers must be proportional to their gain or loss

Political power is based on the costs a group can inflict on the state through political actions, such as votes, strikes, or even war, if their interests are not considered. Failure in these conditions, according to Khan, will lead to the production of value-reducing rents.

Olson's collective action problem helps to understand the reasons why the two conditions required for the production of socially valuable rents could not met. Incentives for free-riding are higher among big groups. As a result, big groups often find it difficult to collect contributions to exert their full political power and their influencing power is de facto reduced. In response, the state may then create rents for small well-organised groups simply because they can spend more in lobbying even if the rights they seek are value-reducing for society.

Finally, since political power is not always proportional to the potential gains from rent-seeking, a third condition is necessary: that political demands for transfers can be met with a stable set of redistributions. If transfers to unproductive groups are being continually re-negotiated, the result is instability and the negative effect of transfers can be greater, because rent-seeking costs will be high if excluded groups continue to contest.

Rent-seeking by the state

Under the third scenario – where the state leads initiatives to create and change rights according to its own agenda –

the state itself becomes the rent-seeker. The variables determining the types of rents produced in this case include the motives of public decision-makers, the transaction costs of collecting payoffs, the structure of the state that determines which costs and benefits are accounted for, and the power of individuals and groups to resist changes that damage them.

According to Khan (2000c), in this scenario, a first condition for value-enhancing rents to emerge is that state officials are value-maximisers who learn quickly from their mistakes. This condition involves state officials operating according to economic objectives. A second condition is that the costs of collecting bribes or taxes do not differ across groups. The possibility that a self-interested, value-maximising state creates value-reducing rents to enrich itself rather than the society is reduced if the state has a long time-span and it does not face different costs of collecting bribes or taxes from different groups. However, this condition is difficult to hold since the collection often requires costly investment in building contracts and trust. It is cheaper to collect a large bribe from a single person engaged in a large project than collecting many small bribes from a large number of people. According to Khan, this is why corruption often results in the allocation of rights to a few cronies of the regime, even when they are value-reducing for society.

A third condition is that the state's institutional structure allows all costs and benefits to be internalised. This means that the state's calculation of the costs and benefits associated to grant a rent or right must coincide with the actual costs and benefits, with no externalities. When the state is fragmented and each agency tries to maximise bribes for itself, the outcome may be worse than under a centralised state, because agencies operate from a partial standpoint, separating themselves from the state plan.

From an assumption that the state can only create value-reducing rents, Shleifer and Vishny (1993), in contrast, argue that a very fragmented state structure is best. Considering a no-rent economy without state intervention as the most efficient, the understanding is that if many state agencies compete with each other to sell the rent or right, the bribe price of the permit will fall to zero, so anyone could have the activity entitled by that right. The key difference between Shleifer and Vishny's model and Khan's is that the latter model is based on the understanding that the state can produce both value-reducing but also value-enhancing rights and rents.

Finally, for the state to be able to produce value-enhancing rents, it would be necessary that those who get affected the most – the losers – do not have the power to politically resist the state. The reason behind this is obvious: if the state faces strong political resistance, the creation of those value-enhancing rights could be threatened, even if their outcomes are expected to be positive. The fulfilment of this condition often depends on the power of the clients of the state. Where its clients are weak, the state can dictate the terms (a feature of a patrimonial patron-client network); where its clients are strong, the state cannot hurt them (a feature of a clientelist patron-client network). The fact that powerful clients are able to resist change might lead the state to fail in creating value-enhancing rent-outcomes.

3. Preventing harmful rents and rent-seeking

Rents exist in every economic system. The question is not how to abolish them, but how to manage them (Schmitz, Johnson and Altenburg 2013). Some development agencies insist that developing countries should limit themselves to creating more efficient working markets and reforming their investment climate. However, the experience of Asian governments in the second-half of the 20th century reveals that market-enhancing policies are not enough, and that economic growth also requires governments to have rent management capabilities (Schmitz, Johnson and Altenburg 2013).

The capabilities required for successful rent management, however, have not yet been fully developed or explored in the academic literature, but some reflections on the issue point to the following ideas: to have the institutional and political capacity to ensure that non-performance is not tolerated for too long; the state capacity to monitor and withdraw subsidies in underperforming industries; and the capacity of governments to learn and create the space for policy experimentation (Schmitz, Johnson and Altenburg 2013).

Moreover, certain conditions are considered necessary for effective rent management. One is having a political context free from political constraints that could prevent the implementation of rent management strategies. After observing a diversity of outcomes from the implementation of rent management strategies in Asian countries with different internal political configurations, Khan and Blankenburg (2009) conclude that the success of rent management strategies depends on the compatibility of the institutions with pre-existing political configurations of power.

Another condition is that both private and public actors should be driven by long-term interests (for example, gains from economic growth over time) rather than by short-term interests (for example, personal enrichment or improving prospects at the next election) (Schmitz, Johnson and Alternburg 2013). Active cooperation between government and the private sector is necessary, and the quality of that relationship will determine the impact of rent management in society.

Abdel-Latif and Schmitz (2011) also identify factors that influence whether public-private alliances have a positive transformational effect or are abused for individual enrichment:

- Organisational capacity of the private sector: the extent to which a certain sector can deliver visible results in terms of economic growth, exports and job creation will determine the willingness of policy-makers to support that sector.
- Open public-private alliances: state-business relations driven by common interest and informed by common understanding of problems play an important role in initiating investment.

- Upward accountability of policy-makers: accountability increases the likelihood of basing public-private relations on trust and collective interest.
- Competitive pressure: the protection of internal markets might prevent the abuse of public-private relations.
- Monitoring of sectoral performance: monitoring and transparency on sectoral performance might prevent public-private relations being abused for private gain.
- Consumer protection laws and agencies: consumer protection mechanisms might reduce the likelihood of private-public initiatives that harm the public.
- Freedom of the press: reduces the risk of using public-private relations for private interests

Part of the necessary change in the relationship between the public and the private sectors is to enhance the learning capacity of both actors. According to Rodrik (2004), it is necessary to create a setting in which they come together to solve problems and where each side learns about the opportunities and constraints faced by the other. Regarding the different ways of organising the learning process and policy experimentation, some authors (Schmitz, Johnson and Altenburg 2013; Heilmann 2008) consider decentralised governments as having greater learning potential than centralised government because, among other reasons, they provide local authorities with more autonomy to conduct their own policy.

Anti-corruption measures, such as integrity pacts (IPs) can also play a crucial role in transforming public-private relations potentially conducive to harmful rents. IPs, a tool developed by Transparency International in the 1990s, are agreements between governments and bidders for a public sector contract. They are both a legal contract and a series of activities for their implementation. IPs establish the rights and obligations so neither side will pay, offer, demand or accept bribes, and bidders will not collude with competitors to obtain the contract (Transparency International 2013). They include the obligation of bidders to disclose all commissions and expenses paid by them to anybody in connection with the contract, or the obligation of government officials involved in the process to subscribe to ethical commitments consistent with the IP. IPs also establish monitoring processes and a process for determining the occurrence of violations with the corresponding sanctions.

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