

# Economic Performance and Political Coordination in Portugal's "Dry" Political System

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## Abstract

We posit that sound, growth-promoting economic policy is more likely to be formulated when major political players have incentives to cooperate. Using Portugal as an arena to test this theory, we provide an in depth analysis of its policymaking environment, finding that Portuguese institutional arrangements are what we term “dry.” That is, they are not well suited to provide incentives for cooperation among actors in the policymaking process. Portugal has had difficulty sustaining economic growth in the long term. Our arguments are supported with both contextual analyses and a statistical examination, in which we find a strong link between single-party majority government and positive economic and fiscal performance. These findings have broad implications for democratic economies across the world.

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## 1. Introduction

Existing institutional theories predict policy rigidity when policy space is characterized by several strong actors with significant policy differences. Such actors are often referred to as “veto players” (see, for example, Tsebelis 2002). The underlying assumption is that political fragmentation increases transaction costs and reduces the size of a possible winset that could beat the *status quo*, thus limiting the probability of policy change. In addition, the difficulty in adjusting policy is exacerbated when the preferences of such veto players are divergent. This paper expands on the notion of transaction costs to include the formal and informal incentives available to veto players to form coalitions and enact effective policy creation.

A wide body of existing research has found a negative relationship between the number of important actors in a democratic system and economic and fiscal performance. Persson and Tabellini (2003) and Roubini and Sachs (1989), for example, have found budgetary deficits to stem from coordination problems. Moreover, Barro (1991) and Alesina et al. (1996) have linked economic growth to government stability, which itself is a product of a cohesive set of decision makers. Adding to this literature, we hypothesize that growth-promoting economic policy is more likely to be formulated when veto players have incentives to cooperate and are able to form solid, intertemporal agreements. Cooperative actors can rapidly adjust to changing external and internal factors and therefore formulate well-tailored economic policies.

To test our expectations, we conduct an in depth analysis of post-revolution Portugal, which we chose for several reasons. First, it has experienced a variety of government types over the last three decades (majority, coalition, and minority),

which provides substantial variation in our key independent variable, cooperation among veto players. Second, in this same time frame, Portugal has joined the European Union and adopted the Euro. This allows us to examine how policy responded to major changes in the country's international posturing and in its monetary system. Third, Portugal has remained a stable democracy since its peaceful revolution, meaning we need not account for democratic instability in our analyses. Finally, Portugal has received relatively little attention in the comparative literature, and we use this as an opportunity to fill this void. Single country studies are useful in that several factors, such as culture, religion, and geography, are implicitly controlled for, which increases the internal validity of findings. However, they are limited in their generalizability. Nevertheless, for the reasons mentioned, Portugal is a useful country in which to conduct a "hands-on" analysis of our theory, and the associated findings provide insight into the policy outcomes of other democratic countries.

Portugal experienced a bloodless military coup that in 1974, known as the "Revolution of the Carnations." This overthrow was followed by democratic reforms and national elections in 1975, which in turn led to Portugal's initial year of parliamentary democracy in 1976. A short time later, a constitutional reform in 1982 and entrance into the European Union in 1986 ushered in a new era of democracy. From this time through the early 1990s, Portugal experience rapid economic growth, but this boom was short-lived, as another shift in Portugal's political circumstances led to relatively lower growth rates from the mid-1990s through the present.

We posit that Portugal's initial upturn following EU membership was precisely due to the country's ability to positively exploit its new influx of foreign capital and the institutional reforms required by Brussels. Given the institutional constraints of the Portuguese case, which eliminate many avenues for cooperation,

this ability stemmed largely from the existence of majority governments, which are not hampered in their capacity to enact positive economic policy. However, the downturn that followed, we surmise, was due to an absence of collective action on the part of Portugal's political actors, which lessened Portugal's ability to maintain the growth ignited by EU membership a decade earlier.

In general, the Portuguese political system does not enhance cooperation among political players because it is "dry." That is, it lacks tradable currencies capable of compensating coalition players for potential losses, it lacks internal and budgetary coordination capacity of governing, and it lacks a credible enforcement mechanism as a result of a politicized and inefficient judiciary system. In this institutional environment, good economic outcomes require cooperation among political players, which in the Portuguese case is fundamentally a function of parliamentary majorities. Our statistical findings support this logic, uncovering a relationship between economic growth and single-party governments. However, obtaining a single-party majority is extremely difficult in the Portuguese proportional system; it has happened only three times since democratization, twice when Cavaco Silva was prime minister (1987-1991 and 1991-1995), and in current administration, in which Jose Socrates is prime minister (2005-).

## **2. From Dictatorship to Democracy**

Thirty-six years of the totalitarian dictatorship of Antônio Salazar came to an end in 1968, after he suffered a stroke (Anderson 2000). His successor, Marcelo Caetano, recognized the growing domestic problems, but continued to push the war effort in Africa (Alexandre 2003). In addition, labor strikes grew fierce, inflation reached

thirty percent (the highest in Europe), the trade balance dropped, and unemployment headed upward.

Concerned with unfair military practices and the futility of imperialism, a group of left-wing military personnel banded together to form the Armed Forces Movement (MFA). The explicit goal of the MFA was to overthrow the standing government. The revolution took place in April 1974, and Caetano was replaced by military general Antônio Spínola (Ortiz-Griffin and Griffin 2003). A military government formed under Spínola. Salaries were increased, political prisoners were released, and officials loyal to the previous regime were removed.

Spínola's political incompetence and overbearing leadership eventually alienated his MFA supporters. On the international front, revolts led Spínola to recognize the independence of African colonies. Growing weary, he organized a September 1974 rally to boost his support from the people. However, he was unable to overcome the blockade of the rally by leftist groups and resigned shortly after, replaced by another general, Costa Gomes, a leftist committed to decolonization. Though Spínola attempted a coup in March 1975, it failed and the socialist ideals of the MFA flourished (Anderson 2000).

On April 25, 1975, Portugal held its first democratic general election. Turnout was high at nearly 92% and twelve parties competed in the election (Anderson 2000, p. 171). A new constitution was produced and took effect one year later. The document was democratic socialist, granting the rights of employment, health care, housing, and a clean environment to the citizenry (p. 172). Elections were again held in April 1976 for the Assembly, in which Mário Soares of the Socialist Party was elected prime minister, and June 1976 for the presidency. As noted by Maxwell

(1997), the struggle for Portuguese democracy was eventually won by civilian politicians with moderate positions.

After the revolution, economic growth, which had steadily risen through the 1960s, declined rapidly (see Figure 1). The decline was due to isolation from the markets of lost African colonies, and a loss of investment due to the nationalization of several industries, and governmental instability; there were six governments between 1974 and 1976 (Ortiz-Griffin and Griffin 2003, p. 171). The post-revolution period was also characterized by violent strikes and terrorist attacks by radical leftists who felt betrayed by the new government (Ortiz-Griffin and Griffin 2003, p. 183). Moreover, the international energy crisis led to inflation, and its new implementation of a generous welfare state contributed to a budget deficit.

To counter its economic woes, Portugal turned to the IMF. Under IMF guidelines, its currency was devalued, spending was cut, and taxes were increased. These adjustments were unpopular with the other parties in Soares' coalition government, and the government fell in the end of 1977. A new government lasted only until mid-1978, leading the president to remove Soares from the post of prime minister (Anderson, p. 175).

At the end of 1979, a conservative government was elected in place of the Socialists. The conservative government demanded the revision of the 1976 constitution in order to remove its socialist ideals. Though the constitution has undergone several amendment processes, its preamble still embodies the original revolutionary mentality, noting the country in its current form was born out of the overthrow of a fascist regime (Ortiz-Griffin and Griffin 2003, pp. 162-163).

[Figure 1 About Here]

### **3. A Recent Economic History**

Starting after World War I, growth in Portugal Growth was largely due to policies that favoured sectors with high productivity levels. These policies were associated with growth in domestic demand and high levels of investment. In addition, GDP growth was boosted by a steady rate of high export levels and continued essential imports, and it increased steadily through the middle 20<sup>th</sup> century (Lains 2007). In the past few decades, however, Portugal has had less success maintaining long-term economic growth.

Portugal applied for European Community membership in March 1978 and became a member in 1986. Access to European Community was seen as an important way to consolidate the young Portuguese democracy (Magone 1996). As a consequence of its entrance into the euro zone and its convergence commitments, Portugal experienced an economic boom, a sharp reduction of inflation, an elimination of country risk, and a decline in nominal and real interest rates. The result was an increase in investment, decreased unemployment, increased wages, and increased account deficits. In fact, Lains (2003) notes that a substantial amount Portugal's economic growth after accession was directly due to gains from joining the EU.

This solid economic performance can be attributed to a kind of external positive shock as consequence of the influx of resources from the European Union and by a sharp decline in borrowing costs, due to EU membership. In fact, Portuguese elite groups have not been able to implement important reforms (such as social security, labor, etc.) that would facilitate economic growth in the long run. Politicians from both sides (left and right) are hesitant to bear the political costs associated with

making the first move. As they are risk-averse, they are slow to take the initiative. Institutional reforms require active policies by governments that are willing to pay a short-term political price for unpopular policy reforms. The Portuguese experience illustrates that “the process of economic reforms has to be a domestic process led by domestic actors willing to carry them out” (Royo 2007).

In order to achieve the Maastricht convergence criteria for membership in the Euro zone, Portugal introduced financial liberalization and tight fiscal measures, and was able to reduce its level of inflation and lower its debt to GDP ratio. Having fulfilled the Maastricht convergence criteria, Portugal became one of the eleven Member States to adopt the Euro. However, the most recent picture is not entirely rose-colored, and in 2004 and 2005 the budget deficit surpassed the three percent Growth and Stability Pact limit.

In less than ten years after accession, the Portuguese economy entered a troubled period. Economic growth was feeble, the budget deficit was large, productivity growth was low, the investment boom was brought to a halt, and the current account deficit remained large. Figure 1 depicts recent economic performance in Portugal. From 1995 to 2000 there was a marked increase in current account deficits (as a percentage of GDP) and GDP growth drastically declined, reaching negative numbers in 2003. Therefore, having access to EU funds is not necessarily a guarantee of economic success. In addition to making wise use of EU funds, solid intertemporal economic performance also depends upon fiscal and monetary discipline and, above all, implementing reforms. With nonproductive domestic policy, the reception of foreign funds does not guarantee economic growth (Alfaro et al. 2004).

Portugal's economic performance has not met its full potential. What constraints have kept Portugal from realizing a consistent and robust rate of economic growth? Portugal's economy, like that of any nation, is affected by the fluctuating tides of the international economic environment and its deep-rooted historical circumstances. This means economic performance in Portugal is not dependent on domestic or contemporary factors alone. However, the ability of domestic actors to cooperate in order to adjust to changing external and internal factors is key to formulating sound economic policies. As we elaborate upon below, the allocation of political power in Portugal is generally inconsistent with the conditions needed to sustain solid economic policies.

#### **4. Political Institutions and the Policymaking Process in Portugal**

Political institutions, by which we mean formal and informal rules, determine the constraints and incentives faced by key players. As such, we surmise that, through the nature of public policy, economic outcomes in Portugal are related to the institutional incentives provided to major political actors. More specifically, the failure of Portuguese institutions to nurture a fluid policy environment is partially to blame for the country's lack of long-term economic growth.

##### **4.1. Overview of Portuguese Political Institutions**

Although the Portuguese political system has an elected parliament with the prerogative of suggesting the prime minister and holding executive functions, it also has an elected president who has, especially in the past, played an important role in the Portuguese policymaking process. Because of this special combination of institutional features, the political system of Portugal is not a typical parliamentary regime. While some authors (Duverger 1980; Braga de Cruz 1994; Frain 1995; Sartori

1997) have classified the Portuguese political system as a semi-presidential, others (Moreira 1992; Shugart and Carey 1997) have designated Portugal as premier-presidential system because the president, even when faced with an opposing parliamentary majority, holds considerable autonomy and powers. On the other hand, the prime minister is the only political player responsible for the government.

The 1976 Constitution provided the president with instruments and privileges over government formation (he can nominate the prime minister) and termination (he can force the prime minister to resign even if he enjoys the support of the parliament) and the survival of the legislative assembly, and also afforded the president the power to effectively veto bills both approved by the Assembly of the Republic and decrees issued by the cabinet. Veto power is a unique institutional feature of the Portuguese Constitution when compared with Western European counterparts. Although the 1982 constitutional reform reduced some presidential powers, it preserved the ability of the president to veto in a large number of policy areas, which require two-thirds majority of the parliament to override a presidential veto. The president though can no longer use the *suspensive* veto with respect to both assembly laws and decrees from the cabinet. The president is also in charge of appointing the prime minister and cabinet members, which are politically responsible to the former.

Political institutions in Portugal do, nevertheless, provide checks on the president because he/she does not have executive functions and cannot initiate new legislation. The revision of the Constitution in 1982 also abolished the Council of Revolution, which was instituted by the military as guardians of the democratization process, and it was replaced by the Constitutional Tribunal with the role of pre-emptive constitutional control. Upon a president's request, the Tribunal must, within twenty days, rule whether a law approved by the Assembly or a cabinet decree is

constitutional. The constitutional revision also reduced the power of the President who now can only dismiss the government when such a measure is essential to ensure the ‘regular functioning of the democratic institutions,’ and after consulting with the Council of the State.

The Portuguese electoral system establishes that presidents are elected by a majority runoff for a five-year term and they can run for reelection just once. The electoral rule for parliament is closed-list d’Hondt proportional representation, and candidate selection is at the national level in twenty multi-member districts. As the order of candidates is put forth by parties, the fate of individual candidates depends mostly on the electoral reputation and achievements of their political parties. This leads to party oriented behavior by legislators in both the electoral and parliamentary arenas (Magalhães 2003). In addition, members of parliament have great incentives to behave according to the will of party leaders, making party discipline very high.

The degree of fragmentation of the party system is, however, not exceedingly high. Lobo (2005) shows that, through 1980, the number of effective parties decreased from 3.47 to 2.46. This reduction was a consequence of the right-wing coalition called ‘democratic alliance’ build up by the PSD and CDS in late 1970s. This coalition was disentangled in the 1983 and 1985 parliamentary elections. As a result the effective number of parties reached its highest value 4.23. After the 1985 parliamentary election, the effective number of parties decreased, and has been stable around 2.5.

#### **4.2. Internal and Budgetary Coordination problems in the Government**

As noted by Tsebelis (2002) and others, when governmental actors have diverse preferences, policy creation slows. According to Lobo (2005), the coordination problems of the Portuguese government are directly associated with

minority and/or coalition governments as a result of the excessive interference of party organizations in the government's business during the first decade of the Portuguese democracy. In the following decade, however, especially as consequence of single-party majority administrations, the government was able to better-coordinate its actions. Lobo (2005), nevertheless, claims that this improved coordination was contingent on the partisan power of the prime minister and not a consequence of institutional changes within the organizational framework of the government. In fact, during single-party majority governments, coordination problems shift from the interparty coalitional dimension to the intraparty dimension, especially when the majority party of the prime minister has several internal fractions, as was the case of the PSD from 1985 to 1995.

Regarding budgetary coordination, Hallerberg et al. (2001) develop two modes of governance conducive to greater fiscal discipline: a mode of *delegation* and a mode of *commitment*. *Delegation* involves vesting the finance minister with significant decision making powers over public monies. Therefore, the finance minister plays a central role in the making of the budget. He maintains a strong position in all budget negotiations, in the monitoring of minister spending behavior, and in making adjustments to the budget during the implementation stage. Under *commitment* a group of agents with similar decision making rights enters an agreement to commit themselves strictly to budgetary norms, i.e., targets for budget aggregates set for one or several years. The theory predicts that *delegation* works effectively in countries where the partners in government are comfortable delegating such power to one central actor. In practice, such countries either have one-party majority governments or have governments with parties who are closely aligned to one another and will almost always participate in elections as one block. *Commitment*

functions well in states where coalition governments among parties that may run against each other in future elections are the norm. After elections coalition partners negotiate budgetary targets and enshrine them in the coalition agreement.

Concerning the role played by the finance minister in the decision-making process of the budget, Portugal was ranked in the last position among fifteen countries of the EU. With regard to the relative power of parliament in the budget process, on a score ranging from zero to five, Portugal was rated a four, suggesting that the Portuguese parliament may constrain the preference of the government regarding the budget if the prime minister and his finance minister do not enjoy the majority of seats. With reference to the role played by the finance minister during the implementation stage, Portugal was considered one of the weakest especially because transfers between chapters of the budget are allowed without the ministerial approval.

#### **4.3. Enforcement Failures: The Judiciary and the Legal System**

Better rule of law, lower corruption, lower risk of expropriation and of contract repudiation, and better citizen access to justice all foster growth. In addition, respect for contractual agreements – low expropriation and repudiation risks – seem to have the strongest impact on growth, followed by a predictable legal framework characterized by a strong rule of law and low corruption.

The judiciary and the Supreme Court in Portugal do not act as important players in the policymaking process and the Court has had in the past only limited intervention in vetoed legislation pursued by the cabinet and assembly. The main problem with the judiciary system is related to the slowness of the judicial process, which in many circumstances leads to its ineffectiveness.

Because judiciaries are important players in the economic policymaking process, Portugal's lacking judicial system may present a critical setback to its

economic performance. According to Tavares (2004), the judicial system affects economic performance through its enforcement of property rights and its facilitation of exchanges between private parties. Though it has made strides as of late, Tavares notes that the judiciary in Portugal is underdeveloped relative to its European and East Asian counterparts. In fact, Portugal ranks forty-sixth in the world in terms of enforcing contracts.<sup>1</sup> The compromised ability of Portugal's judiciary to mediate the business process and enforce deals may play a role in its recently sluggish economic performance.

The judiciary is also swayed by political winds in Portugal.<sup>2</sup> According to Garcia et al. (2009), constitutional judges in Portugal, who are responsible for reviewing the constitutionality of government legislation, are sensitive to their party affiliation when voting. The authors present some evidence that judges are more likely to uphold the constitutionality of a law if it was passed by a government of similar ideological leaning. Party membership thus affects the quality of judicial outcomes in Portugal, and the ability of the judiciary to foster good economic policy may be impeded due to the political considerations of judicial actors.

## **5. Political Institutions, Government Stability, and Economic Performance in Theory**

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<sup>1</sup>See the World Bank's *Doing Business* report, which is available at [www.doingbusiness.com](http://www.doingbusiness.com).

<sup>2</sup>This truism is of course not unique to Portugal. In the United States, for example, justices are swayed by both their attitudes and public opinion. See Segal and Spaeth, (2002) and Mishler and Sheehan (1996).

Previous work examines the effect of regime type on economic performance. That is, do economies perform better under dictatorship or democracy? Authors such as North (1990) have found a positive relationship between democracy and growth, arguing that democracy promotes property rights. In the same vein, Olson (1991) argues that an autocrat cannot credibly commit himself to one policy, thus limiting possibilities for economic growth in non-democratic countries. Other work, such as that of Huntington and Dominguez (1975), argues that democracy discourages growth by increasing demands for immediate consumption at the cost of long-term investment. In addition, the above-mentioned theory alludes that economic policy will be better under dictatorship, as coordination issues will not arise under one-party rule.<sup>3</sup> However, in a review of several quantitative analyses of regime type and growth, Przeworski and Limongi (1993) find no clear directional link between the two variables. Empirical evidence from Portugal fits with the latter predictions, as its highest growth rates came before its democratic revolution. Acemoglu (2008), recognizing the perpetual nature of this debate, notes, “to understand how different political institutions affect economic decisions and economic growth we will need to go beyond the distinction between democracy and nondemocracy,” which is the approach we take here.

As shown by North and Weingast (1989), who examine the institutional conditions of seventeenth century England in terms of economic development, a government’s ability to commit to private rights and exchange is an essential condition for economic growth. Thus, to generate normatively positive economic outcomes, political institutions must provide incentives for politicians to create

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<sup>3</sup> This, of course, assumes that the decision-maker is predisposed to enact sound economic policy.

favorable economic policies, in the short-run and into the future; good economic performance is a function of credible intertemporal commitments of policy makers.

A substantial body of research establishes a link between economic outcomes and the institutional configurations of democracies in particular. It is generally argued that coalition governments are associated with larger costs than single-party governments and that power dispersion increases the chances of fiscal wastefulness. Then, by veto players theory, we should expect governments with fewer veto players to be associated with good economic outcomes. That is, because majoritarian systems limit party numbers and the propensity for coalition governments, coordination problems that may be the root of budget deficits are avoided in these nations (Persson and Tabellini 2003, 156). Accordingly, Roubini and Sachs (1989) argue that a dispersion of power, either across governmental branches or political players, increases the likelihood of inefficient budgetary policy. They find that the size of budget deficits in industrial countries in the past decade is greatest under coalition, rather than majority, governments.

Other research shows a positive relationship between expenditures and the number of legislators and political parties. For example, Weingast (1979) and Shepsle and Weingast (1981) demonstrate that budgets are larger under coalitions, relative to single-party majority governments. This effect is exacerbated by multipartism; as the effective number of parties increases, coalition stability lessens and, because parliaments strive to reach near-unanimous agreements on budgetary matters (Niou and Ordeshook 1985) the size of the budget increases (Scartascini and Crain 2001). Similarly, Alesina (1987) and Alesina and Rosenthal (1995) show that the implementation of fiscal adjustments is relatively difficult under coalition governments.

The relationship between government stability and economic growth, thoroughly scrutinized by the political economy literature, is negative. Barro (1991) finds that governmental instability is negatively related to GDP growth due to its degradation of property rights. Alesina et al. (1996, 1991) reach the same conclusion, noting that risk-averse economic agents will avoid economic initiatives in instable nations, choosing to instead invest abroad, while foreign investors also prefer stable political environments, keeping their money away from unstable political systems. This bodes poorly for Portugal, as coalition and minority governments, when compared to majorities, are characterized by instability (Laver 2003).

Concerning government effectiveness, minority governments are conventionally portrayed as nondurable (Dodd 1976) and as lacking viability and effectiveness, when compared to majority governments (Linz and Stepan 1978). Strøm, however, indicates that there are some minority governments where policy outcomes are good, and others where there are disasters. For Strøm (1990), “undersized governments tend to be somewhat less durable than majority coalitions,” though “minority governments enjoy substantial advantages in electoral success and are less likely to resign under traumatic circumstances.” Strøm concludes that, “Minority governments are, in most respects, inferior to single-party majority cabinets.”

There are situations when the executive and the legislature can form a working relationship even when policy change seems unlikely; one actor may be willing to compromise on a policy in exchange for reciprocal behavior by another. Conversely, as noted, there are circumstances where stability can prevail in systems where instability is expected; perhaps due to a shortage of currencies available for compensation of actors' losses (Pereira et al. 2007). The availability of tradable

currencies, or political goods that can be exchanged for favors, affects the ability of actors in a political system to coordinate and form intertemporal working relationships. With the availability of exchangeable currencies, actors can bargain in order to produce legislation or other political outcomes. Conversely, if tradable currencies are not present, political production may become inefficient or counterproductive. Because Portugal has been prone to coalition and minority governments, coordination has been difficult. Table 1 summarizes the character of governments in Portugal since 1976.

[Table 1 About Here]

In Portugal, political coordination is also hampered by the direct incentives provided to its legislators. Closed-list proportional representation, which encourages loyalties to parties rather than constituents (Jones et al. 2002), decreases the ability of politicians to extract gains from exchange (Foweraker 1998). With closed lists, the ability of leaders in government to reward individual legislators with spending in their home district is lessened, as legislators are reelected on the basis of national-level outcomes associated with their party rather than constituency-level outcomes associated with them personally (Norris 2004). Accordingly, legislators will be less attached to their home districts under closed lists, and therefore less interested in pork-barrel spending.

Following from the above theory, it is expected that economic growth, stemming from effective policy, is more likely when legislatures are cohesive and major actors have incentives to cooperate. If coordination problems within and across government branches can be overcome, the quality of economic policies is likely to increase. Moreover, if governments are unstable economic growth is likely to be

relatively low. Therefore, minority and coalition governments will tend to be associated with less economic growth than single-party majority governments.

Portugal is particularly subject to a boost in growth from majority government status, as its institutional setups make it exceptionally hard to formulate successful intertemporal policy. As such, Portugal's lack of one-party majorities during its three decades of democracy is likely to negatively impact its economic performance. However, other theory, notably associated with Lijphart's seminal book, *Patterns of Democracy* (1999), argues that countries in which government functions through consensus building are better able to produce steady economic policy. Likewise, countries with majoritarian governments are capable of making sharp, abrupt changes in policy that can lead to poor economic performance. Following this logic, Portugal's economic performance should actually be *better* when there are multiple veto players in government.

Nevertheless, we are more persuaded by the theory of authors such as Alesina, Tsebelis, and Weingast, discussed above. While Lijphart tests his argument with a broad measure of consensual government, created with a factor analysis of ten variables, the contending theory explicitly considers the amount of decision makers (or veto players) involved in the formulation of policy. As the theory in our study is based on the ability of specific actors to cooperate, rather than the overall character of governments, we do not expect that our findings will follow those of Lijphart.

The outlook for Portugal in terms of long-term economic performance is gloomy. With semi-presidentialism and few majority governments, cooperation among political players is low, as is government stability. Moreover, closed-list proportional representation discourages cooperation. From political institutional

perspective, Portugal has a weak framework for the encouragement of economic growth.

## **6. Data, Methodology, and Results**

When political actors can cooperate and commit, good policy outcomes will result. When cooperation cannot be achieved, an atmosphere of rigidity prevails, in which conflicted interests are unable to coordinate on economic shocks. As noted, in Portugal the government is often composed of a coalition of parties or a single party without majority of seats. In such cases, adapting to economic shocks or efficiently allocating economic resources is difficult, as several players must coordinate to create or change policy. Conversely, if a single party controls the government, policymaking should be smooth, capable of fluid policy adjustment and resource allocation. Accordingly, we hypothesize that economic growth will be greater when a single party controls the government. We test our hypothesis by regressing GDP growth on a categorical variable gauging whether or not a single party held a pure majority of seats in government. Portugal's experience with majority governments is outlined in Table 1.

We assume that GDP growth responds to other economic variables not immediately, but after an interval of time. Thus, as controls in this equation we include a one year lagged version of the dependent variable, GDP growth,<sup>4</sup> as well as

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<sup>4</sup> Because of the possible ills that accompany the inclusion of lagged dependent variables on the right-hand side of an equation (see Keele and Kelly 2006), we also estimated a model in which we excluded the lagged GDP growth regressor from our equation. The results of this estimation closely mirrored the results presented in Table 3, with the exception that the R-squared was .360, or about forty-five percent of the

one-year lags of unemployment and foreign direct investment. GDP growth is measured per capita and as a percentage of total GDP, while foreign direct investment is measured as net inflows as a percent of GDP and unemployment is measured as a percentage of the total labor force. We also include lagged dummies for EU membership and adoption of the Euro. The EU dummy takes on values of one starting in 1986, the year of Portugal's admission to the Union, and the Euro dummy takes on values of one starting in 1999, the first year in which Portugal used the new currency. All continuous variables were obtained from the World Bank's World Development Indicators. The data is available for the twenty-four years from 1981 to 2004, which unfortunately does not correspond with the entire time series for which we have political data (given in Table 1). Each variable is summarized across the years in the sample in Table 2.

[Table 2 Around Here]

The low number of observations hampers the statistical power of our analysis. Thus, the analyses must be seen as an illustrative exercise rather than one of pure inference. Because of the time series nature of the data, we tested for autocorrelation of the residuals. We did so using an alternative Durbin-Watson statistic, designed to test for autocorrelation with a lagged endogenous variable. A  $p$ -value of .139 indicates that autocorrelation of the residuals is not guaranteed, but is a possibility.<sup>5</sup> Though our

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variance explained by the full model. This suggests that much of the variance in GDP growth is explained by the economic environment of the immediate past; if things are good one year, they will likely be good the next year, and vice versa.

<sup>5</sup> An examination of a corrgram indicated that autocorrelation was present for only one lag. As expected, the coefficient on a 2-year lagged version of the dependent variable, when included in our model, is near zero and statistically insignificant.

coefficients remain unbiased in the face of autocorrelation, our standard error estimates will be inefficient. Thus, to be safe and correct for any possible autocorrelation we use Prais-Winsten regression. This regression technique corrects for serially correlated residuals using the common Prais–Winsten estimator.<sup>6</sup> We also use Huber-White robust standard errors to account for heteroscedasticity of the residuals.<sup>7</sup> Our results are shown in the Table 3.

Based on the results of the regression, it is clear that governments with pure majorities are associated with higher GDP growth. On average, GDP grows about 1.2 percent more the year after a pure majority government is in power as compared to the year after a minority or coalition government is in power. This result is significant at the 5% level (two-tailed). The lag of the dependent variable and unemployment are significant at the 1% level, both relating positively to GDP growth. The finding that unemployment relates positively to growth is curious, but perhaps reflects an increase in people seeking new employment opportunities during periods of economic growth.

Membership in the EU and the adoption of the Euro are positively associated with economic growth, though the latter result does not reach a conventional level of statistical significance. The R-squared value of .89 indicates that a good amount of variance in GDP growth is explained by our equation.

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<sup>6</sup> See Prais and Winsten (1954).

We recognize that the exogeneity of the covariates is not guaranteed, but we are hesitant to enter a more complex regression framework, such as vector autoregression, due to the low number of observations in our analysis.

<sup>7</sup> A Breusch-Pagan test for heteroscedasticity returned a  $p$ -value of .043, indicating that the error variance in the model was likely non-constant.

[Table 3 About Here]

Figure 2, which maps the predicted versus actual values of GDP growth, indicates that we have adequately accounted for the time trend in our dependent variable. The figure shows that GDP growth is cyclical and has fluctuated over the past decades. The growth associated with the first majority government of Prime Minister Cavaco Silva, starting in 1987, is clear in the figure, though this growth tapers after his second majority government took office in 1991. There is a clear period of growth immediately after Portugal was granted EU membership.<sup>8</sup> However, a similar pattern is not apparent after Portugal's adoption of the Euro.

[Figure 2 About Here]

While GDP growth is a telling measure of economic performance, we also examine the impact of political circumstances on fiscal outcomes. Indeed, much of the theory expounded upon in Section 5 relates political coordination to fiscal outcomes. As such, we conduct two more analyses using the same estimation strategy, this time examining the effect of majority governments on Portugal's account balance and its gross savings. We measure both account balance and gross savings as a percentage of GDP. These variables are summarized in Table 2 and are from the World Bank's World Development Indicators.

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<sup>8</sup> This period after EU accession also corresponded with a period of majority government. Thus, it is not certain which factor explains the high economic growth in this period. Indeed, both variables are significant in the multiple regression depicted in Table 3. Most likely, the majority government of the time was able to act cohesively and quickly to reap the benefits of the EU accession.

In regards to the current account balance, the results depicted in Table 3 show that majority governments are associated with smaller deficits, though this result just misses conventional levels of statistical significance. The results also show that majority governments are positively related to gross domestic savings; savings as a percentage of GDP is roughly two points higher in years following a pure majority government. This result is significant at the 5% level (two-sided). In sum, evidence provides that when Portugal's political circumstances encourage cooperation among major actors, both economic and fiscal performance indicators experience a boost.

## **7. Discussion and Conclusion**

Reforming economies tend to follow a J-curve. That is, before things get better, they tend to get worse. In the words of Przeworski (1991, p. 138), countries must get through the "valley of transition" before reaching the "higher hills" obtainable with a reformed system. While the conclusions reached in this project do not place Portugal within the valley of the J-curve, it is not standing on the summit either. Portugal has been less successful than many of its European counterparts in generating economic growth and will need to see through more reforms as a prerequisite to sustained economic growth. Most importantly, Portugal needs to enhance incentives for cooperation among its political players in order to ease the process of economic policy creation.

Unlike many European Union country members, Portugal exploited the opportunity of EU membership in the short run only. We claim that political institutions contribute to this relatively feeble economic performance because those institutions do not provide incentives for intertemporal cooperation of political players. The combination of semi-presidential system without majority parliamentary

support tends to lead to less cooperation among political players and, as a consequence, government instability.

While economic growth is a product of multiple influences, its relationship with cooperation among political actors is remarkable. Our theory suggests that economic performance is at its best in any democratic system when major political actors are few or have incentives to cooperate. Building on veto players' theory, this paper investigates the institutional conditions under which players can extract gains from exchange.

We claim that the Portuguese political system does not enhance cooperation among political players because the system is too “dry.” That is, it lacks tradable currencies capable of compensating coalition players for potential losses; it lacks coordination in governing capacity and budgetary formation; and it lacks a credible enforcement mechanism as a result of its underdeveloped judiciary system. In this institutional environment, good economic outcomes require cooperation among political players, which, in the Portuguese case, is fundamentally a function of parliamentary majorities. Therefore, we hypothesized that good economic outcomes are related to the existence of single-party majority governments, which allow the prime minister to uninhibitedly govern and put forth his agenda.

However, single-party majority is extremely difficult to realize in the Portuguese proportional system, and Portugal's inability to foster positive collective economic action on the part of all political actors has led to its inability to sustain economic growth. In fact, majority government has occurred only three times since re-democratization. One of these occurrences is in the current government of Jose Socrates. Perhaps the economic policies in Portugal will be high-quality and growth-promoting under this favorable institutional condition.

The theory advanced in this paper provides a unique method of explaining economic performance in the world's democracies. To isolate as many growth-affecting factors as possible, we employed a case study framework, restricting our examination to Portugal's democratic period. However, our findings have broad implications beyond Portugal's borders. In any democracy where actors can come together to formulate sound policy, long-term performance will be enhanced. Whether such cooperation is due to majority governments, the nature of inter-branch relationships, bureaucratic effectiveness, or some other factors, likely differs across countries. Nevertheless, we believe that cooperation is related to growth in any democratic country, although the amount of cooperation that stems from one-party governments will vary due to each nation's unique institutional circumstances. Future work may examine the extent to which our theory and empirical findings are "exportable" to other countries, or whether they hold in a cross-national examination.

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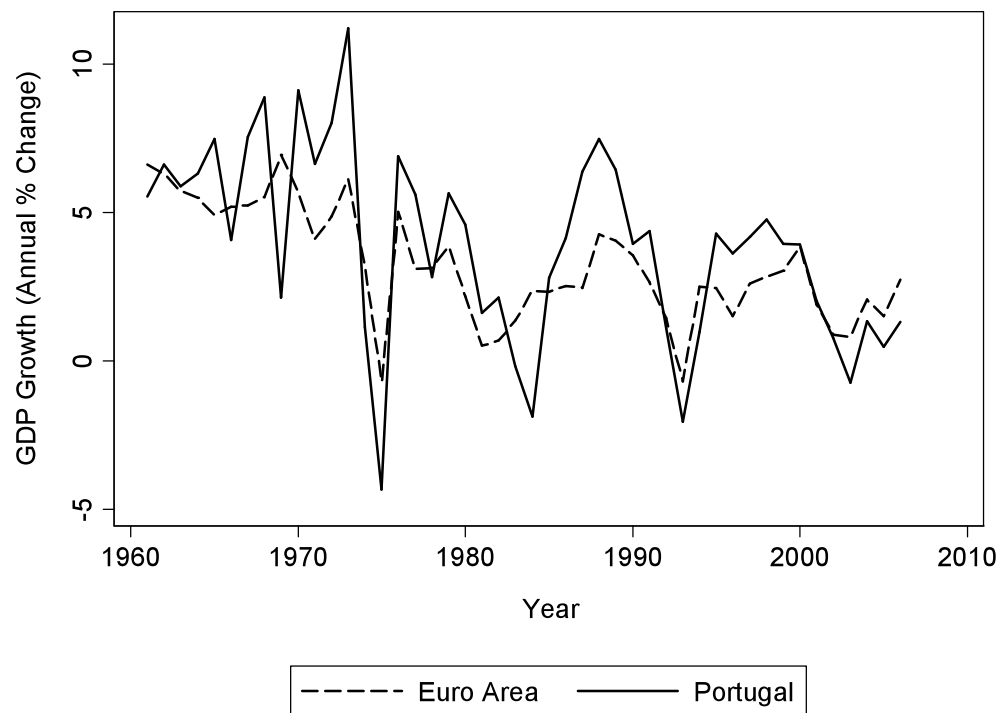
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**Figure 1: GDP Growth**



Source: World Development Indicators

**Figure 2: Actual vs. Predicted GDP Growth**

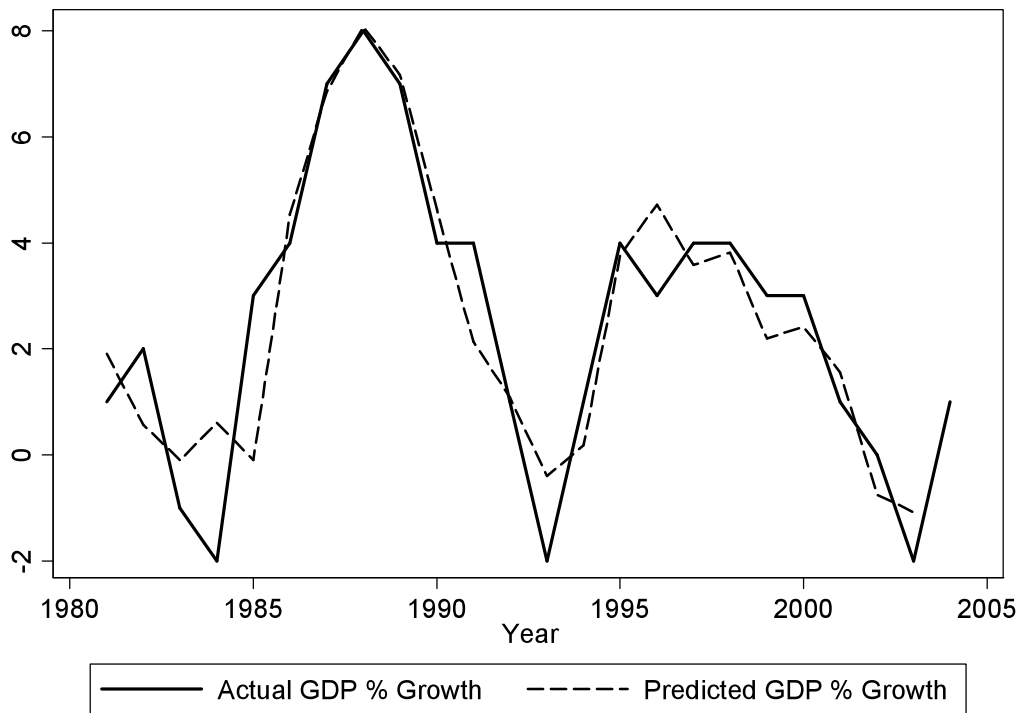


Figure based on the regression results depicted in Table 3.

**Table 1: Portuguese Governments, Type of Government and Coalition Parties**

Prime-Minister	Start-Date	End-Date	Duration (months)	Type of Government	Parties in Government	Number of Deputies	Number of Decrees
<b>Mario Soares</b>	23.07.76	23.01.78	17	Minority	PS	107/263	801
<b>Mario Soares</b>	23.01.78	29.08.78	7	Coalition	PS, CDS	107+42/263	245
<b>Nobre da Costa</b>	29.08.78	22.11.78	3	Non-Partisan	-		68
<b>Mota Pinto</b>	22.11.78	07.07.79	7	Non-Partisan	-		429
<b>Pintasilgo</b>	07.07.79	03.01.80	6	Non-Partisan	-		277
<b>Sá Carneiro</b>	03.01.80	09.01.81	12	Coalition	AD(PSD, CDS, PPM)	128/250	622
<b>Balsemão</b>	09.01.81	14.09.81	8	Coalition	AD(PSD, CDS, PPM)	134/250	236
<b>Balsemão</b>	04.09.81	09.06.83	21	Coalition	AD(PSD, CDS, PPM)		929
<b>Mario Soares</b>	09.06.83	06.11.85	29	Coalition	PS, PSD	101+75/250	1127
<b>Cavaco Silva</b>	6.11.85	17.08.87	21	Minority	PSD	88/250	937
<b>Cavaco Silva</b>	17.08.87	31.10.91	50	Majority	PSD	148/250	1999
<b>Cavaco Silva</b>	31.10.91	28.10.95	48	Majority	PSD	135/230	1371
<b>Antonio Guterres</b>	28.10.95	25.10.99	48	Minority	PS	112/230	-
<b>Antonio Guterres</b>	25.10.99	06.04.02	29	Minority	PS	115/230	-
<b>Durão Barroso</b>	06.04.02	17.07.04	27	Coalition	PSD/ CDS-PP	105+14/230	-
<b>Santana Lopes</b>	17.07.04	12.03.05	8	Coalition	PSD/ CDS-PP		-
<b>Jose Sócrates</b>	12.03.05	-	-	Majority	PS	121/230	-

Source: Martins<sup>9</sup> and authors' creation.

<sup>9</sup> Martins, A. 2006. "The Portuguese semi-presidential system: about law in the books and in action." *European Constitutional Law Review* 2(1), pp. 81-100.

**Table 2: Summary Statistics**

<b>Variable</b>	<b>Mean</b>	<b>Standard Deviation</b>	<b>Min</b>	<b>Max</b>
GDP % Growth	2.417	2.765	-2.00	8.00
Current Account Balance as % of GDP	-4.250	4.693	-15.00	3.00
Gross Savings as % of GDP	21.167	3.397	15.00	27.00
Majority Government	0.333	0.482	0.00	1.00
Unemployment Rate	6.179	1.552	4.00	9.00
FDI as % of GDP	2.042	1.628	0.00	6.00
EU Membership	0.792	0.415	0.00	1.00
Adoption of Euro	0.250	0.442	0.00	1.00

Data sources listed in text.

**Table 3: Economic Performance and Majority Governments**

Variable	DV: GDP Growth	DV: Account Balance	DV: Gross Savings
GDP % Growth (lagged)	0.704** (0.088)		
Account Balance as % of GDP (lagged)		0.177 (0.193)	
Gross Savings as % of GDP (lagged)			0.717* (0.141)
Majority Government (lagged)	1.191* (0.533)	3.413 (2.058)	1.966* (0.932)
Unemployment Rate (lagged)	1.427** (0.202)	0.522 (0.604)	0.819* (0.331)
FDI (lagged)	0.222 (0.335)	-0.052 (0.263)	0.200 (0.266)
EU Membership (lagged)	1.483* (0.699)	0.837 (4.093)	-0.278 (0.967)
Adoption of Euro (lagged)	1.078 (1.074)	-1.647 (1.455)	0.028 (0.754)
Constant	-10.329** (1.727)	-8.500 (8.181)	-0.222 (3.907)
R-squared	.887	.382	.884
Prob > F	.000	.000	.000
N	24	24	24

Note: Results are from a Prais-Winsten regression, along with Huber-White robust standard errors, conducted in Stata 10. *p*-values are two-sided. Data sources listed in text.

Two-sided significance levels: \*\*1%, \*5%. Robust standard errors in parentheses.