Political Budget Cycles and Democratization in Latin America, 1973-2008

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Abstract

We test for political budget cycles in a panel of eighteen Latin American democracies from 1973 to 2008. Recent studies have argued that the pattern of deficit cycles in a large cross-section of countries is driven by the experience of ‘‘new democracies.” As a large share of the countries that underwent democratization during this period are in Latin America, we seek to verify if these patterns are robust using an updated data set on fiscal expenditures, democratization and elections. Our results suggest that political budget cycles are driven by democratic transitions in Latin America. Our findings are robust to whether objective judgment and observational criteria of democracy and democratic transitions are employed, or measures based on vague and arbitrary operational rules. Furthermore, we show that the deficit cycle in transitional Latin American democracies appears to be driven by lower election-year revenue collection rather than an increase in public expenditures.

Keywords: Political budget cycles; Elections; Latin America.

1. Introduction

The literature on political business cycles has produced important insights on the extent to which politicians attempt to manipulate government monetary and fiscal policies to influence electoral outcomes. In particular, some of the strongest evidence produced to date suggests that electoral cycles are particularly marked in the case of government expenditures (Drazen, 2000; Franzese, 2002). Oftentimes, it is also asserted that governments in developing countries and "new democracies" are most susceptible to the manipulation of fiscal and monetary policy to enhance their chances of re-election (Block, 2002b; Brender & Drazen, 2005). The experiences of recently re-established Latin American democracies in a period marked by episodes of heightened macroeconomic volatility followed by the adoption of painful stabilization measures provides fertile ground for testing political budget cycle (PBC) theories and recently formulated arguments on the acuteness of these patterns for young fragile democratic regimes in developing countries.

Arguing that empirical tests seeking to verify political budget cycles must be grounded in theoretically rigorous definitions of democracy, transitions and elections, in this paper we employ different measures of these institutional variables to test for political deficit cycles in Latin American democracies. We provide evidence to support the importance of employing objective measures of these institutions to accurately capture the nature and degree of political competition and using these corresponding measures for testing for political budget cycles. We then show that political deficit cycles in Latin American democracies are contingent on whether a country is in the early phase of its democratic transition or in a subsequent phase (assuming that the democratic regime is maintained). Furthermore, we also show that political deficit cycles in transitional Latin American democracies are driven by lower election-year revenue collection. We argue that these findings suggest that democratic regimes in the transition period are more likely to use tax policy, rather than public expenditures, to garner support because governments are seeking to reduce political instability by quelling those economic groups that are most likely to threaten the continuity of democracy.

This paper seeks to answer two main questions. Are elections catalysts for fiscal policy performance in Latin America? Are electoral competitions held during democratic transitions more likely to provoke larger changes in fiscal deficits? The paper is structured in the following way. Section 2 reviews existing theory on the behavior of democracies with respect to government spending, revenue collection and budget deficits, as well as findings that might suggest why competitive elections held in Latin America during transitional democratic periods may prove to be particularly important and distinct. Section 3 describes the time-series-cross-sectional data set employed for hypothesis testing and introduces the measures that will be employed to test for the impact of elections in all Latin American democracies and on whether cycles differ by whether a democratic regime is in transitional or consolidated stage. In this section, we also discuss different measures for democracy and recent democratization and the importance of using these measures to undertake more robust testing of the findings reported in earlier studies on PBCs in recent democracies. Section 4 introduces the model specifications that will be used for hypothesis testing in this paper and the battery of alternative models that are adopted to check the findings for robustness. Section 5 presents and discusses the results of the empirical analysis. The final section concludes the paper with a summary of the key findings.

2. Review of the Literature

A crucial assumption of political *business* cycle models is that voters choose leaders on the basis of economic variables and accordingly the degree, nature and timing of economic policies exerts influence on citizen decisions at the ballot box.[1] The electoral motivations that may guide government policies were discussed by Schumpeter (1939) in his study of business cycles and described by Kalecki (1943), but the theoretical framework to describe the "opportunistic (office-seeking)" motivations of politicians

[1] For a critique and dissenting view of political budget cycles, see Alt and Chrystal (1981).

were developed formally by Nordhaus (1975) and Tufte (1978). In these early and subsequent models based on the same assumptions: elected leaders in control of monetary policy were able to successfully manipulate economic activity by surprising myopic voters who were limited in forming their opinions based solely on *past* incumbent performance and inflation rates. More recent theories have made important advances in two important realms (Drazen, 2000). First, models including those developed by Rogoff and Siebert (1988) and Rogoff (1990) have incorporated forward-looking, rational expectations. Second, they have further advanced research on the effects of right and left-wing party orientation on macroeconomic outcomes during and after elections (Alesina, 1987).[2]

Arguing that monetary surprises are an unconvincing driving force for political *business* cycles, a group of studies have reinvigorated efforts to develop and test models that emphasize *fiscal policy* as the motivating force for opportunistic cycles (Drazen, 2000). The basic rationale behind models that emphasize the political *budget* cycle is that governments will manipulate fiscal policy, in part, in order to obtain electoral success. Based on empirical research, a significant number of recent studies have argued that PBCs are more acute and more marked in the case of less developed countries (Block, 2002a, 2002c; Block, Ferree, & Singh, 2003; Schuknecht, 2000; Shi & Svensson, 2002, 2006).[3]

Given the widespread political instability in the region and macroeconomic fluctuations that marked Latin America in recent decades, a significant share of the literature directed at PBCs in developing democracies has focused on Latin America.[4] Thus far, the evidence of the "electioneering" of government expenditures and fiscal balances in Latin America, however, has yielded inconclusive findings.

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[2] For a valuable summary of the findings emerging from partisan cycles, see Franzese (2002). The effects of ideological orientation on the findings reported in this paper will be a task for future research.

[3] In contrast, Persson and Tabellini (2003) find that PBCs are also present in developed democracies in a sample that also includes developing countries,.

[4] In this section, we have chosen to concentrate our analysis on a discussion emphasizing cross-national empirical research. There have been a number of notable contributions to the study of political budget cycles in specific Latin American countries including Drazen and Eslava (2009).

Ames (1977) finds that government expenditures rose prior to and after the 65 elections that took place in seventeen Latin American countries between 1948 and 1970, although only post-election spending proved to be statistically significant. For the same group of countries, Ames (1987) reports that government expenditures increased by 6.3 percent in the pre-election year and decreased by 7.6 percent in the year after the 82 elections that took place between 1947 and 1982.

In a study of eight South American democracies during the 1980s, Remmer (1993) reports that the quarterly percentage change in the fiscal balance is heterogeneous across countries. She argues that elections in Latin America during the 1980s provided leaders with greater political capital to enact reform given voter's preferences for reduced income volatility and inflation. Underscoring the importance of the macroeconomic context in the region, she posits that there is evidence of an "anti-political business cycle" in presidential elections in Argentina (1989), Bolivia (1985), Brazil (1989), Ecuador (1984 and 1988), Peru (1990) and Venezuela (1988) for the exchange rate and inflation. However, evidence of disciplined fiscal restraint is not robust across countries. Budget deficits were only reduced in the election of Carlos Andrés Pérez Rodríguez in Venezuela, while the election of Carlos Saul Menem in Argentina was followed by fiscal expansion.

More recent studies on the political determinants of government spending and budget deficits in Latin America have produced stronger evidence of PBCs, but the reported findings have been based on only a sub-set of all Latin American democracies (Amorim Neto and Borsani 2004; Mejía Acosta and Coppedge 2001). Controlling for a multiplicity of political determinants in a study of eight Latin American countries between 1983 and 1998, Mejía Acosta and Coppedge (2001) find that budget deficits worsen during elections, though government expenditures are not found to increase. These findings are confirmed in a study of the influence of presidential and cabinet effects in ten Latin American countries between 1980 and 1998 by Amorim Neto and Borsani (2004). Based on these findings, the authors argue that fiscal difficulties during elections are driven by the reluctance of governments to increase taxes. In this paper,

using data from the entire sample of eighteen Latin American democracies for the period between 1973 and 2008, we seek to elucidate these earlier suggestive, albeit inconclusive, findings.

As we will further argue in the subsequent sections of this paper, one of the problems that poses the greatest challenge in interpreting the empirical evidence that has been produced to date in studies directed at examining PBCs in developing democracies is that all too often insufficient attention has been directed at the selection criteria utilized to define democracy and competitive elections. This point is underscored by Brender and Drazen (2005), who conclude "In our view, if the political budget cycle reflects the manipulation of fiscal policy to improve an incumbent's re-election chances, then it only makes sense in countries in which elections are competitive (1274)." Indeed, our review of the studies that have tested for PBCs during elections in developing countries reveals that many include contests held under both democratic and authoritarian regimes (Block, 2002a, 2002b; Block et al., 2003; Shi & Svensson, 2002, 2006). For example, Block (2002a) finds a marked increase in presidential election-year public expenditures on current consumption goods and away from public investment in 69 developing countries between 1975 and 1990. However, this study includes both multi and single party elections thus confounding interpretation as to exactly how regime type might be influencing the reported results.

The same problem is also found in research specific to Latin America. In both of the cited studies by Ames, elections during periods in which countries were ruled by the military were included. Mejía Acosta and Coppedge (2001) include Mexican presidential elections that include years in which electoral victories were dominated by the Partido Revolucionario Institucional (PRI) and compare these elections with the outcomes from decisions in Argentina, Brazil, Chile, Ecuador, Venezuela and Uruguay after democracy had returned to each of these countries.[5] To address our concern, in this paper we adopt a

[5] The authors also recognize this problem stating, "although Mexico was not clearly democratic until the 2000 presidential election, it offers a useful example of fiscal performance in a hegemonic party system (9)."

research design to test for PBC cycles paying careful attention to how democratic elections are defined.

Political Institutions in Recent Democracies

One of the most often cited arguments made as to why we should expect to find greater political budget cycle effects in developing democracies focuses on the level of development of their political institutions (Brender & Drazen, 2005; González, 2002; Keefer, 2005; Keefer & Khemani, 2005; Persson & Tabellini, 2003). These studies argue that the dynamics of political competition are very distinct in recent democracies due to both the experience level of voters and the level of maturity of political institutions. As voters lack experience and information to hold elected officials accountable in democracies that have recently transitioned from authoritarian rule, they are more apt to believe campaign promises and can therefore be more easily manipulated by politicians in the first few elections. In addition, it has been argued that political institutions such as the legislature, the judiciary, central banking authorities, and the media may not be autonomous or institutionalized in the early stages of democracy (Schuknecht, 2000).

In the related literature on democratization, Przeworski (1991) argues that pressures to bring about greater representation are driven in great part by Keynesian coalitions that coalesce to demand greater redistribution. Accordingly, he argues that incoming elected governments during democratic transitions come to power facing a huge backlog of unfulfilled demands, which weakens their ability to effectively manage the economy. Based on the recognized confluence of economic and political crisis that usually precipitate democratic transitions, scholars have argued that newly elected governments find themselves needing to adopt policies that are unsustainable in the medium to long-run given the high stakes involved threatening a reversion to autocracy (Haggard & Kaufman, 1989). An important test of these theories is the impact of elections on government spending in the early stages of democratization as the explanations cited to explain the vulnerability of recently elected governments to these pressures should be even greater in the elections prior to the stabilization of democracy.

Brender and Drazen (2005) provide an important and noteworthy contribution to the impact of recent democratization on PBCs by robustly testing for them in a cross-section of developed and developing countries from 1960-2001. These authors argue that the pattern of political budget cycle in a large cross-section of countries is driven by "new democracies" and that fiscal manipulation no longer is statistically significant for established democracies once the sample is appropriately separated.[6] Adopting the definition in which the first four competitive elections are considered to be the "new democratic" period, Brender and Drazen (2005) find that there is a significant political deficit cycle for new democracies and argue that higher election-year expenditures in the "first few elections" are the lever triggering this effect. The authors argue that their findings resonate with earlier studies that have found that voters in developed economies are ''fiscal conservatives'' and often tend to remove deficit-producing incumbents from office (Alesina, Perotti, Tavares, Obstfeld, & Eichengreen, 1998; Peltzman, 1992). In contrast, they argue that voters in new democracies are "less experienced" with electoral economics and verify that the net result is that higher spending and deficits are associated with the first few elections after transition.

In a related vein, Block, Ferree and Singh (2003) test whether there are higher peaks in economic policy performance in the early period of democratization. The authors focus on "founding" competitive elections in sub-Saharan African countries between 1980 and 1995, which they define as the first election in which the position of the head of office was openly contested. The authors argue that these elections may be particularly vulnerable to PBCs as authoritarian incumbents have greater discretion to manipulate expenditures prior to elections. Moreover, non-democratic leaders who are reluctantly holding elections may also dig in deep to government coffers to scare off the

[6] It should be noted that this is not the only criterion that has been utilized to test for differences between "new" and "established" democracy periods based on a specific time period. Gasiorowski and Power (1998) argue that a newly established democratic regime becomes sufficiently durable that a return to nondemocratic rule is no longer likely after twelve years. Rodrik and Wacziarg (2005) define "New Democracy" as a variable that "takes on a value of 1 in the year(s) and subsequent five years of any major democratization (as defined by Polity IV), unless the process is interrupted by another major regime change, in which case the dummy is coded as 1 until the interruption"; "Established Democracy" is an indicator variable coded one for the sixth and subsequent years of a democracy (51).

opposition as the winners will undoubtedly have to undertake painful stabilization measures. Countries that have only recently undergone democratization may have reduced capacities to check and balance the powers exerted by the executive branch. In addition, voters may also be more credulous rendering non-democratic rulers with greater power to manipulate fiscal and monetary policies. Based on 65 presidential elections, they report that multiparty competitive elections (22 of total elections) are associated with higher monetary growth and government consumption as a share of GDP. However, the hypothesis that founding elections have an additional effect on government spending is not validated.

In Latin America, some suggestive evidence that increases in political competition during the transition to democracy fuel political budget cycles is provided by González (2002) in a study of autocratic Mexican presidential elections between 1957 and 1997. Claiming to capture increased levels of "democratization" during elections as measured by lower scores on the Index of Political Coercion and the Autocracy Index, she argues that greater levels of "democracy" exacerbate political budget cycles as the PRI responded to the growing threat of losing power by spending more and more resources in election campaigns to ensure its victory. With the development of Mexico's political institutions leading to improvements in transparency and accountability, the study concludes by warning that the election effect will increase as the country becomes more accountable and democratic.

Given that the majority of countries in Latin America experienced a founding election marked by the participation of formerly banned political parties and the retreat of the military between the late 1970s and 1990s, Latin America represents an extremely relevant and important region for examining the vulnerability of democratizing countries to PBCs . Indeed, transitions to democracy occurred in Argentina, Bolivia, Brazil, Chile, Dominican Republic, Ecuador, El Salvador, Guatemala, Peru and Uruguay between 1974 and 1990. Subsequently, democracy also returned to Panama and Paraguay in the mid 1990s and Mexico in 2000.

One of the striking features of the recent empirical research aimed at testing whether recent democratization yields is associated with higher fiscal deficits, decreases in tax collection and higher government spending is that the beginning and end of democratic transition is based on a measure that establishes a given number of elections (i.e. the first election, or the first four competitive elections) as the turning point prior to democratic stabilization. Alternative definitions for distinguishing between the period of democratic transition and stabilization based on subjective criteria have been developed in political science, but have not yet been used in empirical PBC research. In this paper we seek to test the findings that have emerged from studies that have argued that "new democracies" or democratizing countries are more susceptible to political budget cycles by examining whether results differ when objective judgment and observational criteria for democratic transitions are employed in comparison to measures based on subjective definitions that rely on vague and arbitrary operational rules.

3. Data

Fiscal Data

The dependent variables in this paper are drawn from annual data on central government total expenditure, total revenue and grants, and balance drawn from the International Monetary Fund (IMF)'s *Government Finance Statistics* (GFS)(International Monetary Fund, 2009). We used the data set based on the IMF's GFS database that was revised by Brender and Drazen (2005) for the period between 1973 and 2000 and added observations for the period between 2001 and 2008 for those countries in which data were available from the IMF.[7] All three variables are defined in relative terms as a percentage of GDP, which is based on the figures reported by the IMF in its *International Finance Statistics* (IFS). In all eighteen countries the fiscal calendar year follows the calendar year.

[7] The raw GFS data was supplemented by IFS data by the authors. The procedures are described in Brender and Drazen (2005). The data set is available at: http://www.econ.umd.edu/~drazen/.

It should be noted that the terms fiscal balance and deficit will be used interchangeably in the paper as most countries ran persistent budget deficits throughout the period. A positive value of the fiscal balance should be interpreted a budget surplus.

Democracy and Election Data

One the main motivations of this paper is to test those studies that have argued new democracies are more susceptible to political budget cycles by testing whether results differ when objective judgment and observational criteria of democracy and democratic transitions are used. To explore these differences, we run all empirical tests employing two different definitions for democracy and democratic transitions.

We control for the number of elections during democracy years employing two different definitions. The first measure is based on Polity IV, analogous to Brender and Drazen (2005) and Persson and Tabellini (2005), and restricts the sample to those countries who received a score between 0 and 10 on the political regime scale that ranges from -10 (autocracy) to 10 (the highest level of democracy), as first suggested by Londregan and Poole (1990). This is the standard measure used in most empirical research on PBCs. The data are based on country assessments by academics based on available literature (Marshall, Jaggers, & Gurr, 2008). However, as the measure involves subjectivity, it is not easily reproducible.

The second measure is based on a dichotomous definition of democracy that, in contrast to Polity IV, seeks to define democracy based on minimalist criteria and which we will refer to as such throughout the paper. The minimalist criterion for democracy dummy variable is drawn from an updated database developed by Cheibub, Gandhi and Vreeland (2009) that extends—both in terms of country and year coverage and in terms of variables—the dataset first published in Álvarez, Cheibub, Limongi and Przeworski (1996). This measure stresses that the coding of democracy should be restricted to the period in which incumbents lose power through elections and willingly relinquish power to the winner (Przeworski et al. 2000). The strength of this data is that the coding of democracy is driven by its conceptual definition stemming from the political science

literature, as it is based on rules that assess whether the offices of the executive and legislature are filled through elections and whether elections are contested.

Under either Polity IV or the Cheibub et al., Colombia, Costa Rica and Venezuela are considered democratic during the entire period. However, in each case, the sample is unbalanced as the other fifteen countries enter the sample in only some years. In some cases, the coding of democracy is in agreement whether Polity IV or the minimalist definition is employed. For example, Argentina is excluded in both samples between 1976 and 1982. In other cases, there are major differences in the year of entry or exit of a particular country.

The most important differences between Polity IV and the minimalist criterion are in the treatment of Mexico and Peru. Based on Polity IV, Mexico is included as a democracy commencing in 1988 with the election of Carlos de Salinas de Gortari. In contrast, this country is only coded by Cheibub, Gandhi and Vreeland as a democracy after the 2000 election in which Vicente Fox assumed power after the Partido Revolucionario Institucional (PRI), which had dominated Mexican presidential elections since 1910, ceded power to the Partido Acción Nacional (PAN). In the case of Peru, the period between the election in 1990 after which Alberto Fujimori staged a *coup d'etat* in April 1992 until his resignation in 2000 is considered autocractic by Cheibub, Gandhi and Vreeland, but it is considered part of an uninterrupted period of democracy that began in 1980 if the Polity IV data set is used. These differences and additional ones for a smaller number of years in the cases of Bolivia, Chile, the Dominican Republic, Ecuador, Guatemala and Nicaragua result in the fact that 45 years are coded differently depending on which measure is utilized.[8]

The "rule of the year" was used to create a dichotomous dummy variable that codes one for the year of a presidential election. Under this measure, the year was coded as one if a presidential election occurred in that particular year from January to

[8] There are 20 years that are considered democratic years by the minimalist definition that are excluded from Polity IV and 25 years that are coded democracy years in Polity IV that are excluded when the minimalist criterion is adopted.

December. Thus, under the rule of the year methodology "1" indicates that the election occurred after January 1st and before December 31st of the year in question and otherwise the value of "0" was assigned.[9] Election data is drawn from the information reported in Nohlen (2005) and the *Political Database of the Americas* (Center for Latin American Studies at Georgetown University, 2009). Table 1 presents a summary of the elections that are included and specifies which elections are points of contention depending on whether the Cheibub, Gandhi and Vreeland database or Polity IV are utilized to define democratic regimes.

Table 1. Presidential Elections in Latin America, 1973-2008

Country	Presidential Election Dates	Elections excluded by Minimalist Criterion	Elections excluded by Polity IV Criterion
Argentina	9/1973, 10/1983, 5/1989, 5/1995, 10/1999, 4/2003, 10/2007		
Bolivia	6/1980, 7/1985, 5/1989, 6/1993, 6/1997, 6/2002, 12/2005	6/1980	
Brazil	1/1985, 11/1989, 10/1994, 10/1998, 10/2002, 10/2006		1/1985
Chile	12/1989,12/1993, 12/1999, 12/2005	12/1989	
Colombia*	4/1974, 4/1978, 5/1982, 5/1986, 5/1990, 6/1994, 6/1998, 5/2002, 5/2006		
Costa Rica*	2/1974, 2/1978, 2/1982, 2/1986, 2/1990, 2/1994, 2/1998, 2/2002, 2/2006		
Dominican Republic	5/1974, 5/1978, 5/1982, 5/1986, 5/1990, 5/1994, 6/1996, 5/2000, 5/2004, 5/2008		5/1974
Ecuador	4/1979, 1/1984, 1/1988, 7/1992, 7/1996, 6/1998, 10/2002, 10/2006		
El Salvador	3/1984, 3/1989, 4/1994, 3/1999, 3/2004		
Guatemala	3/1974, 3/1978, 11/1985, 11/1990, 11/1995, 11/1999, 11/2003, 9/2007	11/1985	3/1974, 3/1978, 11/1985
Honduras	11/1981, 11/1985, 11/1989, 11/1993, 11/1997, 11/2001, 11/2005	11/1981	
Mexico	7/1988, 8/1994, 7/2000, 7/2006	7/1988, 8/1994	
Nicaragua	11/1984, 2/1990, 10/1996, 11/2001, 11/2006		11/1984
Panama	12/1989, 5/1994, 5/1999, 5/2004		
Paraguay	3/1989, 5/1993, 5/1998, 4/2003, 4/2008		
Peru	5/1980, 4/1985, 4/1990, 4/1995, 4/2001, 4/2006	4/1990, 4/1995	
Uruguay	11/1984, 11/1989, 11/1994, 10/1999, 10/2004	11/1984	
Venezuela*	12/1973, 12/1978, 12/1983, 12/1988, 12/1993, 12/1998, 7/2000, 12/2006		

Notes: * No democratic transition elections.

Source: Elaborated by the authors.

Based on the Polity IV criterion, there are 107 presidential elections. Based on the minimalist criterion, 108 elections took place in Latin America between 1973 and 2008. All eighteen countries in the region had at least one presidential election, but different elections are included or excluded depending on the criterion that is adopted. On average, there are 3.5 presidential elections per country. We limit attention to the years of presidential elections and do not include midterm legislative elections. The focus on presidential elections follows the literature; studies that have included congressional elections have not found that these elections have distinct impacts on electoral cycles (Drazen, 2000).

[9] An alternative measure based on the "rule of the semester" was also tested. The results from this alternative method were used as a check on the results reported in the paper, but are not presented in the discussion that follows.

We employ two measures to test if the PBCs in Latin American democracies are driven by the period of transitional democracy. The first measure follows the definition adopted by Brender and Drazen (2005) in which observations for the first four competitive elections are defined as coming from a ‘‘new democracy.’’ According to this criteria, 60 of the 107 Latin American elections that took place are considered to have taken place in the period of ‘‘new democracy,’’ which represents a share of 56 percent of all elections.

In contrast, the second measure for recent democratization is not based on an arbitrary time period, but one guided by theoretical underpinnings. We created a dichotomous dummy variable that codes one for the period of “transitional democracy”. The beginning of democratic transition is defined as the year of the inauguration of the first democratic regime following a period of authoritarian rule (O'Donnell & Schmitter, 1986). This measure follows Huntington (1991), who defends the alternation in power of opposition parties as a distinct criteria that is important for defining the consolidation of democracy. This measure is also consistent with the definition of democracy adopted in this study following Álvarez, et al (1996), who argue that this regime is characterized by the opposition rising to power through elections.

Huntington (1991) proposes that the onset of stable democracy can be defined as period after the second consecutive democratic turnover in which there is a change in the political party controlling the presidency. This “two-turnover test” in his opinion is an unambiguous measure of the resilience of democracy. In the dataset, we defined the two-turnover test as representing the transitional democracy period comprised of the years between the year of the founding election and the year in which an opposition party wins and assumes office following elections. In the case of Argentina, for example, this implies that the transitional period is between 1983 (the year first democratic elections after the end of the dictatorship of the National Reorganization Process which brought Raúl Alfonsín from the the Radical Civic Union (UCR) to power) and 1989 (the year in which Carlos Saúl Menem from the Peronist party is elected. The year after Menem

assumes office is defined as the first year after transitional democracy. Based on this measure, as Table 2 summarizes, there were 36 elections in Latin America during the transitional democracy phase between 1973 and 2008, which represents one-third of the total number of democratic elections.

Table 2. The political budget cycle in Latin America: Summary Statistics for Democracy and Elections, 1973–2008

	(a) Minimalist criterion of Democracy and One-Turnover Definition of Transitional Democracy	(b) Polity IV criterion and 4 consecutive elections definition of Transitional Democracy
Number of Democracy Years	472	478
Number of Transitional Democracy Years	141	288
Number of Non-Transitional Democracy Years	331	190
Percentage of Transitional Democracy Years	29.87%	60.25%
Number of elections	108	107
Number of elections in transitional democracy period	36	60
Percentage of elections in "transistional democracy period"	33%	56%

Source: Elaborated by the authors.

One of the key challenges in analysis of elections is the extent to which they may be endogenous as oftentimes the end of a particular regime is not pre-determined, but coincides with economic crises (Haggard & Kaufman, 1997; Przeworski & Limongi, 1993). There a few reasons why the endogeneity of elections does not seem to be a significant problem for the questions that will be explored in this paper. First, the problem of simultaneity bias is much more severe in PBC studies that employ economic growth, unemployment and inflation as dependent variables as declines in the performance of these variables are precisely what tend to trigger the collapse of particular administrations. Second, unlike parliamentary democracies, elections are typically held on a fixed schedule in presidential democracies such as those found in Latin America. Of course, there are some notable exceptions. Fueled by rampant hyperinflation, Siles Suazo anticipated presidential elections one year earlier than the end of his term in 1985 in Bolivia. In Argentina, Raúl Alfonsín similarly ceded power earlier than anticipated though only a few months earlier than planned. After only two years in office, President de la Rua resigned from the Argentine presidency in 2001 in light of massive protests and a spiraling economic crisis. The robustness of the results reported in Section 5 without these elections will be tested and reported. Third, control variables in estimations include

measures of per capita economic growth to capture the possible endogenous relationship that exists between government spending and elections.

Control Variables

The demographic and economic variables that are included as control variables are analogous to those used by Brender and Drazen (2005). Demographic characteristics of the population are likely to impact government spending. Two demographic variables representing the fraction of the population aged 15–64 and 65 and over are employed as controls. A higher percentage of elderly and young people in the population are expected to positively increase budget allocations for social programs and social security leading to increases in fiscal spending and the worsening of budget deficits. Unless otherwise noted, the control variables data are from the World Bank's *World Development Indicators* (2009).

Given the heterogeneity in income and growth rates across the region, it is important to include economic variable controls. The first is the level of economic development, defined as the real gross domestic product per capita and measured in constant US$ 2000 dollars. Per capita income is included in the model to control for Wagner's Law, which holds that the level of public spending will be positively correlated with levels of economic development. Higher levels of per capita income are expected to be correlated with higher levels of government spending. A control for the output gap or the proportion of growth that is unexpected in a given year is also included. Analogous to Brender and Drazen (2005), we use the log-difference between real GDP and its (country specific) trend (computed using the Hodrick-Prescott filter).

Trade liberalization increased dramatically in Latin America during the 1990s. Thus, a measure of trade integration is included to control for the degree of an economy's integration with world markets. Trade is calculated as the sum of imports and exports relative to GDP, where the denominator is calculated by converting domestic local currency to current US$ based on exchange rate conversions. In addition to these

variables, a dummy variable was included to control for the additional years that were added to the Brender and Drazen data set to control from the IMF's GFS database.

4. Estimation Procedure and Model Specification

In a first stage, the model used to test the effect of elections on fiscal variables can be summarized as:

$$Y_{i,t} = \alpha_t + \beta_1 Y_{i,t-1} + \beta_2 Z_{i,t} + \beta_3 ELEC_{i,t} + c_i + \mu_{i,t}. \quad (1)$$

The three fiscal policy measures that are used are analogous to those used by Brender and Drazen (2005): a) total government spending as a share of GDP; b) total revenue collection as a share of GDP; and, c) the budget balance as a share of GDP. *Z* is a vector of control variables as described earlier. The index *i* refers to the N observational units (or panels), and *t* indexes the *T* time periods. The term c_i contains country-specific unobserved effects that affect government spending, as well as the democratic character of the regime in a given country. The error term, μ_{it}, is an error term associated with unit *i* at time *t*. In some regressions, we control for fixed time effect and in this case α represents the year dummies reported in the regression model.

This model follows the literature and tests whether there are differences in spending prior to elections by including a dummy variable, ELEC, for the election year. We control for the number of elections during democracy years employing the two different definitions described in the previous section of this paper in which a given year was coded as one for the election year if a country received a score indicating that it was a democracy based on the Polity IV criteria and compare these results with those obtained when the election criteria are determined by a country being classified as democratic per the minimalist criterion defined by Cheibub, Gandhi and Vreeland (2009). We seek to verify if both measures yield a positive coefficient that is statistically significant from zero in the year of the election.

Based on the assumption that past levels of government spending influence the levels of expenditures in future years, a lagged dependent variable is included in each

specification. A series of measures were taken to check for consistency and robustness of the results that will be reported in the next section of this paper. For the sake of brevity, we only report the coefficient estimates for a) pooled ordinary least squares regressions (OLS) with panel corrected standard errors (column 1);[10] B) country fixed effect estimates (column 2); and, c) year fixed effects on top of country fixed effects (column 3). [11],[12] Therefore, the tables presented below consist of a total of three columns.

In a second stage, in order to test whether elections produce differences if an election takes place during either the "new democracy" or "transitional democracy" period (RECENTDEM), we undertake a second estimation:

$$\boldsymbol{Y}_{i,t} = \alpha_t + \beta_1 \boldsymbol{Y}_{i,t-1} + \beta_2 \boldsymbol{Z}_{i,t} + \beta_3 (\boldsymbol{ELEC})_{i,t} + \beta_4 (\boldsymbol{RECENTDEM})_{i,t} + \beta_5 (\boldsymbol{ELEC{*}RECENTDEM})_{i,t} + \boldsymbol{c}_i + \boldsymbol{\mu}_{i,t}. \quad (2)$$

The marginal effect of an election during the democratic transition phase, $\hat{\beta}_4$, measures the marginal impact of the recent democratization period on fiscal performance. The marginal effect of an election during the democratic transition phase, $\hat{\beta}_5$, measures the marginal impact of elections during the recent democratization period on fiscal

[10] The Stata XTPCSE command was used for the estimations that are reported in the tables.

[11] For fixed T, Nickell (1981) demonstrates that the within groups estimate of the coefficient is likely to be biased downward of the order 1/T, where T is the length of the panel. Thus, the magnitude of the bias in the fixed effects estimates can be calculated in the within-group estimator for a dynamic model with fixed individual effects. The exact magnitude depends on which sample and indicator is used as some countries do not report data for the entire period. In a panel of all countries from 1973 to 2008, the length of the sample ranges from 36 years to a minimum length of 19 years for three countries (Honduras, Nicaragua and Paraguay). Hence, the bias from using a fixed effects estimator in these regressions is likely range from 2.77% (1/36) to 5.26% (1/19).

[12] We also estimated the models using two Generalized Methods of Moments (GMM) procedures: the Arellano and Bond (1991) first-differenced GMM estimator (GMM-Diff) and the Blundell and Bond (1998) system GMM estimator (GMM-System). The exercise and commands for GMM estimation are based on Roodman (2006) and were carried out using Stata 10. GMM estimates were also carried out with control for year fixed effects. The results coincided with GMM results without controls for year fixed effects. Two lags of the dependent variable were used in the GMM difference and systems equations. The four specifications present GMM estimates using the Arellano-Bond (difference) and Blundell-Bond (system) procedures with orthogonal deviations to adjust for an unbalanced panel and collapsed to minimize the number of instruments following the recommendations of Roodman (2007). Per capita GDP and the log-difference between real GDP and its (country specific) trend (computed using the Hodrick-Prescott filter) were also included as endogenous variables in the GMM estimations. For GMM estimates standard errors are reported as t-statistics based on Windmeijer (2005) finite sample correction and corrected for serial correlation and heteroskedasticity. The results of an error correction model (ECM), which is also appropriate for highly persistent series, with panel corrected standard errors based on the *first difference* of the dependent variables was also carried out and did not change the findings reported in this paper.

performance. We want to test if the hypothesis that elections in recent democracies result in greater levels of government spending is correct by examining if $\hat{\beta}_5$ is positive and statistically significant from zero and if $\hat{\beta}_3 + \hat{\beta}_5$ (the total effect of an election in a recent democracy) is statistically significant from zero (Brambor, Clark, & Golder, 2006; Braumoeller, 2004).

In this second model, we employ the same measures to test for robustness. The first set of results report the marginal effect if the elections were part of the first four competitive elections following the return of democracy as per the "new democracy" definition proposed by Brender and Drazen (2005). The second results are based on whether there is a marginal effect of an election during transitional democracy. As we described earlier, our motivation for using two different measures is to compare whether the results that are obtained in recent Latin American democracies when testing for PBC cycles are driven by differences in the criteria that are adopted to characterize recent democratization.

5. Results

In this section, we summarize the findings from tests on political budget cycles in Latin American democracies in the nearly four-decade period between 1973 and 2008.[13] Tables 3 and 4 examine whether there are peaks in government spending, revenue collection and the fiscal deficit in the year of a presidential election in Latin America. As observed earlier, all of the dependent variables are measured as a share of GDP. For presentation purposes only the results for the estimate of the coefficient for the dummy variable for the year of the election is presented. The base group is all other democratic years. Table 3 presents the results of the three specifications in which the year of election was only coded as valid if the country was judged to be a democracy based on Polity IV data. Table 4 presents the results of the same test based on the minimalist definition of democracy. Regardless of whether Polity IV or a minimalist criterion are adopted, the

[13] We also carried out the same tests using the original Brender and Drazen (2005) data set for the period between 1973 and 2000. The findings reported in this section were not only confirmed, but generally stronger in terms of statistical significance.

regression results in Tables 3 and 4 suggest that there are political deficit cycles in Latin American democracies when estimations are carried out without controlling for the variation in the stages of democratic regimes in Latin America.

Table 3. Political Budget Cycles in Latin America, 1973-2008: The Effect of Elections based on a Polity IV Definition of Democracy

Dependent Variable:	(1) Pooled OLS PCSE	(2) Pooled OLS PCSE with country fixed effects (f.e.)	(3) Pooled OLS PCSE with country and year f.e.
A. Government Spending/GDP			
Election $Year_t$	0.029	0.132	0.054
	(0.280)	(0.263)	(0.272)
Observations	421	421	421
Avg. Time Series Length	23.39	23.39	23.39
R-squared	0.834	0.855	0.871
B. Government Revenue /GDP			
Election $Year_t$	-0.412	-0.447	-0.544*
	(0.296)	(0.272)	(0.280)
Observations	412	412	412
Avg. Time Series Length	22.89	22.89	22.89
R-squared	0.836	0.862	0.880
C. Fiscal Balance/GDP.			
Election $Year_t$	-0.633**	-0.740**	-0.704**
	(0.309)	(0.296)	(0.291)
Observations	412	412	412
Avg. Time Series Length	22.89	22.89	22.89
R-squared	0.411	0.462	0.548

Notes: The covariates include lags of the dependent variable, the log of per-capita GDP, the ratio of international trade (sum of merchandise exports and imports) to GDP, the level of capital mobility, the fraction of the population over age 65, the fraction of the population between ages 15 and 64, and the log-difference between real GDP and its (country specific) trend, estimated using a Hodrick-Prescott filter. In those cases that are noted, country and year dummy variables were included in regressions but were not reported above for presentation purposes. Pooled OLS regressions were estimated with panel corrected standard errors that correct for groupwise heteroskedasticity and contemporaneous correlations of the errors. Standard errors in parentheses and significance levels are as follows: * significant at 10%; ** significant at 5%; *** significant at 1%.

The results in both tables suggest that there are important increases in fiscal deficits (panel C) in Latin America in the year in which voters choose the next president. It bears mention that the fiscal balance can be either a negative or positive value. A

negative coefficient on fiscal balance is thus measuring a worsening of the government's fiscal balance. Relative to non-election years, both models predict that the deficit will increase by between six and seven-tenths of one percent of GDP. Independently of the criteria used to define a democratic election in the sample, the findings of a marked political deficit cycle are robust across almost all specifications and the coefficients are consistently the same sign and general value.

Table 4. Political Budget Cycles in Latin America, 1973-2008: The Effect of Elections based on a Minimalist Definition of Democracy

Dependent Variable:	(1) Pooled OLS PCSE	(2) Pooled OLS PCSE with country fixed effects (f.e.)	(3) Pooled OLS PCSE with country and year f.e.
A. Government Spending/GDP			
Election $Year_t$	-0.020	0.079	-0.004
	(0.291)	(0.271)	(0.289)
Observations	409	409	409
Avg. Time Series Length	22.72	22.72	22.72
R-squared	0.831	0.854	0.870
B. Government Revenue /GDP			
Election $Year_t$	-0.461	-0.451	-0.688**
	(0.305)	(0.279)	(0.296)
Observations	400	400	400
Avg. Time Series Length	22.22	22.22	22.22
R-squared	0.835	0.864	0.881
C. Fiscal Balance/GDP.			
Election $Year_t$	-0.598*	-0.669**	-0.709**
	(0.323)	(0.305)	(0.315)
Observations	400	400	400
Avg. Time Series Length	22.22	22.22	22.22
R-squared	0.372	0.445	0.517

Notes: The covariates include lags of the dependent variable, the log of per-capita GDP, the ratio of international trade (sum of merchandise exports and imports) to GDP, the level of capital mobility, the fraction of the population over age 65, the fraction of the population between ages 15 and 64, and the log-difference between real GDP and its (country specific) trend, estimated using a Hodrick-Prescott filter. In those cases that are noted, country and year dummy variables were included in regressions but were not reported above for presentation purposes. Pooled OLS regressions were estimated with panel corrected standard errors that correct for groupwise heteroskedasticity and contemporaneous correlations of the errors. Standard errors in parentheses and significance levels are as follows: * significant at 10%; ** significant at 5%; *** significant at 1%.

The exact levers that are driving the propensity of governments to incur higher fiscal deficits, however, are not apparent from the results obtained in either tables 3 or 4. Neither table provides evidence to reject the hypothesis that the increase in election year government spending relative to GDP (panel A) is statistically distinct from zero. On the other hand, both tables provide some suggestive evidence that tax policy, rather than expenditures as commonly assumed, may be the driving force for PBCs in Latin America (panel B). However, this evidence is not robust and is confirmed only in one of the three specifications as statistically significant when we control for both fixed effects in both time and countries.

"New" and Transitional Democracies

Given that a significant share of Latin American countries experienced a transition to democracy in the late 1970s and early 1980s, the results reported in Tables 3 and 4 could be driven by the failure to account for the effects of electoral competition following authoritarian rule, as period in which voters had not had enough experience with elections, as argued by Brender and Drazen (2005). Tables 5 and 6 present the results to control for how government spending varies once controls are employed for whether the election took place in the early democratization stage with the appropriate controls for the interaction effects between transitional democracy and elections. Table 5 tests the hypothesis that political budget cycles are more prevalent in ''new democracies'' by adding dummy variables to capture the effects of the first four competitive elections. Table 6 reports the results based on a theoretically grounded definition of the period of transitional democracy in which only elections that took place prior to the two turnover criteria being satisfied are coded as transitional democracy election years.

Table 5. Political Budget Cycles in Latin America, 1973-2008: The Effect of Elections and New Democracies *(Polity IV Definition of Democracy and 4 Consecutive Elections)*

Dependent Variable: *A. Government Spending/GDP*	(1) Pooled OLS PCSE	(2) Pooled OLS PCSE with country fixed effects (f.e.)	(3) Pooled OLS PCSE with country and year f.e.
Election Year$_t$	-0.238	0.0124	-0.0877
	(0.404)	(0.385)	(0.425)
"New Democracy Year$_t$"	-0.274	-0.205	-0.237
	(0.280)	(0.454)	(0.421)
New Democracy* Election Year$_t$	0.432	0.197	0.223
	(0.557)	(0.526)	(0.564)
Observations	421	421	421
Avg. Time Series Length	23.39	23.39	23.39
R-squared	0.835	0.855	0.871
Total "New Democracy Election Year"(β3+ β5)	0.193	0.209	0.134
	(0.382)	(0.357)	(0.359)
B. Government Revenue /GDP			
Election Year$_t$	-0.403	-0.383	-0.693
	(0.465)	(0.437)	(0.455)
"New Democracy Year$_t$"	-0.321	-0.909**	-0.787*
	(0.308)	(0.429)	(0.408)
New Democracy* Election Year$_t$	-0.0489	-0.144	0.222
	(0.605)	(0.560)	(0.594)
Observations	412	412	412
Avg. Time Series Length	22.89	22.89	22.89
R-squared	0.836	0.864	0.881
Total "New Democracy Election Year"(β3+ β5)	-0.451	-0.526	-0.471
	(0.386)	(0.347)	(0.363)
C. Fiscal Balance /GDP			
Election Year$_t$	-0.453	-0.494	-0.572
	(0.477)	(0.461)	(0.468)
"New Democracy Year$_t$"	-0.543*	-0.771*	-0.776*
	(0.320)	(0.441)	(0.396)
New Democracy* Election Year$_t$	-0.385	-0.453	-0.235
	(0.626)	(0.603)	(0.627)
Observations	412	412	412
Avg. Time Series Length	22.89	22.89	22.89
R-squared	0.419	0.467	0.552
Total "New Democracy Election Year"(β3+ β5)	-0.837**	-.947**	-0.807**
	(0.404)	(0.387)	(0.389)

Notes: The covariates include lags of the dependent variable, the log of per-capita GDP, the ratio of international trade (sum of merchandise exports and imports) to GDP, the level of capital mobility, the fraction of the population over age 65, the fraction of the population between ages 15 and 64, and the log-difference between real GDP and its (country specific) trend, estimated using a Hodrick-Prescott filter. In those cases that are noted, country and year dummy variables were included in regressions but were not reported above for presentation purposes. Pooled OLS regressions were estimated with panel corrected standard errors that correct for groupwise heteroskedasticity and contemporaneous correlations of the errors. Standard errors in parentheses and significance levels are as follows: * significant at 10%; ** significant at 5%; *** significant at 1%.

Both tables present the marginal effect of an election year on fiscal policy for a recent democracy and relative to the effect when the election takes place in post-transitional democracies. In the last row of each panel, we also report the results of the total effect of the election for recent democracies. Relative to all other democratic, non-

election years, Table 6 suggests that Latin American democracies that have undergone less than two democratic turnovers increase fiscal deficits between 0.96 to 1.2 percent of GDP in the year of the election. The sign and magnitude of the coefficient of the total effect of an election for a transitional democracy is robust in all specifications utilizing OLS adjusted for panel corrected standard errors. Table 5, which is based on the four first four elections measure of recent democratization, confirms the same findings in all three specifications, but at a lower magnitude (0.8 to 0.95 percent of GDP).

Table 6. Political Budget Cycles in Latin America, 1973-2008: The Effect of Elections and Transitional Democracy (*Minimalist Definition of Democracy*)

	Two-Turnover Transitional Democracy (Founding + One Turnover)		
Dependent Variable:	(1)	(2)	(3)
A. Government Spending/GDP	Pooled OLS PCSE	Pooled OLS PCSE with country fixed effects (f.e.)	Pooled OLS PCSE with country and year f.e.
Election $Year_t$	-0.102	-0.001	-0.094
	(0.368)	(0.343)	(0.352)
Transitional Democracy $Year_t$	-0.225	0.367	0.712*
	(0.265)	(0.389)	(0.395)
Transitional Democracy* Election $Year_t$	0.287	0.184	0.189
	(0.570)	(0.533)	(0.548)
Observations	409	409	409
Avg. Time Series Length	22.72	22.72	22.72
R-squared	0.831	0.855	0.871
Total "Transitional Democracy Election Year"(β3+ β5)	0.185	0.183	0.095
	(0.438)	(0.412)	(0.441)
B. Government Revenue /GDP			
Election $Year_t$	-0.402	-0.376	-0.534
	(0.383)	(0.352)	(0.355)
Transitional Democracy $Year_t$	-0.248	0.0654	0.215
	(0.281)	(0.400)	(0.432)
Transitional Democracy* Election $Year_t$	-0.192	-0.265	-0.604
	(0.593)	(0.541)	(0.566)
Observations	400	400	400
Avg. Time Series Length	22.22	22.22	22.22
R-squared	0.835	0.864	0.881
Total "Transitional Democracy Election Year"(β3+ β5)	-0.593	-0.641	-1.137**
	(0.455)	(0.413)	(0.466)
C. Fiscal Balance /GDP			
Election $Year_t$	-0.447	-0.483	-0.476
	(0.399)	(0.379)	(0.371)
Transitional Democracy $Year_t$	-0.255	-0.560	-0.673
	(0.310)	(0.435)	(0.459)
Transitional Democracy* Election $Year_t$	-0.514	-0.511	-0.720
	(0.648)	(0.608)	(0.619)
Observations	400	400	400
Avg. Time Series Length	22.22	22.22	22.22
R-squared	0.375	0.449	0.523
Total "Transitional Democracy Election Year"(β3+ β5)	-0.961*	-0.994**	-1.195**
	(0.514)	(0.478)	(0.521)

Notes: The covariates include lags of the dependent variable, the log of per-capita GDP, the ratio of international trade (sum of merchandise exports and imports) to GDP, the level of capital mobility, the fraction of the population over age 65, the fraction of the population between ages 15 and 64, and the log-difference between real GDP and its (country specific) trend, estimated using a Hodrick-Prescott filter. In those cases that are noted, country and year dummy variables were included in regressions but were not reported above for presentation purposes. Pooled OLS regressions were estimated with panel corrected standard errors that correct for groupwise heteroskedasticity and contemporaneous correlations of the errors. Standard errors in parentheses and significance levels are as follows: * significant at 10%; ** significant at 5%; *** significant at 1%.

Our tests confirm the findings of recent research by Brender and Drazen (2005) that have argued that political cycles are expected in those countries that recently democratized. The regression results confirm that these patterns are robust to whether an objective judgment and observational criteria of democracy and democratic transitions are employed or a measure based on a vague and arbitrary operational rule. More importantly, we believe, robust evidence of a political budget cycle in Latin America is confirmed after a minimalist criterion and a two-turnover transitional democracy definition is adopted to separate transitional from established democracies.

6. Conclusion

There is a need for greater understanding of the differences and commonalities that Latin America has with other democracies in either developing or more advanced regions. This paper has sought to undertake a theoretically grounded exploration of political cycles in fiscal policy performance for Latin America during the most profound and widespread period of democratization. It has attempted to address several gaps in past empirical research by considering what happens to performance measures prior to and immediately after elections and when these competitions occur during the transition period prior to the stabilization of democratic institutions.

Based on a battery of specifications, this paper provides compelling evidence confirming that multiparty competitive elections do catalyze fiscal policy in Latin America. The pattern we find, however, has several important distinctions that differ from the trajectories we would expect based on theoretical models, such as Rogoff's (1990) political budget model, and empirical research on recent democracies. While we find that fiscal deficits worsen in the year of election, government spending does not increase. Rather, political deficit cycles are driven by reductions in tax revenue.

Our results underscore that the propensity of a Latin American democracy to be subject to opportunistic spending during an election depends on whether a democracy is in a transition stage. Furthermore, we believe that our results show that past research that has failed to account for the transitional character of democracy and different levels of

competition may be ignoring important factors that impact the effect of democratic elections on fiscal policy. Our findings partially confirm the results presented by Brender and Drazen (2005 and 2007), who argue that recent democracies are more prone to political deficit cycles. In the period following authoritarian rule and prior to the stabilization of the regime, democracies that have endured less than two turnovers of power exert are more apt to engage in fiscal indiscretion in the year of the election.

One potential explanation for the results we obtain in this paper may be that governments are eager to appease those interests that are most threatening to their destabilization, namely the upper classes and military elites, during the politically uncertain period of democratic transition. As a result, Latin American democracies during transition worsen their fiscal deficits because administrations are more apt to cater to these groups and do so by reducing taxes.

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