

POLITICAL INSTITUTIONS, POLICY OUTCOMES AND ECONOMIC GROWTH

Lecture 26
ECON 4524

Figure 1
Institutions and Economic Performance

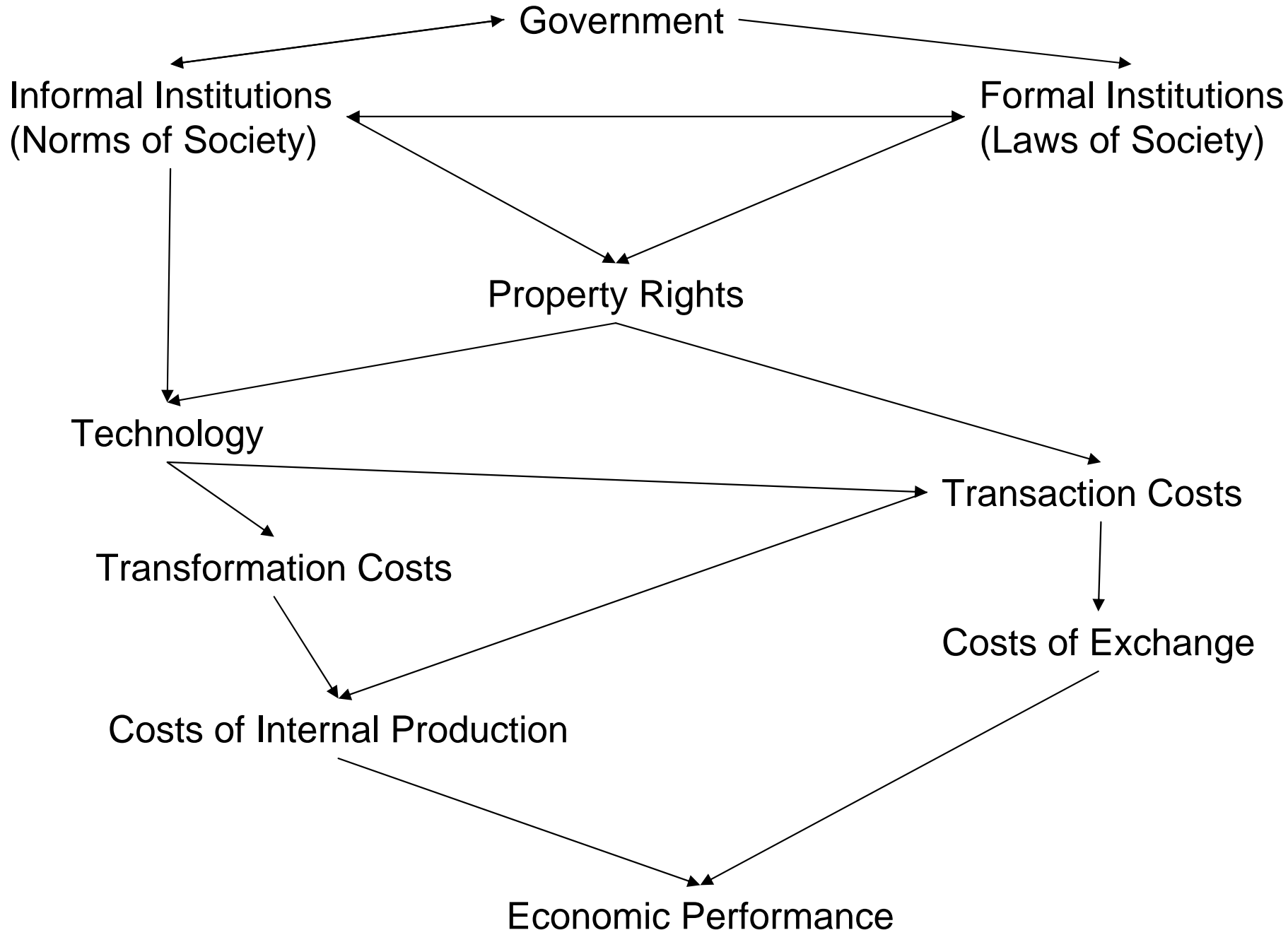
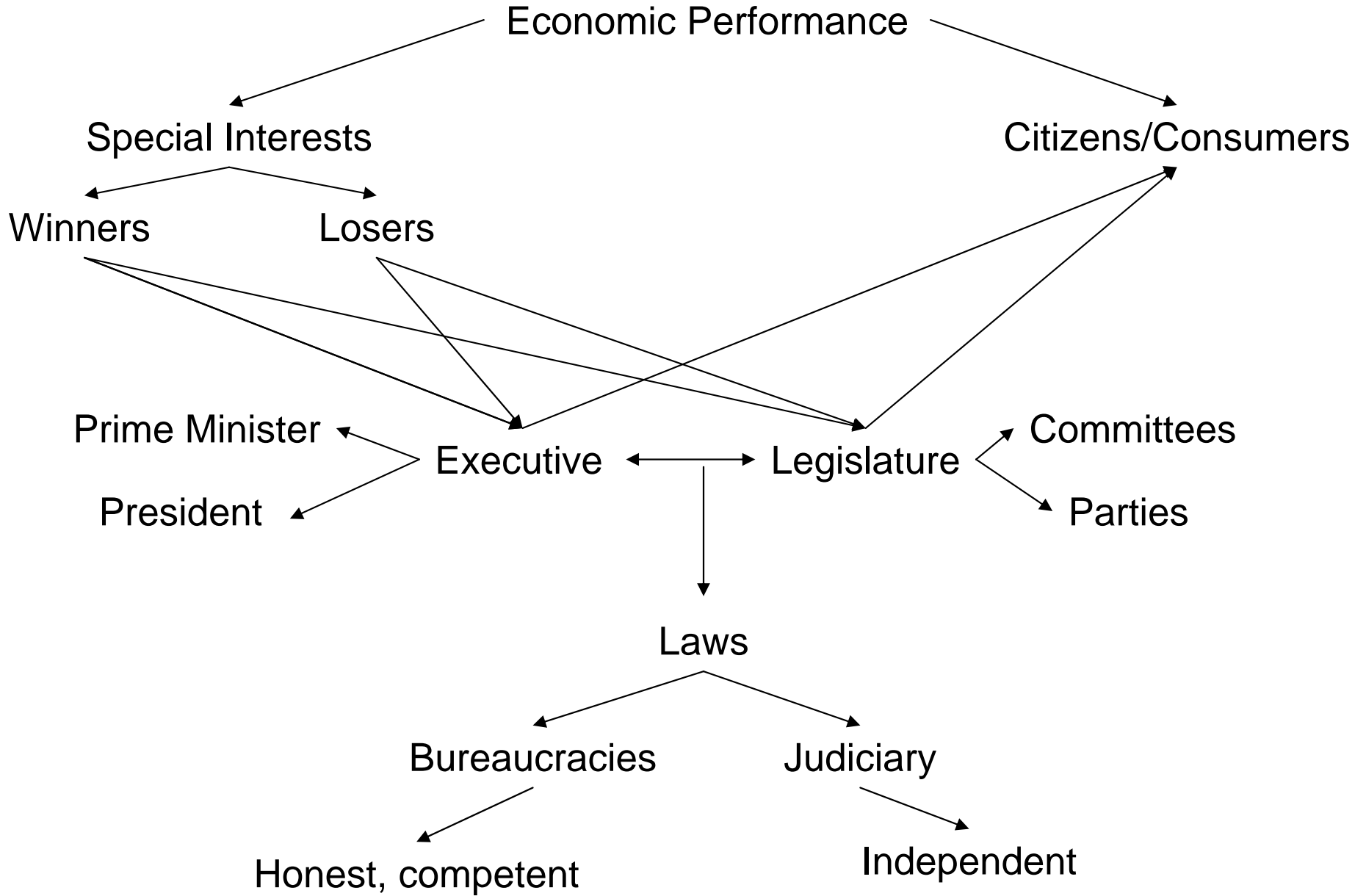


Figure 2
The Determinants of Formal Institutions



Executive and Legislative Political Property Rights

- **Property Rights determine the incentives to engage in exchange in economic and political markets**
- **Presidents: internalize national interests**
- **Members of Congress: internalize gains from redistribution to their districts.**
- **Strong Presidential Property Rights in Brazil**

Outline for Talk

- **Political Property Rights of President and Congress in Brazil**
- **Incentives for Exchange**
- **Model**
- **Predictions**
- **Qualitative Evidence: what did the press report**
- **Econometric results: “Pork for Policy”**
- **Concluding remarks: insecure political p. r.**

Powers of the President

Line Item Veto over budget

- ❑ Execution of the budget
- ❑ Veto on laws
- ❑ Provisional Decrees
- ❑ Urgency Petitions
- ❑ Cabinet Appointments
- ❑ Patronage estimated at 40,000 jobs
- ❑ Pork
- ❑ Exclusive power to propose legislation in some areas

Congress

- ❑ **Veto over President – simple majority**
- ❑ **Weak committees**
- ❑ **Weak party electoral connection**
- ❑ **Strong party cohesion in Congress**
- ❑ **Multi-party representation**
- ❑ **Electorate cares about pork**

Incentives in Policy “Game”

- **President: national goals**
- **Members of Congress (MC): geographic redistribution**
- **Supreme Court Justices: history books**
- **President and Congress: Presidents exchange with party leaders pork for policy in the “shadow” of the court**

Coordinating Institutions



- **Ministry for Political Coordination**
 - **Clearing house for pork**

- **College of Leaders**
 - **Informal arrangement for bloc voting**

Figure 1

Preferences of the President and Parties in the Policy-Patronage Space

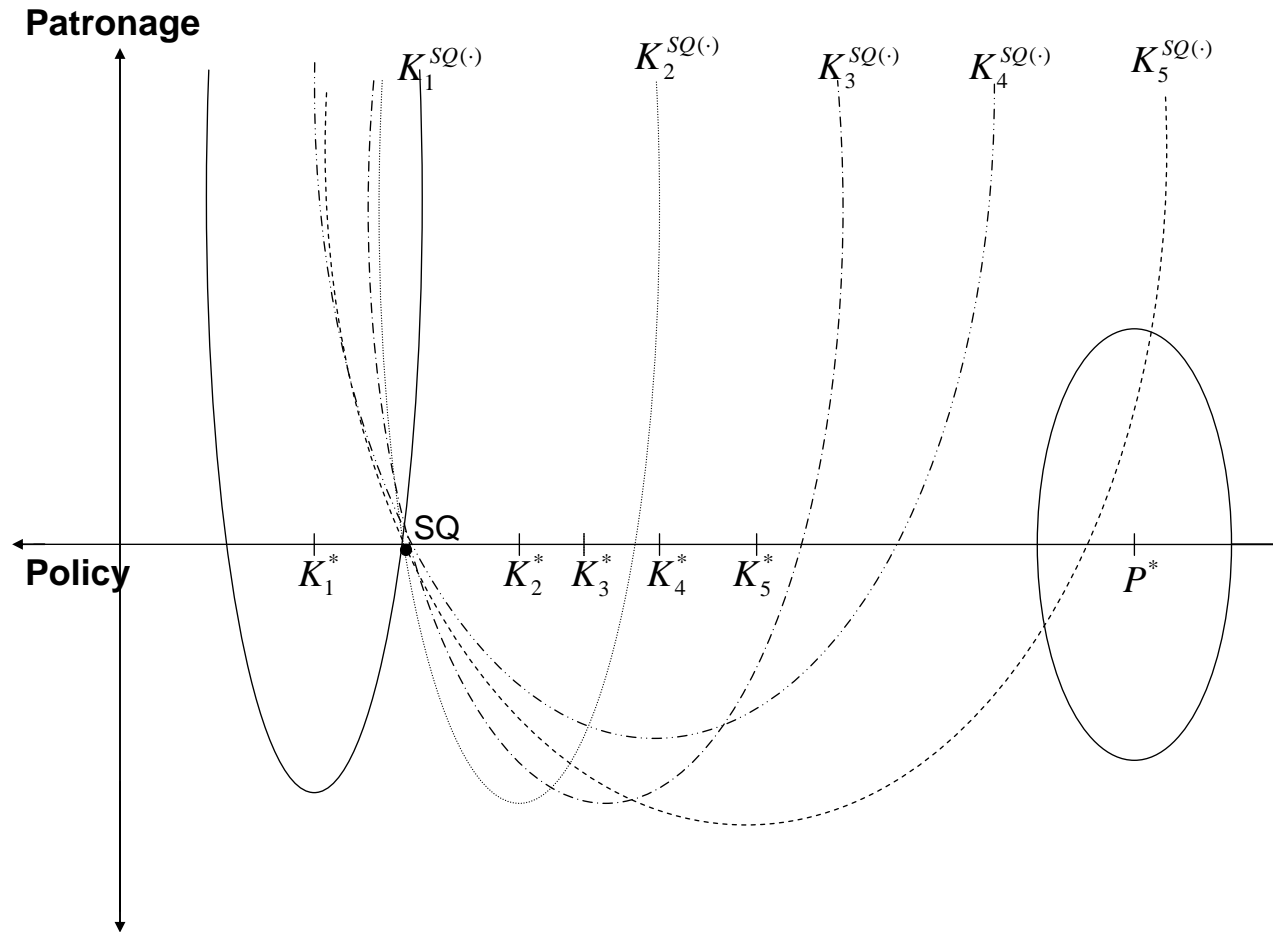
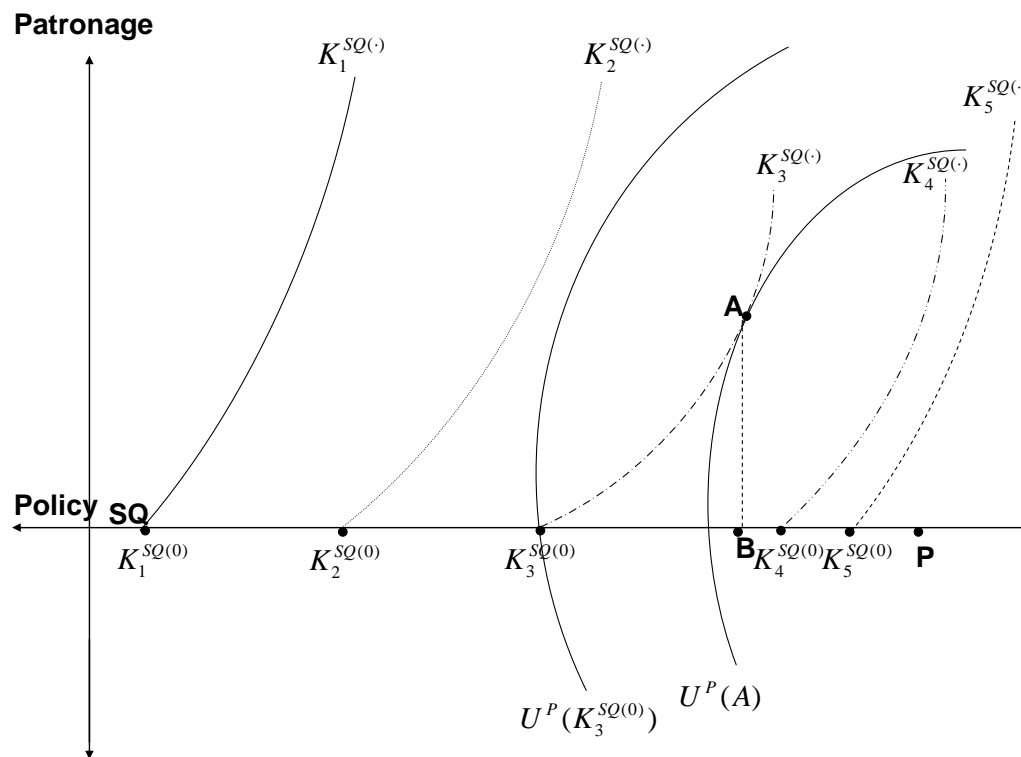


Figure 2

Gains from Trade between the President and Congress



Gains from Trade

Result 1

The Brazilian legislative rules are such that there are significant gains from trade for the members of the coalition and the executive from the exchange of support for patronage. The President's agenda powers guarantee the stability of the relationship and allow him to appropriate most of the gains.

Result 2



Changes that reduce the cost of patronage to the President and the cost of transacting with the coalition parties, lead to greater gains from trade, and policy outcomes more favorable to the President.

Result 3

The larger the benefit that the members of the coalition are able to derive from a given amount of patronage the greater the gains from trade and the more favorable will be policy outcomes to the Executive.

Result 4

The further the preference of a coalition party from that of the President, the greater the patronage that party will receive. Therefore coalition parties that have more divergent preferences from those of the President will receive, ceteris paribus, more compensation than those parties closer to the President up to the point where the President has the number of votes that he needs.

Evidence from Pension Reform: 1995-2002

- Pension Reform is divisive yet huge gains from trade
- Reports from the Press and Econometric Tests

The Brazilian pension system has broken just about every rule known to actuaries. It fixes no minimum retirement age, and allows a host of exceptions and special cases. It allows retired people (called, wonderfully inaccurately, "inactive workers") not only to draw more than one pension but also to go on getting a wage as well. Perhaps uniquely, Brazil not only allows some pensioners to retire on a higher income than they had when working, but also increases their pension every time their working colleagues get a wage rise. (The Economist, June 7, 1997).

After rejection on March 6, 1996:

For the next two weeks, the President went to work... Just what went on behind closed doors is anyone's guess, though the evidence is mounting that it was plenty. By March 21st, order was restored. The lower house backed the welfare reform.

... "we made the only advance that was possible," said a relieved Mr Cardoso, thanking the legislators who supported him. And he paid for it. ...

Pork was on the menu in several states. The first time round, all seven congressmen from Rondonia, a small state in the Amazon, voted against the government's welfare reform. After a cordial chat at the Planalto, all seven changed their minds. Soon \$16m in federal cash will go to improve an important road in Rondonia, and one of the state's favourite sons will be heading the local arm of the federal telephone company. Pure coincidence, say officials in Brasilia. The drought-parched north-eastern state of Paraiba won money for an irrigation canal and reservoirs. A power plant was promised for Rio Grande do Sul. The government was no less open-handed with jobs and promotions. (The Economist, March 30, 1996)

Creation on April 29, 1996 of the Ministry of Political Coordination:

President Cardoso stated, “... *when Congress wants to say yes and can’t manage to do so it is necessary that we get together to create conditions to make the dialogue flow better*” (O Estado de São Paulo, April 30 1996).

Before passage of reforms on Nov 5, 1998:

President Cardoso dispensed with his trademark aloofness of his first term and openly pushed for his program, meeting with party leaders and sending telegrams summoning coalition members to vote. A bloc of 37 legislators representing agricultural businesses was promised by the Government that it would delay repayment of more than \$1 billion in farmers' debt in return for their votes, said Hugo Biehl, leader of the farmers' bloc in Congress. The Government also granted farm businesses \$280 million in concessions in exchange for their support. (The New York Times, November 6 1998.)

After defeat on Dec 3, 1998:

As the vote on the pension approached, some coalition allies jostled for Cabinet posts. Others fielded calls from opponents of the bill. One hundred legislators just stayed away. ... Political analysts say the pension bill failed because the Government, overly confident, neglected the legwork to rally support. The administration also packed too much into one measure, focusing on active and retired government workers along with other groups because of time pressure. (The New York Times, December 12 1998.)

Analysis of House Approval Vote of Jan 20, 1999

The Government invested everything on the crisis argument to wrench from its allies the approval of the project that creates the contribution of the inactive workers, however it also resorted to the traditional promises of posts and threats of firing the appointees of the unfaithful. Government leaders in the House warned the discontented in its coalition that no new appointments would be signed until the start of the new Congress in February. They guaranteed, however, that the pen would work immediately to punish the rebels. (Gazeta Mercantil, Jan. 21 1999.)

Evidence on the Strategic use of Individual Budget Amendments

- **President has discretion over the execution of amendments**
- **Amendments are typically pork projects**
- **Our model implies the President should execute amendments of MC who support his policies**
- **President initial proposal to raise retirement age defeated (May 6, 1998) and new proposal (May 23, 1998)**

Votes on Pension Reform for Pork

- Supermajority needed (2/3) for Constitutional Changes – 308 yes votes
- First Vote: 307 in favor, 148 against and 11 abstentions
- Second Vote: 333 – 149 – 3, with 15 switching from *no* to *yes* and 9 from *yes* to *no*

Dependent Variable: **% of value of each deputy's amendments executed in 1998**

- **Dummy for vote switch from no to yes (+)**
- **Dummy for vote switch from yes to no (-)**
- **Support of the President over time (+)**
- **Value of Executed Amendments in 1997 (+)**
- **# of amendments submitted in 98 (?)**
- **Dummy for powerful position (+)**
- **Seniority (+)**

Results

- **Switch from no to yes: increased value by 11%**
- **Switch from yes to no: decreased value by 5%**
- **Support in the past increased value of amendments**
- **Pork in the past increased pork in the present**
- **Position and seniority did not matter**
- **# of amendments mattered a little**

More Pork for MC in the Coalition but further “ideologically” from President

- Polynomial equation for distance from the President’s ideal point and value of budgetary amendments 1999-2001
- Pattern: Value first increased with distance to some maximum and then decreased
- Fits Result 4: you may need to pay more to get support from those further from you ideologically – Prodigal Son effect

Political Property Rights: Concluding Remarks

- Presidential Property Rights promote: national interests, e.g. economic growth, income equality, economic opportunity and price stabilization.
- Greater Congressional Property Rights: more pork and less prudent developmental policies.
- Without clear political property rights: policy agenda and policies would be either highly unstable or in gridlock

Why are Political Property Rights Insecure?

- 1. Transparent side-payments would undermine the legitimacy of government.**
- 2. Encourages politicians to make “bad” policy in order to be bought out.**
- 3. Credible commitment amongst the political players.**
- 4. Insufficient political competition coupled with informational problems of citizenry.**
- 5. Insufficient media competition coupled with informational problems of citizenry.**