

Electoral Economics in New, Old, and Fragile Democracies

Allan Drazen

University of Maryland and NBER

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Conventional wisdom: **Incumbent politicians use economic policy, especially fiscal policy, to help their re-election efforts.**

1. Is the conventional wisdom correct?
2. How does it depend on country characteristics?
3. What is the actual electoral effect of economic growth, fiscal expansions, or deficits? How would this affect electoral strategies?
4. How does the perception that democracy is weak or not really consolidated affect electoral manipulation?

In a series of papers with either Adi Brender or Marcela Eslava, I have explored these questions.

Summarize a number of the findings

Political Business Cycles (Economic booms in election years)

Little evidence of a regular and statistically significant increase in economic activity before elections

Hence, attention shifted to political cycle in fiscal policy.

Political Budget Cycles (Fiscal expansions in election years)

Conventional Wisdom: Political Budget Cycle is a common phenomenon, especially in developing countries - Shi and Svensson (2006)

Incumbents use fiscal expansion to help their re-election

Another view – incumbents don't manipulate economy

- Very hard to fine tune the timing of aggregate effects
- Voters punish manipulation -- Peltzman (1992), Brender (2003)

Hence, two contradictory views of pre-electoral manipulation:

- ▶ It is a useful instrument to gain voter support and a widespread empirical phenomenon
- ▶ Voters punish rather than reward fiscal manipulation.

First Question: Is there a Political Budget Cycle (PBC) or not??

Brender and Drazen (2005a) examine empirically the existence of PBC in a cross-section of countries

SUMMARY OF KEY RESULTS - "New Democracy Effect"

- ▶ Political Deficit Cycle driven by the experience of "new democracies"
- ▶ Expenditure cycle in new democracies, not found in sample as a whole
- ▶ These countries account for finding political deficit cycle in larger samples including these countries.
- ▶ When these countries are removed from the larger sample, any political deficit cycle disappears.

Methodology

Basic data set - 106 Countries, 1960-2001

Use POLITY IV to limit to **democracies** (Fiscal expansion to influence voting most compelling when elections are competitive)

Number of countries in the sample is increasing over time in both the sample as a whole and in the subsamples of developed and less-developed countries.

1960s - 31 democracies

1970s - 44 democracies

1980s - 53 democracies

1990s - 69 democracies

ESTIMATION TECHNIQUES: Fixed Effects; GMM in small T samples

$$f_{i,t} = \sum_k \mathbf{b}_k f_{i,t-k} + \sum \mathbf{c}' \mathbf{x}_{i,t} + \mathbf{d}ELEC_t + \mu_i + \varepsilon_{i,t}$$

$f_{i,t}$ = fiscal variable in country i at t

x = controls

$ELEC$ = election year dummy

Fiscal variables: Central government balance, total expenditure, total revenue and grants from IFS. IFS data is notoriously noisy. A major part of the project was cleaning the data, using better data than other studies.

Controls: real per-capita income, population fractions by age, GDP relative to trend, trade share (These encompass controls used in Shi-Svensson)

ELEC - 1 in election year, 0 otherwise

- Adjusted to be consistent with fiscal year, when fiscal data are reported for a fiscal year different than the calendar year.
- Later on, we split sample into first- and second-half of year; pre-determined versus endogenous election dates; used a probability of early election variable

BASIC RESULTS: ALL DEMOCRACIES TOGETHER

We could reproduce Shi-Svensson results over 1975-95: Highly significant political cycle in the fiscal balance. Deficit in election year rises by about .3% of GDP relative to non-election years

"Old" versus "New" Democracies

New Democracies (NDs) are countries that became democracies during the sample period (including FSEs in Eastern Europe and the FSU, 1990-2001)

Take (up to) first four competitive elections these countries.

BASIC RESULTS: NEW DEMOCRACIES

- Significant deficit and expenditure cycle (both with and without FSEs)
- Similar coefficients on the fiscal balance and on expenditures
Deficit cycle in NDs appears to be clearly driven by higher election-year expenditures
- Larger coefficient on electoral variable (.8 vs .3) than in full sample

Effect of Economic or Political Characteristics

1. Parliamentary versus Presidential Systems

Significant deficit cycle in *both* presidential and parliamentary systems, but only for NDs.

2. Proportional versus Majoritarian Voting Rules

Deficit cycle is significant only under proportional voting rules in whole sample, but this is driven by NDs

Hence, electoral rule matters, but only in the group of countries where the fiscal cycle exists to begin with, namely, the new democracies.

3. Regularly scheduled versus early elections

In NDs, similar, statistically significant coefficient on $ELEC_t$. Not significant in ODs for either pre-determined or for endogenous election dates.

4. Level of democracy

PBC is stronger in countries with a lower level of democracy, but the effect of the level of democracy is entirely due to the new democracies.

- Composition Effect - Proportion of new democracies is higher in set of countries with low than high level of democracy -- 50 percent of data points versus 7 percent.

For each characteristic, significant findings of a deficit cycle are driven by the experience of new democracies.

The New Democracy Effect

Data show quite clearly that the political budget cycle is a phenomenon of new democracies. **Why are new democracies more susceptible to election-year economics at the aggregate level?**

1. Voters in new democracies are “stupid”, “naïve”, “easily fooled”. ☹️
2. In NDs, voters have less experience with electoral economics; less fiscal information; media also less experienced and thus less able to deliver relevant information to voters or to help them analyze it.
3. In New Democracies, democracy is often not fully “consolidated”.

This suggests a basic question – **How do voters react to fiscal or macroeconomic performance?**

Do deficits, high growth, low inflation actually gain votes?

This has not been tested in a large cross-section of countries!

Brender and Drazen (2005b) - Sample of 74 countries over 1960-2003

Estimate Probability of incumbent being re-elected, as function of macroeconomic and fiscal variables in election year and over term of office

Narrow definition of **incumbent**: leader is running for reelection herself

Expanded definition: add cases in which a leader was substituted by another candidate from his party if: 1) the leader died in the year before the elections; 2) the leader could not run for reelection due to legal term limits.

Electoral Effect of Macroeconomic Performance

1. Higher **growth rates** of real GDP per capita raise the probability of reelection only in the less developed countries and NDs

Consistent with World Values Survey — voters in developing countries and NDs place more emphasis on economic performance than voters in developed countries or ODs.

- Voters are affected by growth over the leader's term in office rather than in the election year itself.
- Voters appear to reward component of growth *not* arising from global growth

(i.e., no evidence that these voters are stupid)

2. **Low inflation** is rewarded by voters only in the developed countries

Electoral Effect of Deficit Spending

No evidence that deficits help reelection in **any group of countries**

- developed and less developed
- new and old democracies
- countries with different government or electoral systems
- countries with different levels of democracy.

In **developed countries** and **ODs**, election-year deficits significantly **reduce** the probability that a leader is reelected (7-8%). Similar negative electoral effects of deficits in the earlier years of an incumbent's term in office

In **developing countries**, **NDs** no significant effect in either direction with narrow definition of incumbent, perhaps a negative effect in broad definition

In short, even in New Democracies, voters do **not** reward deficit spending at the polls

If deficits are strongly punished in **Old Democracies**, what strategies do politicians use to influence voters?

Target expenditures or transfers to some voters at the expense of others to influence voters but keep the deficit unchanged.

But this raises another question: **Why does being targeted before an election lead to expectation of favored treatment after the election? That is, why vote for incumbent who spends on me before the election?**

Existing models of targeting groups (Lindbeck and Weibull, Dixit and Londregan) assume that candidate commits to post-electoral allocation of spending and transfers.

But suppose "citizen-candidates" cannot credibly commit to something other than their preferences

Unobserved Politician Preferences over Groups (or Regions)

Drazen and Eslava (2006)

These preferences have some persistence. Hence, if politician favors a group before election, it expects favored treatment after the election.

Unobserved politician preferences mean voter must solve an inference problem: Am I targeted before election because politician favors me (and will after election) or because I am electorally valuable (and will be ignored after)?

Key **differences** when unobserved characteristic is politician **preferences** rather than **competence**, as in Rogoff:

- Electoral fiscal manipulation occurs even if budget is perfectly observed (consistent with good fiscal information in ODs, developed countries)
- PBC even if all politicians are equally able to provide public goods.

Rational Political Equilibrium

- Politician chooses election-year spending based on electoral response (and on his preferences)
- Rational, forward-looking voter behavior (based on the voter's inference problem) induces that voting behavior.

Key characteristic of voter beliefs: Receiving transfers or targeted expenditures before election implies rational expectation of some probability of favored treatment after the election as well.

In equilibrium, election-year economics succeeds in gaining the votes of rational voters, even though they know there is some probability that they are being targeted solely to get their votes.

In fact, there will be a political budget cycle *even if* voters know their region (or group) is targeted because they have many swing voters.

In New Democracies why are there significant increases in deficits in election years if deficits don't help incumbents get re-elected?

In many NDs, democracy not fully consolidated - some groups, including segments of the public, do not view democracy as "the only game in town".

Hence, high expenditures in election years may be needed not to help defeat the challenger, but to prevent the collapse of democracy.

Expenditures are targeted to help **convince voters that democracy "works"**.

World Values Survey — Significantly greater proportion of individuals in NDs express uncertainty about the value of democracy than in ODs.

Who is targeted: Elites or the Public?

Usual focus in discussions of democratic consolidation is on anti-democratic elites and how they must be placated. (Acemoglu and Robinson [2005]).

In Brender and Drazen (2006) we argue that anti-democratic elites may be unable to overthrow democracy without support from the citizenry.

Hence, affecting regular citizens' attitudes about the effectiveness of democracy is crucial.

Linz and Stepan (1996): "the overwhelming majority of consolidated democracies did not actually begin their transition to democracy with a majority of members of the polity . . . being either convinced democrats. Rather, a democratic majority emerges when elites and ordinary citizens alike begin to evaluate . . . that democratic procedures of conflict regulation are better or less dangerous than any other form of governance."

Why election years?

- These are critical points of vulnerability of democracy?

Democracies are three times more likely to collapse in election years than non-election years.

- Cost of losing office when democratic system is discarded is probably much greater than losing an election in a democratic system not itself in danger.
- Incumbents perceive quite high benefit to showing the system works, even if they are self-interested rather than concerned with the survival of democracy per se.

Newness versus fragility

It is the **combination** of fragility and newness that is key to political deficit cycles in new democracies.

Newness implies incomplete information about how the economic system will function under democracy (and how democracy itself works).

Running deficits to strengthen the public's perception of a well-functioning system (for example, to pay salaries to government workers), will not be seen as electoral manipulation as easily as when voters have more experience with democracy and "election-year" economics.

How might fragility and newness of democracy affect fiscal policy?

1. Overthrow of democracy requires anti-democratic elites having sufficient support from citizens disenchanted with democracy.
2. Citizens form their beliefs based on economic outcomes, that is, their perception of how well the economic system functions. (Voters in NDs especially concerned about economic performance.)
3. Government has incentive to expend resources when democracy is vulnerable to convince voters that "democracy works". Hence, economic policies to preserve democracy aimed not only at elites, but also at citizens.

Summary of argument (continued)

4. More specifically, fiscal policy directed at those things that convince citizens that democracy "works." Expenditures to induce belief in democracy (and resulting deficits) may be quite large.
5. Elections are often focal points for democratic discontent. Hence, election years may be characterized by high deficits.
6. The public's limited experience with the democratic system makes them perceive improved performance before an election as a true indicator that democracy works, rather than simply pre-electoral manipulation.

Concluding comments

We hope this research induces people to re-examine conventional wisdom about "election economics"

- What actually happens;
- What attracts voters;
- Whether playing on the "stupidity" of voters is an effective strategy;
- How New Democracies differ in these respects.

The research on the policy implications of democratic fragility is also connected to a new research agenda of mine

Building general political economy models for weak states and less developed countries and how these models may differ (or not) from those used in strong states and developed countries.