Tenure in Office and Public Procurement

Decio Coviello
UNIVERSITY OF TOR VERGATA

Stefano Gagliarducci
UNIVERSITY OF TOR VERGATA, and IZA

May 30, 2011

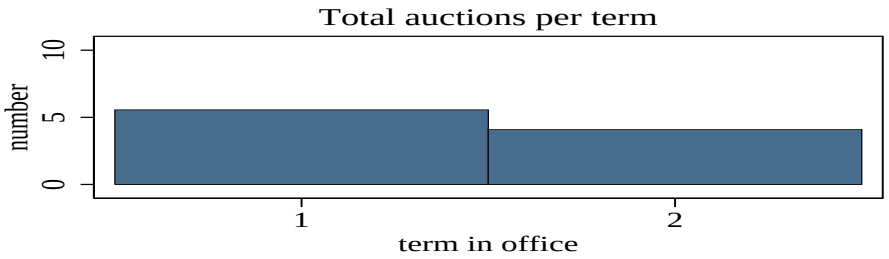
The Paper

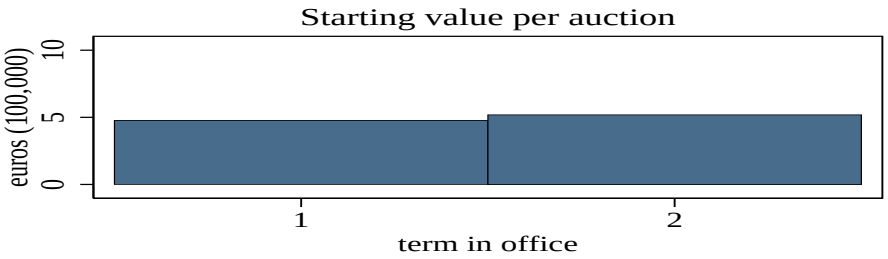
Document the effect of the politicians' tenure in office on public procurement.

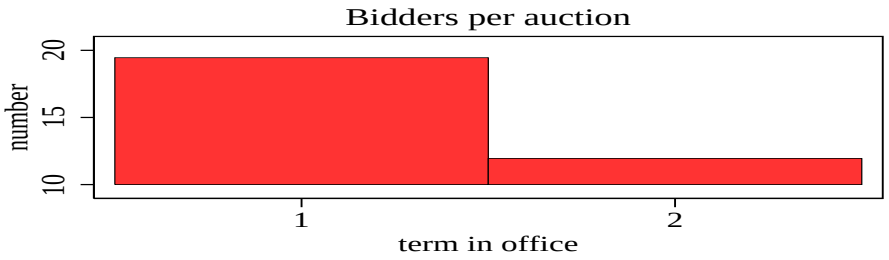
What we do:

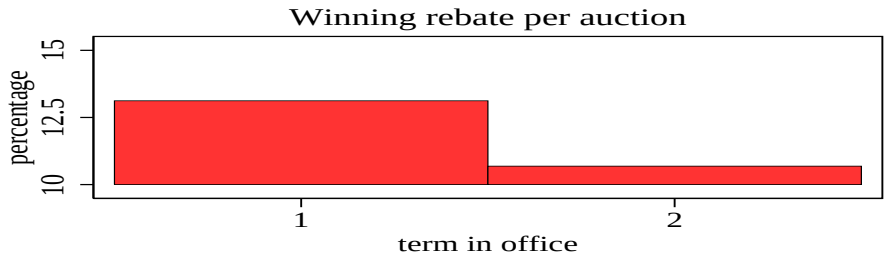
- Collect and match a data set on the politics of Italian municipal governments with a data set on municipal auctions for public works.
- For each auction, relate mayor's **tenure** (number of terms) in office to several **outcomes** of procurement:
  - Number of bidders.
  - Winning rebate/Price paid.
  - Probability that the winner is local and wins repeated auctions.
- Identification, use the variation in tenure induced by a quasi-experimental change in the **electoral law** (the introduction of two-term limit).
- Rationalize the evidence with a stylized model of favoritism in auctions where **tenure** in office progressively leads to higher **collusion** between government officials and a few favored bidders.

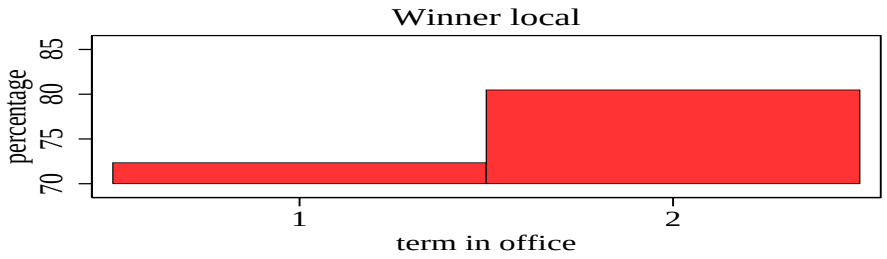
Main Findings

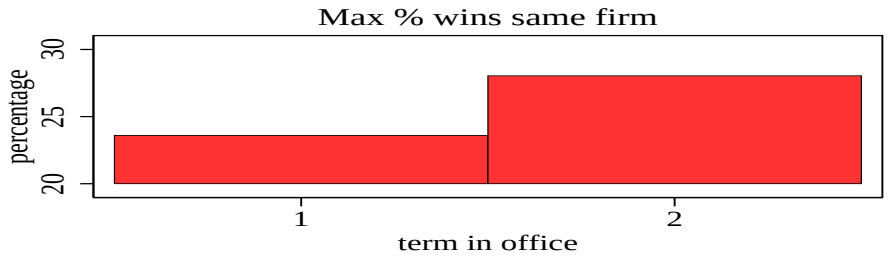












Quality? Mechanisms?

The Broader Question

Whether the **length** of an agency relationship (**political**) progressively affects its functioning.

It arises, in several contexts, as an issue of **rotation** of agents:

- Consulting firms (rotate associates), Banks (loans officers),...

In politics, the debate is whether term limits increase accountability:

- A longer tenure increases the likelihood of a protected elite.

In political **economics**, agency models highlight the importance of elections:

- A lame duck politician has lower incentives to avoid rent-seeking.

Main empirical challenges:

- Find meaningful **outcomes** of the political agency relationship.
- Disentangle the effects of tenure in office (**past**) from the finite political horizon (**future**) when there are term limits.

The Specific Setting

Public procurement auctions:

- Have precise **monetary** outcomes: Winning rebate/Price paid.
- Suggest a **mechanism** to distribute favors: $ex\text{-}post$ renegotiations.
- Are a large fraction of countries **GDPs**: OECD, 14.5%; ITA, 12.5%.

The electoral reform:

- Allows to separate tenure (**past**) from horizon effects (**future**).

Our findings suggest presence of repeated but **informal** (non-functional) interactions between government officials and contractors.

Data

We merge the following data for Italy:

- Mayoral terms between **1985-2008**, and careers at higher offices.
- Municipal procurement auctions for public works between **2000-2005**.

They contain:

- **Mayoral and term characteristics**: demographics, political affiliation and (past-future) experience, electoral results, terms duration and reasons for early terminations.
- **Auction characteristics**: number of bidders, reserve price/starting value, winning rebate (BUT NOT the distribution of the bids), identity of the winner, typology of the work, days of delay in delivery of the works.
- **City characteristics**: demographics, budget, efficiency of the judicial system.

Institutional Framework

Mayors:

- The 1993 electoral reform introduced:
  - The **two-terms limit**.
  - **Individual-ballot** elections and anticipated elections, if resignation.
  - Different length of the legislature (4 instead of 5 years but till 2000).

Auctions:

- Managers **directly appointed** by the mayor (replaced 88% of times when turnover, against 33%). They check documentations and guarantees.
- Sealed, single-attribute (**price only**) and reserve price ($\geq$ 150,000 euros).
- Two **auction formats**: *Pubblico incanto* (open to any certified firm) and *Licitazione privata* (competition between 10 invited firms).
- Assignment with a non-standard mechanism:
  - "As if" **first-price** if there are competing cartels. Conley and Decarolis (2010), theory and evidence of **local** fighting non-local bidders.

City characteristics

	Mean	St.Dev.	Min	p25	p50	p75	Max
North-West	0.40	0.49	0	0	0	1	1
North-East	0.20	0.40	0	0	0	0	1
Center	0.14	0.35	0	0	0	0	1
South	0.22	0.41	0	0	0	0	1
Islands	0.04	0.19	0	0	0	0	1
Population	11,668	63,363	504	1,807	3,845	8,412	2,733,908
N. cities: 3,825							

- Cities with less than 500 inhabitants, and with no auctions between 2000-2005, excluded
- Most of cities in the North-West

Mayor/term characteristics

	Mean	St.Dev.	Min	p25	p50	p75	Max
Female	0.08	0.28	0	0	0	0	1
Age	49.88	9.15	25.30	43.40	49.62	55.82	84.28
Born in the city	0.52	0.50	0	0	1	1	1
Born in the province	0.85	0.36	0	1	1	1	1
Born in the region	0.94	0.24	0	1	1	1	1
*P*olitical party:							
Center-right	0.11	0.31	0	0	0	0	1
Center-left	0.30	0.46	0	0	0	1	1
*P*olitical experience:							
Years in office (as mayor)	2.30	3.24	0	0	0	4.14	14.97
Term in office (as mayor) $= 1$	0.57	0.49	0	1	1	1	3
Term in office (as mayor) $= 2$	0.35	0.48	0	0	1	1	3
Term in office (as mayor) $= 3$	0.05	0.21	0	0	0	1	3
Term in office (as mayor) $= 4$	0.03	0.17	0	0	0	1	3
Term limit binding	0.39	0.49	0	0	0	1	1
Party tenure (years)	1.77	2.63	0	0	0	4.14	15.78
			N. terms: 5,209				

- 35% second term mayors (93% term limit), 4.5% third term (83.4%), 2.9% fourth term (90.7%)

Auction characteristics

	Mean	St.Dev.	Min	p25	p50	p75	Max
*O*utcome:							
Number of bidders	21.34	21.12	1	5	14	31	100
Winning rebate (in %)	12.97	8.39	0	6.90	12.42	17.10	49.99
Winner in the region	0.70	0.46	0	0	1	1	1
Max (%) wins same firm	0.24	0.25	0.02	0.08	0.16	0.33	1
*S*election mechanism:							
Direct negotiation	0.09	0.29	0	0	0	0	1
*C*haracteristics of the good:							
Starting value	5.40	9.35	1.34	2.03	2.94	5.16	190.83
Road	0.23	0.42	0	0	0	0	1
School	0.13	0.33	0	0	0	0	1
Building	0.05	0.22	0	0	0	0	1
Housing	0.01	0.11	0	0	0	0	1
Art	0.04	0.19	0	0	0	0	1
Others	0.54	0.50	0	0	1	1	1
			N. auctions: 27,537				

On average:

- 540,000 euros of starting value, 21 bidders, 13% winning rebate
- 30% of the winners come from outside the region
- 24% of the auctions within a term assigned to the same firm

Summary of the Descriptive Statistics

Auctions (27,537):

- 21.43 bidders, 13 % winning rebate ($Corr(R^{win}, N^{bid}) = 0.57$), 30 % winners from outside the region, 24 % assigned to the same firm.
- 5.41 euros reserve price, majority (91%) $public\ participation$.
- 23 % roads, 13 % schools.

Mayors/Terms (5,209):

- 40% with at term limit.
- 35% second term mayors (93% term limit), 9% $\geq$ third term (83.4%).

Cities (3,825):

- Some missing (originally 8,000): No auctions between 2000-2005.
- Municipalities with more than 500 inhabitants, mostly in the North-West (Lombardy and Piedmont).

Baseline Empirical Model:

$$C_{im} = \alpha + \beta T_{im} + \delta_0 TL_{im} + \delta_1 X_i + \delta_2 X_m + \epsilon_{im} \tag{1}$$

where:

- C_{im}: Auction's i outcome when the mayor m is in office:
  - N. of bidders, Winning rebate, Winner local, Max % wins same firm.
- T_{im}: Tenure of the mayor at the time of bids' delivery.
- TL_{im}: Indicator for term limit binding.
- X_i: Auction characteristics (starting value and squared term, year of bid delivery, object characteristics).
- X_m: Mayor, electoral, party, time from next election, city, region fixed effects, and efficiency of judiciary.

OLS Estimates:

	(1)	(2)	(3)	(4)	(5)	(6)
Mean outcome:	Panel A: N. bidders= 21.33			Panel B: Winning rebate=12.97%		
N. years in office	-1.111***	-0.434***		-0.409***	-0.148***	
	(0.133)	(0.116)		(0.063)	(0.045)	
N. terms in office			-2.153***			-0.741***
			(0.538)			(0.218)
Term limit binding	5.199***	2.354***	2.702***	0.284	0.137	0.261
	(1.386)	(0.889)	(0.927)	(0.651)	(0.378)	(0.407)
Population		0.067***	0.067***		0.057***	0.057***
		(0.025)	(0.025)		(0.014)	(0.014)
Starting value		0.685***	0.685***		0.086***	0.087***
		(0.077)	(0.077)		(0.011)	(0.011)
Party tenure (terms)		-0.373	-0.375		-0.351	-0.351
		(0.470)	(0.471)		(0.213)	(0.214)
N. auctions	27,537	27,537	27,537	27,537	27,537	27,537
R-squared	0.008	0.215	0.215	0.015	0.444	0.444
Region fixed-effects	no	yes	yes	no	yes	yes
Year dummies	no	yes	yes	no	yes	yes
City characteristics	no	yes	yes	no	yes	yes
Auction characteristics	no	yes	yes	no	yes	yes
Mayor characteristics	no	yes	yes	no	yes	yes
Electoral characteristics	no	yes	yes	no	yes	yes

OLS Estimates: (Cont'd)

	(1)	(2)	(3)	(4)	(5)	(6)
Mean outcome:	Panel A: Winner local=70.46			Panel B: Max % same firm=24.41 %		
N. years in office	1.442***	0.486**		1.967***	0.777***	
	(0.188)	(0.200)		(0.287)	(0.287)	
N. terms in office			2.652***			3.581***
			(0.960)			(1.384)
Term limit binding	-7.100***	-1.846	-2.503	-6.947***	-2.201	-2.552
	(1.457)	(1.478)	(1.555)	(2.156)	(1.665)	(1.821)
Population		0.070***	0.070***		-0.024	-0.024
		(0.025)	(0.025)		(0.037)	(0.037)
Starting Value		-0.978***	-0.979***		-0.099***	-0.100***
		(0.075)	(0.075)		(0.028)	(0.028)
Party tenure (terms)		1.124	1.118		2.128**	2.130**
		(0.855)	(0.856)		(0.830)	(0.832)
Observations	27,538	27,538	27,538	23,110	23,110	23,110
R-squared	0.003	0.080	0.080	0.026	0.299	0.299
Region fixed-effects	no	yes	yes	no	yes	yes
Year dummies	no	yes	yes	no	yes	yes
City characteristics	no	yes	yes	no	yes	yes
Auction characteristics	no	yes	yes	no	yes	yes
Mayor characteristics	no	yes	yes	no	yes	yes
Electoral characteristics	no	yes	yes	no	yes	yes

Summary of the OLS Results

One additional term in office is associated with a:

- Reduction in the number of bidders by 8.8%.
- Reduction in the winning rebate by 5.9%.
- Increase in the probability that the winner is local by 3.6%.
- Increase in the maximum percentage wins to the same firm by 14.8%.

Other results:

- Size–of the cities and the projects– matters, not parties.
- Effect of Term limit not robust.

Causal Model: The Electoral Reform

Tenure might be:

- Higher if collusion helps buying votes $(Lobby)$.
- Lower if voters punish unlawful behaviors $(Discipline)$.

$\rightarrow E(T_{im}, \epsilon_{im}) \neq 0$

We use the the exogenous variation in tenure induced by a quasi-experimental introduction of the **two term limit** on March 27, 1993.

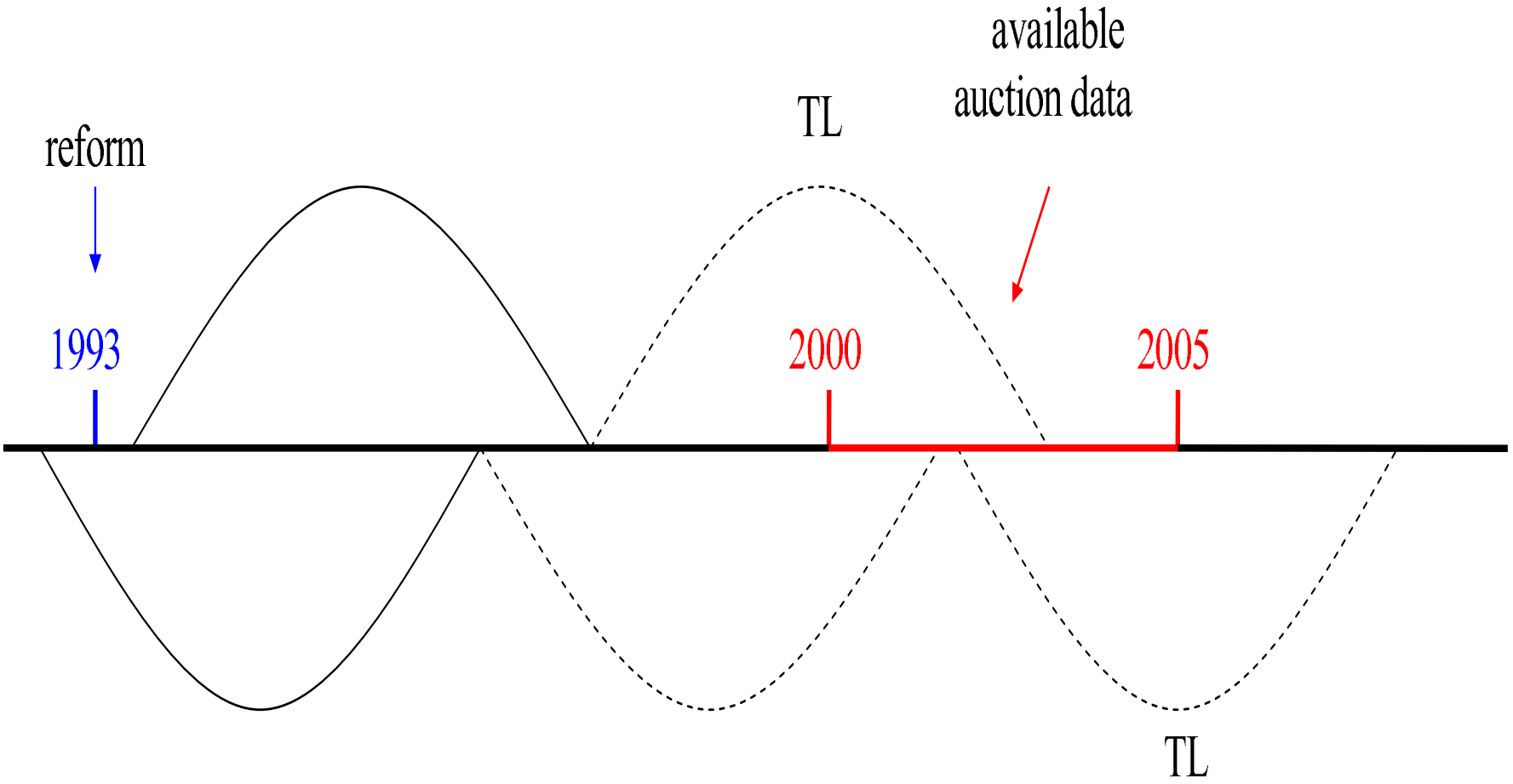
Forces of identification:

- The reform was **non-retroactive.**
- Mayoral elections are **non-synchronized.**

The date of first election determined two groups of mayors:

- elected **before** the reform (treated): Potentially **3 terms**.
- elected **after** the reform (control): Potentially **2 terms**.

The Introduction of the Term Limit



Use of the Reform:

Re-estimate equation (1) with mayors elected between March 27, 1988 and March 27, 1997 (**Naive RDD**):

$$C_{im} = \alpha + \beta_1 T_{im} + \delta_0 TL_{im} + \delta_1 X_i + \delta_2 X_m + \epsilon_{im} \tag{2}$$

and

$$T_{im} = a + bPR_m + c_0 TL_{im} + c_1 X_i + c_2 X_m + \nu_{im} \tag{3}$$

where:

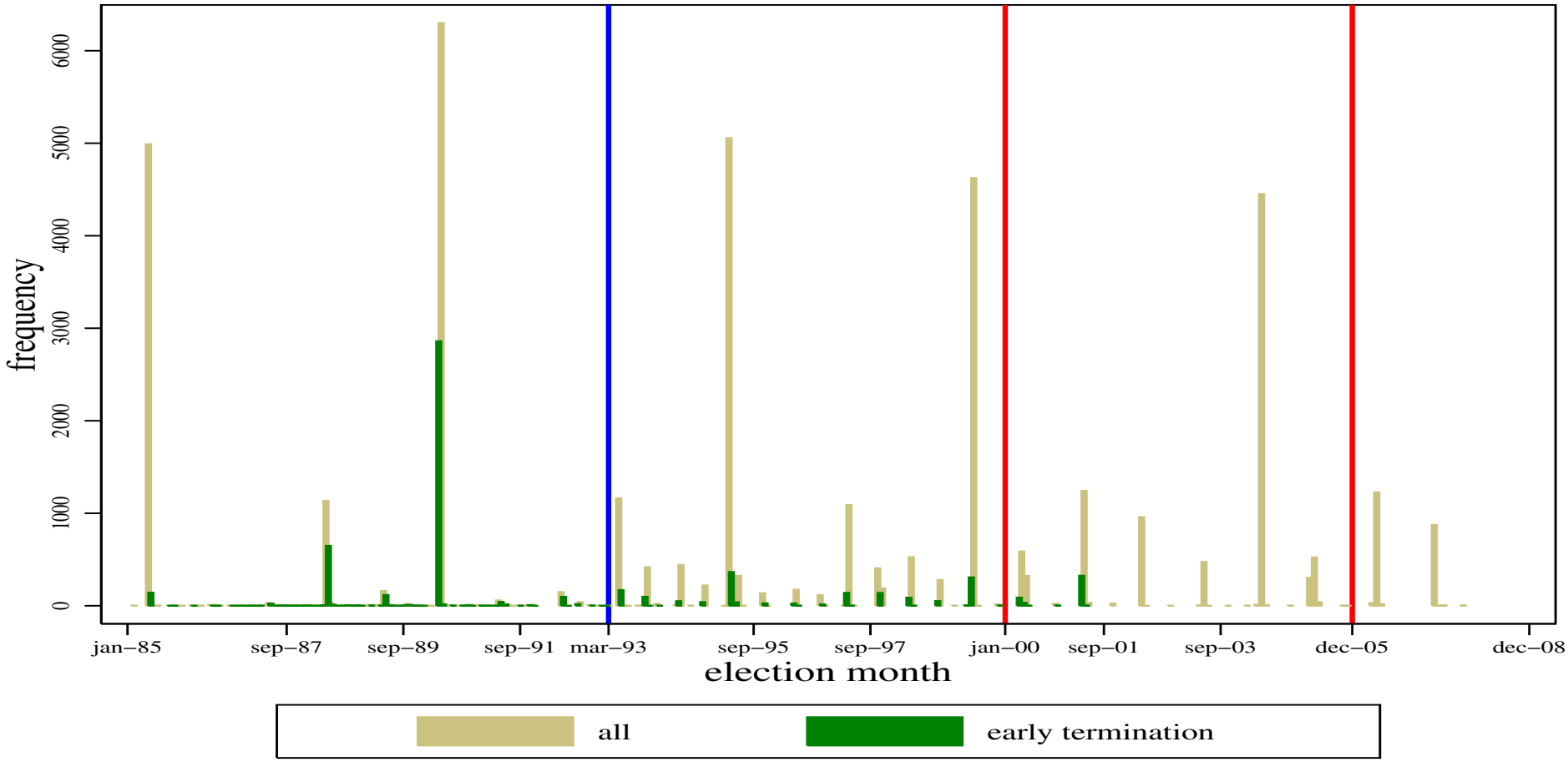
- C_{im}, TL_{im}, X_i, and X_m as before.
- PR_m a dummy for the first election before March 1993.
- If no manipulation, PR_m is an **instrument** for actual tenure.
- By-product: separate **term limit** from **tenure**.

Concerns with the Reform (I)

Mayors could **manipulate** the date of election to avoid/wait the reform:

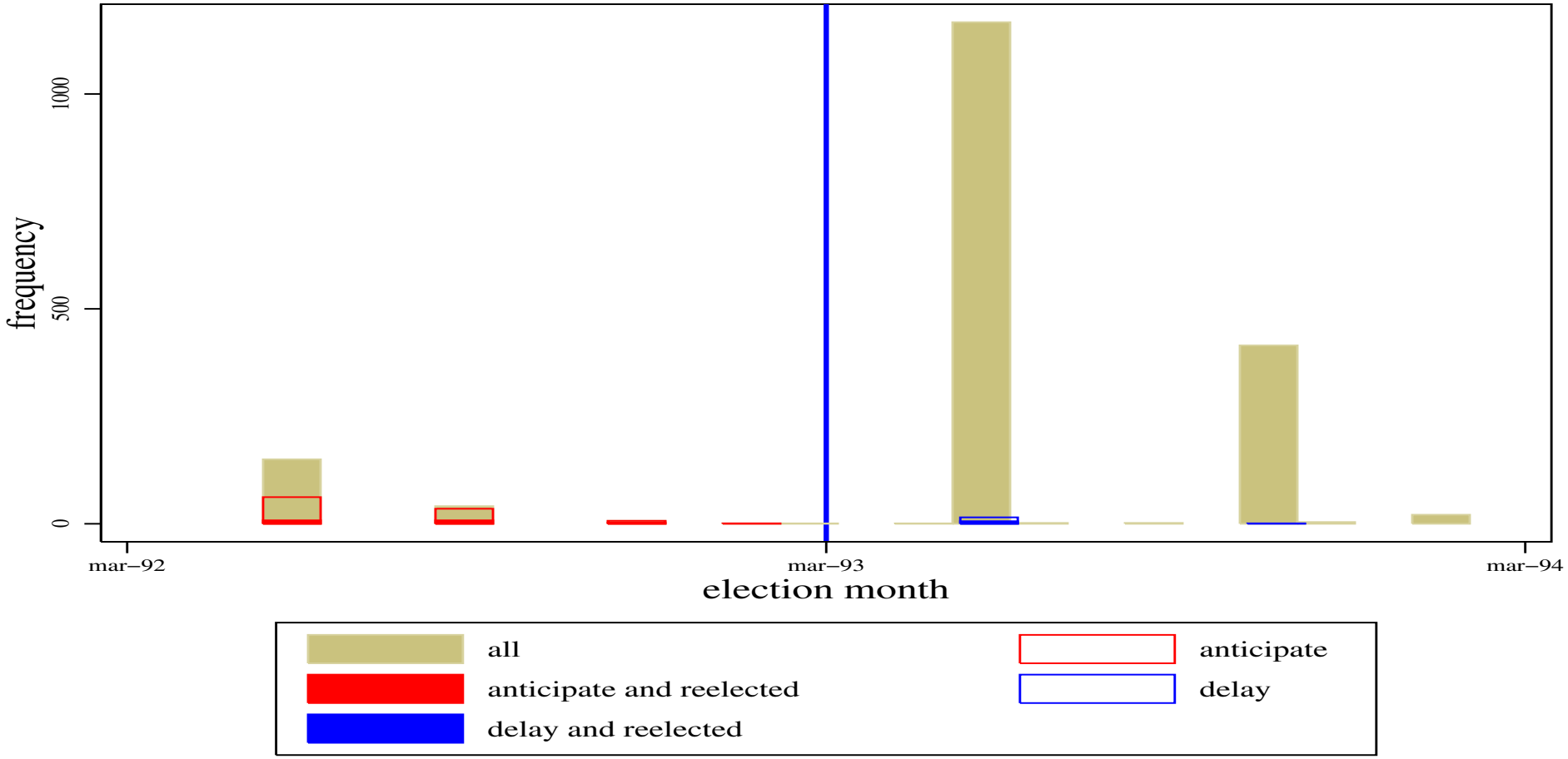
- Inspect the density of the election timing.

Election Timing and Early Terminations



Most elections follow a regular scheduling, excess early termination before March 1993 (no majority premium)

Timing and Early Terminations Around the 1993 Reform



Concerns with the Reform (II)

The introduction of the term limit was not the **unique change**:

- Individual-ballot elections might have changed mayors' composition.

We compare the characteristics of mayors around the reform:

- They should equalize if it took time parties to select "better" candidates for the new system.

If similar, we can use mayors elected in a neighborhood of March 1993 (**fuzzy-RDD**) to estimate the following second-stage equation:

$$C_{im} = \alpha + \beta_1 T_{im} + \beta_2 f(dist_m) + \delta_0 TL_{im} + \delta_1 X_i + \delta_2 X_m + \epsilon_{im} \quad (4)$$

Where $f(dist_m)$ is a function of the distance of the date of election from the reform.

Mayors' Characteristics Around the 1993 reform

	Elected before March 1993	Elected after March 1993	
	Mean	Mean	p-value diff.
	Panel A: $-24/+24$ months bandwidth		
Female	0.063	0.066	0.818
Age	44.824	44.119	0.271
Born in the region	0.953	0.941	0.425
Empl. low-skilled	0.813	0.820	0.756
Edu. college	0.496	0.550	0.106
Previous experience in politics (terms)	0.398	0.424	0.433
Probability of first reelection	0.736	0.775	0.398
Observations	91	1,164	
	Panel B: $-60/+48$ months bandwidth		
Female	0.040	0.080	0.000
Age	44.657	44.397	0.155
Born in the region	0.944	0.937	0.108
Empl. low-skilled	0.756	0.780	0.003
Edu. college	0.383	0.443	0.000
Previous experience in politics (terms)	0.253	0.527	0.000
Probability of first reelection	0.773	0.805	0.003
Observations	1,992	3,782	

- Equalization within 24 months from the reform,
- Similar figures over the estimation sample (198 mayors only).

Other Concerns (III)

Mayors elected before/after the reform may differ over three dimensions:

i. **First reelection (selection)**:

- About 80% probability of being elected for a second term.

ii. Mayors elected before the reform have a **second reelection**:

- All second term mayors without term limit were reelected.

iii. Mayors appointed before the reform had potentially **infinite horizon**:

- All mayors reelected with the same system (term limit and individual ballots).
- No differences between treated and controls on the probability (15%) of having a career at higher offices after term limit.

Fuzzy-RDD, 2SLS Estimates:

	(1)	(2)	(3)	(4)	(5)
Dependent variable:	tenure	N. bidders	N. bidders	Winning rebate	Winning rebate
Method:	OLS	OLS	2SLS	OLS	2SLS
Stage:	First		Second		Second
Mean outcome:	2.07	19.70	19.70	11.68%	11.68%
N. terms in office		-2.604***	-4.284***	-0.530	-1.444***
		(0.876)	(1.381)	(0.324)	(0.441)
Elected before March 1993	0.988***				
	(0.009)				
Term limit binding	0.832***	-0.241	1.052	-0.760	0.077
	(0.049)	(1.976)	(2.211)	(0.749)	(0.824)
Population	0.000	0.094*	0.091*	0.041***	0.041***
	(0.000)	(0.049)	(0.047)	(0.005)	(0.004)
Starting value	0.000	0.796***	0.795***	0.116***	0.116***
	(0.000)	(0.092)	(0.092)	(0.023)	(0.022)
Party tenure (terms)	0.018***	-1.089	-0.778	-0.320	-0.204
	(0.005)	(0.788)	(0.752)	(0.245)	(0.241)
Observations	8,801	8,801	8,801	8,801	8,801
R-squared	0.940	0.231	0.234	0.426	0.428
F-exc.-Inst	10,725				
Region fixed-effects	yes	yes	yes	yes	yes
Year dummies	yes	yes	yes	yes	yes
City characteristics	yes	yes	yes	yes	yes
Auction characteristics	yes	yes	yes	yes	yes
Mayor characteristics	yes	yes	yes	yes	yes
Electoral characteristics	yes	yes	yes	yes	yes

Fuzzy-RDD, 2SLS Estimates: (Cont'd)

	(1)	(2)	(3)	(4)
Dependent variable:	Winner local	Winner local	Max % same firm	Max % same firm
Method:	OLS	2SLS	OLS	2SLS
Mean outcome:	70.61	70.61	24.37	24.37
N. terms in office	2.366	1.909	1.964	6.410**
	(1.761)	(2.695)	(2.169)	(2.525)
Term limit binding	6.882	4.756	-6.446	-6.580
	(4.586)	(4.975)	(9.445)	(9.444)
Population	0.087***	0.083***	-0.851***	-0.892***
	(0.023)	(0.024)	(0.131)	(0.121)
Starting value	-0.996***	-0.998***	-0.106**	-0.101**
	(0.127)	(0.126)	(0.045)	(0.045)
Party tenure (terms)	2.297*	2.410*	2.308*	1.934
	(1.351)	(1.342)	(1.359)	(1.337)
Observations	8,801	8,801	7,616	7,616
R-squared	0.093	0.093	0.331	0.339
Region fixed-effects	yes	yes	yes	yes
Year dummies	yes	yes	yes	yes
City characteristics	yes	yes	yes	yes
Auction characteristics	yes	yes	yes	yes
Mayor characteristics	yes	yes	yes	yes
Electoral characteristics	yes	yes	yes	yes

Summary of the (2SLS) fuzzy-RDD results

One extra term in office causes a:

- Reduction in the number of bidders by 23.28%.
- Reduction in the winning rebate by 12.68%. This corresponds to extra costs of **40,000** euros per term (5 projects each worth 546,000 euros).
- Increase in the max percentage of wins to the same firm by 25.52%.
- No significant effect on the probability that the winner is local (3.2%).

Other results:

- 2SLS estimates larger than OLS (i.e., collusion reelects incumbents).
- Same results when including all mayors elected before March 1993.

Food for Thought:

- Quality and Mechanism.

Discussion: Quality and Mechanism

i. **Equivalent explanation**: Mayors learn the quality of the contractors.

- We consider a small subsample of municipal purchases of goods/services, Bandiera et al. 2009.
- Purchases of chairs and desks, pencils, papers, phone contracts,.. are:
  - **Standardized** across similar PAs.
  - Account for 8% of ITA GDP.

Finding:

- The price increases by about 16%** at each additional term.

ii. **Mechanism**: Mayors favor local contractors with $ex\text{-}post$ renegotiations:

- We consider a subsample of auctions where we observe the **delays** (78%) in public works' delivery (177 days).

Finding:

- Each additional term in office increases the days of delay by 32%**.

The Stylized Model

Two key characteristics of public procurement auctions:

- **Favors** exchanged between politicians and contractors.
- **Repeated** interactions over time.

We develop a simplified two-stage model of repeated auctions:

- **Stage 1**: Matching model of collusion (bribe).
- **Stage 2**: First-price auction with a favored bidder (bid adjustment), **Arozamena and Weinschelbaum (2009)**, Burguet and Perry (2009).

Remarks:

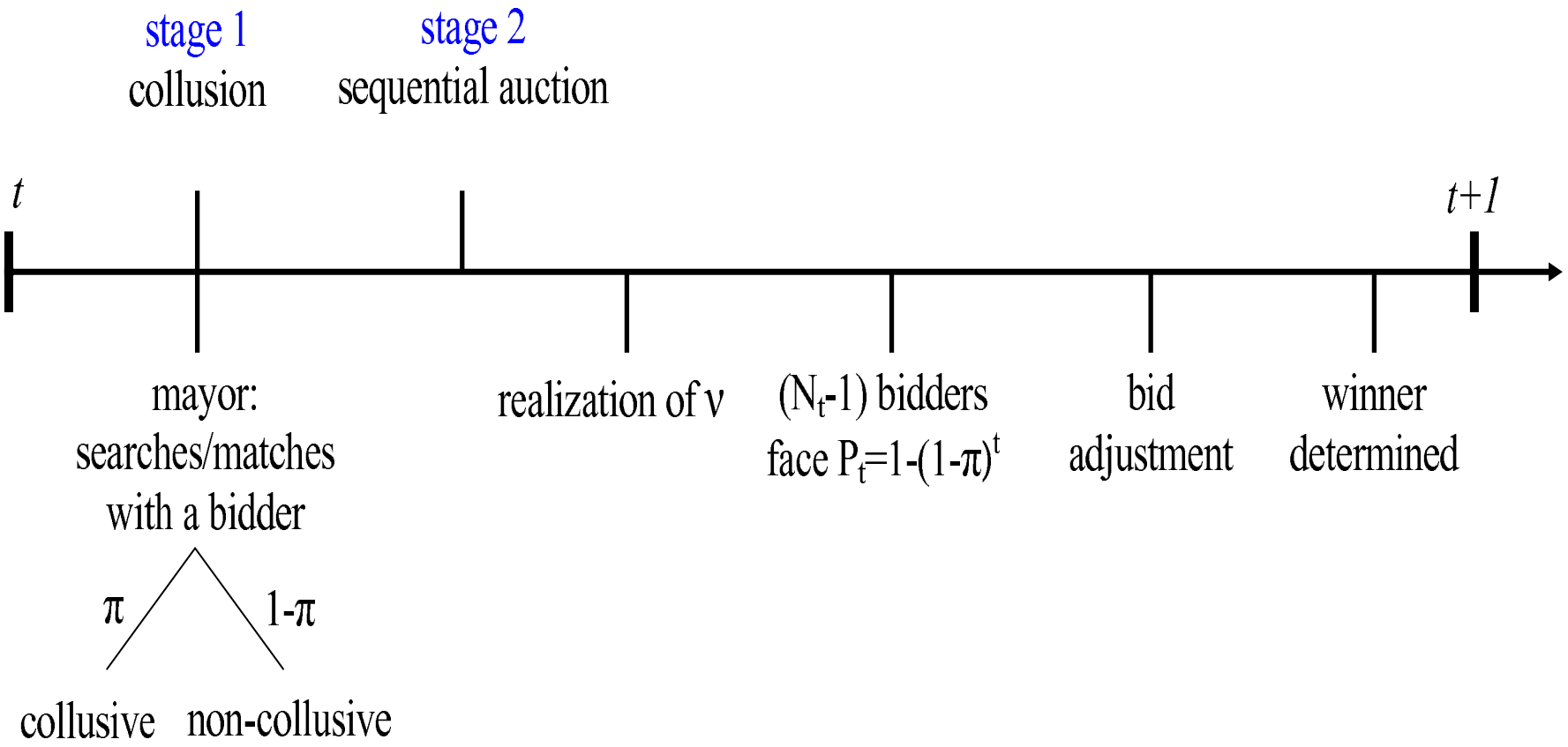
i. Tenure reduces asymmetric information by matching similar types.

ii. Tenure is exogenous (as in our id-strategy): no role for voters.

iii. 15 % of the mayors have a political career after mayoral office: 10 auctions per term, and larger 650.000 euros (game with random termination).

iv. No-collusion: There are competing cartels (local against non-local).

Time Line of the Model



Stage 1: Collusion Game

Mayor:

- At the beginning of the period t, searches-matches with one of the N_t bidders.
- Commits to reveal the highest bid in exchange (simultaneous) of a bribe.
- With probability π he is matched with a collusive bidder that is willing to pay a bribe.
- With probability $1 - \pi$ he is matched with a non-collusive bidder that is not willing to pay a bribe.
- Since $\pi B + (1 - \pi)0 > 0$, it is optimal for him to always collude.
- If he is matched with a non-collusive bidder he searches (again) in the pool of the bidders (at $t + 1$).

Matched Bidder:

- There are two types of bidders. The bribe $B > 0$ is fixed and exogenous.

- Collusive types: have low costs of bribing, C_L, can afford B, and gets every period $V_c^b - B > V_{nc}^b > 0$.
  - Collusion is strictly dominant $\longrightarrow$ The bidder reciprocates forever.

- Non-collusive types: have high costs of bribing, C_H^b, can not afford B, and gets $V_{nc}^b > (V_c^b - B) < 0$
  - Non-collusion is strictly dominant $\longrightarrow$ The bidder never reciprocates.

$V_c^b > V_{nc}^b > 0$ are the expected revenues from collusion and from a standard first price auction, respectively, and, B the bribe paid.

Stage 2: Sequential Auction

The favored bidder is allowed to adjust his bid, Arozamena and Weinschelbaum (2009).

Assumptions:

- Private-value, sealed-bid, and first-price auctions with risk-neutral players.
- N_t bidders, whose valuations ν, are i.i.d., and with c.d.f. $F(\nu)$ over $[\underline{\nu}, \overline{\nu}]$.
- $F(\nu)$ is log concave: $\alpha(\nu_i) = \dfrac{F(\nu_i)}{f(\nu_i)}$ is increasing.
- There is no collusion between bidders.
- Bids depend on their current valuation, and the public history $h(t)$.
- Every period a new set of bidders N_t:
  - Learn $h(t) = t$, the tenure of the mayor, and compute $P_t = 1-(1-\pi)^t$.
  - Rotation supported by the requirements on financial guarantees.

Auction Stage Game:

- At time/auction t, the $N_t - 1$ symmetric bidders know that, with probability P_t, there is a favored bidder in that auction.
- The favored bidder (c) is allowed to observe b^h and may opt to set $b_c = b^h + \varepsilon$, comparing v_c with b^h.
- Non-favored(s) bid accordingly, and compete against favored's valuation.
- Note: v_c can be lower than v_h.

Example: $P_{t+2} = 1 - (1 - \pi)^{t+2} < P_{t+3} = 1 - (1 - \pi)^{t+3}$.

Results: coalition's **expected revenues**, V, is strictly **increasing** in P_t (Arozamena and Weinschelbaum, 2009).

Predictions

An **exogenous** increase in tenure in office (t) is associated with:

1. *An increase in the probability of collusion* ($P_{t+1} > P_t$). (+25.52%***)

2. *A decrease in the revenues of the auction (when* $\frac{F(\nu)}{f(\nu)}$ *is strictly concave) as non-favored bidders bid less aggressively.* (-12.68%***)

3. *A decreases in the number of bidders per auction (with entry costs).* (-23.28%***)

4. *An increases in the probability that the winner is local (if local have low-cost of collusion).* (+3.2%)

5. **Policy:** *A one period term in politics delivers a constant level of collusion, and the outcomes are constant over time,* $P_1 = 1 - (1 - \pi)^1 = \pi$.

Introducing elections into the model: Intuition

For the sake of realism we want to introduce elections in the model.

Need to explain why creating an **inefficiency** (corrupt procurement) is rewarded by voters with **reelections**.

- Elections are held at the end of every period (t) after the auction takes place.
- Before the elections, the **incumbent** can promise corruption (collect and redistribute bribes). **Challenger** commits to no corruption (efficiency).
- **Voters**, vote for the party that promises the most utility.

The incumbent uses bribes to **target** 51 % of the voters, Lizzeri and Persico (2005). Equilibrium outcome is inefficient but majority is happy. The incumbent is reelected due to corruption.

Related Literature

Favoritism in Public Procurement:

- **Political Connections:** drive procurement contracts: Hyytinen et al. (2007), Goldman et al. (2008).
- **Favoritism/Corruption:** **Arozamena and Weinschelbaum (2009)**, Burguet and Perry (2009), Ingraham (2005), Tran (2010).

Political Accountability:

- **Horizon:** Besley and Case (1995); Campante et al. (2008); Ferraz and Finan (2010); Gamboa-Cavazos et al. (2008).
- **Tenure:** **Besley and Prat (2004)**; Padró i Miquel and Snyder (2006); Dal Bó and Rossi (2011).

Conclusions

We find that when politicians stay in power longer:

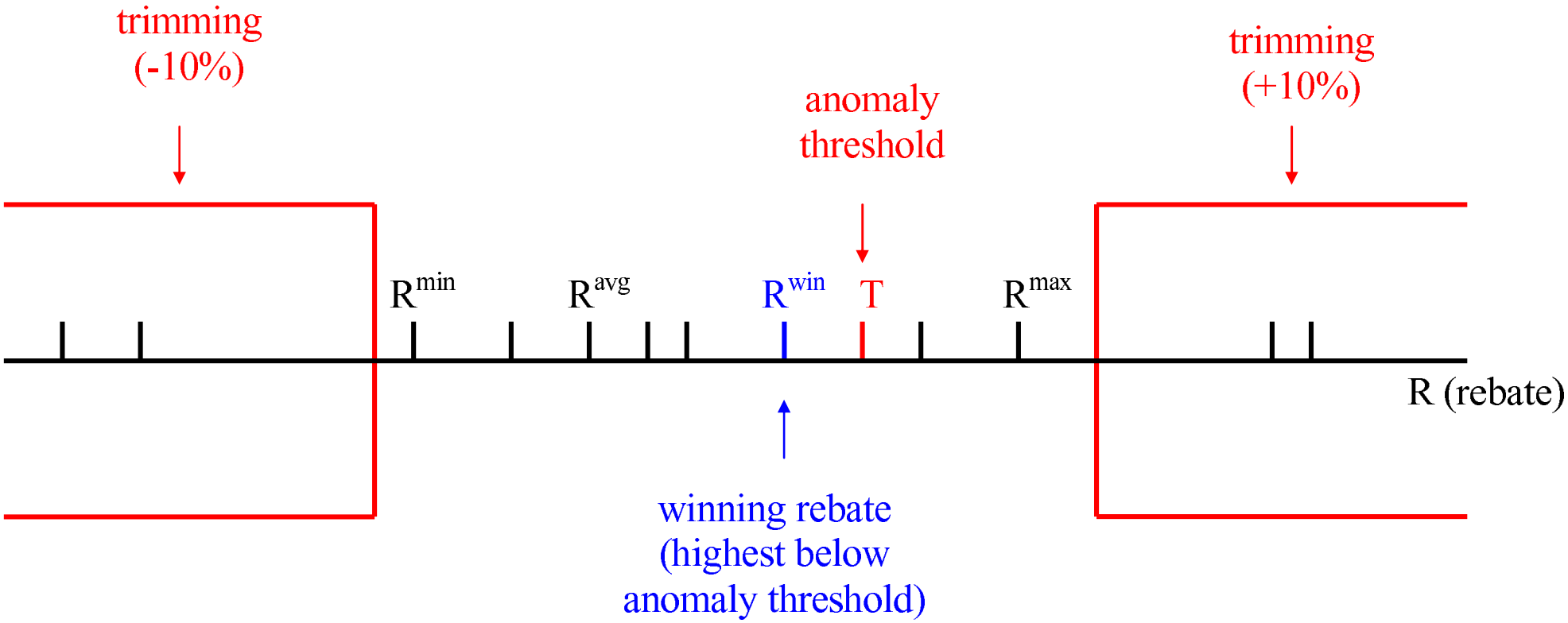
- The functioning of procurement auctions **deteriorates**.
- Public **spending increases**.

Evidence:

- Compatible with a model where tenure in office progressively leads to **collusion** between government officials and few local bidders (elites).
- Preliminary invalidates the "learning" (quality) explanation and highlights a strategic role of $ex\text{-}post$ **renegotiations**.
- Remarks the benefits of **political turnover**.

Extra Material

The Awarding Mechanism



- Decarolis (2010) and Conley and Decarolis (2010).

Characteristics around the 1993 reform