

Explaining the Rent- Producing Channels in the Banking System in Iran Using the Institutional Political-Economical Approach

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Abstract

The present article was an attempt to identify rent producing channels in the banking system of Iran. Institutional political economy approach is used as the theoretical framework due to the nature of the rent-seeking and, consequently, the inclusion and interaction of economic and political variables. In the theoretical part, ownership and regulation system were introduced as two major channels of rent producing in the banking system. Subsequently, in the experimental part, using the library method and content analysis, for the time period of 2005-2015, the performance of the banking system was examined in terms of the above channels. It was found that although private ownership is a rent producing channel in the banking system in Iran, the regulation system plays a more important in this respect. In this regard, powerful factor providing the conditions for production and expansion of rents is the violation of the “interest-free banking operation” law. Examining variables such as lending facilities, non-performing loans and the quality of the banking system in relation to productive sectors also indicates that the rule of law in Iran, in the formulation of laws and regulations, as well as the implementation and supervision, has a significant role in supporting this issue. Therefore, a fundamental reformation of regulation system, especially in the implementation and supervision phases, and necessity of institutional reform of the country's economic requirements with the purpose of protecting private property and increasing social and economic well-being can modify the ownership channel and help significantly to control the rent-seeking behavior.

Keywords: Rent seeking, Banking system, Political economy, institutionalism.

JEL Classification: D72, G21, B52.

1. Introduction

The present study examines the channels of rent producing in the banking system both theoretically and experimentally using a conceptual model and explains the implications of this phenomenon at the macroeconomic level. This is important for some reasons including the existence of a bank-based financing system and also strong evidence for the existence of rents in the banking system of Iran, on the one hand, and the lack of a comprehensive

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study about it, on the other. In the banking system, rent-seeking can be defined as the various types of preferential behavior in the banking intermediary system which distort the allocation of capital and, as a result, provide cheap financing for some specific groups. The consequences of this behavior include the incorrect performance of the banking system and, then, the emergence of increasing rent-seeking opportunities (Chaharband, 2017: 196).

2. Theoretical framework

One of the rent producing channels mentioned in the literature is the type of ownership (LaPorta, 2002; Sapienza, 2004; Khwaja & Mian, 2005; Dink, 2005; Cole, 2009), which examines private ownership against public ownership. However, since any type of ownership, due to its nature, can lead to rent producing in the banking system, a more general and effective channel should be examined. In this regard, the regulation system has been introduced as the most important channel in the theories of political institutions due to its ability to restructure the whole banking system (Acemoglu and Robinson, 2001; Bolton and Rosenthal, 2002).

The emphasis of regulation system is on the “capture theory” and also the performance of the legislature in favor of the interests of the industry which is subject to the law (Stigler, 1971). On the one hand, the importance of legislation and supervision in the banking system is crucial for the stability of the whole economy and, on the other, the importance and consequences of the capture theory are more highlighted in comparison to other financial sectors for such reasons as information asymmetry, the inherent risk of the banking system, complexity of rules and interactions among them, and the need for specialized skills and a wide range of data to supervise (Hardy, 2006).

3. Background

According to empirical studies by Brown and Radaatz (2010), Nissen and Ruenzi (2009) and Faccio et al. (2006), politically connected firms are larger, more profitable and have more market value. The results of Khwaja and Mian’s (2005) study confirmed the findings of the above-mentioned studies in Pakistan examining the costs of related lending. Dink (2005), (Khwaja and Mian, 2011) and Mian (2010), based on their empirical evidence, investigated the reasons for the mutual attractiveness of the relationship between banks and politicians. The revolving doors phenomenon has been introduced as the most important findings in this area (Luka et al., 2014: 3).

4. The conceptual framework

The conceptual model used in this study is based on the interaction and mutual relationship between the institutional system and the state actions including a variety of policies, legislatures, and the bureaucracy system (Mehlum et al., 5: 2005). In response to this interaction, entrepreneurs also determine the direction of their activities with the goal of maximizing their profits and can ultimately become productive, unproductive or destructive entrepreneurs for society (Bamul, 1990; Douhan and Henrekson, 12: 2008). In the case of the banking system in Iran, the state determines its approach toward *riba* for example, in different forms in the framework of legislation, execution and supervision. Economic agents are affected by the results of these actions and determine the type of their business activities with respect to the importance of prohibition of *riba* as a formal institution. Therefore, if the profitability of neglecting the prohibition of *riba* exceeds its respect, its prohibition will gradually disappear due to the continuous activity of entrepreneurs and the low level of adherence to the rule of law by the state in various sectors, including the banking system. So, as far as entrepreneurs are taken away from their productive activities in this way, financing of the productive sectors suffers the most. Since the entrepreneurs try to maintain their status to gain more economic and consequently political power, this cycle will be going on.

5. Findings

The study of banks' ownership in Iran shows that the process of privatization of banks has become a channel for rent producing in the banking system due to the lack of provision of necessary institutional requirements in the business climate. Further investigation of the ownership channel (according to the theoretical framework) suggests the support of the regulation system. The Fourth Development Plan Law, various Central Bank directives regarding the determination of the interest rate on deposits and the way in which the expected interest rates for non-state-owned bank loans can be determined show the support of the regulation system for the expansion of a rentier space in the banking system.

Focusing on the "interest-free banking operation" law can be the starting point for examining the quality of law enforcement in the regulation system. The results of different studies (Motevaseli and Aghababaei, 2006; Talebi et al., 2011; Kiaei et al., 2013; Nazrpour et al., 2014), and also considering the formation of a high volume of debt resulting from banking loans (for both public and private sectors) point to non-compliance with the

“interest- free banking operation” law. Thus, not only the performance of the banking system, in terms of the analysis of labor and money relationship, has become a channel for creation of corruption but also the accumulated debt has not had any major influence at the macroeconomic level on the form of GDP growth. Apart from that, the distribution of loans in private sector is not desirable at all. In other words, reviewing the shares of loans shows the preference of the commercial and then the building sector (Economic Report, years 2005 and 2014). In this regard, the compulsory loans which are granted to some sectors are known as the cause of the huge debt. Paying this type of loan has led to a high share of non-performing loans which are received by both public and private sectors at the end of 2015.

6. Conclusion

The findings of reviewing the type of ownership and the regulation system in the banking system of Iran in the framework of the institutionalist political economy indicate that private ownership is one of the rent producing channels. However, with regard to relevant evidence and literature, the regulatory system seems to be the most important channel. In this context, the most important problem is the violation of the “interest-free banking operation” law, which has caused a huge volume of debt and has not had a real macroeconomic achievement. In addition, the study of variables such as compulsory loans, non-performing loans and the approach of the banking system toward productive sectors also indicate that the regulation system in Iran has played a significant role in supporting this approach.

As the main resolution for solving this problem, the role of the Central Bank in the form of strengthening the regulatory supervision, revising relevant laws, improving the rule of law, and transparency of processes should be considered. In addition, having a comprehensive theory for monetary and banking regulations, emphasis on significant capacities and successful experiences of “interest- free banking operation” and the need for institutional reform can also be effective in controlling the rent-seeking behavior of the banking system.

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