

Party Fragmentation and Latin American

Budgetary Outcomes Revisited*

Abstract

The literature on budgetary politics has traditionally emphasized the importance of party fragmentation on explaining deficits and run-away spending. We argue, however, that this focus is grounded more in theoretical reasoning than in actual empirical evidence. Given that budgets are driven by powerful presidents in Latin America, we review and test the effect of party fragmentation on budgetary outcomes using panel data gathered from 1970 to 2004 of 17 Latin American electoral states. The results lead us to believe that prior emphasis on congressional variables mislead the approach to understanding fiscal outcomes and call for further research around executive behavior and decision and its effect on taxation and spending.

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The Latin America debt crisis of the 1980s provoked concerns regarding how to ensure economic progress in the region. The development strategies of the 1960s and 1970s emphasizing heavy government involvement were no longer seen as the solution to underdevelopment. Instead, these strategies became the culprit for massive government debts, high rates of inflation, and distorted economic incentives (Dornbusch & Edwards, 1991; Gilpin, 2001). During the 1990s, the case for fiscal restraint became stronger as Argentina, Brazil, and Mexico went into crisis. Consequently, governments across the region initiated several reforms to foster fiscal discipline in order to combat the growth of federal and state deficits. Brazil's federal government established a fiscal responsibility law and debt restructuring agreements with sub-national public administrations. Peru's Fiscal Responsibility and Transparency Law has helped manage the deficit of the combined public sector (Webb, 2004).

Despite the emphasis put on fiscal responsibility, why do budget imbalances appear persistently increasing across countries in the Latin American region? One prominent strand of research that tackles this problem can be traced back to Tullock (1959), who looked at fiscal policy in democratic regimes as an example of the Tragedy of the Commons. In his view, individual claimants look at government spending and the tax base as a pool of common resources. The higher the number of individual claimants on the budget, the larger the expected budget expansion and the lower the chances for tax increases because individual claimants cannot be held entirely responsible for the costs of a deteriorating fiscal balance. Since then, a large body of the political economy literature investigating fiscal policy decisions has relied on the idea that the more fragmented a government the higher the government spending, deficits and debt and the lower the chances for tax increases (e.g., Alesina & Perotti, 1995; Bawn & Rosenbluth, 2006; Persson, Roland & Tabellini, 2007).

Given the above mentioned strand in the literature, we test the predictions of the common-pool problem in fiscal policy using panel data from 17 Latin American electoral states, 1970-2004. Our results indicate that party fragmentation within the government coalition and total membership of the parties in government appear to play only a marginal role at explaining aggregate spending and taxation outcomes. We find, however, a positive and robust connection between executive lame-duck periods and increases in government spending. Somewhat unexpectedly, executive term limits appear not to have a significant impact on tax revenue. These findings have alarming consequences for the region since revenues may not be complementing spending, and the fiscal state of each country may be left in disequilibrium. Furthermore, while mixed evidence supports alternative theories explaining fiscal outcomes, and our analysis dismisses the existence of Tragedy of the Commons problem in fiscal policy, it is evident that our empirical results raise the prospect that (Latin American) executives may actually prevail on fiscal policy.

The paper proceeds as follows. In the first section we discuss the literature highlighting previous determinants of fiscal policy. In the second section we present the research design, describe the data sample and explain results. Final remarks follow in the third section with suggestions for further research.

On the Institutional Determinants of Fiscal Policy Outcomes

Standard neo-classical macroeconomics views fiscal policy as government reactions to fluctuations of the economy around potential output. To the extent that the government does not pursue procyclical policies of balancing budgets, the government could smooth business cycles by increasing or decreasing expenditures or tax rates. However, later research suggests that the

explanatory power of New Classical macroeconomics falls short of satisfactory at explaining fiscal policy outcomes (e.g., Roubini & Sachs, 1989). In response, scholars looked for alternative approaches in order to explain patterns of aggregate spending, taxation and public debt. A major criticism of the standard New Classical (Dynamic Stochastic General Equilibrium) model is the assumption that there is a single benevolent policy-maker at the aggregate level, whereas actual decisions and problems in the macro economy often involve the interaction of many heterogeneous agents. Consequently, these heterogeneous agents are captured within the political economy literature that pays attention to political institutions in order to explain fiscal outcomes.¹ For instance, the existence of opportunistic political business cycles, the view that re-election seeking incumbents favor expansionary policies prior to election time because improved macro conditions increases their chances to get re-elected, has been subject to extensive research (e.g., Drazen, 2000). Another strand in the political economy literature looks at political budget cycles as outcomes of fiscal expansions in election years induced by incumbents interested on re-election (Brender & Drazen, 2005).

An alternative and relatively successful approach to the problem of fiscal spending, taxation and debt examines politicians' behavior in response to the perils posed by regular elections. In an attempt to study electoral cycles and fiscal cycles, Rogoff (1990) points to the notion that re-election prospects create an incentive for politicians to build their reputations with a forward looking electorate who may be judging performance based on the politician's ability to govern. Accordingly, politicians' incentive to establish a reputation and signal through the use of fiscal policy can have important outcomes. Rogoff's model implies that term limits in office precludes the adoption of reputation-enhancing policies because term limits eliminate the capacity of the electorate to reward politicians' performance with reelection. In Rogoff's view, it

is in the interest of reelection-seeking budget claimants to keep spending and taxes down because a good reputation in these matters increases their chances to remain in office. However, if subject to term limitations, elected officials in their final term neglect reputation-enhancing policies because a good reputation in these matters will be of no use for future political purposes. Indeed, a number of empirical studies have confirmed that the imposition of term limits in office of executives alters the incumbent's behavior. Besley and Case's (1995) groundbreaking study was the first to test Rogoff's reputation-building model on fiscal policy across 48 American states, 1950 to 1986. After controlling for party loyalty, lack of gubernatorial discretion, and life after governorship, gubernatorial lame-duck periods appeared associated to increases in total state spending and receipts in the form of sales, income, corporate, and total taxes, particularly when a Democrat holds office. Their results also indicate that spending and taxes were lower in the first term in two term-limit states. Rose (2006) examined the effect of fiscal institutions across the American states and found that only in states with strict prohibitions on deficit carry-overs, neither gubernatorial term limits nor the partisan composition of government appear to significantly affect state government expenditures and revenue. Johnson and Crain (2004) used Besley and Case's (1995) empirical model to study executive term limits across 48 electoral states. The authors found substantial evidence of increases in government spending and tax revenue during executive lame-duck periods. Further, government spending and revenue grew systematically in countries with one term limit rule in comparison to countries with two term limits or no term limits at all. Under two-term limits rule, executives also spent more and increased taxes during the lame-duck period. In essence, the available empirical literature corroborates Rogoff's (1990) claim that incumbents in their last term exert less effort to keep spending and taxes down.

Perhaps the approach in the literature on institutions and fiscal outcomes that has received the most scholarly attention is the one examining the collective action problems involved in the policymaking process. Following Tullock's (1959) influential work, fiscal policy making in democratic regimes is just another example of the Tragedy of the Commons. In the author's view, elected officials look at government revenue as a pool of common resources from which to extract resources to carry out projects and endeavors at the relevant constituency level. For reasons of political survival, struggle for the finite resources of the common pool would generate a spending bias to the extent that the political and financial cost incurred per additional unit of spending is shared by the entire group. Velasco (2000) formalized Tullock's discernment in a setting in which the government's net income is a "common property" out of which influential interest groups extract resources to finance expenditures on their preferred items. To the extent in which the benefits from spending accrue to each group, while the costs are spread over all groups, a spending bias emerges: transfers are higher than a benevolent planner would choose them to be, fiscal deficits emerge regardless the countercyclical purpose of fiscal policy, and in the long run, government debt tends to be excessively high (pp. 108-109).

Since then, a large body of the political economy literature investigating fiscal outcomes has relied on the idea that the higher the number of individual claimants on the budget, the larger the expected fiscal imbalance. Much scholarly work, for instance, has examined the "weak government hypothesis:" the more fragmented a government, the higher the public spending, deficits, and debt. And as a further consequence, the lower the chances for tax increases. Alessina and Perotti (1995) study budget expansions and adjustments in OECD countries 1960-1990 and find that different types of governments show different degrees of success at implementing fiscal adjustment, with coalition governments showing the worst performance.

Using yearly time-series cross-sectional data from 1970 to 1998 in 17 European countries, Bawn and Rosenbluth (2006) find that an additional party in government corresponds to almost an additional half percent point of GDP spent in the public sector. Moreover, the authors find little support for the alternative claim that the number of legislative parties affects the size of the public sector, except via the number of parties in government. Persson, Roland and Tabellini (2007) show that proportional elections in parliamentary democracies lead to higher spending because the electoral rule induces more fragmented legislatures and coalition governments relative to majoritarian elections. In the Latin American context, Stein, Talvi, and Grisanti (1998) reach a similar conclusion: proportional representation together with large district magnitude deteriorate budget outcomes to the extent that they increase legislative fragmentation and the likelihood of coalition governments. The above studies share the intuition that fiscal outcomes can be better understood through a common-pool resources approach. They test this hypothesis and find supportive evidence of a Tragedy of the Commons problem in fiscal policy.² Given the above discussion, in the next section we set out to determine what is driving fiscal policy in Latin America countries.

The Empirics

Our empirical analysis centers on the impact of Latin American political institutions and fiscal outcomes. We use panel data from 17 Latin American countries: Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Paraguay, Peru, Uruguay, and Venezuela. The data samples cover the period 1970-2004. Because several nations across the region were characterized as

authoritarian during the 1970s and early 1980s, we do not account for specific countries until they became at least electoral states.

Model Specification and Variable Definitions

The model specification is an extended version of Johnson and Crain's (2004):

$$Pct = \alpha Tct + \beta Lct + \gamma Zct + \varepsilon ct$$

where c and t are country and time identifiers. The dependent variables are total government expenditure and total government revenue as shares of GDP in constant dollars. Following Rogoff (1990), we test the contention that elected officials (executives) in their final term reduce their efforts to keep spending and taxes down. T is a dichotomous variable for whether term limits are binding constraint on the executive. T equals one (1) if the executive is in the lame-duck period, and zero otherwise. L represents a vector of control variables for coalition fragmentation and total membership of the parties in government. We use the probability that two deputies picked at random from among the government parties will be of different parties (GOVFRAC) as our proxy for coalition fragmentation. Our proxies for total membership within the parties in government include the sum of the squared seat shares of all parties in government (HERFGOV) and the fraction of seats held by all government parties with respect to the total number of seats in the legislature (MAJ). Z represents a vector of economic, demographic, and institutional control variables that have been shown determinants of fiscal policy. We control for real income per capita, population, population density, average rate of inflation, and Sachs measure of trade openness. Democratic governments, rather than authoritarian regimes, have an eminent tendency to respond to popular pressures. We use the seven-point Gastil Index of Political Rights to control for the effect of democratic government on fiscal policy. We add

controls for the initial levels of government spending and revenue in order to account for differences among the nations' terms of traditional levels of public welfare.

Government Expenditures and Tax Revenue

Table 1 reports the results for the effect of executive term limits, coalition fragmentation and total membership of the parties in government on aggregate expenditure as a share of GDP. As a robustness check, we first replicate Johnson and Crain (2004) formulation to investigate the effect of executive term limits on government spending. In Model (1) we enter left- and right-hand side data without transformations. Model (2) replicates Model (1) specification except that left- and right-hand variables enter the model as natural logarithms. The results indicate that government spending during executive lame-duck terms increases by 16% in comparison to those periods in which presidents are up for re-election. Models (3) to (5) in Table 1 extend Model (2) to include our controls for coalition fragmentation (GOVFRAC) and overall coalition membership (HERFGOV, MAJ). Coalition fragmentation total membership of the parties in government appears to have a positive impact on government spending although this connection shows below the 90% level of confidence. These results diverge in part from those in the literature finding evidence of a Tragedy of the Commons problem in fiscal policy across the Latin American region (e.g., Stein, Talvi & Grisanti, 1998). In short, throughout Table 1, we find a positive connection above the 99% level of confidence between our indicator variable for executives in the lame-duck period (T) and the size of the budget as a share of GDP. This connection remains robust to changes in model specification and robust to the inclusion of controls for coalition fragmentation and overall coalition membership. Increases in government expenditures, however, do not appear statistically connected to our proxis for coalition fragmentation and coalition membership despite the fact that presidential systems are likely to

back congressional politics. In line with Rogoff (1990), Latin American presidents in their last term seem to reduce their efforts to keep spending down.

Table 2 reports the results for the effect of executive term limits, coalition fragmentation, and total membership of the parties in government on tax revenue as a share of GDP. We replicate the methodology used to study government expenditures except that we run a series of random-effects GLS regressions. Throughout Table 2, we find our control for executives in the lame-duck period (T) persistently associated to decreases in tax revenue although this association remains below the 90% level of confidence.³ Against Rogoff's contention, Latin American executives seem not to reduce their efforts to keep taxes down during their last term. A plausible explanation may be found in the chief executives' prospects for future employment. In a prisoner-dilemma-alike theoretical framework, Cohen and Spitzer (1996) show that term limits make politicians receptive to service private interests. Because no higher position in the public administration is available for chief executives after their last term, potential after-term employment may likely come from businesses and industries that deal directly with the government. In line with Cohen and Spitzer, we presume executives to care about private interests because political responsiveness toward special interests increases their chances of subsequent employment. Model (3) in Table 2 introduces our control for coalition fragmentation. Unexpectedly, higher coalition fragmentation seems to positively impact tax revenue, although this association shows below the 90% level of confidence. In Models (4) and (5) in Table 2 we introduce our controls for total membership of all parties in government on an individual basis. In both cases, our variable indicators for overall coalition membership fall short of statistical significance as well.

The results on the control variables appear as expected. Income per capita and population appear associated to increases in government spending and tax revenue as shares of GDP. In Latin America, like in Western Europe, trade openness seems to go along with fiscal restraint as part of the neoliberal reform packages. The Gastil Index of Political Rights appears negatively associated to government spending and tax revenue. This finding contradicts the conventional wisdom that more democratic institutions favor spending and preclude tax increases, even under governments with conservative ideology. Our controls for the initial levels of government spending and tax revenue show positively associated and statistically significant above the 90% level of confidence.

In sum, even though presidential term limits in Latin America affect spending behavior in the same manner as they do in U.S. states and other democracies, Latin American executives seem not to reduce their efforts to keep taxes down during their last term. Government fragmentation appears to play at best a marginal role at explaining aggregate spending and government revenue. These findings have disturbing consequences for the region since revenues may not be complementing spending, and the fiscal state of each country may be left in disequilibrium. In the next section, we discuss the recent presidential term limit changes and examine the varying impact that these institutional differences have on fiscal outcomes.

One-Term vs. Two-Term Limits

Between 1970 and 2004, most Latin American presidents were institutionally constrained to run for reelection. In recent years, however, Argentina, Brazil, Colombia, Costa Rica, Peru and Venezuela have had constitutional reforms that changed presidential term limits from a one-term to a two-term limit rule. In Argentina, a 1994 constitutional reform reduced the presidential term to four years and limited the president and vice president to two consecutive terms;

presidents are now allowed to stand for a third term or more after an interval of at least one term. In Brazil, Fernando Henrique Cardoso became the first president to be re-elected for a second term after a 1997 constitutional amendment. Colombian President Alvaro Uribe sought a constitutional amendment during his first term that allowed him to run for office again. He was re-elected in the 2006 presidential race. In Costa Rica, a constitutional ban for incumbents to run for re-election was overturned in 2004. An incumbent, however, has to await an inter-term period before running again for office. In 1995, Peru adopted the two-term limit rule for the executive. After one interim term, former presidents may be reelected. A 1996 law allowed President Alberto Fujimori to run for a third term, but this was due to the fact that his first term began prior to the 1995 constitutional amendment. In Venezuela, as Hugo Chavez took power in 1999 various constitutional changes were made, including one allowing the president to run for two consecutive terms and the passage of a 2009 amendment that allows the president to run for reelection indefinitely.

We test for the difference on fiscal performance between executive lame-duck periods in countries under single-term vs. two-term limits rule. For the case of government spending, we use separate dummy variables for the one-term and two-term limit countries and run a series of OLS regressions correlated panels corrected standard errors for the period 1970-2004. Table 3 reports the results. Throughout Table 3 we enter left- and right-hand side variables as natural logarithms. Model (1) shows the case in which we add separate dummy variables for the one-term and two-term limit countries. Our results resemble those of Johnson and Crain (2004) who found robust evidence of lame-duck executives under single-term limit rule spending more on average than those in countries under two term-limit rule. The coefficient of the one-term limit country is positive and statistically significant at the 99% confidence level. The coefficient on

the lame duck indicator in two-term limit countries is positive and statistically significant at the 99% confidence level as well. Our results indicate that spending as a share of GDP increases 2% more during the lame duck of one-term limit presidents compared to the lame duck term of two-term limit presidents. However, controlling for executive lame-duck periods under one- and two-term limits rule does not improve significantly the R^2 (0.5054) in comparison to our results when we do not control for the alternative rules (0.5037).

In order to study the problem of the commons in government spending, we introduce in Models (2) to (4) in Table 3 our controls for coalition fragmentation (GOVFRAC) and total membership of the parties in government (HERFGOV, MAJ) for the case in which the executive is always in his/her last term. In Models (5) to (7) in Table 3 we introduce our controls for coalition politics for the case in which the executive is in the lame-duck period under two-term limit rule. By controlling for the alternative term-limit rules, the picture that emerges diverges from our previous results in which we control for lame-duck executives regardless the term-limit rule. Throughout Table 3, we find evidence of an increasing role of party politics on government spending decisions, in particular during the lame-duck period of executives under two-term limit rule. In this case, higher coalition fragmentation appears associated to increases in spending above the 99% level of confidence. Noticeably, increases in total membership of the parties in government show a robust connection to increases in government spending above the 99% level of confidence as well.

We examine the effect of the alternative executive term-limits rules and the problem of the commons on tax revenue. We replicate the methodology used to study government spending except that we run a series of random-effects GLS regressions, 1970-2004. Table 4 reports the results. Model (1) shows the results for the case in which we add separate dummy variables for

the executive one-term and two-term limit countries. Our results for the Latin American region differ from those of Johnson and Crain (2004) who found a positive connection between government revenue and their variable indicators for the alternative executive term-limit rules. In our analysis, the coefficient of the one-term limit country is negative and below the 90% level of confidence. The coefficient of the lame duck indicator in two-term limit countries is positive and statistically insignificant as well. Moreover, controlling for executive lame-duck periods under one- and two-term limits rule does not improve the value of the R^2 (0.3167) in comparison to our results when we do not control for the alternative rules (0.3151).

In Models (2) to (4) in Table 4, we introduce our controls for coalition fragmentation (GOVFRAC) and total membership of the parties in government (HERFGOV, MAJ) for the case in which a single term-limit rule constrains the executive to run for reelection. In all three models, the coefficient indicator for lame-duck executives shows negative and statistically insignificant below the 90% level of confidence. In Models (5) to (7) in Table 4 we introduce our controls for coalition fragmentation and total membership of the parties in government for the case in which the executive is in the lame-duck period under two-term limit rule. In Models (5) to (7), the coefficient indicator for lame-duck executives shows positive and statistically insignificant as well. Latin American presidents under single-term limits rule seem not to reduce their efforts to keep taxes down. In contrast, lame-duck chief executives under two-term limits rule appear to care less about their reputations in this matter. Higher coalition fragmentation appears to have a positive effect on taxation decisions regardless the executive term-limits rule. This association, however, remains short of statistical significance below the 90% level of confidence. Overall, our results indicate that institutional differences in executive term-limits rules do impact fiscal performance.

Discussion: Executive Prevalence on Fiscal Policy?

While mixed evidence supports alternative theories explaining fiscal outcomes, and our analysis dismisses the existence of Tragedy of the Commons problem in fiscal policy, it is evident that our empirical results raise the prospect that (Latin American) executives may actually prevail on fiscal policy. In institutional regimes of separation of powers, presidents often have a wide degree of latitude in implementing policy. In Latin America and throughout the region, chief executives have the ability to introduce the budget, and have veto powers in addition to amendatory observations faculties (positive veto) while also having decree powers, which when combined, give substantial control to the executive in the area of fiscal policy. However, effective governability requires congressional support to pass laws. This raises important questions of how executives, in particular those in institutional regimes of division of powers, seem persistently successful in the arduous tasks of building a coalition, thus preserving the alliance's cohesiveness and ostensibly leading the budgetary process despite the environment of the region's multi-party politics and periods of divided government.⁴

For an elected government, building and preserving a coalition are perhaps the most important tasks in order to attain governability and lead the policy-making process. In this regard, a strand of the literature maintains that in systems of division of powers, independently elected branches and fixed mandates hamper cooperation, discourage the formation of coalitions and increase the likelihood of legislative impasses. Even if conditions for effective governability are not attained, executives act unhindered by coalition demands in order to remain in office (Mainwaring & Shugart, 1997; Ricciuti, 2004). Alternative institutional designs may then affect fiscal outcomes. In comparison to presidential systems, deteriorating budget balances are more

likely to occur in parliamentary nations where the government has to accommodate the demands of coalition members in order to remain in office (Persson and Tabellini, 2003).

An alternative and rather conflicting line of research theorizes that in presidential systems the status of mutual independence between the executive and the legislature actually boosts coalition politics. Even though indiscipline and defection from coalition members may not constitute a problem of survival for the government in office, presidents, and minority presidents in particular, are still to attain conditions for governability. Following Mainwaring (1993), presidents looking for support for their programs often bargain with congressional representatives offering patronage in order to induce coalition formation and cohesiveness. Bueno de Mezquita, Smith, Siverson and Morrow (2003) advance the selectorate theory. The selectorate theory maintains that leaders who seek the support of a small coalition often favor the use of private rewards that only benefit coalition members. Those who require the support of a large coalition are to favor the supply of public goods rather than private benefits to reward their supporters. Cheibub, Przeworski and Saiegh (2004) notice that between 1946 and 1999, coalition governments under presidentialism formed in more than half of the cases in which official parties did not hold a majority in the legislature. They explain this empirical regularity by showing that presidents have an incentive to make coalition offers and parties to accept them once parties are assumed to care about offices and policies in addition to government funds. In the Latin American context, Geddes (1994) systematically tests forty-four presidential terms via the development of Appointment and Survival Strategy Indices concluding that executives actively take steps to increase state capacity using funding as well as appointment strategies and the assistance of the bureaucracy to gain the support of elite party organizers. Briefly, this line of

research underlines the idea that executives supply patronage, widely defined, in exchange for political support from party leaders in order to increase state capacity and achieve governability.⁵

We rely on this strand of the political economy literature to propose an alternative view to the process of coalition bargaining and cohesiveness. From our perspective, informal reciprocity agreements, the threat of ostracism from the governing coalition and the practice of centralized-exclusive candidate selection for legislative contestation facilitate coalition bargaining and put the executive in an advantageous position to further his/her preferences over policy.⁶ Unless constrained to run for reelection, executives care about their reputations (as per Rogoff 1990). In order to keep spending and taxes down reelection-seeking executives offer to coalition members a pooled amount of a composed good of financial support, resources of the public administration, positions in the bureaucracy, and/or policy-oriented programs of particular interest for individual party leaders, instead of merely public funds. Lame-duck executives, however, have no incentive to pursue reputation-enhancing policies, as their efforts will not be rewarded in the future. Within this context, even if presidential systems boost coalition politics; this does not imply an aggravation the problem of the commons in fiscal policy.

We acknowledge party leaders in the coalition interested in political survival, hence they are vulnerable to intra-party competition and susceptible to their parties' electoral success. We presume party leaders to care more about the total amount of resources instead of the specific combination of the basket. At any time, party leader i pursues legislation that gives him/her an amount of resources at least equivalent to his/her reservation value; i.e. the minimum amount of resources needed to ensure political survival. This provides the foundation for a problem of the type of the Tragedy of the Commons to arise. Because the strength of their political positions outside the coalition is increasing with the amount of resources party leaders attain through the

coalition bargaining process, their efforts will be directed to capture as many resources as possible. Hence, under the above conditions, rational self-interested party leaders concerned with political survival have an incentive to accept the executive's offers.

Transaction costs enter in the form of bargaining costs for the executive to negotiate with each party leader policy changes and resources. Unlike Cheibub, Przeworski and Saiegh (2004) and Geddes (1994), we foresee the methods employed by political parties to select candidates for legislative contestation to have a substantial impact on coalition bargaining costs. In Latin America, national party leaders, regional party bosses, or leaders of intraparty factions often monopolize candidate selection decisions for legislative contestation (Jones and Hwang, 2005, p. 267).⁷ Following Hazan (2002) and Norris (1996), contenders for party nomination selected by means of exclusive-centralized methods must adhere to the directives of the party leadership. Otherwise, newcomers would find themselves in faulty conditions to compete for party nomination and incumbents would face the threat of deselection.⁸ Patently, selection decisions on the hands of the few reduce coalition bargaining costs by two means. They remove the need for the executive and party leaders to negotiate with members of the legislature on an individual basis. They also enable party leaders as effective negotiators with the strength to enforce coalition agreements in the legislature.

Unlike party leaders in the coalition, we presume chief executives interested on the composition of the basket of resources x . In line with Rogoff (1990), we ascribe to reelection-seeking executives preferences initially decreasing in the fiscal component of x , but eventually increasing in the amount of monetary funds supplied to coalition members as the executive's national electorate may perceive deteriorating macro-indicators. Hence, reputation-building executives favor a basket of resources that relies on policy concessions and/or appointments in

the public administration in order to keep spending and taxes down and sustain coalition cohesiveness. In contrast, lame-duck executives are assumed to reduce their efforts to keep spending and taxes down since a good reputation in these matters will be of no use for future political purposes. Consequently, the executives' institutional control over most of the components of the basket of resources offered to party leaders transforms the task of coalition building and sustainability into one of resources allocation.

Concluding Remarks

This paper makes both an empirical and theoretical contribution regarding the importance of political institutions in determining aggregate spending and taxation decisions by targeting Latin America as a region of interest. Our empirical results indicate that coalition politics may only play a marginal role at defining the size of the budget and tax revenue. We find, however, presidential lame-duck periods robustly associated with fiscal imbalances. These findings suggest that institutions enabling executive prevalence create conditions wherein persistent fiscal imbalances are fostered. We propose an alternative view aimed at explaining our results. Members of the government coalition use informal reciprocity agreements that put the executive in an advantageous position to further his/her preferences on (fiscal) policy.

Overall, economic and institutional conditions in a state drive fiscal outcomes. Without certain incentives to ensure accountability to an electorate in future terms, executives have no incentive to implement economic policy without immediate payoffs. However, in Latin America, as in other places across the globe, long-term economic growth requires policies which may not show immediate "rewards" to politicians. In this regard, our findings create new avenues of research aimed to disentangle the potential impact that term limits can also have on other

standard macroeconomic policy variables such monetary and trade policy, as well as the trade-off between employment and inflation. These topics deserve more scholarly attention.

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Notes

¹ From an institutional standpoint, a variety of motives can drive fiscal decisions. Wibbels (2000) finds that higher subnational spending and deficits lead to greater deficits at the national level. Treisman (1999) shows that failure to coordinate economic policy across levels of government leads to fiscal indiscipline and macroeconomic instability. According to Alesina and Tabellini (1990), governments use public debt to influence the choices of their successors.

² However, despite its patent logic, a number of empirical studies have dismissed the existence of a Tragedy of the Commons dilemma in fiscal policy (e.g., Cheibub, 2006; Hahm, Kamlet & Mowery, 1996; Sakamoto, 2001; Steinmo & Tolbert, 1998; Volkerink and de Haan, 2001).

³ As a robustness check, we replicate our study using aggregate government revenue as a share of GDP as dependent variable. Reliable time series of aggregate government revenue for Latin American countries are rather scarce. We use panel data 1990-2004 from the IMF International Financial Statistics and Government Finance Statistics and run a series of random-effects GLS regressions. Allowing for some variations in the details, results remain consistent with those in our main study.

⁴ The term *limits literature* captures what the principal agent literature implies of reputation building. While the reputation-building thesis helps us understand the reasoning behind policy choices, the current state of the literature fails to point to the reasoning and institutional mechanics behind changes in fiscal policy.

⁵ In support to this view, a strand in the literature hypothesizes that government ministries matter for the political parties in the coalition because parties accrue influence and benefits from the programs and policies carried out by the government. Gamson (1961) anticipate that parties

forming government should each get a number of ministries that reflects the share of seats they bring to the coalition (p. 376); a statement known as Gamson's Law. In a cross-country cross-section study of parliamentary governments, 1997-2005, Carroll and Cox (2007) find evidence in support of Gamson's Law in governments based on pre-election pacts. The authors also find support in favor of Gamson's Law in a sample of West European governments, 1945-2000.

⁶ Informal reciprocity agreements sustaining government coalitions are likely to occur when bargaining costs, the members' patience, and the probability of meeting again rise, and as the time between meetings and the number of members in the coalition fall.

⁷ For a more detailed inspection on the methods and consequences of candidate selection for legislative contestation employed by political parties in Latin America see Mainwaring and Scully (1995), Morgenstern and Nacif (2002) and Siavelis and Morgenstern (2008).

⁸ Scholars in the field often place the locus of political authority and control within political parties on the hands of those making nomination decisions. At examining the high levels of party discipline in the British House of Commons, Mayhew (1974, pp. 25-27) overtly identify the potential denial of re-nomination as a crucial element to understand the conformity of a member of the lower chamber with the wishes of those making intraparty selection decisions. Chaube (2003, p. 212) develops a similar case in order to explain party discipline in the Indian parliament.

Table 1
Government Expenditures, Executive Term Limits and Government Fragmentation
17 Latin American Electoral States, 1970-2004

Dependent Variable:	(1) Gov. Exp./GDP	(2) Gov. Exp./GDP (double-log)	(3) Gov. Exp./GDP (double-log)	(4) Gov. Exp./GDP (double-log)	(5) Gov. Exp./GDP (double-log)
Model Specification:	OLS regressions, correlated panels corrected standard errors.				
Executive Lame-Duck	2.1403*** (0.34)	0.1493*** (0.01)	0.1332*** (0.02)	0.1333*** (0.02)	0.1594*** (0.02)
Income Per Capita	0.0001*** (0.00)	0.0435*** (0.02)	0.0477*** (0.02)	0.0477*** (0.02)	0.0491*** (0.02)
Population Growth	0.0000*** (0.00)	-0.0488*** (0.01)	-0.0410*** (0.01)	-0.0410*** (0.01)	-0.0521*** (0.01)
Population Density	0.0034 (0.00)	-0.0072 (0.01)	0.0024 (0.01)	0.0024 (0.01)	-0.0040 (0.01)
Average Inflation	0.0008*** (0.00)	0.0269*** (0.01)	0.0293*** (0.01)	0.0293*** (0.01)	0.0251*** (0.01)
Trade Openness	-0.0221*** (0.01)	-0.0422*** (0.01)	-0.0386*** (0.01)	-0.0386*** (0.01)	-0.0530*** (0.01)
Gastil Index	-0.1262 (0.10)	-0.0060 (0.01)	-0.0110* (0.01)	-0.0109* (0.01)	-0.0076 (0.01)
Gov. Expenditure 1970	0.5976*** (0.06)	0.5382*** (0.04)	0.5131*** (0.04)	0.5132*** (0.04)	0.5317*** (0.04)
GOVFRAC			0.0399 (0.03)		
HERFGOV				-0.0406 (0.03)	
MAJ					-0.0526 (0.06)
R ²	0.4454	0.5037	0.5137	0.5138	0.5073
Prob > X ²	0.0	0.0	0.0	0.0	0.0
Observations	419	414	395	395	395

Standard errors in parentheses.

* Significant at 90% confidence level, ** significant at 95% confidence level, *** significant at 99% confidence level.

Table 2
Tax Revenue, Executive Term Limits and Government Fragmentation
17 Latin American Electoral States, 1970-2004

Dependent Variable:	(1) Tax Rev./GDP	(2) Tax Rev./GDP (double-log)	(3) Tax Rev./GDP (double-log)	(4) Tax Rev./GDP (double-log)	(5) Tax Rev./GDP (double-log)
Model Specification: Random-effects GLS regressions.					
Executive Lame-Duck	-1.6413** (68)	-0.0576 (0.05)	-0.0695 (0.06)	-0.0695 (0.06)	-0.0721 (0.05)
Income Per Capita	0.0010*** (0.00)	0.5752*** (0.19)	0.6100*** (0.20)	0.6097*** (0.20)	0.5630*** (0.20)
Population Growth	0.0000 (0.00)	-0.1474 (0.09)	-0.1725* (0.10)	-0.1724* (0.10)	-0.1462 (0.09)
Population Density	0.0047 (0.01)	-0.1601 (0.11)	-0.1605 (0.12)	-0.1603 (0.20)	-0.1513 (0.12)
Average Inflation	-0.0003* (0.00)	-0.0763*** (0.02)	-0.0741*** (0.02)	-0.0742*** (0.02)	-0.0776*** (0.02)
Trade Openess	0.0026 (0.02)	0.1205 (0.11)	0.0536 (0.12)	0.0538 (0.12)	0.0824 (0.11)
Castil Index	-0.0871 (0.15)	0.0002 (0.01)	-0.0003 (0.01)	-0.0003 (0.01)	-0.0027 (0.01)
Gov. Revenue 1970	0.1006 (0.22)	0.3227** (0.16)	0.3293* (0.18)	0.3293* (0.18)	0.3340** (0.17)
GOVFRAC			0.0681 (0.05)		
HERFGOV				-0.0685 (0.05)	
MAJ					0.0134 (0.07)
R ²	0.2448	0.3167	0.3462	0.3463	0.3170
Prob > X ²	0.0	0.0	0.0	0.0	0.0
Observations	274	273	263	263	266

Standard errors in parentheses.

* Significant at 90% confidence level, ** significant at 95% confidence level, *** significant at 99% confidence level.

Table 3
Government Expenditures, Alternative Executive Term-Limit Rules and Government Fragmentation
17 Latin American Electoral States, 1970-2004

Dependent Variable:	(1) Gov. Exp./GDP (double-log)	(2) Gov. Exp./GDP (double-log)	(3) Gov. Exp./GDP (double-log)	(4) Gov. Exp./GDP (double-log)	(5) Gov. Exp./GDP (double-log)	(6) Gov. Exp./GDP (double-log)	(7) Gov. Exp./GDP (double-log)
Model Specification:	OLS regressions, correlated panels corrected standard errors.						
Executive Lame-Duck (one-term limit rule)	0.0648*** (0.01)	0.0525*** (0.01)	0.0525*** (0.01)	0.0629*** (0.01)			
Executive Lame-Duck (two-term limit rule)	0.0495*** (0.02)				0.0044 (0.02)	0.0042 (0.02)	0.0055 (0.02)
Income Per Capita	0.0456*** (0.01)	-0.0342* (0.02)	-0.0342* (0.02)	-0.0458*** (0.02)	-0.0357** (0.02)	-0.0357** (0.02)	-0.0526*** (0.02)
Population Growth	0.0403*** (0.00)	-0.0269*** (0.01)	-0.0269*** (0.01)	-0.0346*** (0.01)	-0.0010 (0.00)	-0.0010 (0.00)	-0.0007 (0.01)
Population Density	0.0092* (0.01)	0.0017 (0.01)	0.0016 (0.01)	-0.0053 (0.01)	0.0224*** (0.01)	0.0224*** (0.01)	0.0177*** (0.01)
Average Inflation	0.0233*** (0.01)	0.0230*** (0.01)	0.0230*** (0.01)	0.0177*** (0.01)	0.0354*** (0.01)	0.0354*** (0.01)	0.0314*** (0.01)
Trade Openness	-0.0571*** (0.02)	-0.0507*** (0.02)	-0.0507*** (0.02)	-0.0662*** (0.02)	-0.0156 (0.01)	-0.0155 (0.01)	-0.0215 (0.02)
Gastil Index	-0.0071*** (0.00)	-0.0076*** (0.00)	-0.0076*** (0.00)	-0.0069*** (0.00)	-0.0039* (0.00)	-0.0039* (0.00)	-0.0031 (0.00)
Gov. Expenditure 1970	0.5489*** (0.04)	0.5271*** (0.04)	0.5271*** (0.04)	0.5529*** (0.04)	0.4958*** (0.05)	0.4962*** (0.05)	0.5333*** (0.04)
GOVFRAC		0.0227* (0.01)			0.0411*** (0.02)		
HERFGOV			-0.0232* (0.01)			-0.0415*** (0.02)	
MAJ				-0.0155 (0.03)			-0.0046 (0.03)
R ²	0.5054	0.5073	0.5073	0.5006	0.4690	0.4689	0.4446
Prob > X ²	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Observations	414	395	395	399	395	395	399

Standard errors in parentheses.

* Significant at 90% confidence level, ** significant at 95% confidence level, *** significant at 99% confidence level.

Table 4
Tax Revenue, Alternative Executive Term-Limit Rules and Government Fragmentation
17 Latin American Electoral States, 1970-2004

Dependent Variable:	(1) Tax Rev./GDP (double-log)	(2) Tax Rev./GDP (double-log)	(3) Tax Rev./GDP (double-log)	(4) Tax Rev./GDP (double-log)	(5) Tax Rev./GDP (double-log)	(6) Tax Rev./GDP (double-log)	(7) Tax Rev./GDP (double-log)
Model Specification:	Random-effects GLS regressions.						
Executive Lame-Duck (one-term limit rule)	-0.0513 (0.05)	-0.0695 (0.06)	-0.0694 (0.06)	-0.0721 (0.05)			
Executive Lame-Duck (two-term limit rule)	0.0700 (0.08)				0.1039 (0.07)	0.1039 (0.07)	0.1045 (0.07)
Income Per Capita	0.6038*** (0.19)	0.6010*** (0.20)	0.6097*** (0.20)	0.5630*** (0.20)	0.6062*** (0.20)	0.6060*** (0.20)	0.5700*** (0.20)
Population Growth	0.1651* (0.10)	-0.1725* (0.10)	-0.1724* (0.10)	-0.1462 (0.09)	-0.1971** (0.10)	-0.1971** (0.10)	-0.1771* (0.10)
Population Density	-0.1761 (0.12)	-0.1605 (0.12)	-0.1603 (0.12)	-0.1513 (0.12)	-0.1672 (0.12)	-0.1671 (0.12)	-0.1821 (0.12)
Average Inflation	0.0726*** (0.02)	-0.0741*** (0.02)	-0.0742*** (0.02)	-0.0776*** (0.02)	-0.0743*** (0.02)	-0.0743*** (0.02)	-0.0787*** (0.02)
Trade Openness	0.1204 (0.11)	0.0536 (0.12)	0.0538 (0.12)	0.0824 (0.11)	0.0453 (0.12)	0.0454 (0.12)	0.0871 (0.11)
Gastil Index	-0.0005 (0.01)	-0.0003 (0.01)	-0.0003 (0.01)	-0.0027 (0.01)	0.0011 (0.01)	0.0011 (0.01)	-0.0007 (0.01)
Gov. Revenue 1990	0.3363** (0.17)	0.3293* (0.18)	0.3293* (0.18)	0.3340** (0.17)	0.3568** (0.18)	0.3568** (0.18)	0.3607** (0.18)
GOVFRAC		0.0681 (0.05)			0.0786 (0.05)		
HERFGOV			-0.0685 (0.05)			-0.0791 (0.05)	
MAJ				0.0134 (0.07)			-0.0032 (0.07)
R ²	0.3151	0.3462	0.3463	0.3170	0.3695	0.3695	0.3344
Prob > X ²	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Observations	273	263	263	266	263	263	266

Standard errors in parentheses.

* Significant at 90% confidence level, ** significant at 95% confidence level, *** significant at 99% confidence level.

Data Appendix 1. Sources

Government Expenditure/GDP	Penn World Tables 6.2.
Tax Revenue/GDP	DataGov-Governance Indicators Database. Inter-American Development Bank. Available at http://www.iadb.org/datagob/
Income Per Capita	Penn World Tables 6.2.
Population	Penn World Tables 6.2.
Population Density	Penn World Tables 6.2.
Inflation	IMF World Economic Outlook.
Trade Openess	Penn World Tables 6.2.
Gastil Index	Polity IV Project: Political Regime Characteristics and Transitions, 1800-2002. M. G. Marshall & K. Jaggers. Center for International Development and Conflict Management. University of Maryland, College Park. Available at www.cidcm.umd.edu/inscr/polity/
Executive Term Limits	Stateman's Yearbook.
Coalition Fragmentation and Membership	2004 Database of Political Institutions. P. Keefer. Development Research Group. The World Bank.

Data Appendix 2. Summary Statistics

	All	Countries:	
		One-Term Limit Rule	Two-Term Limit Rule
Government Expenditure	18.6074 (4.93)	19.4845 (5.86)	19.6958 (3.64)
Tax Revenue	14.6613 (4.61)	14.3540 (3.69)	13.6807 (1.16)
Income Per Capita	4707.5110 (2478.90)	4581.50 (2193.91)	6187.33 (2942.42)
Population	25825.55 (38923.84)	31394.23 (41716.87)	59109.99 (61122.51)
Population Density	53.2982 (64.65)	65.3058 (73.66)	22.6711 (11.08)
Average Inflation (%)	15.3601 (8.48)	16.8775 (8.05)	8.5130 (10.01)
Trade Openess	43.3353 (22.06)	45.2208 (21.60)	31.1543 (12.22)
Gastil Index	2.69 (1.29)	2.7317 (1.12)	3.5652 (1.50)
GOVFRAC	0.1800 (0.27)	0.1859 (0.27)	0.4035 (0.34)
HERFGOV	0.8226 (0.26)	0.8175 (0.27)	0.5996 (0.34)
MAJ	0.5780 (0.18)	0.5639 (0.18)	0.6275 (0.22)