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Electoral Fiscal Policy in New, Old, and Fragile Democracies

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Electoral Fiscal Policy in New, Old, and Fragile Democracies

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ABSTRACT: I review recent findings on political budget cycles in new and old democracies that show that they are a phenomenon of new democracies, and are statistically insignificant in old, established democracies. I then consider what may account for this and review several hypotheses. Recent empirical work also finds that voters in new democracies do not reward election-year deficit spending, raising questions about explanations focusing on the use of election-year deficits to gain votes. This suggests that the increase in election-year expenditures and deficits in new democracies may reflect other motives. Specifically, it is suggested that they may reflect attempts to shore up fragile democracy.

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1. Introduction

The last quarter century has been marked by widespread democratization across the world. Since the beginning of the "third wave" of democratization in 1974 (Huntington 1991), dozens of states have adopted democracy as a form of government. This includes of course, most of the former Soviet bloc nations, especially in Eastern Europe.

This sea change has raised a large number of crucial questions. On the normative side, there are obviously questions of how democratization, that is, the transition to a democratic form of government, can be encouraged, as well as how democratic consolidation in new and fragile democracies can be strengthened. On the positive side, there is a range of questions associated with the economic performance of new democracies. (See Rodrik and Wacziarg (2005) for a short summary of results on economic growth).

In this paper I consider one such positive question. Specifically, I consider elections in new democracies – what they imply for fiscal policy (that is, political budget cycles), how electoral results depend on economic performance and fiscal policy, and how the results that are found in new democracy may be related to democratic fragility and consolidation.

As Riker (1982) and others have argued, elections are the defining feature of a democracy. They are not sufficient to define a country as a democracy, as most, if not all, non-democratic hold elections, even though such elections are generally a sham. But they are certainly a necessary condition for a country to be called democratic. No system can be called democratic if it does not hold regular, free elections. Hence, understanding the two-way causation between elections and economic policy or outcomes seems central to understanding the effects of democratization.

In a series of papers with Adi Brender (Brender and Drazen [2005a], [2005b], [2006]), I have explored some of these questions. In this paper I summarize a number of these findings, especially as related to new and fragile democracies. I also discuss a number of theories of the different behavior of election-year fiscal policy in new versus old democracies and suggest how it may be related to problems of democratic fragility and consolidation.

The plan of this paper is as follows. In the next section, I review recent empirical work on political budget cycles which find that the increase in deficits in election years which other researchers have found are a phenomenon of new democracies. In section 3, I discuss possible explanations of the "new democracy effect". Section 4 presents results on voter response to deficits and economic growth in both new and old democracies. These results suggest that the political budget cycles found in new democracies may reflect something other than the incumbent's attempt to gain votes. In section 5, I consider an alternative explanation, namely that the "new democracy effect" reflects high expenditures (and deficits) meant to protect newly democratized regimes from reversion to non democracy, that is, to consolidate democracy. Section 6 presents some concluding observations.

2. Political Budget Cycles

Conventional wisdom is that incumbents often try to use expansionary economic policy before elections to increase their re-election chances, and the term "election-year economics" or its equivalent is common in many countries. In the political economy literature, this view is summarized as the "political business cycle", that is, the possibility of a macroeconomic cycle induced by the political cycle.

Models of the political business cycle are motivated by the finding that good macroeconomic conditions prior to the elections help an incumbent to get re-elected, a finding that has wide support in studies (conducted mainly in developed economies). The strength of this finding was an important factor generating formal modeling of how opportunistic incumbents may manipulate economic policy to induce economic expansions before elections.

However, empirical studies (especially in developed economies) provide little evidence of a regular, statistically significant increase in economic activity before elections. The lack of empirical evidence for political cycles in economic outcomes induced a shift in focus to cycles in policy instruments, especially fiscal expansions in election years, termed the "political budget cycle".

A typical view is that the Political Budget Cycle is a common phenomenon, consistent with conventional wisdom. This is seen as strongest in developing countries, as for example in Shi and Svensson (2006). Brender and Drazen (2005a) find a political budget cycle in a large cross-section of countries, but argue that this finding is driven by the experience of "new democracies". It is the strong fiscal cycle in these countries that accounts for the finding of a fiscal cycle in larger samples including these countries. Once these countries are removed from the larger sample, the political fiscal cycle disappears. The political cycle in new democracies accounts: for findings in both developed and less developed economies; for the finding that the cycle is stronger in weaker democracies; and for differences in the political cycle across government or electoral systems.

I now turn to estimation of political budget cycles. The basic data set used in this study consisted of 106 countries for which data were collected on the central government balance, total expenditure and total revenue and grants from the IFS database. The sample period is 1960-2001, although the data for many countries cover shorter periods.

Democracies were separated from non-democracies by applying the POLITY IV classification covering nations with a population exceeding half a million people. Each country is assigned in this dataset a value that ranges from -10 (autocracy) to 10 (the highest level of democracy). The sample was restricted to democracies, by selecting only the countries that receive a score between 0 and 10 on this scale; this reduces our sample to 68 countries. These countries may be classified as those that were in the OECD for the entire sample period, the "transition" economies of Eastern Europe and the former Soviet Union (for the period 1990-2001), and all others.[1] The list of democracies is given in Table 1.

Consistent with the discussion in the introduction, the number of countries in the sample is increasing over time. This feature reflects not only the expanded coverage of the IFS, but also an increase in the number of democracies. Using the POLITY filter to identify democracies, we find that there are 31 democracies in the sample in the 1960s;

[1] The structural changes that went along with the shift to democracy in these countries implies, among other things, that high deficits associated with the economic transition occur simultaneously with the political transition, without either one causing the other. Conversely, politicians facing the new phenomenon of contested elections who are aware of the desire for rapid economic transition may respond especially strongly with deficit spending. One therefore needs to be careful in how one treats the transition economies in the first years after transition, and interprets the results. To err on the safe side, we exclude all the elections that took place in the first two years following the transition.

44 in the 1970s, 53 in the 1980s, and 59 in the 1990s, not counting the formerly socialist economies. If the transition economies are included the number of democracies rises to 68 in the 1990s, more than twice the number in the 1960s. More specifically, *new* democracies are being added to each of the samples over time.

The basic regression is of the form:

$$f_{i,t} = \sum_k \mathrm{b}_k f_{i,t-k} + \sum \mathbf{c}'\mathbf{x}_{i,t} + \mathrm{d}ELEC_t + \mu_i + \varepsilon_{i,t} \qquad (1)$$

where $f_{i,t}$ is a fiscal indicator in country i in year t, $\mathbf{x}_{i,t}$ is a vector of control variables, $ELEC_t$ is an electoral dummy, and μ_i is a country fixed effect. (Year effects were generally insignificant and were dropped from the regressions.)

In addition to fixed country effects, the control variables were those commonly used in the literature. These include real GDP per capita taken from the 2002 version of the World Bank's World development Indicators dataset (WDI)), the trade share, two demographic variables representing the fraction of the population aged 15-64 and 65+ (also taken from WDI), and the log difference between real GDP and its (country specific) trend (computed using the Hodrick-Prescott filter), as a measure of the output gap. (See our working paper for more details.)

The electoral dummy, meant to capture pre-electoral effects, is that used by other authors. It equals 1 in an election year and 0 otherwise, no matter when during the year the election occurred. However, the electoral year definition was adjusted to be consistent with the fiscal year, when fiscal data are reported for a fiscal year different than the calendar year. Election dates and institutional data on the election process are taken from the DPI dataset, provided by the World Bank (Beck et. al., [2001]). These data were complemented, where needed, by other political datasets, such as the IDEA (Institute for Democracy and Electoral Assistance, “Voter Turnout Since 1945 to Date”) and IFES (International Foundation for Electoral Systems, election guide).

In the first column of Table 2 (taken from Brender and Drazen [2005a]) are fixed-effects regressions for the fiscal balance, revenues and expenditures, all as a percentage of GDP.[2] (Only the coefficient on the electoral variable is presented, indicating the presence or absence of a political cycle. The complete regressions may be found in the appendix of working paper underlying Brender and Drazen [2005a], available at http://www.tau.ac.il/~drazen/Unpublished_Papers.htm.) There is a highly significant political cycle in the fiscal balance, with the deficit rising in an election year by about three-tenths of one percent of GDP relative to non-election years.[3] (These results correspond to those found in Shi and Svensson (2006) over the sample they used.)

As mentioned in the introduction, the number of democracies in the sample increased substantially as more countries, both developed and less-developed, became democracies. To test the hypothesis that political budget cycles are more prevalent in "new democracies", Brender and Drazen (2005a) used the POLITY filter to separate those countries that had competitive elections during the entire sample period from those that began having competitive elections only within the sample period. For the latter, they took observations for the first four competitive elections and define those observations as coming from a "new democracy".[4]

The second and third columns of Table 2 show the results over only new democracies in the sample both including and excluding the new democracies in Eastern Europe (columns 2 and 3, respectively). The fourth column of the table presents results for only *old*, that is, established, democracies (that is, all countries which were in a sample of democracies using the POLITY filter, *excluding* the new democracies).[5]

A number of results stand out. First, there is a significant deficit cycle for the set of new democracies, whether or not the formerly socialist economies are included. The coefficients on the electoral variable are larger than in the sample of all democracies.

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[2] Because of estimation bias problems of using country fixed effects in an OLS regression with lagged dependent variables in short panels, we also presented GMM estimates, using the Arellano-Bond procedure. The results were quite similar.

[3] The qualitative results in the regressions do not significantly change when the White Heteroskedasticity Consistent Covariance correction is used to calculate standard errors.

[4] An alternative characterization of elections in a new democracy is those elections that occur within a specific time period after the country became democratic. We tried alternative definition of all elections in the first 10 years and the first 15 years after becoming democratic. The results (available on request) are very similar, not surprisingly, since generally the same elections are being captured.

[5] Short sample length in the new democracy panels means there is a possible bias in using a fixed effects estimator including lagged dependent variables. GMM estimates give similar results.

There is also a significant political expenditure cycle in the new democracies. Note, moreover, that the coefficients on the fiscal balance and on expenditures in the analogous equations are very similar (and of opposite sign), while the coefficient on revenues is smaller in absolute value and not significantly different from zero. The deficit cycle in the new democracies appears to be clearly driven by higher election-year expenditures.[6]

To summarize, the political deficit cycle is a phenomenon of new democracies. The finding of a statistically political deficit cycle in a cross-section of *all* democracies is due to the first few elections in countries that are new democracies. Once these are removed from the sample and only elections in established democracies are considered, the political deficit cycle as a statistically significant phenomenon in aggregate data disappears.

Brender and Drazen (2005a) also tested whether the strength of cycle depended on a country's economic or political characteristics, such as the level of economic development, whether elections dates are predetermined or not, constitutional rules determining electoral rules and form of government (following the work of Persson and Tabellini, 2003), and the "level" of democracy. For each of these arguments, they showed that significant findings of a deficit cycle are driven by the experience of new democracies.

More specifically, we found that: 1) in both developed (OECD) and developing countries, any political deficit cycle observed in the data is driven by the experience of new democracies; 2) the new democracy effect is observed in elections held both on their constitutionally pre-determined date and those held early; 3) the effect is independent of whether the system is Presidential or Parliamentary and whether voting is proportional or majoritarian; and 4) the argument that the Political Budget Cycle is stronger when democracy is weak is supported by the data, but the result is entirely due to the new democracies. There is a significant deficit cycle in both strong and weak new

[6] The "new democracy" effect was also tested by using separate dummy variables for each of the first four elections, a dummy for all elections in old democracies and a dummy for all elections after the fourth in "former" new democracies in regressions for the sample as a whole, Each of the four new election dummies were significant in regressions for a fiscal balance cycle, with approximately equal magnitude, while the coefficients on the dummies for elections after the fourth in new democracies and for elections in old democracies were not significant.

democracies, while the cycle is insignificant in old democracies, independent of the strength of democracy. The finding that the political budget cycle is stronger in weak democracies is entirely a composition effect. The 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.

3. The New Democracy Effect

The data show quite clearly that the political budget cycle is a phenomenon of new democracies. The obvious question is: Why? That is, why are new democracies more susceptible than established democracies to election-year economics at the aggregate level?

To begin, I reject the argument that voters in new democracies are "stupid", "naïve", "easily fooled" or whatever in comparison with voters in old democracies. It does not fit casual observation, nor is it consistent with information from the World Values Survey which indicates that citizens in new democracies are no less concerned with current affairs than citizens elsewhere and perhaps more so.

A more reasonable hypothesis is that rather than voters in new democracies being naïve, they are less experienced with electoral economics, as well as having far less information on which to make judgments. That is, not only are voters less experienced with competitive elections, and thus perhaps less able to see through policy manipulation before elections, but the media are also less experienced and thus less able to deliver relevant information to voters or to help them analyze it. (See, for example, Brender [2003]). They are both less experienced in analyzing fiscal data, but the data in fact may be less available in regimes that until the transition to democracy were less accountable to voters for their policy choices. Hence, whether election-year deficits are rewarded or punished at the polls may depend on the availability of information. In the absence of information by voters opportunistic incumbents can hide the manipulation and make the public believe that the good economic conditions reflect the success of his policy or his high ability.

This argument would not hold in old democracies where voters have a lot of experience with election campaigns and understand the incentives and the tools of electoral manipulation. The electorate in an established democracy knows that election years are particularly "suspect" for manipulation, and hence they will interpret "surprises" in these years with special caution. Therefore, in economies in which the electorate has a lot of experience with elections, and where the collection and reporting of the relevant data to evaluate economic policy are common, voters would be unlikely to "fall" for the trick of making the economy look good right before elections.

In contrast, fiscal manipulation may work when voters lack the necessary information to draw such inferences, as well as the ability to process that information correctly. This would reflect a lack of experience with an electoral system, of the availability of data, and of media experienced in finding, disseminating and analyzing the relevant data.[7] This is more likely to characterize a new democracy.

The ability to draw inferences about incumbent performance from pre-electoral economic variables is not meant simply to represent the experience of voters, but of experience and interactions of all actors with the electoral system. Put another way, it is not that new democracies are characterized by unsophisticated or naïve voting population, but that in countries with less of an electoral history, and hence less exposure to pre-electoral fiscal manipulations, a political cycle is more likely to occur. In many new democracies, even basics like the collection of data and reporting it to the public are not well established, so that fiscal manipulation is easier to engage in. (The demand for data may in fact be driven in part by the possibility of holding office-holders accountable through elections.)

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[7] Another reason why the interpretation of economic data by voters may be more complicated in new democracies is the shift in economic structure that often goes along with the shift to democracy, as, for example, in the transition economies.

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A number of recent papers have found evidence consistent with this view in specific countries. Brender (2003) shows how the electoral response to deficit spending in local Israeli elections changed dramatically over the period 1989 -1998. He found that when direct elections for mayors were introduced in Israel, voters were initially indifferent to deficits and local fiscal management. By the 1998 elections, however, when accounting and reporting standards were enforced on the local authorities, and when the local media expanded, deficit spending was "punished" at the polls.

A number of papers have considered the role of transparency more formally and may thus shed further light on one important characteristic of new democracies. Gonzàlez (1999, 2002) and Shi and Svensson (2006) extend Rogoff's (1990) model to study the effect of the degree of democracy and the level of institutions on the magnitude of fiscal cycles. Both models stress the importance of "transparency," which ultimately means the probability that voters learn the incumbent's characteristics costlessly, that is, independent of signaling. The higher the degree of transparency, the smaller is the political budget cycle.

Shi and Svensson further argue that while the proportion of uninformed voters – those who may be influenced by fiscal manipulation – is initially large, it is likely to decrease over time, thus decreasing the magnitude of budget cycles. They create a measure of the availability of information and show that as voters become more informed the magnitude of the cycle decreases.[8]

Other papers also find that greater transparency is associated with smaller political cycles. Akhmedov and Zhuravskaya (2004) find similarly that measures of the freedom of the regional media and the transparency of the regional governments were important predictors of the magnitude of the cycle. Alt and Lassen (2003) find that in OECD countries, higher fiscal transparency also lowers the magnitude of the electoral cycle. All these results are consistent with ours if lack of transparency or information, as measured by these papers, is an important characteristic of new democracies.

[8] The index is a product of the number of radios per capita and a binary variable of whether the country had freedom of broadcasting.

One should also note an essential difference between some of these arguments and the argument made above about experience. Whereas Shi-Svensson and Gonzàlez, for example, view transparency primarily as a characteristic of political systems (that may evolve over time, with institutional change or development), the Brender and Drazen new democracy results suggest a somewhat different view. "Transparency" reflects experience with the elections themselves, with the crucial variable being the number of competitive elections a country has held (or, the length of time a country has been a democracy), rather than the level of democracy. The finding discussed above that the importance of the level of democracy in explaining the cycle reflects the behavior of new democracies underlines the importance of distinguishing the two. A key implication of the new democracy view is that the signal content of fiscal actions necessarily *changed* over time as voters became more experienced over time with electoral fiscal manipulation and were provided with more economic and fiscal information in order to draw inferences. This is certainly consistent with the findings of Akhmedov and Zhuravskaya (2004) discussed at the beginning of this section. Hence, any positive effect of deficit spending on an incumbent's electoral prospects would not only diminish over time, but would probably change sign as a country has more experience with a competitive electoral process.

The argument that the inexperience with the electoral system allows politicians to manipulate fiscal policy for electoral purposes is quite sensible. However, the argument that significant election-year deficits in new democracies arise due to the attempt of incumbents to gain votes has a testable implication – namely, that such deficits actually have that effect. I now turn to this issue.

4. Voter Response to Deficits and Growth in New and Old Democracies

Brender and Drazen (2005b) look at the effects of fiscal performance and growth on reelection in various groups of countries, including whether: 1) increased deficits during an election year raise the probability of reelection; 2) loose fiscal policies during the term in office help reelection; 3) GDP growth during the term in office, and specifically in the election year, helps incumbents to get reelected; and, 4) these forces work differently in countries at different levels of economic development, strength of democracy, or with different electoral or government systems.

The dataset used was the same as in Brender and Drazen (2005a), supplemented by additional information on the political structure of countries, their electoral system, and data on election outcomes. The key political variable REELECT was a binary variable with a value of 1 if the incumbent was reelected and 0 if he or she was not. (Details of its construction may be found in Brender and Drazen [2005b]). Two definitions of REELECT were used in the analysis. A **narrow** definition included only observations where the leader is running for reelection herself (either as the leader of her party in parliamentary elections or personally in presidential ones), where the sample was constrained to leaders who were in office for at least two fiscal years prior to the elections and were candidates in the elections or retired within the month before the elections (in which case we classify the leader as losing reelection). The **expanded** definition added cases in which a leader was substituted by another candidate from his party under the following specific circumstances: 1) the leader died in the year before the elections; 2) the leader could not run for reelection due to legal term limits. In these cases the substitute leader (in the first case) or the candidate from the leader's party (in the second case) is treated as the incumbent. Additionally, in the expanded sample, leaders who quit their job within a year before the elections were treated as having lost reelection. (In the narrow sample it is defined as a missing value as long as the leader quits more than a month before the elections.) In the basic data set there were 347 usable elections in total in 74 countries over the period 1960-2001, though the number of elections in specific set of regressions will depend on the definition of REELECT being considered.

Fiscal performance was characterized by two variables, either the *change* in the central government's *balance* (that is, budget surplus) to GDP ratio over the *term* in office or in the *election year* relative to the previous year, which is an indicator for election year fiscal expansions. The indicator for macroeconomic performance is the average annual *growth rate* of real *GDP per capita* between the current and the previous election year. (In cases where the leader assumed power after the previous elections, growth was calculated only over the period since his appointment.)

The results showed a clear difference between old and new democracies. (Readers may refer to the paper for the details of the results. It is available at http://www.tau.ac.il/~drazen/Unpublished_Papers.htm.) Voters in old democracies significantly punish deficits at the polls. Both the full term and the election year increase in the ratio of the fiscal deficit to GDP decrease the probability of reelection. The effects of fiscal policy that they find are not only statistically significant, but also quite substantial quantitatively. An increase of 1 percentage point in the central government deficit (as a percent of GDP) over the term decreases the probability of reelection by 3-4.5 percentage points in an established democracy. An increase of 1 percentage point in the deficit to GDP ratio in an election year decreases the probability of reelection by 7-9 percentage points! These magnitudes are broadly in line with those reported in Brender (2003) for similar variables in the local elections in Israel.

While voters in established democracies significantly punish deficits at the polls, Brender and Drazen (2005b) find that in new democracies there is no statistically significant effect in either direction. Voters in new democracies do not punish deficit spending the way that voters in old democracies do, but they also do not reward deficit spending at the polls.

Voter response to economic growth also differs in old and new democracies. In old democracies, the effect of GDP growth on the probability of reelection in old democracies is weak and only significant when the expanded reelection sample is used.[9] In contrast, there is a significant effect of GDP growth over the term on the probability of reelection in new democracies. An increase in the average growth rate of 1 percentage point is associated with an approximately 7-8 percent increase in the probability of reelection. This finding is consistent with the importance put on economic growth by respondents to the World Values Survey in new democracies.

To summarize, in the new democracies – the group of countries for which a significant political budget cycle was found in the earlier paper – Brender and Drazen (2005b) found *no* significant effect of the fiscal balance on the probability of reelection. This is surprising given the results in Brender and Drazen (2005a), if one believes, as discussed in the previous section, that the political budget cycle arises because opportunistic leaders run deficits because it helps (or is believed to help) their reelection prospects. The joint findings that Political Budget Cycles exist in new democracies and

[9] Interestingly, the U.S. is an exception to this pattern, with per capita GDP growth having a significant effect on reelection probabilities, in line with the work of Fair (1978).

that fiscal expansions in election years do not raise the probability of reelection suggest there may be an explanation for the observed fiscal expansions in election years in new democracies other than the one discussed in the previous section. That is, the significant increase in the election year budget deficit observed in new democracies may be serving a function other than gaining votes for the incumbent. I now turn to this issue.

5. Democratic Fragility and Election-Year Fiscal Policy

In many new democracies, democracy is not fully consolidated, meaning that some groups, including perhaps large segments of the public, lack full commitment to the democratic process. This makes its democracy more vulnerable to anti-democratic forces.

How might this affect economic policy? As was argued above, voters in new democracies appear especially concerned about economic performance. But if these voters are not fully convinced that democracy leads to good economic results, the government may have a strong incentive to expend resources at critical points of democratic vulnerability in the attempt to convince voters that "democracy really works".

How is this related to political deficit cycles? Two arguments imply a possibly strong connection. First, elections are often focal points for democratic discontent and hence times of potentially large vulnerability of a new democracy to a reversion to its previous nondemocratic regime. Brender and Drazen (2006) find that in newly democratized states, democracy is three times more likely to collapse than in non-election years, a figure far higher than the corresponding difference in old democracies. Hence expenditures to shore up democracy may be especially important in election years.

Second, these expenditures (and the resulting deficits if taxes are not raised, consistent with the logic of the argument) meant to protect the democratic regime from reversion to non-democracy may be quite large. The reason is that if the attitude of large segments of the citizenry is crucial for the for the survival of democracy, rather than simply the attitude of a narrow elite, then the magnitude of expenditure needed to convince them that "democracy works" may be significant.

These points are explored in detail in Brender and Drazen (2006), and I summarize some of the main arguments which will clarify the above points. First, they argue that focus should be on the role of the public in democratic consolidation, rather than on simply placating anti-democratic elites. Much of the literature on the transition to democracy has focused on elites, those with special political position or power, in leading the push for democracy or in being key in blocking the democratic transition. Seminal works such as Rustow (1970) or Huntington (1984) make this argument. For example, the latter argues (p. 212) that "democratic regimes that last have seldom, if ever, been instituted by mass popular action. Almost always, democracy has come as much from the top down as from the bottom up; it is as likely to be the product of oligarchy as of protest against oligarchy." This focus on elites has carried over to much of the discussion of consolidation of newly democratic regimes, as for example, in the recent book by Acemoglu and Robinson (2005).

In contrast, Brender and Drazen (2006), consistent with another strand of the literature, argue that anti-democratic elites may be unable to successfully overthrow democracy without support from the citizenry. Hence, public attitudes are crucial in ensuring the survival of democracy. In fact, there is much evidence which suggests that it is inaccurate to consider the citizenry as being unconditionally committed to democracy. In contrast to an established democracy, in a fragile democracy, there may be incomplete acceptance of democracy not only by the elites, but also by the masses. (See, for example, Linz and Stepan [1996].) As indicated by the World Values Survey, new democracies are distinguished from older democracies by a significantly greater proportion of individuals who express uncertainty about the value of democracy.

Second, convincing the citizenry that the new democratic regime is superior to the previous regime depends crucially on the economic performance of the new democracy. Hence, the "efficiency" of the new political system, and not just its legitimacy, becomes a crucial issue. Do citizens believe that the new democratic government is doing a credible job in trying to overcome economic problems? If they do not believe that democracy is able to solve economic problems, it may be fatal for democracy, as has unfortunately often been observed. Conversely, if the economic system is perceived as working, democracy is quite resilient to economic setbacks, as Przeworski, *et al*. (2000) have stressed.

To summarize the "masses" are crucial in the consolidation process, but they are not unconditional supporters, so they must be brought on board. This requires a belief by the citizenry in the ability of democracy to "deliver" on the economic front.

The implication of this view, Brender and Drazen (2006) argue, is that the government may need to target voters based on their forming beliefs about the efficacy of democracy on the basis of economic outcomes. This leads government to increase expenditures and deficits before elections in the attempt to convince voters that "democracy really works", with these expenditures going primarily to citizens rather than elites.

The argument that problems of democratic consolidation may help explain political deficit cycles in new democracies raises an obvious question: why should the policy effects that are implied by the need to demonstrate good performance in the face of democratic fragility be manifest especially in election years (relative to non-election years)? New and fragile democracies may face certain "critical points" at which democracy may be especially vulnerable, so that political support is crucial for democracy to survive. Why are these critical points more likely to be in election than non-election years? First, if democracy is fragile, the most obvious time for this to have implications is in an election year. It is not simply that dissatisfaction can be expressed at ballot box, but also, almost "by definition" the democratic system is being tested at election time: a leader may cancel elections; turnover of parliament is time of mechanical fragility. In fact whether the first elections take place after the transition to democracy is generally seen as crucial to the legitimacy of a newly democratic system. Second, in a new democracy there is probably a much greater cost of being thrown out of office (or of the whole system being discarded) than in an old democracy, so that the benefit to showing the system works is quite high.

Brender and Drazen (2006) further point out that fragility alone is not sufficient to explain election-year effects; 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). Hence, running deficits to pay salaries to government workers (for example), that is, to strengthen the public's perception of a well-functioning system, will not be seen as electoral manipulation as easily as when voters have more experience with democracy and election-year economics. As voters gain more experience with the democratic electoral system, using fiscal policy to "grease the wheels" of the economic system may be increasingly less effective in affecting voter perceptions, and hence may be less likely to occur. This is consistent with the arguments made in section 3.

How, more specifically, may a government use fiscal policy to try to convince voters that democracy works? In many established democracies, targeted transfers are often important in gaining electoral support. (See Drazen and Eslava [2006] for a formal model of this.) When democracy is not yet consolidated, such transfers may play the further crucial function of generating support for the democratic process itself. While some of these transfers or expenditures are directed to elites (for example, placating the military), Brender and Drazen (2006) find there is no evidence that the high election-year expenditures in new democracies go primarily to elites. Many authors suggest that the newness of democracy implies *overabundance* of demands due to high expectations. In short, "buying off" groups to gain their support for democracy itself is an important aspect of fiscal policy in new democracies. Hence, democratic consolidation may be what is driving the "new democracy effect" found for political budget cycles.

6. Concluding Comments

New democracies are different than old democracies in the prevalence of political cycles in fiscal aggregates. Recent empirical findings make that quite clear. A key question is: Why?

Many of the world's new democracies are fragile and unconsolidated, and many countries that democratized have reverted back to nondemocratic rule. The ability of young democracies to maintain popular support depends in no small part on the ability of their governments to deliver good economic results, or, perhaps more importantly, to be perceived to be able to do so and to be able to weather economic crises. In concrete terms, this means such mundane, but crucial, activities as paying wages on time or at least not too far in arrears, delivering basic services such as electricity, and so on. These are expensive, but vital to the survival of democracy. It should not be at all surprising if governments make a special effort to appear to be able to address economic problems in times of greatest vulnerability of the new regime to challenges. On both conceptual and empirical grounds, election periods would appear to be such times. So, it is not surprising if we see expenditure and deficit “bulges” in election years. However, the problem of democratic fragility means these bulges need not be associated with standard opportunistic election-year economics.

There is much more work to be done in studying the relation between democratic fragility in new democracies and economic policy (and fiscal policy in particular). But, it is obviously a topic of crucial importance if one believes in the superiority of democratic to authoritarian rule. I hope this paper helps stimulate further work in that direction.

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Table 1: Sample Characteristics.

No.	Country	Years Included in the Expanded Sample	Elections in the Narrow sample[1]	Additional Elections in the Expanded sample[1]	Developed Economy	Parliamentary System	Proprotional System	Years as a New Democracy in the Sample
1	**Argentina**	1983-2003	3 (3)	1 (1)			X	1983-2003
2	**Australia**	1961-2002	13	1	X	X	X	
3	**Austria**	1960-1999	7	1	X	X	X	
4	**Belgium**	1960-1998	8	1	X	X	X	
5	**Bolivia**	1985-2003	0	4 (3)			X	1982-1997
6	**Brazil**	1985-1994	0	1 (1)			X	1985-1994
7	**Bulgaria**	1990-2003	1 (1)	0			X	1990-2003
8	**Canada**	1965-2001	7	2	X	X		
9	**Chile**	1960-1972, 1989-2000	0	3 (2)				1989-2000
10	**Colombia**	1971-2003	0	7			X	
11	**Costa Rica**	1972-2002	0	8			X	
12	**Cyprus**	1975-2003	5 (1)	0			X	1975-1983
13	**Czech Republic**	1993-2003	2 (2)	0		X	X	1993-2002
14	**Denmark**	1960-2000	11	0	X	X	X	
15	**Dominican Republic**	1978-2000	2 (2)	4 (2)			X	1978-1994
16	**Ecuador**	1979-2003	0	5 (4)			X	1979-1996
17	**El Salvador**	1984-2000	0	3 (3)			X	1984-2000
18	**Estonia**	1991-2001	0	1 (1)		X	X	1991-2001
19	**Fiji**	1970-1986, 1990-1999	4 (4)	0		X		1970-1986, 1990-1999
20	**Finland**	1960-1998	7	0	X	X	X	
21	**France**	1972-1997	5	0	X	X	X+	
22	**Georgia**	1998-2002	1 (1)	0			X	1998-2002
23	**Germany**	1971-1998	6	1	X	X	X	
24	**Greece**	1960-1966, 1975-1999	4 (2)	1	X	X*	X	1975-1989
25	**Guatemala**	1966-1973, 1986-2003	0	4 (4)			X	1966-1973, 1986-2003
26	**Guyana**	1966-1979, 1992-1997	2 (2)	1 (1)		X*	X	1966-1979, 1992-1997
27	**Honduras**	1982-2000	0	3 (3)			X	1982-1997
28	**Hungary**	1990-2003	2 (2)	1 (1)		X	X	1990-2003
29	**Iceland**	1972-2003	8	0	X	X	X	
30	**India**	1960-2001	5	3		X	X	1960-1967
31	**Ireland**	1960-2002	10	0	X	X	X	
32	**Israel**	1961-1972, 1974-1984, 1986-2001	6	3		X*	X	
33	**Italy**	1960-1998	6	0	X	X	X	
34	**Jamaica**	1975-1985, 2000-2002	2	0		X		
35	**Japan**	1970-1993	5	1	X	X	X	
36	**Korea**	1963-1971, 1988-1997	1 (1)	1 (1)		X*	X	1963-1971, 1988-1997
37	**Lithuania**	1993-2002	2 (2)	0			X	1993-2002
38	**Luxembourg**	1970-1974, 1976-1997	5	0	X	X	X	
39	**Madagascar**	1992-2001	2 (2)	0			X	1992-2001

Table 1: Cont.

No.	Country	Years Included in the Expanded Sample	Elections in the Narrow sample[1]	Additional Elections in the Expanded sample[1]	Developed Economy	Parliamentary System	Proprotional System	Years as a New Democracy in the Sample
40	**Malaysia**	1960-1999	7 (3)	1		X		1960-1978
41	**Mali**	1992-2003	1 (1)	1 (1)				1992-2003
42	**Mauritius**	1981-2003	5	0		X		
43	**Mexico**	1988-2003	0	2 (2)			X	1988-2003
44	**Moldova**	1997-2001	1 (1)	0			X	1997-2001
45	**Mongolia**	1990-1992, 1994-2003	2 (2)	0				1990-2003
46	**Nepal**	1990-2001	1 (1)	0		X		1990-2001
47	**Netherlands**	1960-1998	7	0	X	X	X	
48	**New zealand**	1960-1988, 1990-2001	10	2	X	X	X+	
49	**Nicaragua**	1990-2003	2 (2)	0			X	1990-2003
50	**Norway**	1960-2003	5	2	X	X	X	
51	**Pakistan**	1988-1998	2 (2)	1 (1)		X		1988-1998
52	**Panama**	1989-2000	0	2 (2)			X	1989-2000
53	**Papua new Guinie**	1975-2002	5 (3)	0		X		1975-1992
54	**Paraguay**	1989-2003	2 (2)	1 (1)			X	1989-2003
55	**Peru**	1980-1999	1 (1)	2 (2)			X	1980-1999
56	**Philipines**	1960-1971, 1987-2003	2	1 (1)				1987-2003
57	**Poland**	1991-2001	2 (2)	0			X	1989-2001
58	**Portugal**	1976-1998	5 (3)	0	X	X*	X	1976-1987
59	**Romania**	1990-2001	1 (1)	0		X	X	1990-2001
60	**Russia**	1995-2001	0	1 (1)			X	1992-2001
61	**Slovak Republic**	1994-2003	2 (2)	0		X	X	1994-2003
62	**Slovenia**	1993-2003	0	1 (1)		X	X	1993-2003
63	**Solomon Islands**	1978-1990, 1993-1999	2 (1)	0		X		1978-1990
64	**South Africa**	1994-2003	1	0			X	
65	**Spain**	1978-2003	5 (2)	0	X	X	X	1978-1989
66	**Sri Lanka**	1960-2001	5 (1)	1		X*	X+	1960-1965
67	**Sweden**	1961-2000	10	1	X	X	X	
68	**Thailand**	1978-1990, 1992-2003	4 (2)	0		X		1978-1990
69	**Trinidad & Tobago**	1962-1972, 1976-1989, 1993-1995	3	1		X		
70	**Turkey**	1976-1979, 1983-2001	5 (4)	0	X	X	X	1976-1979, 1983-1995
71	**United Kindom**	1960-1999	8	0	X	X		
72	**United States**	1960-2003	7	3	X			
73	**Uruguay**	1985-2001	0	2 (2)			X	1985-2001
74	**Venezuela**	1960-2001	0	6 (3)			X	1960-1978

[1] The number in the parentheses indicates the number of elections that took place in a country during the years it is defined as a "new democracy".

* Some of the Elections are in a Presidential System

\+ Some of the Elections are in a Majoritarian System

Table 2: The Political Budget Cycle Across Countries, Fixed Effects Estimates.

	All Democracies			All "New Democracies"			"New Democracies" Excluding "Transition Economies"[3]			"Old Democracies"		
	(1)			(2)			(3)			(4)		
Estimation period	1960-2001			1960-2001			1960-2001			1960-2001		
Dependent variable[1]	balance	texp	trg	balance	texp	trg	balance	texp	trg	balance	texp	trg
Elect[2]	-0.352***	0.085	-0.251	-0.868***	0.747**	-0.153	-0.684**	0.434*	-0.237	-0.109	-0.131	-0.223*
	(0.123)	(0.193)	(0.171)	(0.273)	(0.292)	(0.236)	(0.290)	(0.260)	(0.247)	(0.135)	(0.146)	(0.118)
Adjusted R^2	0.683	0.905	0.915	0.461	0.937	0.954	0.504	0.928	0.920	0.764	0.959	0.969
F- Statistic	47.96	211.63	239.87	9.42	150.57	203.18	11.62	140.19	120.61	94.937	693.30	928.81
DW Statistic	1.955	1.562	1.455	1.821	2.051	2.114	1.682	1.925	2.134	1.900	1.987	1.872
No. of countries	68	68	68	36	36	36	26	26	26	32	32	32
No. of obs.	1616	1631	1640	415	423	415	336	344	336	1105	1112	1128
Avg. time series length	23.8	24.0	24.1	11.5	11.8	11.5	13.0	13.3	13.0	34.5	34.8	35.3

The covariates include one lag of the dependent variable, the log of per-capita GDP, the ratio of international trade to GDP, 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.

[1]Variable definitions (all in percent of GDP): balance-central government surplus; texp-total expenditure by the central government; trg-total revenue and grants of the central government.

[2]Elect - a dummy variable with the value 1 in the election year and 0 otherwise.

[3]The "new democracies" among the transition economies are listed in Table A1.

* - Significant at the 10 percent level; ** - Significant at the 5 percent level; *** - Significant at the 1 percent level.