

Pillars of Prosperity

The Political Economics of Development Clusters

Chapter 7: Political Reform

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Outline

- 1 Motivation
- 2 The Core Model and Political Reform
 - Political Reform under a Veil of Ignorance
 - Strategic Political Reform
- 3 Developing the Model
 - Micropolitical foundations for θ
 - Micropolitical foundations for γ
 - Constitutional rules
 - Political Violence
 - Trust
 - Governance
- 4 Political Reform in Practice

Motivation

- Broad theme of the modeling so far
 - ▶ cohesive institutions are vital for maintaining peace, as well as for generating investments in state capacity
 - ▶ but then, why are such institutions not universally adopted?
 - ▶ given the importance of cohesiveness, how can we think about forces that may shape it?
- Begin analyzing the choice of political institutions
 - ▶ when political reform is costless and enforceable, but may be chosen strategically or under a veil of ignorance
 - ▶ start with case when there is no political violence
 - ▶ mention results with institutional inertia, or endogenous violence

A few basic facts – Figure 7.1, Table 7.1

- Binary classification for cohesive institutions
 - ▶ top score (on 1 to 7 scale) for Polity IV “constraints on the executive” variable
- Old states
 - ▶ of the 51 states that have continuous data, only about 30% had cohesive institutions in 1900, and 55% 100 years later
- New states
 - ▶ of 112 states created in 1945-1995, only 22 had cohesive institutions at outset, only 4 clean streak over first 30 years

Prevalence of high executive constraints

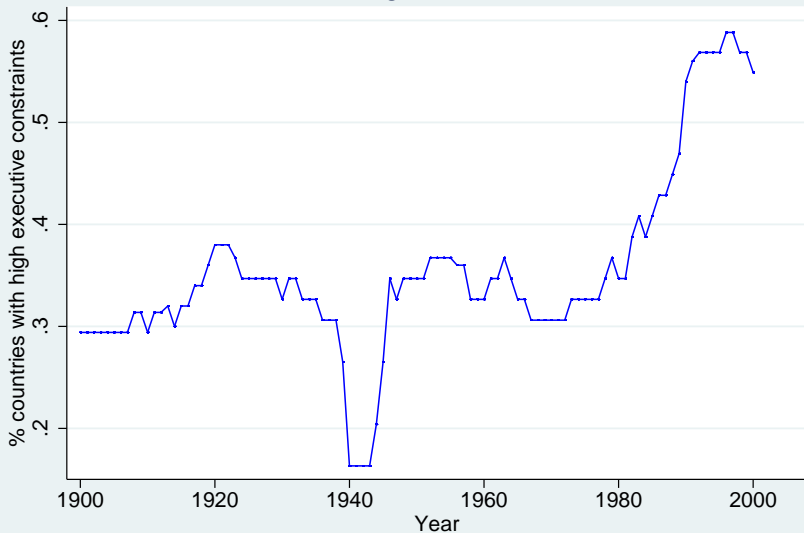


Figure 7.1 Prevalence of high executive constraints among 51 countries

Table 7.1 Persistence of high executive constraints

At independence	5 years after	10 years after	15 years after	20 years after	30 years after
Belarus (1991) *	Botswana (1966)	Botswana	Botswana	Botswana	Botswana
Cyprus (1960)	Czech Republic	Fiji	Cyprus	Cyprus	Cyprus
Czech Republic (1993)	Estonia	India	Fiji *	India	India
Estonia (1991)	Fiji	Israel	India	Israel	Israel
Fiji (1970)	India (1947)	Jamaica	Israel	Jamaica	Jamaica
Guyana (1966) *	Israel	Myanmar *	Jamaica	Mauritius	<i>Lesotho</i>
Israel (1948)	Jamaica	Mauritius	Mauritius	<i>Nigeria</i>	Mauritius
Jamaica (1962)	Latvia	Malaysia *	Pap. New Guin.	Pap. New Guin.*	<i>Sudan</i>
Latvia (1991)	Lithuania	Pakistan (1947)*	Sri Lanka	Sri Lanka *	Trinidad&Tob.
Lesotho (1966)	Moldova (1991)	Pap. New Guin.	Trinidad&Tob.	Trinidad&Tob.	
Lithuania (1991)	Myanmar	Sri Lanka			
Myanmar (1948)	Mauritius	<i>Sudan</i>			
Mauritius (1968)	Malaysia	Syria			
Malaysia (1957)	Nigeria	Trinidad&Tob.			
Nigeria (1960)	Pap. New Guin.				
Papua New Guinea (1975)	Somalia *				
Sudan (1956)	Slovak Rep (1993)				
Somalia (1960)	Slovenia				
Slovenia (1991)	Sri Lanka				
Sri Lanka (1948)	Trinidad&Tob.				
Trinidad & Tobago (1962)					
Uganda (1962)*					

Notes: The table lists all countries coming into existence as independent states after 1945, if they score the highest value of 7 for the Polity score on executive constraints at one of the time horizons listed in the table. The independence year is given (in brackets) for the first entry in the table. Countries are marked with "|" in the last column they can appear, due to right censoring of the data (last entries in the Polity IV data in 2000). Countries are marked with "*" the last time they appear in the table (except in the last column). Countries are printed in *italics* if they re-enter the table after a period with less than the highest score on executive constraints. Countries are printed in **bold** in the last column of the table if they have a full 30-year history of high executive constraints.

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Reformulation of model

- Reform of political institutions
 - ▶ happens ex ante under a veil of ignorance, or ex post in a strategic manner
- new timing
 - 1 We begin with initial stocks of state capacities $\{\tau_1, \pi_1\}$.
 - 2 Period-1 political institutions, θ_1 , are chosen.
 - 3 Nature determines the incumbent group I_1 , α_1 , and R .
 - 4 I_1 chooses policies $\{t_1, r_1^I, r_1^O, p_1^I, p_1^O, g_1\}$ and determines (through investments) the period-2 stocks of fiscal and legal capacity $\{\tau_2, \pi_2\}$. (If political violence is modeled, I_1 and O_1 simultaneously invest in violence levels L^I and L^O .) If permitted, I_1 also chooses period-2 political institutions, θ_2 .
 - 5 I_1 remains in power with probability $1 - \gamma$ (or $1 - \Gamma(Z, \nu, \xi)$ if political violence is modeled), and nature determines α_2 .
 - 6 I_2 chooses period-2 policies $\{t_2, r_2^I, r_2^O, p_2^I, p_2^O, g_2\}$.

Binding ex ante choice of cohesiveness

- State-capacity decisions

- ▶ always made by period-1 incumbent, and given by

$$\tau_2 = T(\tau_1, \pi_1; \theta, \alpha_1) \text{ and } \pi_2 = P(\tau_1, \pi_1; \theta, \alpha_1)$$

the same outcomes as in **chapter 3** with given γ

- Expected payoff in s , to any group, under veil of ignorance

$$\frac{U^I(\tau_s, \pi_s; \theta) + U^O(\tau_s, \pi_s; \theta)}{2} = (1 + \tau_s [E(\lambda_s; \theta) - 1]) y(\pi_s) - E[\lambda_s m_s]$$

where the expectation is taken over α_s , $\lambda_s = \max\{\alpha_s, 2(1 - \theta)\}$ and

$$E(\lambda_s; \theta) = \begin{cases} \phi \alpha_H + (1 - \phi) \alpha_L & \text{if } \alpha_L \geq 2(1 - \theta) \\ \phi \alpha_H + (1 - \phi) & \text{otherwise} \end{cases}$$

A (normative) benchmark result

- Ex ante payoff is

$$\begin{aligned}\hat{U}(\theta; \tau_2, \pi_2) = & (1 + \tau_1 [E(\lambda_1; \theta) - 1]) y(\pi_1) - E[\lambda_1 m_1] \\ & + (1 + \tau_2 [E(\lambda_2; \theta) - 1]) y(\pi_2) + E(\lambda_2; \theta) R\end{aligned}$$

Proposition 7.1

Under a veil of ignorance, citizens choose cohesive institutions with $\alpha_L \geq 2(1 - \theta)$.

- Intuition
 - ▶ ex ante, redistributive concerns wash out in the objective \hat{U} we see that γ drops out of expressions above
 - ▶ a common-interest state implements efficient investments in state capacity

Strategic ex post choice of cohesiveness

- Expected period-2 payoff to period-1 incumbent

$$\begin{aligned} & (1 - \gamma) U^I(\tau_2, \pi_2; \theta) + \gamma U^O(\tau_2, \pi_2; \theta) \\ &= (1 + \tau_2 [E(\lambda_2) - 1]) y(\pi_2) + E(\lambda_2) R \end{aligned}$$

where, as in **chapter 2**,

$$E(\lambda_2) = \phi \alpha_H + (1 - \phi) \lambda_2^L$$

is the *expected* value of period 2 public funds with

$$\lambda_2^L(\theta) = \begin{cases} \alpha_L & \text{if } \alpha_L \geq 2(1 - \theta) \\ 2[(1 - \theta)(1 - \gamma) + \gamma\theta] & \text{otherwise} \end{cases}$$

so now γ plays an important role

A (positive) predictive result

$$\frac{\partial [(1 - \gamma) U^I(\tau_2, \pi_2; \theta) + \gamma U^O(\tau_2, \pi_2; \theta)]}{\partial \theta} = \begin{cases} (1 - \phi) 2 [2\gamma - 1] [\tau_2 y(\pi_2) + R] & \text{if } 2(1 - \theta) > \alpha_L \\ 0 & \text{otherwise} \end{cases}$$

Proposition 7.2

A period-1 incumbent chooses cohesive institutions with $\alpha_L \geq 2(1 - \theta)$ when the prospect of replacement is high ($\gamma \geq 1/2$) and noncohesive institutions with $\theta = 0$ when the prospect of replacement is low ($\gamma < 1/2$).

• Intuition

- ▶ when perceived turnover is high, redistribution appears fearsome and the incumbent buys insurance by cohesive institutions
- ▶ an entrenched incumbent wishes to remove constraints on her own future redistribution when public goods not very valuable
- ▶ reform motive up with τ_2 , π_2 , R down with ϕ

Endogenous entrenchment

- If incumbents can also pick γ , the following result is immediate:

Proposition 7.3

The period-1 incumbent's preferred combination of period-2 institutions is $\theta_2 = \gamma_2 = 0$.

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Micropolitical foundations for θ

- institutional choice as designing the rules under which policy is made
 - ▶ $\theta(i, l)$ and $\gamma(l)$, where $l \in \mathcal{L}$ are constitutional rules and
 - ▶ policy making is delegated to a subset of citizens
 $i \geq 1/2$ is the size of the incumbent group's representation in policymaking set.
- We assume a two-stage decision making procedure, where:
 - 1 The (majority) incumbent group in the policymaking set unilaterally chooses $\{p_s^J, p_s^O, g_s, t_s\}$ in period s , and $\{\tau_2, \pi_2\}$ in period 1.
 - 2 The incumbent group and the opposition in the policymaking set bargain over the allocation of $\{r_s^I, r_s^O\}$.
 - ▶ The second stage corresponds to a classic “divide-the-dollar” transfer game where the size of the redistributive cake per capita is:

$$(R + t_s y(\pi_s) - m_s - g_s) = z_s$$

Any transfer allocation must satisfy $r_s^O + r_s^I \leq 2z_s$.

Bargaining outcome

- Bargaining protocol:

- ▶ One-round, closed-rule: incumbent's representation offers $r_s^O \leq 2z_s$.
- ▶ Opposition chooses to reject or accept.
- ▶ If rejects, opposition gets: $r_s^O = \begin{cases} \Psi(\ell) 2z_s & \text{w.pr. } \Omega(i, \ell) \\ 0 & \text{w.pr. } 1 - \Omega(i, \ell) \end{cases}$

- Solving backward:

- ▶ opposition will accept r_s^O at stage 2 only as long as:

$$r_s^O \geq \Omega(i, \ell) \Psi(\ell) 2z_s .$$

- ▶ optimal for incumbent to offer $r_s^O = 2\Omega(i, \ell) \Psi(\ell) z_s = 2\theta(i, \ell) z_s$.
- ▶ define $\theta(i, \ell) \triangleq \Omega(i, \ell) \Psi(\ell)$,
 θ is the product of the bargaining power of the opposition ($\Omega(i, \ell)$) and opposition's status quo outcome ($\Psi(\ell)$).

- The choice of policy in stage 1 is as before.

Micropolitical foundations for γ

- Consider a simple model for determining composition of the policymaking set (i).
- Suppose representation is organized by constituencies (electoral districts, ethnic groups, units in army, ...)
 - ▶ continuum of constituencies indexed by $d \in [0, 1]$
 - ▶ fraction of group- J individuals in d : $\beta^J(d; l)$
 - ▶ order constituencies so β^J is decreasing in d .
 - ▶ threshold to win a constituency: $\frac{1}{2} + n^J(l)$.
 - ▶ popularity shocks: an aggregate random shock \tilde{u}_s^J towards group J in period s
 - ▶ start with an initial value, \tilde{u}_1^J , the period-2 value is

$$\tilde{u}_2^J = \varphi(l) \tilde{u}_1^J + (1 - \varphi(l)) \eta$$

where η is symmetrically distributed with mean zero on $\left[-\frac{1}{2\varrho}, \frac{1}{2\varrho}\right]$ and $\phi(l)$ captures serial correlation.

Preliminaries

- group J wins constituency d if:

$$\beta^J(d; \ell) - (1 - \beta^J(d; \ell)) + \tilde{u}_s^J \geq n^J(\ell)$$

- define the pivotal constituency for group J , \tilde{d}_s^J , implicitly from:

$$\beta^J(\tilde{d}_s^J; \ell) = \frac{1 + (n^J(\ell) - \tilde{u}_s^J)}{2}$$

- Then, group J becomes the incumbent group if

$$i_s^J = (\beta^J)^{-1} \left(\frac{1 + (n^J(\ell) - \tilde{u}_s^J)}{2}; \ell \right) \geq 1/2$$

Endogenous Political Stability

- Probability that the period-1 incumbent loses control:

$$\gamma(\ell) = \text{Prob} \left\{ (\beta^l)^{-1} \left(\frac{1 + (n^l(\ell) - \varphi(\ell)) \tilde{u}_1^l - (1 - \varphi(\ell)) \eta}{2} ; \ell \right) < 1/2 \right\}$$

- Persistence in shocks, i.e. higher $\phi(l) \Rightarrow$ more stability

Constitutional rules

- Study the possibility that changing constitution is NOT a unilateral decision by the incumbent.
- Consider there is a supermajority requirement for changing θ which the incumbent adheres to.
- Inertia in political institutions:

Proposition 7.4

If changing θ requires a supermajority, then $\theta_2 = \theta_1$.

Political Violence

- Reintroducing political violence as in chapter 4.
- constitutional change affects $\gamma(L^I, L^O; \xi)$, by changing L^I and L^O .
- keep state capacities $\{\tau_2, \pi_2\}$ fixed.
- Period-1 incumbent chooses $\{L^I, \theta\}$ to maximize:

$$\left(1 - \gamma(L^I, L^O; \xi)\right) U^I(\tau_2, \pi_2; \theta) + \gamma(L^I, L^O; \xi) U^O(\tau_2, \pi_2; \theta) - \omega(\pi_1) \lambda_1 L^I.$$

- opposition maximization problem is the same as in chapter 4.
- let $\gamma_0 = \gamma(\hat{L}_0^I, \hat{L}_0^O; \xi)$, where $\{\hat{L}_0^I, \hat{L}_0^O\}$ denote the equilibrium investments in violence when $\theta = 0$.

Cohesiveness under the threat of violence

- incumbents may now choose cohesive institutions to avoid the (resource) costs associated with violence.

Proposition 7.5

Suppose that $\phi < 1$. Then, if $\gamma_0 \geq 1/2$, the period-1 incumbent chooses cohesive institutions. If $\gamma_0 < 1/2$, the period-1 incumbent chooses cohesive institutions if and only if

$$[R + \tau_2 y (\pi_2)] (1 - \phi) [2 (1 - \gamma_0) - \alpha_L] - \omega (\pi_1) \lambda_1 \hat{L}'_0 \leq 0 .$$

Aid revisited

- Now we can predict the impact of aid on the choice of political institutions:

Proposition 7.6

An increase in aid or natural resources, R , increases the likelihood that the period-1 incumbent chooses noncohesive institutions in repression but has an ambiguous effect on this choice in civil war.

- from proposition 5.1 γ_0 is decreasing in R
higher R makes the second case of proposition 7.5 more likely.

Trust

- alternative enforcement of cohesive politics, can model trust as
 - ▶ behavior: θ is rooted in repeated interaction of the two groups in office when members are strategic and forward looking.
 - ★ can explain choice of θ_2 being binding
 - ★ even weak formal institutions sustain strong norms of cooperation (cohesive institutions)
 - ★ BUT there are typically multiple equilibria.
 - ▶ trait: trust is a product of individual types

Predation and governance

- consider reforms aimed at increasing the governance parameter $\zeta \in \{0, 1\}$
 - ▶ this is the resource cost if incumbent tries to extract resources by predation and expropriation (defined in chapter 3).
- an elite e^I controls power within the incumbent and earns all the returns from predation
- focus on the case where under bad governance ($\zeta = 0$), $p^I = p^O = 0$.
- to separate this dimension of reform, assume $\theta = 1/2$.
- from chapter 3, recall the level of rents for each member of the elite, in case of bad governance:

$$\hat{\Pi}_0 = \frac{\sum_{J \in \{I, O\}} [\mu(\hat{\chi}_0, 0) \tilde{y}(0) - C(\hat{\chi}_0)]}{e^I}$$

- ▶ where $\hat{\chi}_0$ is the associated predation level

Optimal Governance

- Optimal choice of governance by period-1 incumbent maximizes

$$(1 - \gamma) U^I (\tau_2, \pi_2; \zeta) + \gamma U^O (\tau_2, \pi_2; \zeta)$$

where U^I and U^O are payoffs to period-1 incumbent elite if their group is respectively the incumbent or the opposition in period-2.

Proposition 7.7

The period-1 incumbent prefers good governance ($\zeta_2 = 1$) in period 2 if and only if

$$(1 - \gamma) \hat{\Pi}_0 - [1 + \tau_2 ([\phi \alpha_H + (1 - \phi) \alpha_L] - 1)] (y(\pi_2) - y(0)) \leq 0.$$

A good governance reform is less likely the smaller the elite and the lower the state capacity.

- entrenched and small elites are likely to raise higher hurdles for good-governance reforms

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Political Reform in Practice

Anecdotal evidence

Can model shed light on historical waves of reform?

- Introduction of cohesive institutions – after high- γ shock
 - ▶ reforms by center-right majorities threatened by labor movement in early 1900s Europe – cf. Rokkan hypothesis
 - ▶ (current events in Arab world?)
- Repeal of cohesive institutions – after low- γ shock
 - ▶ reform from European-style institutions to presidential regimes without checks and balances by unchallenged independence movements in 1960s post-colonial Africa
- Careful empirical work necessary
 - ▶ approach (i) and (ii) with theory-guided historical case studies, or turn to well-identified econometric analysis .