

The Democratic Debt Advantage Revisited: It Is Veto Players

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Table of Contents

Do Democracies Have an Advantage in the Sovereign Debt Market?

1. Puzzle: The Democratic Advantage
2. Argument: Veto Players, Not Contested Elections
3. Re-Considering Historical Evidence
4. Evidence for Recent Sovereign Rating Data
5. Conclusion

1. The Democratic Advantage: Puzzle

3

Hypothesis: Democracies have an advantage in the sovereign debt market.
(Schultz & Weingast 2003)

	PUZZLE (Beaulieu, Cox & Saiegh 2012)	SOLUTION
Historical Data from 17th to 19th century	Democratic advantage	No democratic advantage, but veto players
Recent Data since 1970s	No democratic advantage (evidence for sovereign ratings)	No democratic advantage, but veto players

Democracy Definition for Recent Sovereign Rating Data:

- Archer et al. 2007: electoral accountability; indicator: combined polity2
- Beaulieu, Cox & Saiegh 2012: regime with contested elections; indicator: Democracy-Dictatorship by Cheibub et al. 2010

1. Puzzle – 2. Argument – 3. Historical – 4. Ratings – 5. Conclusion

2. Argument: Veto Players, Not Contested Election

4

- **Why not regimes with contested elections?**
 - opportunistic political business cycles: incentive to default before elections
 - Foley-Fisher 2012: leaders who default are more likely to be re-elected
 - Enderlein et al. 2012: democracies more coercive debt negotiations
 - electoral uncertainty: lower investment in country (Canes-Wrone & Park 2012, Brooks & Mosley 2007)

- **Why regimes with veto players?**
 - veto players can block the decision of the executive to default or impose high costs if it defaults
 - parliaments (Kohlscheen 2010), coalition governments (Saiegh 2009), independent judiciaries (Biglaiser & Staats 2012), independent central banks

- **Veto player vs. regimes with contested elections?**
 - electorate is one veto player, but variance within regimes with contested elections
 - regimes without contested elections can have veto players

3. Evidence for Historical Cases

5

Study	Countries	Polity Change	Polity (from -10 to 10)
North & Weingast 1989	England	first in 1800	-2
Summerhill 2008	Brazil	1824 (first)	-6
Dincecco 2009	Belgium	1830 (first)	-4
	Netherlands	1847-1848	-7 → -4
	Prussia	1847-1848	-9 → -8
	Portugal	1851	-4
Saiegh 2009a	Argentina	1851-1853	-5 → -3
Dincecco 2009	Italy	1861 (first)	-4
	Sweden	1866-1870	-5 → -4
	Austria-Hun.	1860-1867	-6 → -4
	France	1869-1877	-3 → 7
	Spain	1873-1876	-5 → -1

3. Evidence for Historical Cases

6

Study	Countries	Polity Change	Polity (from -10 to 10)	exec. elect. (from 1 to 3)	Constraints (from 1 to 7)
North & Weingast 1989	England	first in 1800	-2	1	7
Summerhill 2008	Brazil	1824 (first)	-6	1	1
Dincecco 2009	Belgium	1830 (first)	-4	1	5
	Netherlands	1847-1848	-7 → -4	1	3 → 6
	Prussia	1847-1848	-9 → -8	1	2
	Portugal	1851	-4	1	3
Saiegh 2009a	Argentina	1851-1853	-5 → -3	1	1 → 3
Dincecco 2009	Italy	1861 (first)	-4	1	3
	Sweden	1866-1870	-5 → -4	1	4 → 5
	Austria-Hun.	1860-1867	-6 → -4	1	1 → 3
	France	1869-1877	-3 → 7	1 → 3	1 → 7
	Spain	1873-1876	-5 → -1	1	1 → 7

4. Evidence for Sovereign Ratings (1)

7

Panel Data

- yearly sovereign ratings for Standard & Poor's, Moody's and Fitch
- from 1980-2010 (unbalanced)
- more than 1000 observations for more than 100 countries

Control Variables

- positive: GDP per capita, GDP growth, current account surplus
- negative: inflation, debt to GDP, past default history

Econometric Models

- Ordinary least squares with White-robust standard errors (Fitch)
- OLS with PCSE and Prais-Winsten Transformation (Archer et al. 2007)
- Ordered Probit with robust standard errors clustered on country

1. Puzzle – 2. Argument – 3. Historical – **4. Ratings** – 5. Conclusion

1) No Advantage for Regimes with Contested Elections

	Standard & Poor's		Moody's		Fitch		
	PCSE (ar1)	Ordered Probit	PCSE (ar1)	Ordered Probit	PCSE (ar1)	POLS	Ordered Probit
	Rating	Rating	Rating	Rating	Rating	Rating	Rating
Ln(GDP per capita)	2.740***	1.033***	2.711***	0.957***	2.919***	3.145***	1.270***
	(0.153)	(0.099)	(0.176)	(0.120)	(0.133)	(0.072)	(0.126)
GDP Growth	0.027*	-0.001	0.013	-0.014	0.019	-0.014	-0.003
	(0.015)	(0.019)	(0.013)	(0.015)	(0.019)	(0.032)	(0.016)
Current Acc. Surplus	-0.000	0.023**	0.008	0.014	0.005	0.027**	0.014
	(0.014)	(0.010)	(0.010)	(0.009)	(0.011)	(0.012)	(0.012)
Inflation	-0.001*	-0.002**	-0.000	-0.001***	-0.000	-0.004**	-0.001**
	(0.000)	(0.001)	(0.000)	(0.000)	(0.000)	(0.002)	(0.001)
Default History	0.411	-1.451***	0.089	-1.065***	-0.137	-3.350***	-1.351***
	(0.345)	(0.216)	(0.296)	(0.278)	(0.382)	(0.445)	(0.253)
Public Debt to GDP	-0.014***	-0.007***	-0.006	-0.003	-0.000	-0.006*	-0.005
	(0.004)	(0.003)	(0.004)	(0.003)	(0.005)	(0.003)	(0.003)
Democracy (Cheibub)	-0.031	0.231	0.004	0.251	-0.205	-0.165	-0.089
	(0.322)	(0.230)	(0.256)	(0.242)	(0.222)	(0.262)	(0.295)
Constant	-9.604***		-9.574***		-11.041***	-12.161***	
	(1.169)		(1.561)		(1.035)	(0.680)	
Observations	1,470	1,470	1,541	1,541	1,008	1,008	1,008
	0.669	30.88,9.68	0.693	30.43,8.92	0.756	0.752	31.94,16.54
countries	111	111	101	101	101	101	101

2) Constraints on the Executive: Positive Impact Electoral Competitiveness: Negative Impact

	Standard & Poor's		Moody's		Fitch		
	PCSE (ar1)	Ordered Probit	PCSE (ar1)	Ordered Probit	PCSE (ar1)	POLS	Ordered Probit
	Rating	Rating	Rating	Rating	Rating	Rating	Rating
Ln(GDP per capita)	2.861*** (0.149)	1.081*** (0.102)	2.785*** (0.173)	0.986*** (0.121)	2.929*** (0.145)	3.174*** (0.071)	1.291*** (0.122)
GDP Growth	0.013 (0.017)	0.027* (0.016)	0.008 (0.014)	0.006 (0.013)	0.016 (0.018)	0.041 (0.026)	0.020 (0.014)
Current Acc. Surplus	-0.017* (0.009)	0.014 (0.011)	-0.005 (0.009)	0.013 (0.010)	-0.004 (0.010)	0.031*** (0.011)	0.015 (0.012)
Inflation	-0.001 (0.000)	-0.002** (0.001)	-0.000 (0.000)	-0.001*** (0.000)	-0.000 (0.000)	-0.003** (0.002)	-0.001** (0.001)
Default History	0.402 (0.330)	-1.345*** (0.226)	0.058 (0.279)	-1.069*** (0.302)	0.020 (0.351)	-3.268*** (0.438)	-1.350*** (0.263)
Public Debt to GDP	-0.009** (0.004)	-0.005* (0.003)	-0.005 (0.004)	-0.002 (0.003)	-0.001 (0.004)	-0.004 (0.003)	-0.003 (0.003)
Constraints	0.247** (0.120)	0.233** (0.098)	0.279*** (0.103)	0.267*** (0.097)	0.242 (0.149)	0.778*** (0.120)	0.245** (0.102)
Electoral Competitiv.	-0.371** (0.185)	-0.306* (0.179)	-0.325* (0.193)	-0.376* (0.201)	-0.429 (0.274)	-1.688*** (0.258)	-0.521** (0.204)
Constant	-11.114*** (1.242)		-10.843*** (1.554)		-11.516*** (1.066)	-13.131*** (0.590)	
Observat.	1,457	1,457	1,514	1,514	1,042	1,042	1,042
Fit Statistics	0.698	29.58,8.09	0.705	30.31,8.57	0.749	0.761	30.42,15.30
Countries	100	100	91	91	96	96	96

3) Positive Impact of Political Constraints Holds for Different Measures

	Standard & Poor's		Moody's		Fitch		
	PCSE (ar1)	Ordered Probit	PCSE (ar1)	Ordered Probit	PCSE (ar1)	POLS	Ordered Probit
	Rating	Rating	Rating	Rating	Rating	Rating	Rating
Ln(GDP per capita)	2.809*** (0.133)	1.048*** (0.104)	2.866*** (0.151)	0.951*** (0.132)	2.942*** (0.130)	2.965*** (0.068)	1.240*** (0.128)
GDP Growth	0.007 (0.013)	0.016 (0.018)	0.010 (0.013)	0.002 (0.014)	0.009 (0.019)	0.023 (0.033)	0.012 (0.016)
Current Acc. Surplus	-0.012 (0.009)	0.014 (0.011)	0.001 (0.011)	0.009 (0.010)	0.000 (0.011)	0.028*** (0.010)	0.016 (0.011)
Inflation	-0.001 (0.000)	-0.002*** (0.001)	-0.000 (0.000)	-0.001*** (0.000)	-0.000 (0.001)	-0.004** (0.002)	-0.002** (0.001)
Default History	0.431 (0.355)	-1.341*** (0.220)	-0.024 (0.324)	-1.023*** (0.312)	-0.305 (0.421)	-3.417*** (0.486)	-1.342*** (0.295)
Public Debt to GDP	-0.010** (0.005)	-0.007*** (0.003)	-0.005 (0.004)	-0.004 (0.003)	-0.001 (0.005)	-0.008** (0.003)	-0.006* (0.003)
Constraints (Henisz)	1.389*** (0.485)	1.342*** (0.418)	1.210*** (0.388)	1.206*** (0.448)	0.901* (0.505)	2.256*** (0.445)	0.842* (0.508)
Constant	-10.733*** (1.088)		-11.390*** (1.390)		-11.610*** (0.905)	-11.992*** (0.675)	
Observations	1,300	1,300	1,379	1,379	883	883	883
Fit Statistics	0.726	33.46,11.00	0.725	33.13,10.83	0.784	0.775	33.29,17.39
Countries	98	98	94	94	97	97	97

5. Conclusion

11

Question: Do financial markets favour or are they sceptical of democracies?

Argument: No democratic advantage, but a veto player advantage

- Historical cases: countries with democratic institutions never had better borrowing conditions, instead veto players mattered
- Evidence for recent sovereign rating data: rating agencies favour constraints on the executive, but not democratic institutions

Standard & Poor's: *“extensive checks and balances between institutions”* (2011)

Moody's: *“democracies as well as autocracies (...) default alike”* (2008: 8)

Further: Veto Players, Not Contested Elections

12

Number of Veto Players	Number of Defaults	Total Observations	Probability of Default in %
1	76	1,809	4.20
2	13	380	3.42
3	15	849	1.77
4	14	804	1.74
5	5	342	1.46
6 or more	2	185	1.08

	Number of Defaults	Observations	Probability of Default
No Election Year (-/+1)	28	1,594	1.76
Election Year (-/+1)	17	542	3.14