Institutions, Incentives, and Power
**High Level Institutions**

**Selectorate**: The portion of the population that has some chance of playing a role in the selection of the leader.

**Winning Coalition**: The portion of the Selectorate needed to keep a leader in power.
**Typology**

**Democracy**
- Selectorate: Adult Citizens
- Winning Coalition: Majority (or plurality) of voters

**Autocracies**
- Selectorate: Party members
- Winning Coalition: Central committee

**Juntas or monarchies**
- Selectorate: Military offices or nobles/clergy
- Winning Coalition: Some critical group of generals and colonels or barons and bishops
Two Types of Public Policy

Public Goods

Private Goods to members of winning coalition
**Basic Argument**

Leaders choose mix of private and public goods to keep WC from defecting to challenger

With small WC inexpensive to do so with private goods
  - Bad policy is good politics

With large WC too expensive to provide private goods
  - Good policy is good politics
Policy and Leader Survival

Survival Rates Large WC

Survival Rates Small WC

Good Policy Outcomes
Bad Policy Outcomes
Incumbent leader \((L)\), Challenger \((C)\), Selectorate of size \(S\), Population of size \(N \geq S\)

\(L\) has winning coalition of size \(W < S\)

Government has resources \(R\)
Strategies

Each politician proposes whether to provide the public good \((g \in \{0, 1\})\) at price \(p\)

- Providing public good is good policy \((N > p)\)

Each politician proposes how much private good \((x)\) to provide to each member of the politician’s winning coalition

\[ pg + Wx \leq R \]

Each member of the Selectorate chooses which politician to support
Leadership Transition

$L$ loses power if the following things both happen:

1. Challenger gets the support of a group of size $W$.
2. Leader loses support of at least one member of WC.

$L$ is committed to her WC

Before election, Selectorate members don’t know if they will be in $C$’s WC

- Each is equally likely to end up in the Challenger’s winning coalition: $\frac{W}{S}$
Payoffs

Winning Coalition member:

\[ U_W(x, g) = x + g \]

Selectorate member not in WC:

\[ U_S(x, g) = g \]

Politician in office:

\[ B + u(R - pg - Wx) \]
Steps in the Analysis

1. For an arbitrary level of spending (∆), how do the Leader’s and Challenger’s allocations differ?
   - Leader focuses on welfare of her WC.
   - Challenger can’t target Leader’s WC. All Selectorate members equally likely to be in Challenger’s WC.

2. The Challenger will offer his optimal allocation of the full budget, \( R \).

3. If the Leader were to offer her optimal allocation of the full budget, the members of her WC would strictly prefer her to the Challenger. So she can offer less and still retain power.

4. How much does the Leader spend, and on what, as a function of the institutions (i.e. \( W \) and \( S' \))?
Challenger’s Optimal Allocation of $\Delta$

Expected utility of a Selectorate member from $(g, x)$

$$\frac{W}{S}x + g \quad \text{with} \quad pg + Wx = \Delta$$

$$\left(pg + Wx = \Delta \implies x = \frac{\Delta - pg}{W}\right)$$

$$\frac{W}{S} \times \frac{\Delta - pg}{W} + g$$

Offer public good if

$$\frac{\Delta - p}{S} + 1 \geq \frac{\Delta}{S} \implies p \leq S$$
Leader’s Optimal Allocation of $\Delta$

Expected utility of a Winning Coalition member from $(g, x)$

$$x + g \quad \text{with} \quad Wx + pg = \Delta.$$  

$$\left( pg + Wx = \Delta \Rightarrow x = \frac{\Delta - pg}{W} \right)$$

$$\frac{\Delta - pg}{W} + g$$

Offer public good if

$$\frac{\Delta - p}{W} + 1 \geq \frac{\Delta}{W} \Rightarrow p \leq W$$
Comparing Challenger’s and Leader’s Optimal Allocations

Challenger provides private and public goods

Leader provides private and public goods

Challenger provides only private goods

Leader provides only private goods

Leader gets larger benefit from private goods because of commitment

Especially acute when $W$ is small
The best the Challenger can do is to choose his optimal allocation of the full budget

\[ p > S: \text{Full budget on private goods} \]

\[ \frac{W}{S} \times \frac{R}{W} = \frac{R}{S} \]

\[ p \leq S: \text{Public good and remainder on private goods} \]

\[ \frac{W}{S} \times \frac{R - p}{W} + 1 = \frac{R - p}{S} + 1 \]
The Winning Proposal

The Leader can win without allocating whole budget

\[ p > S: \Delta^* \text{ exclusively on private goods such that} \]

\[ \frac{\Delta^*}{W} = \frac{R}{S} \Rightarrow \Delta^* = \frac{W}{S} \times R \]

\[ W < p \leq S: \Delta^* \text{ exclusively on private goods such that} \]

\[ \frac{\Delta^*}{W} = \frac{R - p}{S} + 1 \Rightarrow \Delta^* = W \left( \frac{R - p}{S} + 1 \right) \]

\[ p < W: \text{Public good and remainder of } \Delta^* \text{ on private goods} \]

\[ \frac{\Delta^* - p}{W} + 1 = \frac{R - p}{S} + 1 \Rightarrow \Delta^* = W \times \frac{R - p}{S} + p \]
Outcomes and Institutions

Total government spending increasing in size of the Winning Coalition and decreasing in size of Selectorate

Public goods increasing in size of Winning Coalition

Private goods decreasing in size of Winning Coalition

Welfare of population members not in WC increasing in size of Winning Coalition

Large Winning Coalition $\rightarrow$ good policy is good politics

Small Winning Coalition $\rightarrow$ good policy is bad politics
Institutions and Development: An Empirical Strategy

Mortality at the time of colonization affected settlement patterns.

Settlement patterns affected historic institutions.

Historic institutions affect modern institutions.

Modern institutions, we believe, affect economic outcomes.
Settler Mortality and Modern Economy

Log GDP per capita, PPP, 1995 vs. Log of Settler Mortality
SETTLER MORTALITY AND MODERN INSTITUTIONS

Average Expropriation Risk 1985-95 vs Log of Settler Mortality

Countries shown on the graph include:

- AGO
- ARG
- AUS
- BFA
- BGD
- BHS
- BOL
- BRA
- CAN
- CHL
- CIV
- CMR
- COG
- COL
- CRI
- DOM
- DZA
- ECU
- EGY
- ETH
- GAB
- GHA
- GIN
- GMB
- GTM
- GUY
- HKG
- HND
- HTI
- IDN
- IND
- JAM
- KEN
- LKA
- MAR
- MDG
- MEX
- MLI
- MLT
- MYS
- NGA
- NIC
- NZL
- PAK
- PAN
- PER
- PRY
- SDN
- SEN
- SGP
- SLE
- SLV
- TGO
- TTO
- TUN
- TZA
- URY
- USA
- VEN
- VNM
- ZAF
- ZAR

Graph shows a negative correlation between average expropriation risk and log of settler mortality.
Good institutions seem to lead to better economic outcomes

Moving from the twenty-fifth percentile to the seventy-fifth percentile in quality of institutions, yields a seven-fold increase in GDP

- Nigeria to Chile.
A Possible Problem: Human Capital

Mortality and Human Capital (Glaeser et al. 2004)
Take Aways

Different institutions create different incentives for leaders seeking to retain power

When power depends on the support of a small number of people, good policy is bad politics

When power depends on the support of a large number of people, good policy is good politics