

Cronyism

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Motivation

- “No jobs for the boys”, António Guterres, October 1995.
- Governments can appoint cronies to public-sector positions, regardless of needs or merits
- Public-sector organisations: soft budget constraints, reduced exposure to competition
- Cronyism consistent with large size of the public sector, performance gap between public and private firms (Shleifer JEP 1998)
- Detrimental effects of corruption (Shleifer & Vishny QJE 1993), including potential for disruption of internal labour markets and interaction with rigid employment protection

Methodology 1

- Empirical evidence on cronyism is challenging: both sides want to hide relationship from public scrutiny
- No evidence of jobs cronyism found, despite the considerable anecdotal reports
- Related research that presents evidence of corruption: Duggan & Levitt AER 2002, Jacob & Levitt QJE 2003, Hsieh & Moretti QJE 2006, Wolfers AER 2006

Methodology 2

- Simple model of cronyism: politicians supply appointments demanded by cronies, in exchange for political or other favours
 - Greater supply and demand of appointments near general election periods generates spikes in hirings both before at those periods
 - Post-election spikes are predicted to be stronger if new government of different political colour
- Require data covering public sector and its appointments at high frequency (Akhmedov & Zhuravskaya QJE 2004)
- We use longitudinal matched employer-employee panel data set covering the population of firms that operate in Portugal
- Private-sector hirings as possible counterfactual (eg business cycle or seasonal effects)

Preview of the results

- Large spikes in hirings just after a new government takes office, especially if of different political colour
- Hirings also increase just before a new government takes over
- Results hold under different specifications or data subsets, eg less-skilled workers and different sectors
- Changes in the top management of private firms do not result in significant evidence of hikes in hirings
- First paper that provides systematic empirical evidence about cronyism

Privatisation literature

- Consistent with evidence on the gains from privatisation (Megginson & Netter JEL 2001, Brown et al JPE 2006)
 - Eg Porta & Silanes QJE 1999: 1/3 of efficiency benefits from privatization in Mexico from transfers from laid-off workers
 - Bertrand et al 07: publicly-traded firms managed by politically connected CEOs display higher rates of job creation and lower profits
 - Bandiera et al 2009: favouring 'connected workers' hurts firm performance

Theoretical considerations 1

- Two types of agents: politicians (either in power or in opposition) and cronies, bipartisan system
- Politicians care about obtaining or keeping power, which is facilitated by favours made by cronies
- Cronies care about public-sector appointments, which involve rents
- Informal market for appointments in the public sector
 - Supply of appointments by politicians: responds (positively) to price (relevance of favour made by the crony) and other variables ('political', 'economic' and 'private')
 - The case of politicians in opposition is similar
 - Demand for appointments: responds (negatively) to price and other variables, including proximity to elections and likely election result

Theoretical considerations 2

- Crony demand increases near elections
 - Cronies of same political colour as incumbent increase demand for appointments near elections
 - Cronies of opposition party more interested in delivering favours near elections
- Crony supply also increases near elections: critical time to keep or obtain power when favours more useful

Theoretical predictions

- Under null of no cronyism, electoral cycle does not influence public-sector hirings
- Under cronyism: periods just before or just after elections will be times of above-average crony appointments (demand and supply curves both shift to the right)
- Post-election hirings spike greater when new government of different political colour than antecessor (deferred appointments, conditional on the victory of the challenger, will only apply in that case)
- Cronyism can be detected from differences over time in hirings levels, in particular in months near general elections

Political system - Portugal

- 13 governments since 1980; only four led to full four-year term
- Government headed by the prime minister (from most voted party in general elections), who chooses ministers and deputies
- Ministers are responsible for overseeing state-owned firms
- Stability in party structure: PS ('Partido Socialista', left wing) and PSD ('Partido Social Democrata', centre/right wing)
- Election dates tentatively scheduled for September
- (State-owned or private) firms have no influence on election dates

Governments of Portugal, 1980-2008

Gov't no.	Party/Coalition	Start	End	New colour	Elections
6	PSD+CDS+PPM	Jan-80	Jan-81	x	x
7	PSD+CDS+PPM	Jan-81	Sep-81		
8	PSD+CDS+PPM	Sep-81	Jun-83		
9	PS+PSD	Jun-83	Nov-85	x	x
10	PSD	Nov-85	Aug-87	x	x
11	PSD	Aug-87	Oct-91		x
12	PSD	Oct-91	Oct-95		x
13	PS	Oct-95	Oct-99	x	x
14	PS	Oct-99	Apr-02		x
15	PSD+CDS	Apr-02	Jul-04	x	x
16	PSD+CDS	Jul-04	Dec-04		
17	PS	Mar-05	Oct-09	x	x
18	PS	Oct-09			x

State-sector firms I

- Our empirical analysis will focus on state-sector firms only (not ministerial appointments)
- State-owned firms are supposed to pursue economic (and social) goals: the political cycle should not affect appointments (apart from a small number of top positions and then only after elections)
- Wave of nationalisations following the 1974 *coup d'etat*
- More than 230 privatisation events from 1987 to 2005
- SOE's still account for 4.7% of GDP and 2.4% of employment (2005)
- SOE's can be found in large number of sectors (utilities, transport, infrastructures, finance, health, urban renewal, etc)

State-sector firms II

- Many SOE's do not meet economic conditions for public ownership (opportunities for cost reductions that lead to non-contractible reduction in quality, weak potential for innovation, weak competition and consumer choice, weak reputation mechanisms (Shleifer JEP 1998))
- Many make losses: state transfers in 2005 amounted to 7.4 billion euros (excluding loans taken by those state-owned firms)
- Recruitment of employees by SOE's does not need to meet stringent procedures for public servants
- Analysis of wage practices of SOE's: significant wage premiums, even controlling for large range of heterogeneity sources

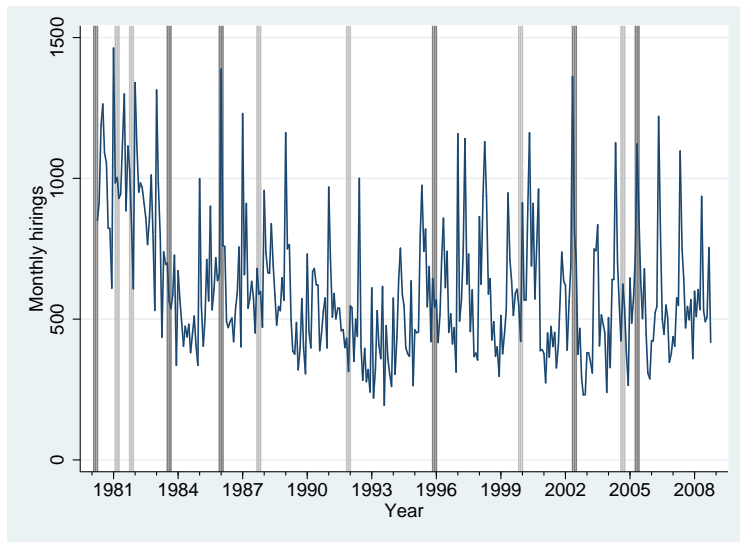
Data

- 'Quadros de Pessoal': rich annual census of all firms that operate in Portugal and that employ at least one worker
- Census ongoing since 1982, up to 2008
- Long list of variables: identifiers, ownership structure of the firm, month and year when each employee was hired
- We construct time-series of number of workers hired in each month by type of firm (state- or private-owned)
 - Miss short employment spells; 1990 and 2001 worker data not released (we use longer-lasting employment spells in those periods); also considered appointments made since April 1980 that last until March 1982
 - Drop firms that do not appear in at least five years or that do not employ at least 20 workers in at least one year
 - 10% sample of private sector firms (and all their workers)

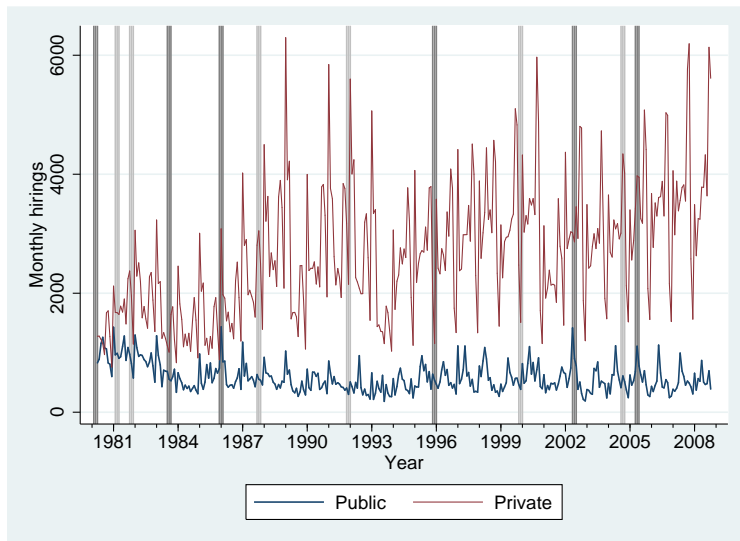
Descriptive statistics

Variable	Mean	Std. Dev.	Min.	Max.	N
State-owned firms					
Hirings	584.096	241.487	182	1436	342
Log hirings	6.291	0.398	5.204	7.270	342
Mean schooling years	10.382	1.522	6.631	13.435	342
Mean age	28.881	1.762	25.196	40.854	342
Mean job level	5.206	0.456	4.164	6.717	342
Mean real hourly earnings	7.054	1.531	3.813	12.045	342
Private firms					
Hirings	2667.778	1113.072	758	6297	342
Log hirings	7.799	0.434	6.631	8.747	342
Mean schooling years	7.633	1.223	5.581	10.099	342
Mean age	29.994	1.919	26.603	35.891	342
Mean job level	5.94	0.284	5.043	6.592	342
Mean real hourly earnings	4.835	1.175	2.686	7.587	342
Both state-owned and private firms					
Distance	6.974	5.159	0	23	342
Before 1994	0.453	0.499	0	1	342
New gov't (3 months after)	0.099	0.3	0	1	342
New colour (3 months after)	0.047	0.211	0	1	342

Monthly hirings by state-owned firms, 1980-2008



Monthly hirings by SOE's and sample of private firms



State-sector only

- Event study approach



$$\log(\text{Hirings}_t) = \beta_1 \text{NewGovt}_t + \beta_2 \text{NewParty}_t + X_t \beta_3 + e_t \quad (1)$$

- NewGovt_t : dummy equal to one in the first three months after a new government takes office
- NewParty_t : dummy equal to one in the first three months after a new government of a different political colour than its predecessor takes office
- X includes several time controls (a dummy for each month, a dummy for each month in the period up to March 1993, a variable capturing the number of months between the census month and t , a quadratic trend)
 - Robust standard errors
 - Significance levels: *:0.05 **:0.01 ***:0.001

Results - State-sector only

	(1)	(2)	(3)	(6)	(7)
New gov't (3m after)	.150 (.040)***		.123 (.050)**		.118 (.052)**
New colour (3m after)		.173 (.058)***	.057 (.074)		.079 (.076)
New gov't (3m before)				.117 (.050)**	.126 (.052)**
New colour (3m before)				.008	.014 (.082)
Before 1994	.071 (.125)	.068 (.123)	.072 (.125)	.071 (.124)	.087 (.125)
Distance	-.015 (.004)***	-.015 (.004)***	-.015 (.004)***	-.015 (.004)***	-.014 (.004)***
Trend	-.007 (.0007)***	-.007 (.0007)***	-.007 (.0007)***	-.007 (.0007)***	-.007 (.0007)***
<i>Trend</i> ²	.001 (.0002)***	.001 (.0002)***	.001 (.0002)***	.001 (.0001)***	.001 (.0002)***
Obs.	342	342	342	342	342
<i>R</i> ²	.579	.575	.579	.574	.589

State vs. private sector

- Months of high state-sector hirings may also correspond to months of high (or low) private-sector hirings
- Governments may tend to call early elections for periods of economic expansion; or oppositions tend to bring down minority governments in periods of downturn

$$\log(\text{Hirings}_{it}) = \beta_1 \text{NewGovt}_t \times \text{SO}_{it} + \beta_2 \text{NewParty}_t \times \text{SO}_{it} + \beta_3 \text{SO}_{it} + \gamma_t + e_{it} \quad (2)$$

- SO_{it} : State-Owned firm

Results - State vs. private sector

	(1)	(2)	(3)	(4)	(7)
New gov't (3m after) × <i>StateOwned</i>	.294 (.105) ^{***}		.094 (.143)		.090 (.143)
New colour (3m after) × <i>StateOwned</i>		.514 (.126) ^{***}	.426 (.186) ^{**}		.470 (.187) ^{**}
New gov't (3m before) × <i>StateOwned</i>				.383 (.137) ^{***}	.412 (.136) ^{***}
New colour (3m before) × <i>StateOwned</i>				-.024 (.185)	-.025 (.186)
<i>StateOwned</i>	-1.538 (.030) ^{***}	-1.533 (.029) ^{***}	-1.538 (.030) ^{***}	-1.545 (.030) ^{***}	-1.578 (.031) ^{***}
Obs.	684	684	684	684	684
R ²	.906	.907	.908	.908	.912

Robustness analysis

- Month-by-month analysis

$$Hirings_{it} = \sum_{j=-12}^{12} \beta_j^A E_j \times SO_i + \sum_{j=-12}^{12} \beta_j^B ENC_j \times SO_i + \phi SO_i + \theta_t + e_{it}, \quad (3)$$

- Industry analysis
- Data subsets
 - Job levels
 - Time periods (subsets of years, subsets of distances)
 - Left vs right
- Falsification test: local councils electoral cycle
- Levels instead of logarithms, seasonally differenced dependent variable
- Some evidence that employment levels increase around elections
- No evidence of similar spikes in private firms (when new CEO is appointed)

Results and policy

- Appointments to state-owned firms increase significantly over the months just before and just after a new government takes office
- Post-elections hirings spike is particularly strong if the new government is of a different political colour
- Results explain private/public performance gap, gains from privatisation (and reluctance against it)
- Possible policy approaches: restrictions on hirings near elections; greater transparency on profiles/timings of appointments