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RESEARCH ARTICLE

The impact of economic institutions on government policy: does contract-intensive economy promote impartial governance?

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Abstract
The objective of this study is to show how contract-intensive economic institutions can promote diversity and inclusion of social and political groups in economic and business opportunities provided by governments. Building on the interdisciplinary political economy and governance literatures, two types of economic institutions are identified: rent-seeking and contract-intensive. It is argued that rent-seeking economic activities can reinforce in-group norms, gift-giving practices, and governments' discrimination of groups. However, when contract-intensive activities increase in an economy, they can enhance diversity and inclusion of groups in the marketplace creating opportunity structures outside the state and as businesses press governments toward greater impartiality. Analyses of 165 countries from 1961 to 2011 show that a one standard deviation increase in contract-intensive economic activity is associated with a substantial 18 percent increase in the equality of access to state business opportunities for both social and political groups in the long run.

Key words: Contract-intensive economy; gift-giving; governance; impartial governance; rent-seeking; states and markets

1. Introduction

Scholars of political economy have long observed that rent-seeking as a practice of receiving privileges or funds from state authorities has been common in many ethnically and socially divided states. Rent-seeking is usually identified as a zero-sum economic activity, often creating biased governance and favoritism by states toward specific groups (Alesina and Ferrara, 2005; Tullock, 1993). The discriminatory provision of economic and business opportunities by states on the basis of group identity can increase grievance and conflict in societies. Since impartial governance in the distribution of opportunities to different groups is a desirable end to attain greater diversity and inclusion in state-business relations, what kind of institutional developments can affect states to become more impartial in their governance?

This article draws on economic norms theory to develop and test the idea that contract-intensive economic activities can increase economic opportunities in the marketplace for social and political groups from different backgrounds and affect state impartiality in a positive way (Mousseau, 2009, 2019). A great deal of theoretical and empirical research has paid attention to institutions and norms such as democracy, economic development, and civic identity in promoting an impartial state, but the role of contract-intensive commerce, as an institutional component of a liberal economy, has not been analyzed in terms of its impact on state impartiality in governance. This study draws on prior studies that identify 'rent-seeking' and commercial 'contract-intensive' institutional activities as two different kinds of economic activities in state–business relations (ibid., see also; Boehmer and Daube, 2013; Cedrini *et al*., 2020; Enia, 2017; Enia and James, 2015; Krieger and Meierrieks, 2015; Meierrieks, 2012). It suggests that 'contract-intensive' institutional activities can enhance the access of social and political groups to business opportunities. In this way, this study contributes to the governance and political economy literatures by enhancing our understanding on how contract-intensive economic institutions can promote group diversity and inclusion in state–market relations.

Rent-seeking norms can reinforce discrimination of business groups by states on the basis of group identity because these norms encourage gift-exchanges and favors between political patrons and business actors using communal, ethnic, religious, or other group ties (Easterly, 2001; Esman and Herring, 2001; Mousseau, 2021). When doing business relies on commercial-oriented activities in the market through contracting with strangers, in contrast, individuals and businesses are relatively free from political patrons, and groups do not completely rely on coalitions with politicians on the basis of group identity. Contract-intensive economic activities integrate individuals and groups from diverse backgrounds into the marketplace through contracting, and enhance market-based opportunity structures outside the state. At the same time, contract-intensive firms develop interest in a state that treats businesses equally regardless of their social and political affiliations, and form business organizations – such as chambers of commerce – to demand government impartiality as their shared commercial interest. In this fashion, the development of contractual economic activities can press governments toward impartial policies for providing equal opportunities.

The effect of contract-intensive economic activities on the levels of access to state business opportunities by groups is tested drawing on data in the Varieties of Democracy (V-Dem) dataset (Coppedge *et al*., 2019; Pemstein *et al*., 2019). The V-Dem dataset offers index measures of equal access to state business opportunities by social and political groups. In this dataset social and political groups in countries are identified with respect to various identity factors, including ethnicity, religion, race, language, or political affiliation. To gauge the extent at which businesses engage in contract-intensive exchange, I utilize data from the World Bank that indicate the intensity of non-self-enforcing contracts in countries – the kind of contracts that cannot be enforced by personalistic gift-giving relationships within groups (Mousseau, 2019).

This study is organized as follows. It begins with a review of prior research that has produced several factors as potentially influential on government impartiality. Next, the literature that distinguishes rent-seeking and contract-intensive economic institutions is reviewed. Following that, this study's theoretical perspective on how contract-intensive economy can promote impartial governance and equitable access to business opportunities by different social and political groups is presented. Subsequently, the data sources and test procedures are reviewed, and the implications are explained.

2. Previous research on impartial governance

Sometimes called 'good governance', impartial governance broadly refers to the limits of governments' arbitrariness in its policies, including the proper functioning of the private sector, an efficient and transparent bureaucracy, and the provision of public goods (Acemoglu and Robinson, 2012; La Porta *et al*., 1999; North, 1990). Acemoglu and Robinson (2012) and North (1990) showed that the institutional capacity of states in government impartiality was crucial in dealing with social and economic problems. However, complex social and identity-based divisions in a society can render the implementation of impartial rules difficult in the allocation of resources (Esman and Herring, 2001).

Rothstein and Teorell (2008) emphasize the equal treatment of citizens in policy outcomes regardless of their social, political, or ethnic background as an important aspect of impartial governance. High level of impartiality in public administration means that public officials have strong norms to pursue impersonal rules rather than personal, family, kinship influences and values in handling their administrative cases (Fernandez-Carro and Lapuente, 2016). Utilizing these definitions in the literature, this study assesses impartial governance in terms of how social and political groups are treated in state–market relations and business opportunities provided by states.

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Many governments give favors and privileges in economic and business opportunities to the groups that they feel associated with. For example, government partiality in the distribution of resources and opportunities is a particular problem in Sub-Saharan Africa, where politicians often prefer their co-ethnics in providing access to state resources (Easterly and Levine, 1997; Esman and Herring, 2001). In fact, in many African countries, poor economic growth has often been associated with rent-seeking (Alesina and Ferrara, 2005; Easterly and Levine, 1997; Mauro, 1995). Although the implementation of impartial rules in divided societies appears to be a challenging task especially considering the complex rent-seeking practices along social and ethnic lines, this study points out that the development of contracting institutions and norms can enhance state impartiality and promote group diversity and inclusion in a business environment.

Social science has produced a great deal of theoretical and empirical research regarding how some governments develop relatively impartial treatment toward social and political groups in policy-making. Democracy, higher income levels with economic development, and civic identity, rather than ethnic loyalty, are the most common identified factors particularly in the liberal modernization literature that might affect government impartiality in a variety of areas.

Starting with *democracy*, selectorate theory suggests that democratic states produce public goods over particularistic goods, as the provision of public goods is the more efficient strategy for elected governments to retain power through rent redistribution (Bueno de Mesquita *et al*., 1999). To the extent that impartial treatment of groups is a public good, we should expect democratic governments to be more likely than autocratic governments to make available more equal access to economic and business opportunities across groups. Rummel (1983) highlights in his classical work on libertarianism that individual freedom and liberty play an important role in how politics is conducted. If citizens and the press are sufficiently empowered and influence policies of the rulers, they can serve as a deterrent to unwanted policy outcomes (Rummel, 1983).

Still, scholars acknowledged that state impartially has been especially difficult in ethnically divided democracies. Acemoglu (2003) showed that democracy may not stop state predation as a majority can discriminate against a minority. Studies have documented that rent-seeking and ethnic outbidding in ethnically divided democracies is common, as politicians tend to compete for the support of certain groups at the expense of others (Baylis and Robert, 2004; Bluedorn, 2001; Heckelman and Wilson, 2013; Posen, 1993).

Some studies have also noted *economic development* as a potential factor affecting governments' impartiality in producing inclusive policies and public goods. Higher income means a higher tax base, which in turn can increase the capacity of states to respond to group demands by improving institutional arrangements for policy-making (La Porta *et al*., 1999; Treisman, 2000). A higher tax base also allows for greater inclusion of disadvantaged groups in state allocations. Rummel (1983) emphasizes liberal economic development as a conflict-preventive process. He argues that liberal markets promote bonds between citizens and rulers and self-interested actors who engage in market exchange, rather than conflict.

Another factor that might affect state discrimination is *ethnic fractionalization*. A large number of empirical studies report ethnic diversity as a factor linked with patronage and nepotism, affecting governments' performance in a wide variety of areas, including the provision of public goods and policies related with economic growth (Alesina *et al*., 1999; Alesina and Ferrara, 2005; Easterly and Levine, 1997). For example, scholars have observed that in African countries, jobs, contracts, and promotions are often distributed on the basis of favoritism toward certain ethnic groups (Chabal and Daloz, 1999; Kimenyi, 2006; Smith, 2003).

While factors involving democracy, economic development, and civic identity, rather than ethnic loyalty, might together bolster state policy toward greater impartiality as the above literature suggests, this study introduces a fourth reinforcing factor: *contract-intensive economic activity*. Before explaining this study's theoretical perspective, the next section reviews the interdisciplinary literature that has documented two kinds of economic activities in history – 'rent-seeking' and 'contract-intensive' institutional activities.

3. Rent-seeking and contract-intensive economic activities

Scholars of political economy and conflict have paid attention to the existence of two primary kinds of economic activities and norms in history: 'rent-seeking' and 'contract-intensive' (e.g. Boehmer and Daube, 2013; Cedrini *et al.*, 2020; Enia, 2017; Krieger and Meierrieks, 2015; Meierrieks, 2012; Mousseau, 2009, 2019). While rent-seeking is the practice of receiving privileges or funds from state authorities (Tullock, 1993), a 'contract' is a *quid pro quo* exchange – this for that – usually between private actors (Benyishay and Betancourt, 2010). Contracts require at least one party to trust that the other will fulfill its obligations. For instance, an auto-credit company has to trust that a lendee will pay its commitments. A society with contract-intensive activities is therefore one where commercial enterprises regularly trust the contractual commitments of strangers. Since these kinds of contracts are not enforced by personal ties, a contract-intensive economy is characterized with a robust consumer marketplace populated by strangers.

Rent-seeking businesses are dependent on political patrons for access to state rents, and rely on personal or communal relationships developed and nurtured with 'gift-exchanges' between patrons and clients (Easterly and Levine, 1997; Eisenstadt and Roniger, 1980; Tullock, 1993). The distinctions of rent-seeking and contracting are well known in the wider literature. Karl Popper noted that Plato observed the breakdown of 'tribalism' with the rise of commerce in ancient Athens (1945: 151–155). In the 19th century British scholar Maine (1917[1861]) showed with comparative historical method that contracting was relatively rare outside of Europe and the settler countries, and even rarer in ancient societies. In fact, contracting in life insurance was invented in 17th century London, as merchants, ship owners, and traders met at The Lloyds Coffee House (Nelli, 1972). Life insurance contracts are perhaps the most reliably non-self-enforcing of all kinds of contracts, because the insurance benefit is expected only after the death of the policyholder (Mousseau, 2019: 167; see also, North *et al.*, 2009: 159).

Maine's breakthrough launched what we can now observe – looking back – was the discovery of two primary ways of doing business in history: contractual and gift exchange (Mousseau and Mousseau, 2022). The classical sociologists – such as Ferdinand Tonnies, Emile Durkheim, and Max Weber – all sought to account for variance in contractual exchange in societies. Following in their footsteps was Malinowski (1920) – who originated the ethnographic method of participant observation – and Durkheim's nephew and favorite student, Mause (1990 [1924]).

Engaging in participant observation among the Melanesian islanders of eastern New Guinea, Malinowski made a ground-breaking discovery: the prevailing mode of exchange was not contractual but in the form of gift-exchanges among those in relationships. The gift-exchanges had explicit economic ends, even as the quid and the quo were never directly linked and the gifts were always expressed with altruistic motives. Drawing on Malinowski's observations and others, Mause used comparative method to show that gift-exchange is the historical norm, and contractual-exchange the historical exception. He described gift-giving as 'total social phenomenon' in ancient societies (1990 [1924]: 3), motivated to form and nourish long-term relationships and obligations based on reciprocity. Hierarchies often form, as gift 'debtors' come to depend on gift 'creditors', and the exchanges institutionalize inclusive networks (Cedrini *et al.*, 2020; Parry, 1986; Sherry, 1983).

Gift-giving and rent-seeking are ubiquitous in most countries of Latin America (Simeon and Peress, 2017). In the vast urban slums of the developing world, gift-giving ties are crucial for getting access to government services, at least as documented in Latin America (Kranton, 1996) and India (Auerbach, 2016). In a comprehensive meta-analysis of the literature, Charrad and Adams (2011) report that rent-related gift-giving 'is found in most regions of the world'. Experimental games corroborate diverse economic behaviors of peoples in gift-giving *versus* contractual economies (Henrich *et al.*, 2005; Kachelmeier and Shehata, 1997).

Scholars of international business have long noticed gift-giving reciprocity in countries with weak contractual economic institutions (Bat, 2007; Berger *et al.*, 2020; McCarthy *et al.*, 2012; Smith *et al.*, 2012). Drawing on surveys administered to IBM employees in 53 countries, Hofstede (1980) corroborated the individual-collectivism and authority-hierarchy dimensions. Using World Values Surveys data, Nevitte and Kanji (1999) show that people in the 'advanced industrial states' are less deferential in status than those in other states. Ferraro and Briody (2017: 170) review a wide range of studies that corroborate these dimensions and multiple other related findings, as well as the preference in particularistic cultures for relationships managed with reciprocity rather than equitable rules.

Probably all societies have some mix of rent-seeking practices and contracting exchanges. We know that contracting was present in ancient societies (Larsen, 2015), and that gift-giving exists in modern commercial orders (Dolfsma *et al.*, 2009). In fact, rent-seeking may even lift an economy during development. Weber (1968 [1922]) described the concept of patrimonial prebendalism as a form of patron–client system similar to rent-seeking in traditional societies which helped their transition to modern capitalism. Ang (2016) suggested that China's development success may be partly a function of rent-seeking, as local and national officials improvised the building of stronger institutions gradually in response to the problems of emerging markets.

How a country develops into a contract-intensive economy is exogenous to the argument of this study and there can be different paths in this direction. Our main research concern here is the level of contract-intensive exchanges in an economy. Although rent-seeking may contribute to economic development to a certain extent, it may not be enough to promote a diversified market and state impartiality in the long-run due to its zero-sum aspects in divided societies. Thus, this study suggests that the more the contract-intensive an economy, the more the state might become impartial in providing equal opportunities to social and political groups from different backgrounds. The following section elaborates on this theoretical expectation.

4. Contract-intensive economy and group diversity and inclusion

How can contractual economic activities affect government impartiality in providing opportunities to different groups? Where contractual institutions and exchange prevail, enterprises compete in the marketplace based on common rules for all. Business enterprises are comparatively free from political patrons and do not need to seek protection by them. Profitability is less determined by gift exchanges and political activities than it is in crafting better products and services in the marketplace (Boehmer and Daube, 2013; Cedrini *et al.*, 2020; Enia, 2017; Krieger and Meierrieks, 2015; Mousseau, 2009, 2019).

Where gift-exchange through rent-seeking prevails, in contrast, there are no equal rules, at least in practice. Instead, enterprises must often gift tribute to patrons with government connections, who gift back state rents. Competition is not fair and equal, as firms align with groups connected to state agencies – local and national – often through political party, ethnic, and neighborhood gift-exchange networks (Bat, 2007; Easterly and Levine, 1997; Eisenstadt and Roniger, 1980; Tullock, 1993). Rent-seeking profits are usually tied to gift connections and political activities rather than competition in the market.

Numerous studies have documented that ethnic leaders and politicians in African countries frequently adopt rent-seeking behavior in political and business relations, giving favors to their ethnic groups (Esman and Herring, 2001; Mousseau, 2021). Easterly and Levine (1997) showed that patronage relations and rent-seeking between politicians and their co-ethnics were common practices in doing business in Sub-Saharan Africa. Disadvantaged individuals and communities usually turn to their closest ethnic organizations for favors, showing loyalty to prominent group leaders (i.e. political, clan, rebel, and so on).

Burkina Faso, which is a low-income and highly ethnically divided country, exemplifies well how partialist or biased governance in providing opportunities to individuals and groups can bolster identity-based grievances among minority populations. Socioeconomic structures that provide subsistence to clan groups constitute the main group divisions in Burkina Faso. Group grievances and tensions along socioeconomic clan structures are reflected in the relationship between the Mossi farmers and Fulbe/Fulani herders. The Mossi are the predominant group, working mostly as farmers, and make up just over 50% of the total population. The Fulani are a poorer, nomadic group (around 8% of the total population), who primarily make their living from pastoralism (Englebert, 1996). A member of the majority group, Mossi, the former authoritarian president Compaoré held office over 27 years until Kaboré, who is also from the majority group Mossi, replaced him in the 2015 elections.

Group tensions and armed activities in Burkina Faso gained a momentum with the rise of a domestic jihadist group under the leadership of Ibrahim Malam Dicko, a Fulani preacher who founded Ansarul Islam and established his own mosque in 2014 (Crone, 2017). His political ideas continue to influence militant groups who recruit Fulani youth, particularly in areas where the state is perceived as discriminatory and negligent. Many Fulani people are recruited by jihadists due to the exposure of Fulani herders and landowners to injustice and relative discriminatory policies of the government, especially in the neglect of economic and business opportunities to Fulani populated areas (International Crisis Group, 2020). Likewise, in the eastern regions of Burkina Faso, jihadist preachers target their sermons toward minority communities who have been deprived of access to water, gold deposits, pastures, hunting, and fishing groups (ibid.).

When access to economic resources and opportunities depends on favors and rewards by political patrons on the basis of group identity, the disadvantaged groups can accumulate grievances. While rent-seeking activities can create wealth they also redistribute it (Stiglitz, 2012). Rent-seeking practices can promote a more zero-sum-like environment in divided societies as enterprises compete over access to state rents, which in turn promotes intergroup conflict (Easterly, 2001; Mousseau, 2021).

Hodgson (2003) offered that socio-economic institutions change and mould individuals' preferences, capacities, and behaviors by affecting their habits. Cedrini *et al.* (2020) articulated gift-giving was an institutionalized form of economic behavior that preceded market-exchange. Building on these perspectives in the institutional literature, this study argues that when economic and commercial activities increase through the spread of contractual institutions in a market, they can change gift-giving and rent-seeking norms of doing business. Contract-intensive economic activities integrate individuals and groups from diverse backgrounds into the marketplace as relatively free actors who do not rely on coalitions with political patrons on the basis of group identity.

As Putnam (2000) put it, bonding social capital within groups can produce adverse effects and mistrust in a society in the absence of more organizational or 'bridging' social capital, which links individuals across groups in broader civic networks. Contracting market institutions can provide a socioeconomic civic network to link individuals and promote norms of trust among them. McCannon *et al.* (2018) found an interaction effect between contracts and trust, as contracting and trust complement each other. Similarly, Rothstein and Uslaner (2005) suggested that countries with more equal opportunities for individuals had more generalized social trust than particularized in-group trust.

Thus, by proliferating opportunities in the market outside the state, contract-intensive economic and commercial activities can decrease the role of rent-seeking in the state (Mousseau, 2009, 2019). As markets become more diversified through the contractual engagements of more individuals, states need to act more impartial in extending contracts, since their existence largely relies on taxes and the variety of emerging productive activities in the market (rather than traditional rent-seeking business). While contract-intensive businesses might have a collective action problem in constraining the state (Olson, 1993), they can defend and press for impartial governance through business associations – such as chambers of commerce – in order to promote a fair competition and impartial treatment of diverse groups.

In summary, a rise in contract-intensive businesses can create diverse productive activities and opportunity structures in the market and produce a body of actors with the distinct combination of common interests in the impartial state. In this way, contract-intensive economic institutions may lie at the backbone of an increased diversity and equal access to opportunities by social and political groups; and play a mediating role in terms of enhancing diversity and group inclusion in state–market relations. Accordingly, this study proposes the following hypothesis and proceeds with the section on research design for the test of this hypothesis:

H1: The governments of countries where contract-intensive economic activities prevail may be more likely than other governments to provide more equitable access to economic and business opportunities across social and political groups.

5. Research design and data

To gauge the extent of equal access to state economic and business opportunities by social and political groups I drew on the V-Dem dataset (Coppedge *et al*., 2019; Pemstein *et al*., 2019). The dataset offers separate measures for access to state business opportunities by social and politic group. State business opportunities are defined as 'the ability to compete for or receive a public procurement contract, to partner with the government in public-private partnerships, etc.' (Coppedge *et al*., 2019: 202–204). The variable *Access to State Business Opportunities by Social Group* defines social groups as those 'differentiated within a country by caste, ethnicity, language, race, region, religion, migration status, or some combination thereof' (ibid.). The variable *Access to State Business Opportunities by Political Group* defines political groups as those 'affiliated with a particular political party or candidate, or a group of parties/candidates that can be distinguished from others in terms of access to power' (ibid.).

The V-Dem variables cover 165 countries identified as sovereign by the Correlates of War (COW) (Singer *et al*., 1972) with populations larger than 500,000 from 1960 to 2010.[1] Both measures are based on five-point item survey expert responses converted to interval-level values by the V-Dem measurement model, and range between −2.9 and 3.6 (social) and −2.9 and 3.8 (political). Both have a strong normal distributions with skewness scores close to zero.

To estimate the levels of the institutionalization of contract-intensive economic activities in countries this study follows most prior studies (e.g. Enia, 2017; Hegre *et al*., 2020; Krieger and Meierrieks, 2015; Mousseau, 2009, 2019) and draws on data on life insurance premiums in force developed by Beck *et al*. (2010) under the auspices of the World Bank. As explained by Mousseau (2019: 167), life insurance contracts are perhaps the most reliably non-self-enforcing of all kinds of contracts, 'because the insurance benefit is expected only after the death of the policyholder' (see also, North *et al*., 2009: 159). Dependent on a credibly-impartial state, a large life insurance marketplace cannot exist unless contract-intensive economic norms and activities are highly institutionalized and the impartiality of state institutions is widely credible. As Putnam (2000) described it, if in-group social capital exists without civic social capital, there can be low level of general trust in a society. Likewise, when gift-exchange and rent-seeking are highly institutionalized along group lines, the impartiality of state institutions is dubious and it is difficult to establish a sizable life insurance market that can be trusted. Policy holders would have no basis for trusting that the life insurance companies would meet their obligations after death.

The Beck *et al*. (2010) data cover 98 non-micro countries identified as sovereign by the COW (Singer *et al*., 1972) from 1960 to 2010. To reduce the number of missing values I interpolated the variable *Lnslife* (ratio of life insurance premiums to gross domestic product (GDP)) by year.[2] I converted this measure to per capita by calculating the product of Inslife and real GDP using the variable *RGDPL* from Penn World Tables, version 7.1 (Heston *et al*., 2012). The RGDPL is in constant (2005) prices converted to international dollars using purchasing power parity (PPP) rates. This study uses PPP to account for the fact that the needed death benefit to cover the typical household increases with the income level of an economy. I then extrapolated 40 data points for three countries (Germany, Taiwan, and Turkey) drawing on an earlier version of the life insurance data developed

[1]I drop micro-countries from the analyses because life insurance markets (below) in small-populated countries appear to be biased upwards, possibly because wealthy foreignors from contract-intensive countries often have second residences in micro-countries.

[2]Interpolation added 100 data points, 3.8% of the total. As a pre-caution, before interpolation I dropped single data points surrounded by gaps of five or more years.

by Beck and Webb (2003). Because this study is interested in level of contract activities rather than specific year-to-year changes in life insurance contracting, I smoothed year-to-year fluctuations by calculating the eight-year moving average.

Sixty-seven countries identified as sovereign by the COW project are not in the life insurance data. These missing countries pose a problem because by the logic of the thesis they are missing not at random (MNAR). By their very nature rent-seeking enterprises pursue their interests in the shadows. In addition, state officials in rent-seeking societies are generally averse to collecting and reporting data of any kind because disclosures of state-spending activities can be politically troublesome. Governments of contract-intensive economies, in contrast, actively collect and publish economic data because they are under constant pressure from business enterprises, organizations, and voters to be transparent and report economic conditions.

Alas, countries missing from the life insurance data probably have economies riddled with gift-exchange and rent-seeking. To test this thesis I regressed a dummy indicator of missing values of life insurance on two predicted outcomes of weak contract norms: the intensities of neopatrimonialism and corruption. For the former I drew on V-Dem's index measure *Neopatrimonialism* (Sigman and Lindberg, 2018), which is a regime 'that combines clientelistic political relationships, strong and unconstrained presidents and the use of public resources for political legitimation' (Pemstein *et al.*, 2019: 161). For corruption, I drew on V-Dem's measure *Public Sector Corrupt Exchanges*, where corruption is defined as the extent at which 'public sector employees grant favors in exchange for bribes, kickbacks, or other material inducements' (Pemstein *et al.*, 2019: 120). In both cases the dummy for missing status yielded a highly significant coefficient in the expected direction, indicating that countries not in the data have 19 percent higher levels of Neopatrimonialism and 10 percent higher levels of Public Sector Corrupt Exchanges compared with other countries in the data. I controlled for income (as measured below) in these tests, so the impact of missing status is not likely attributable to a state being unable to collect and report data due to a lower tax base related with lower income.

Corroboration of this study's prediction that missing values reflect rent-seeking economy poses a dilemma. Since missing countries are systemically different from the non-missing ones, analyses with the original data are biased. To address this issue as safely as I can, I report two sets of results. For this study's main results, I address the MNAR problem by setting missing data points for countries that never enter the data to 0, since the evidence indicates that these countries have rent-seeking economies throughout the temporal domain. I calculated the natural logarithm of life insurance per capita (after adding 1) and call the variable *Contract-intensive Exchange* (CIE). To ensure there is no alternative systematic explanation occurring in the data, I include the dummy *Contract-intensive Exchange Missing* in all dynamic panel models. These analyses have the value of including 74% of all data points for the 165 countries in the data.[3] After the main results, I report the findings with the original data only, with missing countries treated as missing. Identical outcomes in both cases would yield greater confidence in the estimates.[4]

This study also examined four potentially confounding factors: democracy, income, ethnic fractionalization, and population size. As discussed above, selectorate theory suggests that democracy can promote public goods provisions by states (Bueno de Mesquita *et al.*, 1999). Since equal access to state opportunities is a public good, democracy can affect the dependent variable. As democracy could conceivably cause contract norms by reducing the power of patrons, it is a potentially confounding factor in our analyses. To gauge *Democracy* I drew on the electoral democracy index (*v2x_polyarchy*) in the V-Dem dataset (Coppedge *et al.*, 2019).

Income is a standard measure of economic development in the quantitative-related literatures on state building and democracy. I thus include it in some analyses as a precaution. To gauge *GDP*

[3] I do not apply the zero assumption for missing years of countries otherwise in the data because, to my knowledge, these missing years are missing at random.

[4] A third common approach to missing data is multiple imputation. This is not an option here because multiple imputation assumes that missing data are missing at random, not MNAR (Yuan, 2014).

Per Capita, I use the *e_migdppcln* variable in the V-Dem dataset, which is the natural logarithm of GDP per capita as determined by the Maddison Project Database (2018), version 2–9 (Bolt *et al.*, 2018).

Conceivably, more ethnically diverse and larger populations might affect governments toward rent-seeking while hampering the rise of non-self-enforcing commerce. I obtained data for ethnic fractionalization from the Historical Index of Ethnic Fractionalization Dataset (HIEF) (Drazanova, 2019). The measure *Ethnic Fractionalization* in this dataset has the value over most prior measures of ethnicity in that it varies over time. I interpolated by year a very small number of missing data points, and drew on the more traditional time-invariant Atlas Narodov Mira data (1964) for seven countries not in the HIEF dataset: Cameroon, France, India, Montenegro, Mozambique, Papua New Guinea, and Yemen. I gauge *Population* as the natural algorithm of population size available in the NMC dataset (Singer *et al.*, 1972). The merging of the data yielded a sample for all key variables that includes all 165 countries in the data.

6. Results

To address the threat of serial correlation in the OLS regressions I analyze dynamic panel models by lagging the dependent variable one year behind the dependent variable. To comply with the requirements of the time-series aspect of the dynamic analyses (Boef and Keele, 2008), this study first experimented with a variety of specifications moving from the general model to various restrictions. The lowest (best) Schwarz Information Criterion was produced by the finite distributed lag model, which includes the lag of the independent variables on the right-hand side. Finite distributed lag models are in the logic of Granger causality that the dependent variable 'can be better predicted from the past of X and Y together than the past of Y alone' (Freeman, 1983: 328). I also include time fixed effects (year dummies), to control for systemic shocks that can occur over time, such as changes in world dollar exchange PPP rates that can effect the life insurance data.

This study began with examinations of democracy and development as potential confounders. Because ethnic fractionalization and population are exogenous – neither can be caused by contract-intensive exchange – I include them in all the dynamic models as a precaution.

In model 1 in Table 1, the coefficient for democracy (0.25) is positive and significant, indicating that democracy might promote equal access to state business opportunities by social group. Surprisingly, however, this effect appears weaker for political groups. In model 2, the coefficient for democracy (0.12) is positive but closer to zero and not significant at usual thresholds. In both models the coefficients for ethnic fractionalization (−0.16/−0.20) are negative and significant, indicating that ethnic fractionalization is associated with group inequality in access to state business opportunities.

Models 3 and 4 add consideration of contractual business activities. The coefficients for contract-intensive exchange in models 3 and 4 (0.04/0.07) are positive and significant, corroborating expectations that contract-intensive activities might be associated with more equal access to state business opportunities across social and political groups. The coefficients for democracy (0.02/−0.12) are both now closer to zero and insignificant. It thus appears that contractual economic activities may account for any association of democracy with equal access to state business opportunities. The coefficients for ethnic fractionalization (−0.03/−0.09) are also closer to zero and insignificant, suggesting that contractual activities may account for any association of ethnic fractionalization with equal access to state business opportunities. Models 5 and 6 report identical results relying on the original data for contract-intensive exchange, with missing values treated as missing.

Table 2 reports the same examinations for GDP per capita. In models 1 and 2, the coefficients for GDP per capita (0.08/0.10) are positive and significant, suggesting that there is something about higher income associated with greater inclusion of groups in state business opportunities. This might be due to the availability of wider level of resources in developed economies to governments to provide more opportunities to various groups. However, in models 3 and 4, the coefficients for GDP per capita (0.02/0.01) become near zero and insignificant once contractual economic exchanges

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Table 1. Contract-intensive exchange and equality of access to state business opportunities, with consideration of democracy

Equality of access to state business opportunities by group		Model 1 Social	Model 2 Political	Model 3 Social	Model 4 Political	Model 5 Social	Model 6 Political
Contract-intensive exchange	*β*	–	–	0.04**	0.07**	0.05**	0.09**
	SE	–	–	0.02	0.02	0.02	0.03
Democracy		0.25**	0.12	0.02	−0.12	−0.08	−0.40
		0.08	0.11	0.11	0.16	0.16	0.25
Contract-intensive exchange missing		–	–	−0.07	−0.09	–	–
		–	–	0.07	0.11	–	–
Ethnic fractionalization		−0.16**	−0.20**	−0.03	−0.09	−0.02	−0.23
		0.07	0.09	0.09	0.12	0.12	0.21
$\text{Population}_{\text{Logged}}$		0.01	0.03**	−0.01	0.00	−0.01	0.01
		0.01	0.01	0.01	0.02	0.02	0.03
Lagged dependent variable		9.91**	9.93**	9.90**	9.87**	9.89**	9.88**
		0.02	0.03	0.02	0.04	0.04	0.05
Intercept		−0.14	−0.24	0.06	−0.07	0.04	0.07
		0.09	0.16	0.15	0.21	0.19	0.26
Observations		6,915	6,906	5,093	5,092	2,542	2,541
Countries		162	162	162	162	97	97

Dynamic OLS regressions with time fixed effects. Standard errors clustered by country in parentheses. Countries missing from the data on contract-intensive exchange assumed to zero in models 3 and 4 and treated as missing in models 5 and 6. All independent variables lagged one year behind the dependent variable. All coefficients multiplied by 10 for presentation purposes.
*$p < 0.10$, **$p < 0.05$, two-tailed tests.

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Table 2. Contract-intensive exchange and equality of access to state business opportunities, with consideration of GDP per capita

Equality of access to state business opportunities by group		Model 1 Social	Model 2 Political	Model 3 Social	Model 4 Political	Model 5 Social	Model 6 Political
Contract-intensive exchange	β	–	–	0.04 **	0.06 **	0.06 **	0.08 ***
	SE	–	–	0.02	0.02	0.02	0.03
GDP per capita		0.08 **	0.10 **	0.02	0.01	−0.02	−0.02
		0.02	0.03	0.04	0.05	0.04	0.07
Contract-intensive exchange missing		–	–	0.00	−0.01	–	–
		–	–	0.01	0.01	–	–
Ethnic fractionalization		−0.13 *	−0.16 **	−0.06	−0.12	−0.03	−0.24
		0.07	0.08	0.09	0.11	0.12	0.20
Population$_{\text{Logged}}$		0.01	0.03 **	0.00	0.01	−0.01	0.00
		0.01	0.01	0.01	0.02	0.02	0.02
Lagged dependent variable		0.99 **	0.99 **	0.99 **	0.99 **	0.99 **	0.98 **
		0.00	0.00	0.00	0.00	0.00	0.00
Intercept		−0.08 **	−0.12 **	−0.04	−0.05	0.02	0.02
		0.03	0.03	0.04	0.05	0.04	0.06
Observations		6,788	6,778	4,942	4,941	2,566	2,565
Countries		154	154	154	154	97	97

Dynamic OLS regressions with time fixed effects. Standard errors clustered by country. Countries missing from the data on contract-intensive exchange assumed to zero in models 3 and 4 and treated as missing in models 5 and 6. All independent variables lagged one year behind the dependent variable. All coefficients multiplied by 10 for presentation purposes.
*$p < 0.10$, **$p < 0.05$, two-tailed tests.

Table 3. Contract-intensive exchange and equality of access to state business opportunities controlling only for exogenous variables

	Model 1 Social		Model 2 Political	
Equality of access to state business opportunities by group	β	SE	β	SE
Contract-intensive exchange	0.04	0.02**	0.06	0.02**
Contract-intensive exchange missing	−0.01	0.01	−0.01	0.01
Ethnic fractionalization	−0.04	0.09	−0.11	0.12
$\text{Population}_{\text{Logged}}$	−0.01	0.01	0.00	0.02
Lagged dependent variable	0.99	0.00**	0.99	0.00**
Intercept	−0.02	0.03	−0.04	0.03
Observations	5,201		5,200	
Countries	162		162	

Dynamic OLS regressions with time fixed effects. Standard errors clustered by country. All independent variables lagged one year behind the dependent variable. All coefficients multiplied by 10 for presentation purposes.
*$p < 0.10$, **$p < 0.05$, two-tailed tests.

are introduced into the models. The coefficients for contract-intensive exchange (0.04/0.06) are positive and significant, indicating that the impact of contract-intensive norms on equality in access to state business opportunities is robust to consideration of income. Models 5 and 6 report identical results relying on the original data for contract-intensive exchange, with missing values treated as missing.

Table 3 reports the results without consideration of democracy and GDP per capita. The coefficients indicate that a one standard deviation increase in contract activities is associated with a substantial 18 percent increase in the level of equal access to state business opportunities for both social and political groups in the long run. Consequently, analyses of 165 countries from 1961 to 2011 show that contract-intensive economic activities could promote equitable access to state business opportunities by groups. These results are robust controlling for a democracy, GDP per capita, ethnic fractionalization, and population size.

As a precaution I re-examined the analyses in Tables 1–3 using an alternative gauge of contract-intensive exchange: contract-intensive money (CIM), the proportion of a nation's currency not in banks as developed by Clague *et al.* (1999). CIM is not a direct gauge of contract flows but is theorized by its creators to reflect social trust in contracting, which is in turn is theorized to reflect contract flows (ibid.). CIE and CIM correlate moderately high at 0.65. In every test (unreported), the coefficient for CIM has a positive and significant impact on both social and political group inclusion in business opportunities.

Correlation, of course, is not causation. While finite distributed lag models are in the logic of Granger causality, they do not completely preclude the possibility of reverse order causation: that greater social and political inclusion of businesses in government contracting could be enhancing contract flows. However, as documented in the above literature, the attainment of impartial and inclusive state policies is a challenging task as rent-seeking and outbidding tend to be rampant along ethnic, social, and political divisions. Likewise, compatible with the above literature, this study theorizes an institutional impact of rising contractual exchange on impartial state policies rather than vice versa. Theoretically, I expect that as private businesses that depend on contract exchange in the marketplace become more influential *vis-à-vis* rent-seeking groups, they can put increasing pressure on the state toward impartial policies.

Still, to dig deeper into the cause-and-effect of economy and polity, I identified all cases in the data where the measure contract-intensive exchange changed at least one standard deviation (z-score) from

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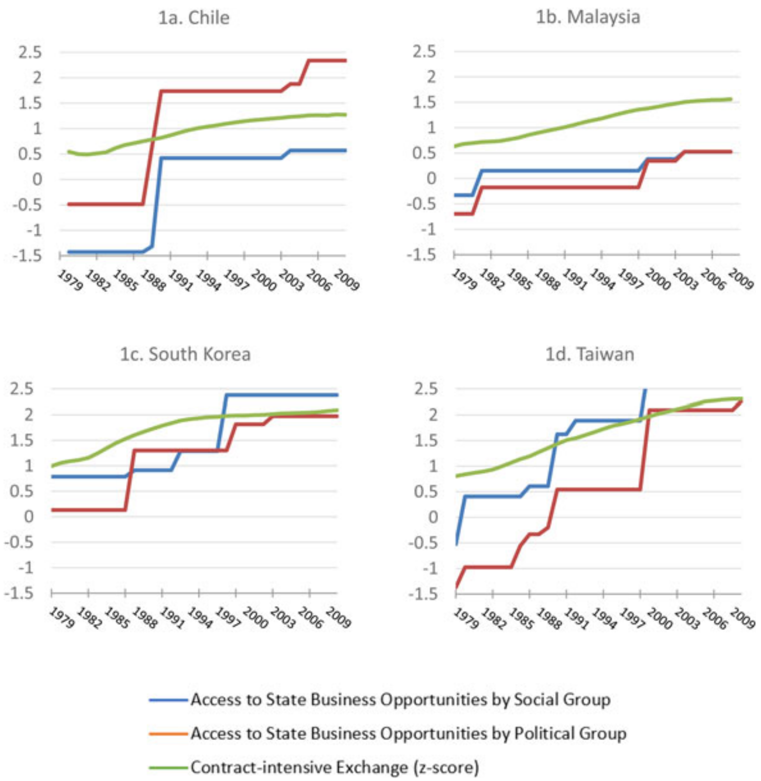

Figure 1. Contract-intensive exchange and access to state business opportunities, visualizing four cases, 1979–2010.

1979 to the end of the data series – the period when most countries in the data are in it – and the country had at least one of these years at least two *z*-scores above the mean. I then dropped members of the European Union (EU) from the resultant, because the EU has specific requirements regarding social and political group inclusion (European Commission, 2021). The correlations of contract intensity and group inclusion in the EU cases are thus plausibly a function of a third factor – EU membership. The result yielded three cases: Singapore, South Korea, and Taiwan. To include more cases I then lowered the threshold for change in contract-intensive exchange to three-quarters of a *z*-score with at least one of these years at least one *z*-score above the mean – thus including Chile and Malaysia.

Of the now-five included cases, one, Singapore, had near constant very high levels of both social and political business inclusion throughout its period in the data (both dimensions always above 2). In this specific case, the state's inclusion of groups in business or some other factors could be triggering the country's economic change toward contracting.

Figure 1 graphs changes in the intensity of contractual exchange and social and political group inclusion in business opportunities for the four remaining cases of change during the period of observation: Chile, Malaysia, South Korea, and Taiwan. As can be seen, in all four cases the intensity of contracting and the equitable treatment of groups in business seem to go hand-in-hand over time, and in no case does one dimension go up while the other goes down. It can also be seen in every case that some initial increase in contractual exchange appears to have preceded initial changes in governments' inclusive treatment of social and political groups. We cannot see the relationships of these variables before the countries entered the data (all in 1979 or 1980). As discussed above, countries with very low levels of business contracting tend to be missing from the data. We can thus surmise with caution that the economies in all four cases were on the upswing in contract intensity at the start of the data series in the graphs.

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In Figure 1a, Chile had low levels of business inclusion while its contracting increased from roughly 1983 to 1988, then its political group inclusion shifted from a very low −0.5 to above 1.5. Soon afterward Chile's social group inclusion also shifted from a very low −1.5 to a moderate 0.5. Following Chile's increasing contract intensity in the 1990s, in the early 2000s both political and social group inclusion increased again, though the latter remains moderate.

Figure 1b shows that changes in Malaysia's contract intensity roughly parallel those of Chile, changing from about 0.5 in 1979 to about 1.5 in 2009. Like Chile, following increasing contract intensity in the 1990s Malaysia's social and political group inclusion increased, though both remained moderate.

To put these figures in perspective, I checked all founding members of the Organization for Cooperation and Development (OECD) that are classified by the World Bank as 'high income' (13 countries). The average contract intensity of this group from 1979 to 2010 was 1.54 and the average social and political group inclusions were, respectively, 2.32 and 2.66. Thus, both Chile and Malaysia approached the high-income OECD average in contract intensity only toward the end of the data series in 2010 (Malaysia closer). This could account for these countries' relatively weaker scores in inclusion at the end of the data series.

The figures for South Korea and Taiwan also show that contract-intensity exchanges in their economies increased in the 1980s before substantial rises in social and political group inclusion. Both countries enter the data with contract intensity just below one *z*-score above the mean and end the data series above two, and thus had higher levels of contract intensity than Chile and Malaysia throughout the period of observation. Both South Korea and Taiwan reached the level of contract intensity at or above the high-income OECD countries (of 1.54) in the late 1980s, and within the next decade or so both countries largely reached the high-income OECD mean levels of social and political inclusion (roughly about 2.5).

For comparison purposes, Figure 2 graphs the data for China, which enters the data in 1986 with a level of contract intensity (−0.3) substantially below the countries in Figure 1. China ends the series with a contract intensity of 0.96 – noticeably lower than Chile and others and far from the high-income OECD average. Since China's economy has unquestionably boomed since the 2000s, the figure illustrates that contract intensity is not the same thing as economic growth or GDP; though China's contract intensity did increase from a very low level. While China's contract intensity is lower than the cases in Figure 1, we can nevertheless see that after about a decade of increasing contract intensity a small jump in social group inclusion occurred in 2000. In perspective, however, China's near constant social and political group inclusion over the observation period is a little higher than Malaysia's even in 2010. Of course other factors also affect inclusion, and in this case Malaysia's relatively high level of

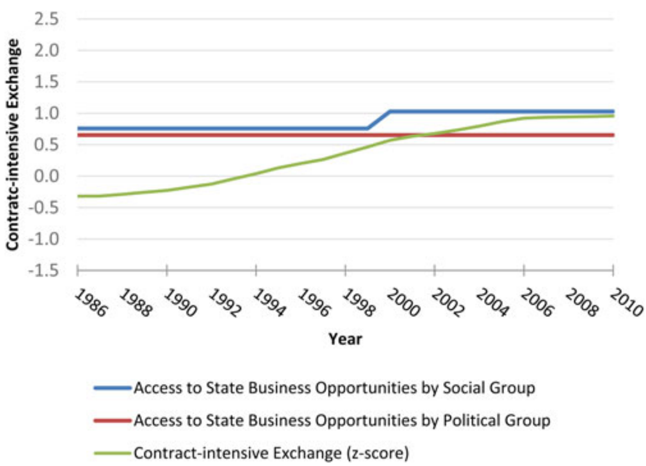

Figure 2. Contract-intensive exchange and access to state business opportunities, visualizing China, 1986–2010.

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ethnic fractionalization could explain its weak group inclusion compared with China. Whether China's contract intensity will develop with its economic growth is yet to be seen.

Overall, analyses of 165 countries from 1961 to 2011 show that contract-intensive economic activities could promote equitable access to state business opportunities by groups, and these results are robust controlling for democracy, GDP per capita, ethnic fractionalization, and population size. Of the five clearest-cut (non-EU) cases of economic transformation from 1979 to the end of the data series – Chile, Malaysia, Singapore, South Korea, and Taiwan – all but Singapore seem to present, with caution, support for the possibility that rising contractual exchanges have the effect of enhancing government inclusion of businesses with equity, as a rising contractual business sector gains influence *vis-à-vis* rent-seeking businesses. State impartiality seems to be a bigger problem in low-income countries such as Burkina Faso, as discussed formerly, with deep social and ethnic divisions. Cases such as Malaysia and Chile can perhaps set examples to the states of poor countries such as Burkina Faso in kicking off their economies with contract-intensive businesses. To increase diversity in the economy and commerce, the policy implication is to encourage contract-intensive investments and reduce the role of particularistic rent-seeking in acquiring state resources.

7. Conclusion and implications

Governments' discrimination of some groups in policy-making can increase the level of grievance and conflict in societies. At the same time it is well-documented that rampant rent-seeking and gift-giving activities can have a negative impact on economic growth (Alesina and Ferrara, 2005). This article introduced and tested a new way governments can be constrained toward greater impartiality in the provision of economic and business opportunities across social and political groups and in the promotion of diversity in commerce. Drawing on economic norms theory (Mousseau, 2009, 2019), this study distinguished 'rent-seeking' economic institutions from 'contract-intensive' institutions, and suggested that the latter might promote greater diversity and inclusion in the creation of economic opportunities available for all groups.

Where rent-seeking prevails, enterprises form gift-giving relationships with state officials, often mediated with political or ethnic leaders, and ultimately compete over state rents. Since rents shift wealth rather than create it, competition in the marketplace is comparatively zero-sum like and cooperation is low. Where contractual exchange prevails, in contrast, businesses are more likely to compete under common rules in the marketplace without relying on patronage relations and favoritism from leaders. Profits are comparatively more dependent on wealth creation rather than its redistribution. Thus, contract-intensive exchanges create diverse productive activities and opportunities for individuals in the marketplace and diminish the importance of rent-seeking. While they integrate diverse individuals into the markets through contracting, competing businesses develop shared interests. These include the existence of an impartial and functional state that credibly treats enterprises from all social and political groups equally. In this way, contract-intensive economic actors may also form their associations to demand impartial and equitable policy by governments toward different groups.

This study tested this novel contingent claim by drawing on data on equality in access to state business opportunities by groups available in the V-Dem dataset (Coppedge *et al.*, 2019; Pemstein *et al.*, 2019). Following prior studies (e.g. Enia, 2017; Krieger and Meierrieks, 2015; Mousseau, 2009, 2019), I gauged contractual business activities by drawing on data on life insurance premiums in force (Beck *et al.*, 2010). With most non-micro independent countries included in this study's sample from 1961 to 2011, the results robustly supported expectations of this study. Contract flows have a significant statistical association with state impartiality in its treatment of groups. A one standard deviation increase in contract-intensive economic activities is associated with a substantial 18 percent increase in the level of equal access to state business opportunities for both social and political groups in the long run.

What are the implications for promoting impartial governance toward social and political groups in state–market relations? Rent-seeking and giving partial favors to businesses on the basis of group and identity ties can increase grievance and conflict, as enterprises from different groups compete over state rents in a zero-sum like environment. To reduce the risk of conflict and increase diversity as well as promote economic growth, the policy implication is to encourage governments of countries at risk to facilitate the growth of contract-intensive investments and activities in the marketplace. When enterprises are compelled to compete in the open marketplace, rather than seeking favors from the state, they create opportunities for diverse groups and form common interests in impartial government. In this way, contract-intensive economy can facilitate the institutionalization of impartial governance and mediate group conflict in terms of different groups' access to state opportunities.

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