Clientelism in politics and administration

Conflicts of interest and preferential allocations of resources in the Republic of Moldova

Expert Grup

October 2012

Political clientelism: using public resources as “carrots”?!

1. Research problem and analytical framework

Clientelism occurs when political parties use public resources, and particularly government programs and offices, as a means of rewarding political supporters and extract rents for themselves and their entourage. Politicians provide not programmatic public policies, but individual benefits, like resource allocations for their supporters and other favors that use public resources. The existence of such relationships is harmful for the development of any society; the deviation of public investments from their most welfare-enhancing usages is economically damaging. Moreover, private investments directed at capturing political rents create additional social welfare losses because of the divergence effect from more productive activities (from a social point of view).

In this context, the questions we ask are the following: Does clientelist politics exist in the Republic of Moldova? If so, how widespread is it and how does it affect political decisions? And finally, what are the conditions that facilitate or restrain the emergence and persistence in time of this type of behavior?

In order to investigate the existence and extent of clientelist politics that has economic ramifications, we need to emphasize the features of political behavior favoring some groups at the expense of the public interest. Political and economic institutions are, in effect, strongly interconnected and major changes in the set of political incentives can have widespread effects on economic opportunities, and vice versa. We now have many societies in which only a small fraction of the population are given the opportunity to get into the (economic) action. The Republic of Moldova, as many other countries with weak institutional infrastructure, is one of those countries where many economic opportunities are reserved for specific groups. Because economic incentives and opportunities do not exist in a vacuum, but are shaped by the political, social and legal constraints, the study of political decision making is of paramount importance in elucidating the causes that undermine economic and social progress.

Political decisions that favor some groups, thereby undermining total social welfare, give rise to extractive institutions. These extractive institutions can take the form of **weak constraints on authorities in charge of allocating public resources – such as resource allocations for capital investments to local governments**. Such arrangements are likely to be used as "carrots" by the established political elite to influence political preferences at local level governments and can furthermore serve as devices that political incumbents can use in order to commit to their promises of rent dissipation in exchange of specific groups' support.

A deeper comprehension of the issue of political commitment can thus help in understanding why high shares of public resources may be allocated to satisfying some individuals' *private* interests rather than to the maximization of the *social* welfare. Politicians, in weak democracies, face a commitment problem because they would like to offer specific policies to interest groups (private firms, local – political – organizations, local authorities, etc.) in exchange of their political support. Since law cannot be used to enforce this type of exchanges, some mechanisms that could enforce politicians' promises ex post are necessary. Rent creation, market power, privileges, and differences between economic agents are those mechanisms that offer incentives to local political organizations and private agents to support a given political elite. For a politician to ensure the support of those that can secure him additional votes, he must be able to use policies that tie their continuation utility to his political success. **Favoritism in intergovernmental allocation mechanisms satisfies these conditions**.

This theory suggests that economic and political systems are organically related and that political competition also entails systematic economic competition and long term economic development, whereas systems that limit access to politics exhibit clientelist economic interactions. This hypotheses has been empirically tested and confirmed within different contexts/countries (Hanes, 2007 found that under Socialist government in Sweden municipalities with a high share of Socialist voters were more likely to apply for grants and to receive them[1]). Our purpose here is to emphasize the limited access political and economic order in the Republic of Moldova. And also, to test this hypothesis, offering an objective measure of clientelism – what has never been done before. The analytical framework set above will help in better indentify the areas susceptible to clientelism and it offers valuable insights into how we can switch to a superior social equilibrium.

First, we will assess the allocation procedures of public resources from the Government to each of the first level local governments. The existence of clear and stable rules with regard to the transfer amounts from the state budget designated to resource allocations of capital investments to local governments would moreover temperate the members of Parliament when they examine the proposal issued by the Ministry of Finance together with the Government within the framework of the annual budget law. **It is worth noting here that there is no such regulation in the Republic of Moldova**. This institutional weakness, as it shall become clear in the next sections, significantly contributes to the existing bias in the allocation of scarce public resources to local authorities. This hypothesis is corroborated by our results obtained from the econometric test. The case of independent candidates also presents interesting insights. Public resources are, in effect, used as "carrots" to ensure independent candidates' loyalty toward the political majority.

[1] See also, Veiga, L.G. and M.M. Pinho (2007), The political economy of intergovernmental grants: Evidence from a maturing democracy, *Public Choice*, V.133.

Understanding the sources and manifestations of intergovernmental and economic clientelism is critically important to our understanding of the transition from limited access political and economic order to open political and economic competition (as we noted earlier, both are organically related). No wonder, then, that the approach and subjects we propose to investigate are important for both, policy makers and the international donor community together with our European partners.

2. Bias in resource allocations from central to local governments: the case of capital investments

Capital investments represent the resources invested in the acquisition or building of new assets; or major repair in and replacement of existing assets that have an economic life longer than one year and a value above a specified threshold[2]. In the Republic of Moldova, capital investments have also the highest share in total capital expenditures. In the 2012 state budget Law published in the Official Monitor on January 25th, 2012, the amount allocated to capital investments for local governments represented MDL 30 million – that is almost 30% from total local authorities' expenditures for the same period – remaining approximately at the 2011 level. The amounts allocated for the purpose of capital investments at the first level of local governments vary, however, in time, quite significantly. For instance, the annual budget law for 2010 allocated slightly more than MDL 70 million to local governments for capital investments; in 2009, the resources allocated to local capital investments were even greater, amounting to MDL 190 million with an execution rate of 97.7%. All the relevant information regarding the projects that have been approved to receive the demanded resources, the list of local governments that are the beneficiaries from the respective projects and the amounts allocated per project are presented in the annexes to each annual state budget Law[3].

Although financial management rules vary greatly from country to country, there are few core principles outlined in World Bank's guidebook to capital investments for local governments:

- The allocation of public resources to capital investments must fulfill the principle of public interest. That is, a local government takes care of assets only if they are needed to provide local public goods to constituencies or to perform other mandatory obligations of the local authorities;
- Since the (public) resources are scarce, their allocation need to be rigorously evaluated in lights of the competing needs of various local authorities, so that to maximize the value of the financial resources in the areas of highest priority;

[2] This is the definition used in the World Bank's reports. See World Bank's Guidebook on Capital Investment Planning for Local Governments, http://siteresources.worldbank.org/INTURBANDEVELOPMENT/Resources/336387-1319755058239/Chapter1.pdf
[3] See Ministry of Finance's website, http://www.minfin.md/ro/actnorm/budget/law/lowbudget1/

- Local financial policies need to be formulated and capital investment priorities clearly set;
- Alternatives should be carefully assessed and considered within the framework of life cycle costing;
- The process and results need to be transparent to the decision makers and the public.

Following these core principles of governance for the allocation of capital investments, the goal is to impact (eventually in a positive way) people's lives. The key implications are:

- On the overall quality of life through the provision of the most essential public goods and related services. Given that public resources are scarce, it is important to make the right choices among competing investments;
- On the economic progress of given localities. Locating capital investments wisely can affect the attractiveness of some regions for private sector investments.

In this context, it is important to examine whether capital investment allocations follow the aforementioned principles that favor public interest or if, alternatively, there are some mechanisms that deviate resources to the satisfaction of some other interests – namely politicians'. To do so we, first, need to diagnose the existing (in)efficient arrangements.

2.1 The existing institutional framework

The Directorate for National Economy's Finances and Capital Investments (hereafter, the Directorate) is the administrative structure within the Ministry of Finance that is responsible for the realization of investment policies in Moldova. The Directorate determines the (social) necessity and economic efficiency of budgetary allocations for investment purposes and examines the materials presented by the eventual beneficiary party (or parties) regarding the net social value of the project and the way resources allocated to the project's implementation will be used. It is also responsible for monitoring the way projects are implemented.

There are two main factors restraining the behavior of local public officials who apply for capital investment allocations:

- On the one hand, the Ministry of Finance has elaborated a methodological note that contains a specific procedure to be respected when applying for budgetary resources. In writing down the project that is to benefit from public capital investments, the potential beneficiary must strictly obey by the rules of procedure stated in the Ministry of Finance's methodological note. Here we should note that the procedure elaborated by the Ministry of Finance does not specify clear criteria for the assessment of alternative projects. Moreover, it does not make explicit the difference between goods and services the provision of which is required by law and public supply that is actually at local government's discretion – the latter is more specifically dependent on constituents' preferences and welfare. These loopholes are likely to undermine the efficiency and fairness in the provision of local public goods.

- On the other hand, there is a set of legal provisions that apply when planning and managing the execution of public capital investments by local governments, such as: the Law on construction quality (72-XIII from February, 2, 1996); the Law on budgetary process (847-XIII from May, 24, 1996); and the Law on public procurement (96-XVI from April, 13, 2007). Respect for the legal procedures mentioned above is binding upon all public actors financed partially or entirely from budgetary resources. However, it is worth noting that Moldova's national Court of Accounts has issued few reports pointing out to the existing (numerous) deviations from the *de jure* constraints, and in particular the chaotic organization of the allocation and monitoring processes[4].

There is therefore no unitary legal framework that would offer clear rules of procedures for the application to and execution of resources designated to capital investments by the local governments. More important, this legal loophole generates uncertainty and perverse motivations for those in charge of deciding about who is going to get the scarce public resources and which projects are not eligible for receiving budgetary support. The Ministry of Finance together with the Directorate for National Economy's Finances and Capital Investments have the discretionary power to accept or refuse a proposal, to augment or reduce the amount demanded for the realization of the respective project. For instance, at the stage of deciding which projects will be included on the list that will eventually be annexed to the annual state budget law, the Ministry of Finance and the Directorate collaborators follow a code that is not legally binding and which consists in ensuring a certain equilibrium between the ongoing long term projects and the incoming ones to be financed. It is not a formal rule, but since there are no clear constraints on decision makers' choices, it is up to them to define this trade-off. It is worth noting that in 2012 the costs of all projects eligible for public capital investments represented MDL 0.5 billion whereas the available funds were approximately MDL 117 million. Because resources are highly scarce, in 2011 only a very limited number of new projects are accepted for financing from budgetary resources.

Moreover, when the list of projects to be financed is further transmitted to the Government and then to the Parliament, the lack of clear legal basis regulating approval of capital investment projects creates greater incentives for the members of Parliament to deviate from that list by adding new beneficiaries and remove some others. The latter can, in effect, uphold the list of projects and the amounts stipulated on the Ministry of Finance and Government's proposal or they can considerably modify the list of beneficiaries as well as the amounts

---

[4] http://www.ccrm.md/libview.php?l=ro&idc=2&id=4755&t=/Presa/Noutati/Utilizarea-mijloacelor-publice-pentru-investitii-si-reparatii-capitale-la-Ministerul-Finantelor

allocated per project. There is indeed a non negligible difference between the draft law with the annexes containing resources for capital investments elaborated by the Ministry of Finance and the final list of projects approved by the Parliament when examining the budget for the next year. Negotiations take place, indeed, between the members of Parliament that result in new projects being included on the list of those that are going to be financed and the suppression of some other projects that are considered of minor importance or rather investment projects that are not so visible for their respective electorates. The members of Parliament can thus make amendments to the draft elaborated by the Ministry of Finance and propose these changes to the Legislative Commission for the Economy, Budget and Finances. The latter can approve or alternatively disapprove the proposed amendments. Obviously, the Commission is more likely to uphold projects proposed by members of the ruling elite.

There is no objective criterion that members of the Parliament follow in deciding whether a project from a local public authority is going to obtain the demanded funds or not. The lack of such criteria at this stage but also when the draft law is prepared by the Ministry of Finance clearly violates the aforementioned principles of good governance layed down in World Bank's guidebook to capital investment for local governments. However, we should mention that our representatives cannot greatly change the total amount allocated for the purpose of public capital investments without pointing to credible sources of financing the additional expenses.

In the next section we empirically investigate and prove the existence of politically motivated resource allocations to local governments – namely that local governments' political affiliation significantly affects the share of resources for capital investments that one will obtain, as opposed to the public interest theory. Our findings, thus, do not support the romantic vision of public decision-making which says that political decisions are taken solely in the public's interest. The results presented below put the emphasis on the necessity for credible and hence functioning constraints on public decision makers in order to reduce their discretionary power over public resources.

2.1 Empirical evidence of politically motivated resource allocations to local governments

We empirically test the hypothesis about the existence of political bias affecting the resource allocation for capital investments to local governments (via transfers from the state budget). We use a database with the transfer amounts from the state budget designed for capital investments for each first level local government, as well as the political affiliation of each mayor. Hence, the political bias hypothesis will be confirmed if the localities governed by mayors affiliated to a ruling political party or coalition benefit, on average, of more transfers as opposed to the other parties. The analyzed period is 2009-2012 which allows testing for political bias before and after the political shift from the mid-2009. Additionally, we compare the estimates for the transfers proposed by the Government with the finally approved ones by the Parliament. Hence, in case the political bias hypothesis is confirmed, we may check whether it is determined mainly by the executive of legislative powers.

In order to test whether the allocations for capital investments are statistically influenced by the political affiliation of mayors, we will use an ANOVA econometric model. We control for the dimension of each locality, since it can also explain the amount of transfers allocated from the state budget. Hence, in order to avoid the endogeneity bias, our dependent variable will be the ratio between the transfers for capital investments and own revenues accumulated by each local government. The explanatory variables will be binary dummies which describe the political affiliation of each mayor. Thus, for each year from 2009 to 2012 we will perform two regressions (the first one with the transfers approved by the Government and the second one is with the final amounts voted by the Parliament), each containing 5 binary variables. In order to avoid the dummy variable trap, we excluded the constant. The model specification is as follows:

$$Y_i = a_1 D1_i + a_2 D2_i + a_3 D3_i + a_4 D4_i + a_5 D5_i + e_i,$$

Where:

Y_i = the ratio between the amount of transfers for capital investment and own revenues of each locality *i*

$D1_i$ = 1 if the mayor of *i*th locality is a member of PCRM; $D1_i$ = 0 if otherwise.

$D2_i$ = 1 if the mayor of *i*th locality is a member of AMN; $D2_i$ = 0 if otherwise. For the year 2012: $D2_i$ = 1 if the mayor of *i*th locality is a member of PLDM; $D2_i$= 0 if otherwise.

$D3_i$ = 1 if the mayor of *i*th locality is a member of PD; $D3_i$ = 0 if otherwise.

$D4_i$ = 1 if the mayor of *i*th locality is a member of PL; $D4_i$ = 0 if otherwise.

$D5_i$ = 1 if the mayor of *i*th locality is a member of other parties or is a politically non-affiliated candidate; $D5_i$ = 0 if otherwise.

The political bias hypothesis affecting the allocation of resources for capital investments in local governments will be confirmed if some of the estimated parameters of ANOVA regression ($a_1 - a_5$) will have a positive sign and be statistically different from zero.

The estimation results (see Table 1) confirm the fact that the political affiliation of mayors is relevant for explaining the decision of the Government and the Parliament regarding the allocation of resources to local governments. For example, in 2009, when PCRM has been the ruling party, the estimated coefficient of the dummy variable D1 is statistically significant and has the highest value. It means that the ratio between transfers allocated to the localities with a mayor affiliated to this party and locality's own revenues were, on average, higher by MDL

0.8312 million in comparison with other parties. The political bias characterized the allocation pattern for the 2010, 2011 and 2012 years as well, while the beneficiaries were the localities led by mayors affiliated to the parties forming the current ruling coalition: PD, AMN (till 2012) and PLDM (since 2012), PL being an exception. For example, according to the state budget law for 2012, the localities with mayors affiliated to PLDM and PD have, on average, by MDL 1.49 million and, respectively, by MDL 1.3 million more transfers for capital investments than other parties.

Additionally, it is worth point out the fact that the political bias is much stronger for the transfers initially approved by the Government: the coefficients standing for each binary variable are much higher in comparison to the regressions with the transfers approved by the Parliament. It means that political affiliation has a higher importance in the decision making of the executive branch which could be the result of lobby and negotiations between the mayors and the Government.

Table 1. Estimation results of ANOVA econometric model

	2009	2010		2011		2012	
	Parliament	Government	Parliament	Government	Parliament	Government	Parliament
PCRM	**0.8312* (0.4540)**	**0.5514*** (0.1627)**	**0.2306*** (0.0800)**	**0.3315*** (0.1268)**	**0.0777* (0.0431)**	0.2709 (0.1841)	0.2922 (0.3355)
AMN	**1.0726* (0.6472)**	**0.6024** (0.2334)**	**0.2367** (0.1147)**	**0.6298*** (0.1818)**	**0.2623*** (0.0619)**	-	-
PD	0.0497 (0.9631)	0.0674 (0.3525)	**0.3355* (0.1732)**	0.0954 (0.2746)	**0.1359 (0.0935)**	**0.4799*** (0.1767)**	**1.2953*** (0.3215)**
PL	0.4776 (1.4711)	0.0867 (0.8239)	0.1563 (0.4049)	0.00 (0.6418)	0.0534 (0.2185)	0.2774 (0.2665)	0.1254 (0.1542)
Other	**0.2626*** (0.4773)**	**0.6096*** (0.1673)**	**0.2373*** (0.0822)**	**0.0085*** (0.1303)**	**0.0077** (0.0443)**	**0.4846* (0.2785)**	**0.3824* (0.2051)**
PLDM	-	-	-	-	-	**0.3366** (0.1538)**	**1.4893*** (0.2814)**

Source: Author's calculations

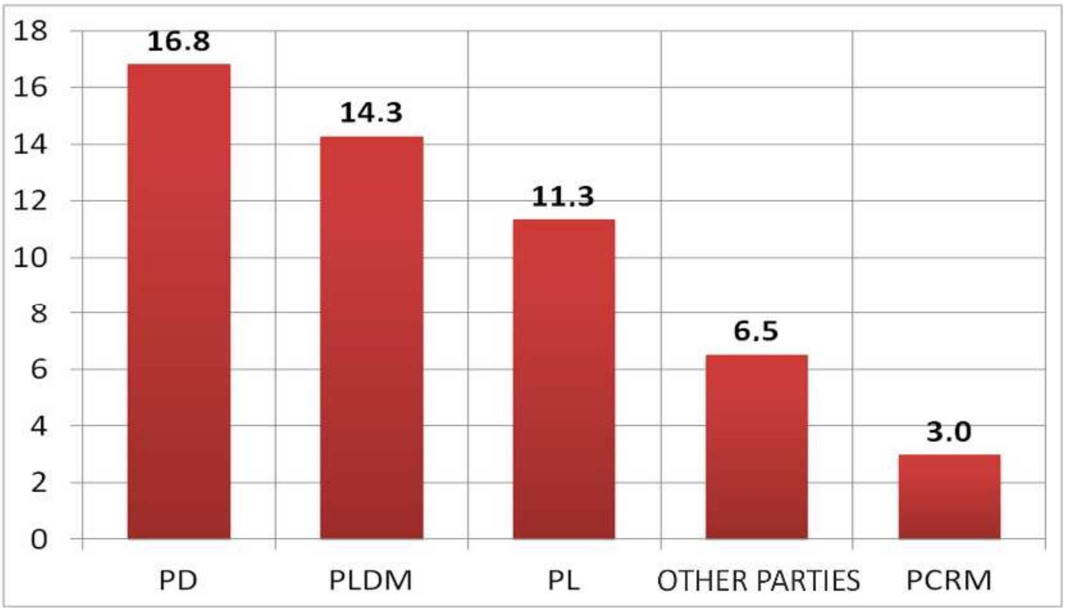
3. Public resources for capital investments used as "carrots"

3.1 Is the Executive picking up the winners?

The interesting and probably counterintuitive result that we obtained from our estimations is that there is a greater influence from the Government on the allocation decisions than the alterations that take place within the Parliamentary negotiations. Executive's interference in the allocation and execution of resources designated to local governments' capital investments is greatly facilitated by the lack of any regulatory framework that would set general rules of procedure and thereby restrain decision makers' discretionary power. In effect, despite numerous initiatives for building a stable, clear (containing general rules) and credible (enforceable) framework governing the choice and execution of capital investments for local governments – for most of them advocated by Moldova's international partners – there is no real progress to report on this key issue. Only in 2012 a team of national and international experts has sought to elaborate such a regulatory framework. However, there is no official information regarding the term when it will be approved by the Government, voted by the members of Parliament as an organic law and de facto implemented.

As our results clearly indicate, the Executive strongly favors local governments that have political connections/belong to the ruling parties' political family (AEI – the alliance for European integration). First, one can clearly see that local governments affiliated to the ruling majority (i.e. to the AEI) are way more likely to obtain budgetary resources for capital investment. Figure 1 presents the likelihood a local mayor has to obtain budgetary resources for capital investments given his political connections: 42.2% of the mayors politically affiliated with the current elite were granted allocations by the Ministry of Finance and the Government within the framework of the draft annual budget law, while only 3% of the mayors from the communist party have been included on the list of beneficiaries.

Figure 1. The probability[5] of capital investment allocations to first level local governments, depending on their political affiliation, 2012, %



Source: Author's calculations from data provided by the Ministry of Finance

Although we see in the Figure 1 a strong effect of the political affiliation on allocation outcomes, the clientelist hypothesis is only partially confirmed. In effect, localities with AEI

---

[5] $P_i = \frac{number\ of\ localities\ whcih\ received\ transfers_i}{total\ number\ of\ localities}, i = 1 \ldots n, n - number\ of\ political\ parties.$

affiliated mayors may coincidentally have investment needs that would render the highest social value or some other factors might have influenced the allocations. This is why we used the ANOVA model and have obtained the results depicted above. These results confirm the existence of a significant effect from mayors' political affiliation on the likelihood of them receiving budgetary resources for capital investment even when controlling for such criteria as the amounts allocated and the size of local governments.

3.2 The (not so) puzzling case of independent candidates

We also observe that independent candidates are clearly in a better position than, as for instance in 2012, the main party from the opposition – the Communist Party. In effect, independent mayors were twice as likely as were the communists to obtain budgetary resources for capital investments at the first level local governments. This effect holds even when controlling for local governments' internal revenues that serve as a good proxy for each locality's size and when taking into account the relative importance of the amounts received. There is a rational explanation for this phenomenon. Besides offering benefits to their party-fellows, the ruling elite is also strongly interested in influencing regions where neither they nor their main opponent has succeeded. Regions where the electorate is highly likely to switch to the opposition or alternatively to the incumbents, need to be offered "carrots" so that to alter electorate's and independent candidates' preferences by directing them toward the ruling class in the next election cycle. One would rationally expect candidates publicly affiliated to the ruling elite to receive the highest share of resources from the central government (even when controlling for their number, the amounts received and the economic importance of their respective localities). But one would also expect independent candidates to receive more than the opposition. Independent candidates are thus only formally independent. That is, after elections, they depend upon and support the ruling party or coalition of parties. This hypothesis is thus corroborated by our empirical findings.

4. Concluding remarks

Political clientelism undermines the economic development of the Republic of Moldova by deviating public resources from their most efficient usages. It is, therefore, of outmost importance to understand how and why clientelist arrangements emerge and persist over time. It is only through a diagnosis of the conditions under which politicians engage in the dissipation of public resources for satisfying private interests that one can devise credible and efficient constraints that restrain politicians' discretionary power. Weak institutional constraints generate corrupting behavior and lack of accountability that is the main source of socially harmful political choices. The lack of an unitary legal framework that would offer clear rules of procedures for the application to and execution of resources designated to capital investments by the local governments facilitates decisions that do not always are taken in the public interest. As our empirical examination demonstrates, the political bias is very stronger for the transfers initially approved by the Government. The Executive is, in effect, picking up the projects that affect people's lives not on the basis of their social value. Instead the winners are determined in accordance with their political affiliation.

The political affiliation also matters when the state budget Law is examined within the Parliament. The members of Parliament do not always transpose into law people's preferences. They usually propose amendments so that localities that are politically-friendly to the incumbents, get more of public resources and the opposition less. In between, there are the so called independent candidates that get less than mayors that belong to the ruling party or parties, but still more than the opposition. This observation suggests independent candidates' only partial independence. They exchange their support for the incumbents for a higher share of public resources allocated to their respective localities. All in all, these results suggest us a less romantic account of public decision making and that self-interest also applies to political actors.