

Norman Schofield · Gonzalo Caballero · Daniel Kselman *Editors*

Advances in Political Economy

Institutions, Modelling and Empirical Analysis

This book presents latest research in the field of Political Economy, dealing with the integration of economics and politics and the way institutions affect social decisions. The focus is on innovative topics such as an institutional analysis based on case studies; the influence of activists on political decisions; new techniques for analyzing elections, involving game theory and empirical methods.

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553 (1810–1821) and resulting political instability provide an example of the importance
554 of legal authority. The internal and external threats faced by the elites in different
555 regions in the aftermath of independence from Spain did not lead to centralization.
556 It took almost fifty years for the region to stabilize its newly minted state. Centeno
557 (2002) argues that this was a result of the authority void left by the Spanish crown:
558 no group was superior to the rest.
559

561 2.1 *England*

564 In contrast to other European nations, England lacked a standing army from the
565 late fifteenth to the late seventeenth centuries. Its landed aristocrats were also ef-
566 fectively demilitarized; by the 1640s “four out of five aristocrats had no military
567 experience at all” (Brewer 1989, 12). This was partly a result of England’s non-
568 involvement with major international conflicts during that time-period. According
569 to Brewer (1989, 12), “England was sheltered not just by her insular position but by
570 the scale of war in early modern Europe.” The large increase in army sizes and num-
571 ber of troops deployed made an invasion of England complicated, and an English
572 invasion of the continent difficult. English naval power only began to be established
573 in the second half of the seventeenth century. Castilian and French fleets managed
574 to seize and sack various English ports during the Hundred Years war. Further, prior
575 to the seventeenth century, the navy depended heavily on private support and armed
576 merchantmen ships.²⁸
577

578 The Civil War (1642–1651) marked a turning point for the need to secure the
579 state against domestic rivalries. An interregnum of civil warfare and challenges to
580 hierarchy created the conditions for a watershed in England’s fiscal and military
581 history. Importantly, the succession of events “forged a political consensus among
582 England’s wealthy elites for an altogether stronger and more centralized state, above
583 all to maintain order and political stability, but also to afford greater protection for
584 the economy’s growing commercial interests overseas” (O’Brien 2011, 426). The
585 threat of internal political stability together with the lack of military protection pro-
586 vided the conditions for an alignment of the executive’s and the elite’s benefit from
587 creating a standing army and strengthening the navy.

588 The important role played by Parliament in fiscal matters gives evidence of the
589 need to negotiate and obtain cooperation from the wealthy elites. Parliament de-
590 cided on the selection of the levels and types of taxes, the rules for their assessment
591 and collection, and had control over the state departments in charge of implement-
592 ing those rules.²⁹ In fact, the landed elites set the terms for cooperation by initially
593 avoiding direct taxes on land. It was not until 1799 that Pitt managed to introduce
594

595
596 ²⁸This paragraph summarizes Brewer (1989, 8–13).

597 ²⁹Horowitz (1977) and O’Brien (2011).
598

599 Britain's first income tax.³⁰ "Only the armies of Revolutionary France and the prob-
600 able collapse of public credit prompted the political classes to accept [direct taxa-
601 tion]" (O'Brien 1988, 22).

602 In sum, English fiscal history shows the importance of a threat of internal unrest
603 (evident after the Civil war) in increasing fiscal centralization. By aligning the bene-
604 fit from military protection for a majority of the wealthy elites and monarch, a tran-
605 sition out of a low-contribution and low-public-good-provision was possible. Also,
606 the role played by parliament attests to the need to negotiate with the elites and to the
607 importance of centralized and public fiscal policies to ensure every elite group that
608 others were cooperating and contributing with the forging of a fiscal-military state.
609

611 2.2 Colonial Mexico

614 The Spanish crown faced practically no internal or external challenges in its Ameri-
615 can territories during its first 200 years of colonial rule.³¹ The crown did not need to
616 incur in major expenses to defend its colonial territory and relied only on minimal
617 forces at the ports and borders for the protection of the Spanish American empire.³²
618 The vulnerable position of colonial Mexico is evidenced by the efforts to garner a
619 field army in 1762 in the port of Veracruz, on the coast of the Gulf of Mexico.³³
620 This port was the point of entry and exit for all European trade with New Spain, and
621 therefore one of the most guarded locations in colonial Mexico. In 1760, the port
622 and fortress were guarded by around 1,000 men.³⁴ The port of Veracruz was vul-
623 nerable to attack just before the end of the Seven Years' War. The Viceroy Marqués
624 de Cruillas spent 3,398,471 pesos of extraordinary funds to ready the fortifications
625 and mobilize a force of 8,500 men in and around Veracruz.³⁵ This was a force eight
626 times the size of the previous force. Notwithstanding, according to the Viceroy, a
627 much larger force was necessary to ensure the security of the kingdom.³⁶

628 The lack of military protection in conjunction with the Seven Years' War (1756–
629 1763) identify a watershed in colonial Mexican history. The Seven Years' War
630

631 ³⁰O'Brien (1988).

632 ³¹Arias (2012) provides a thorough historical analysis of colonial Mexico supporting the theoret-
633 ical argument presented here.

634 ³²McAlister (1953, 2).

635 ³³Colonial Mexico was part of New Spain, one of the Spanish viceroalties in colonial Spanish
636 America. After the conquest, the Spanish crown divided the territory in two viceroalties, New
637 Spain and Peru, comprising roughly contemporary Mexico and Peru, respectively. In the 18th
638 century, two more viceroalties were created: New Granada and Río de la Plata. The viceregal
639 governments functioned as a link between the crown in Spain and its subjects in America. Even so,
640 colonial corporations and powerful individuals negotiated directly with the government in Madrid.

641 ³⁴McAlister (1953, 2–3).

642 ³⁵Archer (1981, 315).

643 ³⁶McAlister (1953, 7).

645 changed the balance of power within colonial territory among the European pow-
 646 ers.³⁷ In 1756, France declared war on Great Britain. This was the beginning of the
 647 French-Indian War, as the conflict was known to the colonists. The war was a strug-
 648 gle for primacy between Britain and France. For the first time in European history,
 649 battles occurred in colonial territory.³⁸ There were battles in India, North America,
 650 the Caribbean isles, the Philippines, and coastal Africa, and Europe. By the autumn
 651 of 1760, all French territory in mainland America was in British hands. An agree-
 652 ment made in August 1761 between the Bourbon kings of Spain and France, the
 653 Family Compact, brought Spain into the war. In August of 1762, the British Royal
 654 Navy captured Havana, Cuba, and Manila in the Philippines. The war ended follow-
 655 ing the Treaty of Paris on February 10, 1763, with a victory for Great Britain, who
 656 emerged as the dominant European power.

657 The military defeats suffered by Spain during the Seven Years' War highlighted
 658 the need to secure Spanish colonial possessions against British attack. Also, be-
 659 cause of the demographic recovery of the Indian population in the first half of the
 660 eighteenth century, many provinces in colonial Mexico saw internal unrest increase
 661 to new levels.³⁹ The Seven Years' War, together with the increased Indian unrest,
 662 marked the fiscal centralization and military reorganization undertaken by royal of-
 663 ficials in the second half of the eighteenth century.

664 A growing body of scholarship demonstrates that centralization was pursued
 665 through bargaining, compromise, and political contestation between crown officials
 666 and the main elites and local authorities.⁴⁰ There were few military or police forces
 667 in the Spanish colonies that the crown could rely upon for a top-down imposition, at
 668 least in the initial stages of reform. Furthermore, because net transfers were always
 669 positive from the Americas to Spain, the fiscal-military transition could not have
 670 been financed with continental monies.⁴¹

671 Reform was more successful in the regions where the elites' network of privi-
 672 lege and patronage relied on the existence of the Spanish monarch and were more
 673 affected by the British threat. In the imperial capitals Mexico and Peru, and in Ve-
 674 racruz, Cuba and coastal regions of Panama and Colombia the crown's officials
 675 transformed the state administration into a more highly structured apparatus, in-
 676 creased fiscal revenues by means of a larger and more efficient fiscal bureaucracy,
 677 and renovated military establishments to a larger extent than in other regions.⁴²

678 Failed attempts to implement fiscal reform earlier in the colonial period also
 679 attest to the importance of the Seven Years' War. In 1626 the Count-Duke of Oli-
 680 vares attempted a fiscal reform through the creation of the Union of Arms with the
 681

682
 683 ³⁷See, for instance, Bonney (2004) and Elliott (2006).

684 ³⁸Elliott (2006, 292). The conflict in North American soil began in 1754, two years before the
 685 formal outbreak of war in Europe.

686 ³⁹Fisher (1982, 219).

687 ⁴⁰Kueth and Inglis (1985, 122–123). See also Paquette (2007).

688 ⁴¹See Irigoien and Grafe (2008) and Marichal and Souto Mantecón (1994).

689 ⁴²Marichal (2007, 48–80), Kueth and Inglis (1985), Brading (1971, 1987).

691 goal of sharing the burdens of defense in mainland Europe between the Spanish
 692 kingdoms and the Spanish American colonies. A fixed annual contribution was de-
 693 manded from every part of the empire. Colonial territory, however, was not subject
 694 to territorial threats and the colonial elites resisted the fiscal reforms. Only tempo-
 695 rary increases to trade tax rates took effect.⁴³

696 The evidence of negotiation with the elites, and earlier failed attempts to increase
 697 fiscal centralization, provide evidence for the inability to implement reform in col-
 698 onial Mexico lacking an alignment between the fate of the crown and that of the local
 699 and corporate elites regarding the provision of military protection.

702 3 Conclusion

704 This chapter contributes to the literature by providing a complementary mechanism
 705 for why threats of external invasion or internal unrest can lead to increases in fis-
 706 cal centralization. Fragmented fiscal capacity leads to free riding in the face of a
 707 threat. Fiscal centralization provides an institutional framework that allows elites to
 708 commit to contribute to military protection by ensuring others also contribute. The
 709 analysis shows that, even if there is agreement on the need to provide military pro-
 710 tection, it is not until a majority of the fiscally powerful have stakes on the survival
 711 of the ruler for their economic future (and so their benefit from military protection
 712 aligns with that of the ruler) that they can agree to the centralization of fiscal capac-
 713 ity.

714 The analysis here highlights two issues that suggest avenues for future research.
 715 First, the theoretical argument assumes the ruler can commit to implement the pol-
 716 icy profile agreed to before the increase in centralization. Once a ruler invests in
 717 fiscal centralization, the ruler could renege on the policy agreement and unilater-
 718 ally increase future taxes or default on its debts.⁴⁴ Reputation, however, limits the
 719 ruler's incentives to renege on his agreements. If the future is sufficiently impor-
 720 tant, the ruler has a reputation to maintain. Scholars have argued, however, that in
 721 some cases reputation may not be enough to limit rulers, and that more elaborate
 722 institutional arrangements may be required (e.g. institutions of representation).⁴⁵

723 My analysis complements this literature on the need to constrain the ruler by em-
 724 phasizing another commitment problem—that between the elites resulting from free
 725

726
 727 ⁴³Elliott (1986, 246–274).

728 ⁴⁴Notice that fiscal fragmentation serves as a commitment device for the ruler to pay its debts.
 729 By granting the corporation/debtor the right to directly collect certain taxes, rulers were able to
 730 obtain payments in advance and guarantee the service of interest and repayment. The major legal
 731 form used for this transaction in Spain and its colonies were the *asientos*. *Asientos* were contracts
 732 between the Crown and a private corporation or individual through which the latter promised to
 733 pay an amount to the Crown in exchange for the right to make use of the revenues resulting from a
 734 specific royal tax. See Domínguez Ortiz (1960), Conklin (1998), and Alvarez-Nogal and Chamley
 (2011). For the case of England, see Brewer (1989, 93).

735 ⁴⁵See for example North and Weingast (1989), Greif et al. (1994), and Bulow and Rogoff (1989).
 736

riding under fragmented fiscal capacity. The results suggest that guaranteeing credibility from the ruler may not be enough. If the benefit from overcoming free riding is not sufficiently large, both the ruler and the corporations prefer fragmented capacity. The results also suggests that institutions of representation are not necessary, at least in the initial stages of fiscal centralization, to the extent that the corporate elites' and the ruler's benefits from military protection are aligned in response to a threat. The case of colonial Mexico corroborates that institutions of representation are not necessary for the elites to agree to fiscal centralization. Future research needs to study more carefully the timing between centralization and representation and the links between the two commitment problems mentioned.

Second, the theoretical argument does not incorporate dynamics to explain whether the investments in fiscal capacity are irreversible. Why should we not observe a reduction in fiscal centralization once the threat disappears? Incorporating the complementarity between the creation of a standing army and a fiscal administration with monitoring and enforcement capabilities, could make an increase in fiscal centralization difficult to reverse. In addition, the sunk-cost nature of the investment in fiscal centralization can lead to irreversibility after the threat disappears, all else constant.

Both the theoretical argument and the evidence from England and colonial Mexico emphasize the defensive, public-good aspect of military protection in leading to an increase in fiscal centralization. In so doing, the analysis here may tell us something about the evolution of fiscal capacity at other times and places. For a state relying on fragmented fiscal capacity to increase fiscal centralization, a sufficiently large shock jointly affecting the income of both the central government and the relevant fiscal actors is necessary. Two conditions are key: that the shock creates a collective action problem among the key actors, and that those actors believe the ruler can credibly monitor and enforce tax collection. The new fiscal regime allows for the coordination of policies and the enforcement of contributions.

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UNCORRECTED PROOF

Stable Constitutions in Political Transition

Katja Michalak and Gerald Pech

1 Introduction

This paper develops a spatial model where an autocrat selects a status quo constitution. This constitution may or may not be accepted by a succeeding elected constitutional assembly as a blue print for negotiations on constitutional reform. A constitution defines as legitimate a status quo point in policy space with policy dimensions redistribution and social policy. Moreover, it guarantees property rights and provides a policy rule of how the status quo point can be modified. We model constitutional design and reform as a dynamic game. As the first mover, the autocrat is free in selecting the status quo point. If accepted by the succeeding assembly, it becomes the default outcome when the assembly enters negotiations over constitutional reform which take the form of changing the status quo policy. In the absence of a prior constitution or after a rejection of the prior constitution, the assembly enters free negotiations on a new constitution.

More recently, constitutional succession has become an issue in many Arab countries where autocratic regimes were succeeded by freely elected governments. When the White House called for Husni Mubarak, then president of Egypt, to step down, the question immediately arose whether the rules of succession would apply as laid out in the Egyptian constitution or whether the constitution had to be suspended to negotiate a transition between the old regime and the opposition (see Brown 2011). After Mubarak eventually resigned, the interim military government, i.e. the

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Supreme Council of the Armed Forces, adopted a provisional constitution which contained significant amendments and aimed at paving the way to parliamentary elections.¹ The elected parliament set out on what proved to be a bumpy road towards negotiations over a new constitution.

Of these events, two facts stand out: On the one hand, the Mubarak constitution turned out to be not acceptable to all parties involved in the transition process. Therefore, on the face of it the Egyptian case is one of discontinuity of the existing authoritarian constitution. On the other hand, the leadership of the military, which had significant bargaining power in the transition process, was widely seen to be able to hold on to their privileges and property interests.² These two observations suggest that the Egyptian transition is an ambivalent case where the formal constitution handed down by the autocrat lacked perseverance yet the property order established under the constitution was kept in place.

Moreover, whilst this paper looks into the possibility for an autocratic regime to select a constitution which is accepted as a blue print by its successors, the Supreme Council of the Armed Forces faced a rather similar choice problem when drafting the amendments of the provisional constitution.³ In principle, our framework should lend itself to analyzing constitutional choice in this slightly different context. Whilst it is still too early to judge the outcome of this constitution project, at the time of finalizing this paper it appeared as if the army was revoking its support for the constitutional reform process in the face of a legislature dominated by Islamist parties.⁴

Chile, as the second example which we look at, is a clear example of successful constitutional succession.⁵ In 1980, the Chilean military junta adopted a constitution which subsequently not only governed the internal workings of the junta and imposed constraints on its exercise of power, but which set the rules by which the transition to democracy finally took place: In 1988, Pinochet stood for election, thereby sticking by the letter of the constitution. Following electoral defeat, the Chilean parties of the right and the center negotiated constitutional amendments which were adopted as part of a reformed constitution by plebiscite in 1989. The amendments included restrictions on presidential powers, the lowering of the quorum for changing non vital parts of the constitution, admittance of parties of the left, and a modification of the relative voting power of civilians versus the military on the national security council. In large parts, the constitution of 1980 remains in place today.

There are clear differences but also similarities between Egypt and Chile: Chile has a long and recent history of constitutionalism. The Chilean constitution was a

¹For details of the process see Brown and Dunnes (2011).

²Egypt's freedom, Financial Times, 20 May 2012.

³Other classification schemes agree on the ambiguity of the Egyptian case: In the framework of Munck and Leff (1997) the Egyptian transition can be classified as one of defeat of the old order. Yet if one considers the military as part of this order, one could equally argue that the transition can be classified as a pact.

⁴Egypt court orders parliament dissolved, Financial Times, 15 June 2012.

⁵For an overview see Barros (2002) and Montes and Vial (2005).

93 binding constraint on the dealings of the junta (see Barros 2002). Most significantly,
94 transition took place because the regime, after some hesitation, obeyed the letter of
95 the constitution. In Egypt, on the other hand, the transition of power was brought
96 about by street protests. Common to both countries is the influence exercised by
97 parties and organizations associated with the old regime during the transition period.
98 In Egypt this was mainly the military which served as a power broker during the
99 revolution whilst in Chile these were the parties of the right which bargained in the
100 shadow of power which was projected by the military.

101 In this paper, we see a preexisting constitution as a natural focal point in the
102 transition process which can serve both as a reference but also as a reversion point
103 for constitutional reform. The reform process in which a society attempts to newly
104 arrange its social compact creates many uncertainties. The negotiating parties may
105 end up in a game of attrition where each tries to secure concessions from the other
106 parties involved in the process. The attempt of constitutional reform may end in
107 open conflict if the participation constraint of one of the players is not satisfied.
108 For those reasons, the elected successor parties which are interested in changing the
109 constitution may yet agree on the preexisting constitution as a default outcome in
110 order to insure against the risks otherwise involved in negotiating a new constitution.

111 If the autocrat expects a succeeding constitutional assembly to use a preexisting
112 constitution in that way, it creates an avenue through which the autocrat, in writing a
113 constitution, can influence the power play after his demise. In this paper we assume
114 that the interest group of the property owning class can exert sufficient influence on
115 the autocrat to make him write a constitution on their behalf.

116 We show, first of all, that constitutions exist which are stable in the transition
117 process. Whether or not the autocrat strictly prefers to hand down a constitution
118 depends on who he expects to bargain over constitutional reform. If the autocrat
119 expects that the future constitutional assembly is dominated by parties which favor
120 redistribution, he does not want to bind himself by the constitution. If not a single
121 party dominates the constitutional assembly and the middle class opposes redistribu-
122 tion or it is expected to forge a coalition with the right dominate, stable constitutions
123 exist which are in the interest of the autocrat. Here, our model provides a theoretical
124 underpinning for the frequently stated idea that a middle-class which is interested in
125 maintaining property rights is a prerequisite for constitutional stability.⁶

126 Moreover, we show that if the autocrat can hand down a constitution immediately
127 before his demise, he may choose to write a stationary constitution, i.e. a constitu-
128 tion which he predicts to be accepted by a succeeding constitutional assembly with-
129 out further amendment. Only if the autocrat expects that he will have to abide by the
130 constitution himself for some time, he will compromise on the stationarity property.
131 We also argue that, theoretically, a succeeding assembly will elect the prior con-
132 stitution as default bargaining outcome, irrespective of what it says. Hereby, cases
133 are possible where a preexisting constitution is accepted in the reform process even
134 when it has hardly constrained the autocrat and is significantly amended in the re-
135 form process.

136
137 ⁶See e.g. Ordeshook (1997), Easterly (2001).
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