ECON 3510: Political Economy of Development
Lecture 12: Politicians II

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Besley and Case (1995)

► Many laws directly impact government performance and actions.

► This paper: How do term limits affect politicians' incentives?

► Basic idea:
  • Politicians who can be re-elected: may need to consider the next election when making a policy.
  • Politicians who cannot be re-elected (lame ducks): have no election to worry about.

► Besley and Case (1995) study the effects of gubernatorial term limits on economic policies. Why governors?

Formalizing the Idea: A Toy Model

- Two periods: $t = 1, 2$

- A single politician (governor) chooses effort $e_t \in [0, 1]$

- Output (performance):

$$y_t = \theta + e_t + \varepsilon_t$$

  where

  - θ: competence (unknown to voters)
  - ε_t: random shock, $E[\varepsilon_t] = 0$

- Politician dislikes effort: cost $c(e_t) = \frac{1}{2} e_t^2$

- Receives office rents R when in office

Timing

1. Competence θ is determined

2. Period 1:
   - Politician chooses e_1
   - Voters observe $y_1 = \theta + e_1 + \varepsilon_1$
   - Voters re-elect the incumbent with probability $p(y_1)$, where $p(\cdot)$ is an increasing function.

3. Period 2:
   - If reelected, chooses e_2
   - Outcome y_2 realized

4. Payoffs realized

Politician's Objective and Optimal Effort

▶ **When term-limited (cannot run again):**

$$U = R - \tfrac{1}{2}e_1^2$$

Optimal effort:

$$e_1^* = 0.$$

▶ **When reelection is possible:**

$$U = (R - \tfrac{1}{2}e_1^2) + p(y_1)(R - \tfrac{1}{2}e_2^2)$$

where $p(y_1)$ is the probability of being reelected, and $y_1 = \theta + e_1 + \varepsilon_1$.

Optimal effort:

$$e_2^* = 0$$
$$\max_{e_1}(R - \tfrac{1}{2}e_1^2) + p(y_1)R \quad \Rightarrow \quad e_1^* = p'(y_1)R$$

▶ Term limits remove reelection incentives $\Rightarrow$ lower effort.

Research Design

▶ Regression model:

$$P_{st} = \zeta_s + \psi_t + \gamma T_{st} + \alpha Z_{st} + \varepsilon_{st}$$

- ζ_s: state fixed effect
- ψ_t: year fixed effect
- T_{st}: indicator that equals one if the governor of state s in year t <u>cannot</u> run again.
- Z_{st}: control variables that might be thought to affect policy choices, e.g., state income and demographic variables.

▶ γ is the coefficient of interest. What variation is used to estimate γ?
- State laws & turnovers.

▶ What may cause a bias in estimated γ?

Sample

TABLE I
GUBERNATORIAL ELECTIONS, PARTY AFFILIATION, AND TERM LIMITATIONS
1950–1986

Year	Party in office = 1 if Democrat	Incumbent cannot run = 1 if term limit binds	Incumbent Democrat cannot run	Incumbent Republican cannot run
1950	0.60	0.33	0.25	0.08
1951	0.48	0.31	0.25	0.06
1952	0.48	0.33	0.27	0.06
1953	0.38	0.33	0.21	0.13
1954	0.40	0.31	0.21	0.10
1955	0.56	0.29	0.25	0.04
1956	0.56	0.29	0.25	0.04
1957	0.60	0.38	0.27	0.10
1958	0.60	0.40	0.29	0.10
1959	0.69	0.35	0.29	0.06
1960	0.69	0.35	0.29	0.06
1961	0.69	0.33	0.33	0.00
1962	0.69	0.31	0.31	0.00
1963	0.67	0.38	0.29	0.08
1964	0.67	0.38	0.29	0.08
1965	0.65	0.31	0.25	0.06
1966	0.65	0.33	0.27	0.06
1967	0.48	0.27	0.19	0.08
1968	0.48	0.27	0.19	0.08
1969	0.40	0.27	0.19	0.08
1970	0.35	0.25	0.15	0.10
1971	0.58	0.27	0.19	0.08

TABLE II
Term Limitations by State, 1950–1986

State law:	
States with no term limits	AZ, AR, CA, CO, CT, ID[a], IL, IA, MA, MI, MN, MT, NH, NY, ND, RI, TX, UT, VT, WA, WI, WY
States limiting governors to 1 term in office	KY, MS, VA[b]
States limiting governors to 2 terms in office	DE[c], NJ, OR
State law changed from no limit to 2-term limit (year of change)	KS (1974), ME (1966), MD (1954), NB (1968), NV (1972), OH (1966), SD (1956)
State law changed from allowing 1 term to allowing 2 terms in office (year of change)	AL (1970), FL (1970), GA (1978), IN (1974), LA (1968), MO (1966)[c], NC (1978)[c], OK (1968), PA (1972), SC (1982), TN (1980), WV (1972)
State law changed from 2-term to 1-term limit (year of change)	NM (1972)

a. No term limitation after 1956.
b. Restriction on terms enacted in VA in 1954.
c. Two-term limit over a lifetime. Enacted in DE (1968), MO (1968), and NC (1978).

Term Limits and Policies

TABLE IV

THE IMPACT OF TERM LIMITS ON TAXES, SPENDING, AND MANDATES,[a] 1950–1986

(t-STATISTICS IN PARENTHESES)

	Dep var: sales taxes	Dep var: income taxes[b]	Dep var: corporate taxes	Dep var: total taxes	Dep var: state expenditure per cap	Dep var: state minimum wage[c]	Dep var: maximum weekly benefits[d]
Incumbent cannot stand for reelection	7.86 (2.58)	8.74 (2.54)	0.57 (0.67)	6.71 (1.56)	14.38 (2.10)	−0.14 (2.57)	2.25 (0.83)
State income per capita (1000s)	17.46 (4.58)	9.96 (2.52)	6.60 (5.27)	25.46 (4.87)	3.52 (0.46)	−0.04 (0.88)	8.64 (3.92)
Proportion state population elderly	980.78 (5.38)	20.68 (0.08)	8.36 (0.13)	695.14 (2.74)	−1143.34 (2.21)	−9.22 (3.69)	−1358.73 (6.65)
Proportion state population young	229.57 (2.08)	1564.84 (9.39)	221.38 (5.92)	1590.94 (9.95)	1293.53 (4.00)	0.18 (0.10)	646.86 (6.67)
State population (millions)	−0.99 (1.04)	7.68 (5.02)	2.61 (8.39)	−1.41 (0.62)	−16.70 (4.07)	−0.05 (4.39)	−7.74 (5.90)
R^2	0.8938	0.8721	0.8253	0.9170	0.9397	0.7619	0.7462
Number of observations	1728	1327	1364	1728	1728	1721	1604

Effects by Party Affiliation

TABLE V

TERM LIMITS, PARTY AFFILIATION, AND FISCAL BEHAVIOR,[a] 1950–1986

(t-STATISTICS IN PARENTHESES)

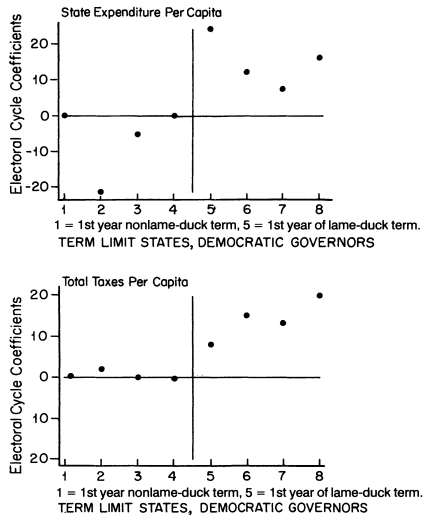|	Dep var: sales taxes	Dep var: income taxes[b]	Dep var: corporate taxes	Dep var: total taxes	Dep var: state expenditure per cap	Dep var: state minimum wage[c]	Dep var: maximum weekly benefits[d]
Democratic incumbent cannot stand for reelection	11.25 (3.55)	9.43 (2.56)	1.86 (1.95)	11.30 (2.42)	17.28 (2.17)	0.03 (0.51)	6.41 (2.02)
Republican incumbent cannot stand for reelection	−0.21 (0.04)	4.38 (0.78)	−1.61 (1.23)	−4.28 (0.68)	4.91 (0.50)	−0.46 (5.90)	−4.89 (1.28)
Governor's party (=1 if Democratic)	2.72 (1.02)	8.07 (2.61)	−2.03 (2.30)	4.18 (1.13)	13.39 (2.13)	−0.15 (3.38)	−6.70 (2.42)
Controls included: income per capita, state population, proportion elderly and young	YES	YES	YES	YES	YES	YES	YES
R^2	0.8942	0.8734	0.8261	0.9175	0.9401	0.7660	0.7474
Number of observations	1728	1327	1364	1728	1728	1721	1604

Fiscal Cycles

FIGURE I
The Impact of Term Limits on State Spending and Taxation

Term Limit Effects During Natural Disasters

- How should natural disasters change incentives of term-limited politicians?

TABLE VII
THE IMPACT OF TERM LIMITS AND NATURAL DISASTERS ON FISCAL BEHAVIOR
(t-STATISTICS IN PARENTHESES)

Dependent variables:[a]	Total state taxes			Expenditure per capita		
Explanatory variables:						
Incumbent cannot run for	13.97	18.55	—	11.85	15.99	—
reelection	(2.72)	(3.38)		(1.44)	(1.86)	
Democratic governor	—	—	27.56	—	—	17.59
cannot run			(4.61)			(1.81)
Republican governor	—	—	−0.80	—	—	4.28
cannot run			(0.11)			(0.37)
Natural disaster	12.65	—	—	17.26	—	—
	(3.20)			(2.57)		
Disaster X incumbent	—	0.52	—	—	6.29	—
cannot run		(0.08)			(0.58)	
Disaster X incumbent can	—	17.19	—	—	21.36	—
run		(3.70)			(2.72)	
Disaster X Dem incum-	—	—	−4.99	—	—	7.09
bent cannot run			(0.65)			(0.58)
Disaster X Rep incumbent	—	—	14.98	—	—	−3.74
cannot run			(1.42)			(0.19)
Disaster X Dem incum-	—	—	16.58	—	—	13.15
bent can run			(2.87)			(1.35)
Disaster X Rep incumbent	—	—	18.49	—	—	28.20
can run			(2.35)			(2.30)
Governor's party =	—	—	−3.48	—	—	9.94
Democratic			(0.86)			(1.44)
State and year indicators	yes	yes	yes	yes	yes	yes
R^2	.9218	.9221	.9229	.9426	.9426	.9429

Retirement

TABLE VIII
TERM LIMITS, RETIREMENTS, AND CONGRESSIONAL BIDS,[a] 1950–1986
(t-STATISTICS IN PARENTHESES)

	Dep var: total state taxes per cap				Dep var: state expenditure per cap			
Governor cannot stand for reelection	7.97 (1.83)	—	—	8.21 (1.87)	17.98 (2.60)	—	—	18.52 (2.68)
Governor retires and does not run for Congress	—	3.13 (0.59)	—	3.83 (0.72)	—	7.27 (0.75)	—	8.83 (0.92)
Governor retires and does run for Congress	—	—	−9.27 (1.65)	−9.20 (1.64)	—	—	−25.07 (2.50)	−24.91 (2.49)
R^2	.9102	.9101	.9102	.9104	.9374	.9372	.9374	.9377
Number of observations	1776	1776	1776	1776	1776	1776	1776	1776

a. Taxes and income are per capita in 1982 dollars.
All regressions include year and state effects. Huber standard errors were used in calculating t-statistics.

Impacts on Income

TABLE IX
THE IMPACT OF TERM LIMITS ON STATE INCOME PER CAPITA,[a] 1950–1986
DEP VAR: LOG (STATE INCOME PER CAPITA)
(t-STATISTICS IN PARENTHESES)

Democratic governor (=1)	−0.0011	−0.0011
	(0.28)	(0.35)
Dem gov who cannot run for reelection	−0.0218	−0.0115
	(4.29)	(2.91)
Rep gov who cannot run for reelection	0.0069	−0.0009
	(0.98)	(0.14)
State demographic vars?[b]	no	yes
Year effects?	yes	yes
State effects?	yes	yes
Number of obs	1776	1728
R^2	.9585	.9713

a. Huber standard errors.
b. State population, proportion population elderly, and proportion population young.

References I

Besley, Timothy and Anne Case (1995). "Does electoral accountability affect economic policy choices? Evidence from gubernatorial term limits". *The Quarterly Journal of Economics* 110.3, pp. 769–798.