The Politics of Strategic Budgeteering

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Motivation

All else equal, politicians prefer winning elections to losing them.
All else equal, voters prefer not to be fooled.

Incumbents aim to increase the voters' welfare before elections (i.e., by providing more public goods, or giving pre-electoral gifts).

Monetary business cycles unlikely because CBI & fixed exchange rates (Clark and Hallerberg 2000).

Can governments use fiscal policies to achieve this goal?

i) deficit spending (Rogoff 1990; Shi & Svensson 2002; Drazen 2000)
ii) tax revenues (Persson & Tabellini 2003)
iii) compositional spending (Drazen & Eslava 2005; Schneider 2010; Katsimi & Sarantides 2012)

Conservative Voters and Deficit Spending

Empirical evidence is weak at best:

Ability to create political budget cycles depends on availability of information.

i) fiscal transparency (Alt & Lassen 2006)
ii) state-enforced media (Ferejohn 1999)
iii) new and weak democracies (Brender and Drazen 2005; Shi and Svensson 2006)
iv) European Monetary Union

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Main Question: Has fiscal transparency eliminated the ability of governments in developed democratic countries to pursue opportunistic fiscal policies before elections?

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Our Contribution: Integrated theory of how governments choose between alternative fiscal policy instruments, given the (domestic/international) institutional constraints they face.

➔ Politics of strategic budgeteering

Assumptions

Voters want to maximize their expected income and value increased consumption.

But they are fiscal conservatives (Peltzman 1992, and many others).

Fiscal transparency allows voters to observe public deficits.

Incumbents want to signal economic competence.

Incompetent incumbents will try to appear competent through hidden action.

(Incumbents do not have monetary policy autonomy.)

Different policies:

- Deficit spending
- Compositional spending (current consumption vs long-term investment spending)
- (Tax revenues)

The Argument

Deficit spending is more flexible than compositional spending, but not feasible in fiscally transparent economies.

Compositional spending is less flexible, but more feasible in transparent economies.

⇨ Trade off between flexibility and feasibility.

H1: The lower fiscal transparency, the greater the likelihood that governments use deficit spending to increase public goods provision in preelection periods, ceteris paribus.

H2: The greater fiscal transparency, the more likely governments use compositional spending to increase public goods provision in preelection periods, ceteris paribus.

Other implications:

- Closeness of elections
- Interest rates
- EMU membership

Empirical Analysis

- 32 OECD countries (1970-2012)
- Main DV: Ratio of government consumption to investment spending (OECD)
- Main IVs:
  - Preelectoral Period
  - Government debt (OECD)
  - Fiscal transparency (OBI and Alt/Lassen index)
- Other explanatory variables:
  - Closeness of election
  - Interest rates
  - EMU membership
- Controls: Unemployment, pc GDP, government control, fractionalization, checks and balances, polarization, FDI, GDP pc growth, gross savings, trade, inflation, age dependency ratio, tax revenue, etc
- Main model specification: Fixed effects TSCS regressions

Robustness Checks

Alternative dependent variables (consumption vs. investment vs deficit/debt; individual items)

Alternative fiscal strategies (interest rates, inflation, taxation)

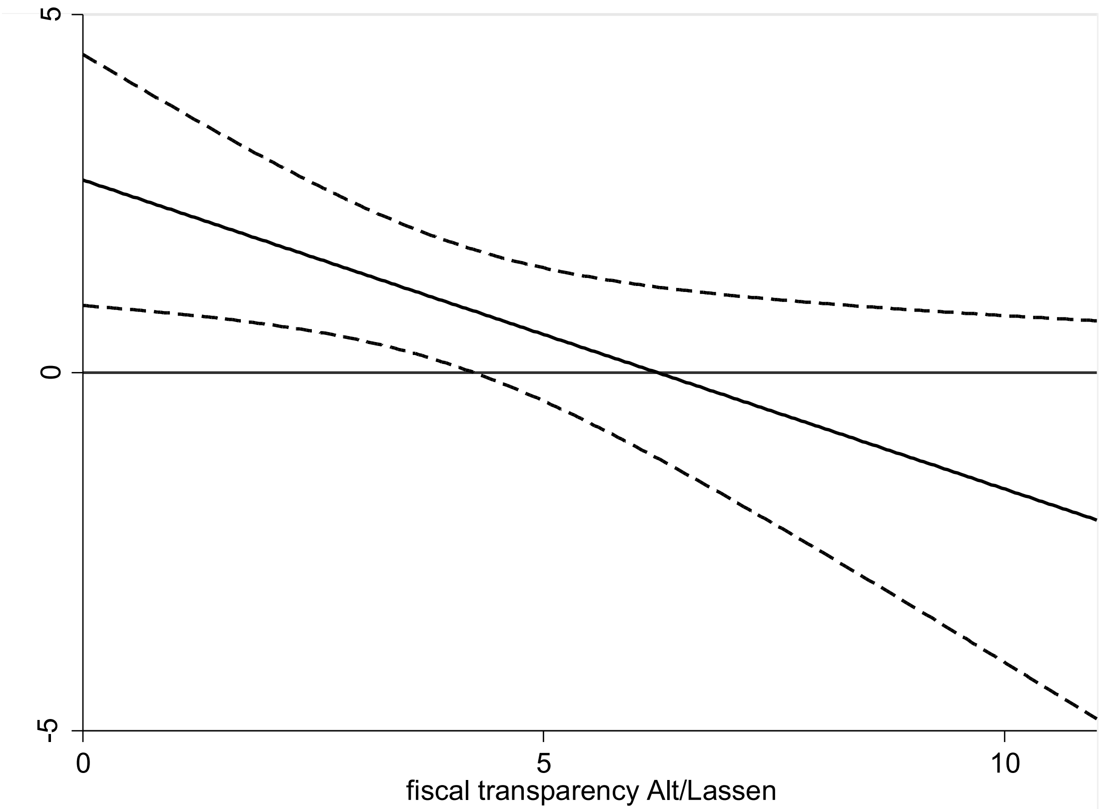
Alternative model specifications (endogenous elections, random effects, etc)

Post-election effects

Alternative Samples: Established vs weak democracies

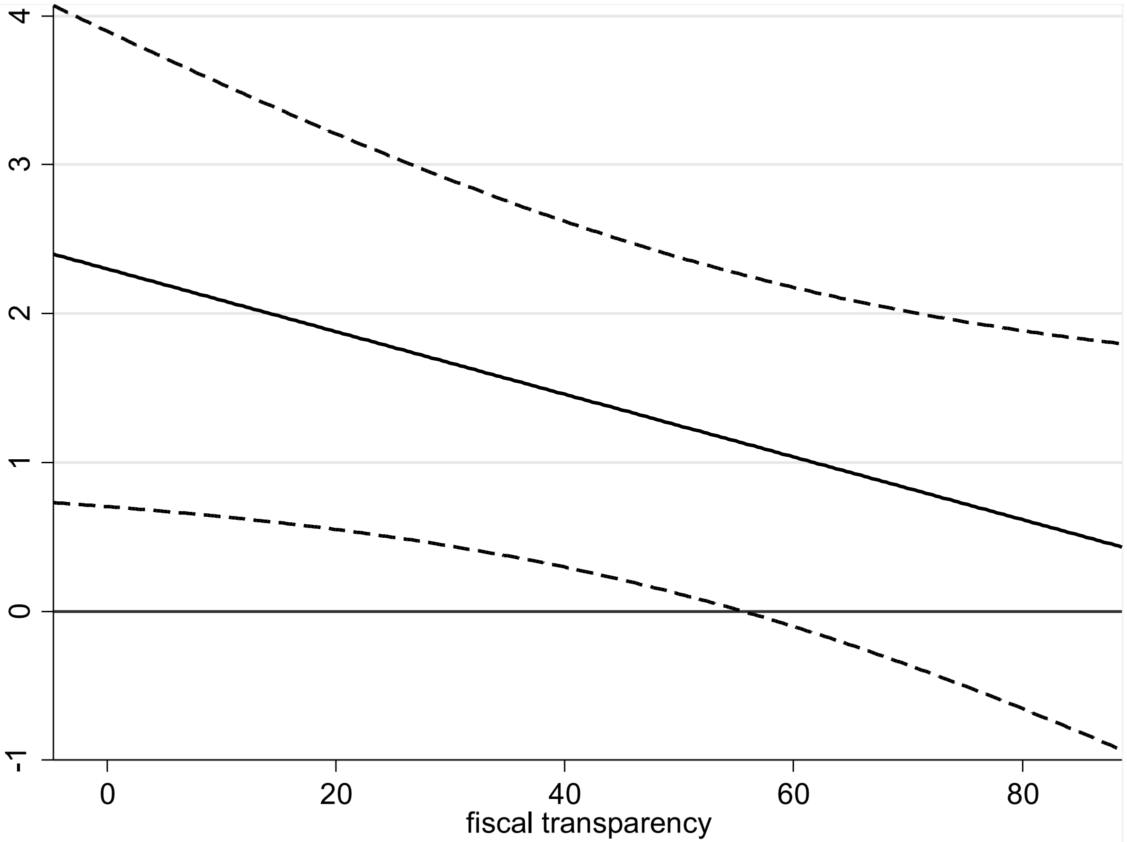
Partisan cycles

Main Empirical Results (I)



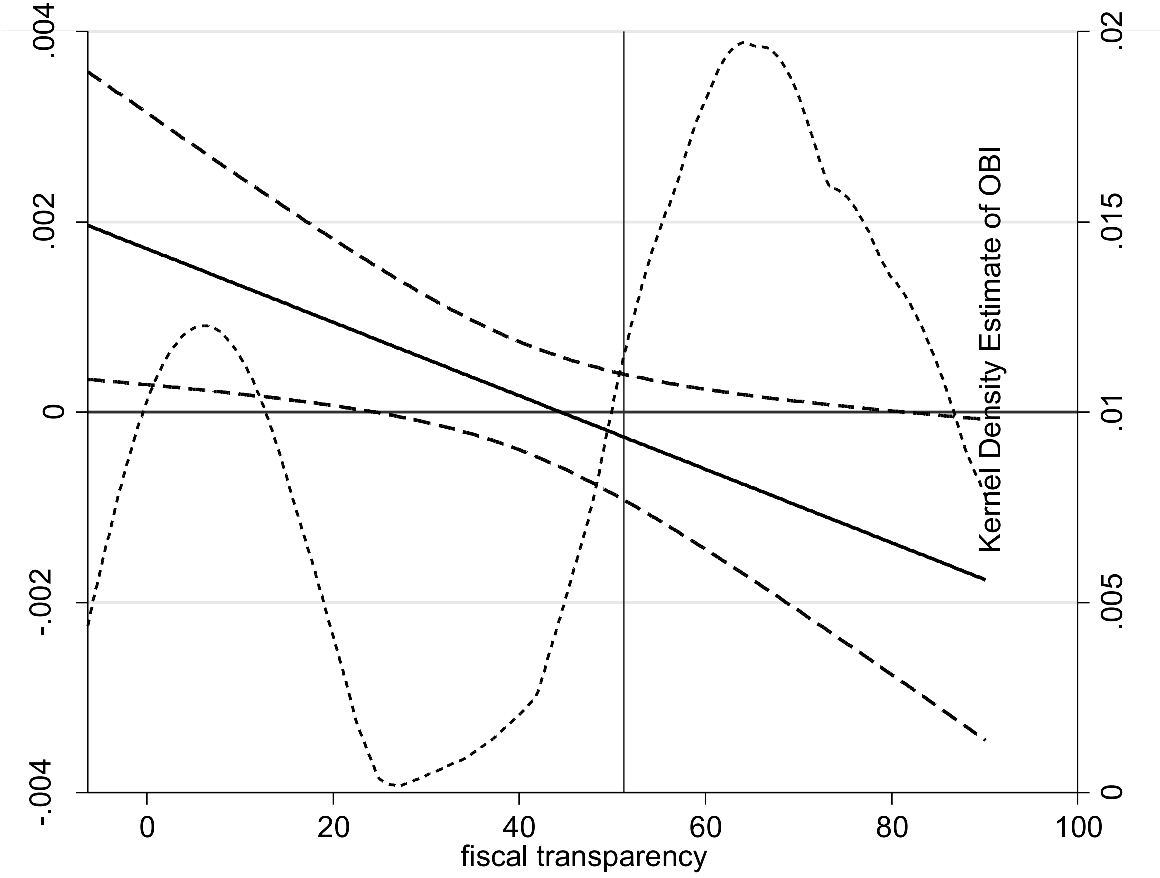
Preelectoral Effect on Changes in Debt

Main Empirical Results (II)



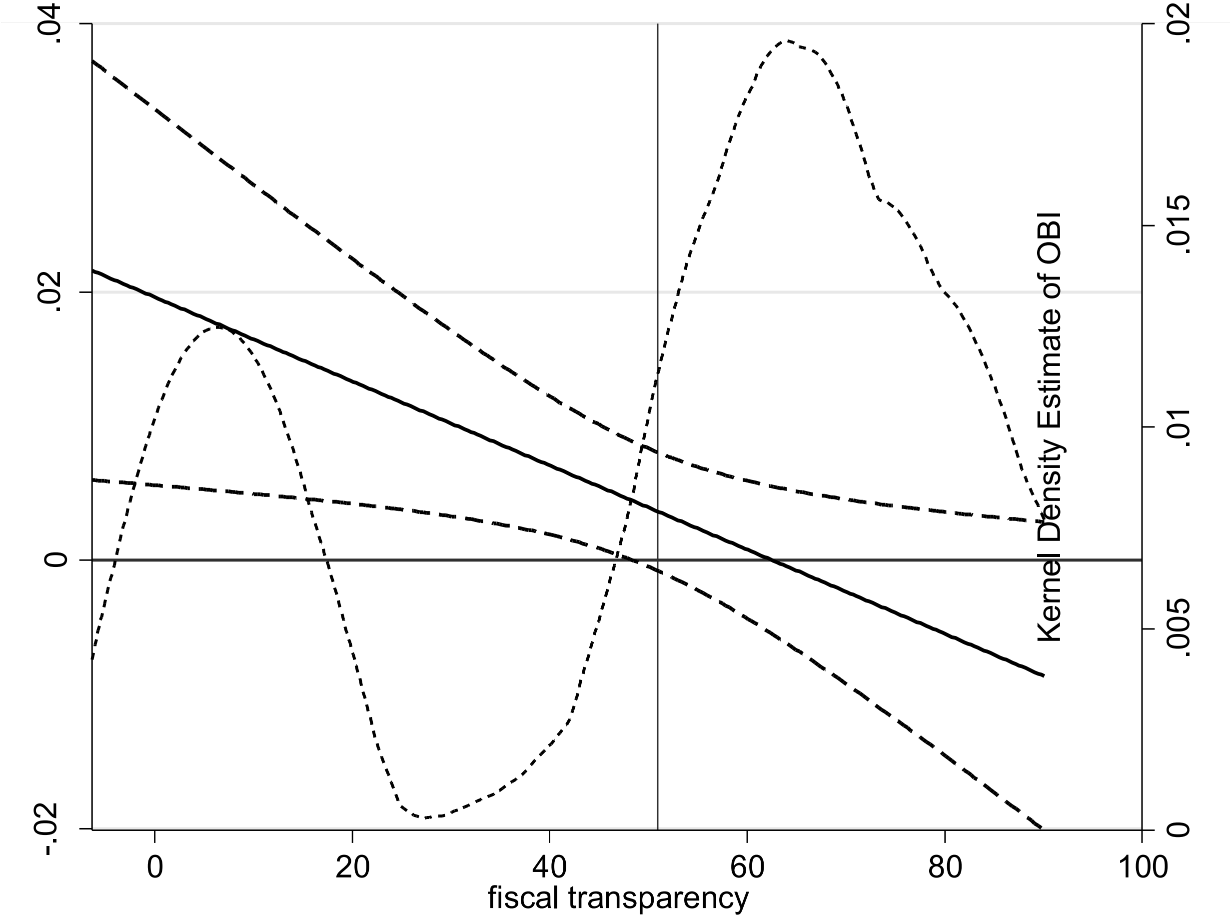
Preelectoral Effect on Government Consumption

Main Empirical Results (III)



Preelectoral Effect of Deficit Spending on Government/Investment Ratio

Main Empirical Results (III)



Preelectoral Effect of Deficit Spending on Consumption

Other Findings

Closeness of elections strengthen political budget cycles

No preelectoral effects for revenues or monetary policies

Small postelectoral effect for tax revenues (increase)

No effect of EMU membership on consumption-investment ratio (but overall better fiscal performance)

No effect of endogenous

Partisanship matters

Conclusions

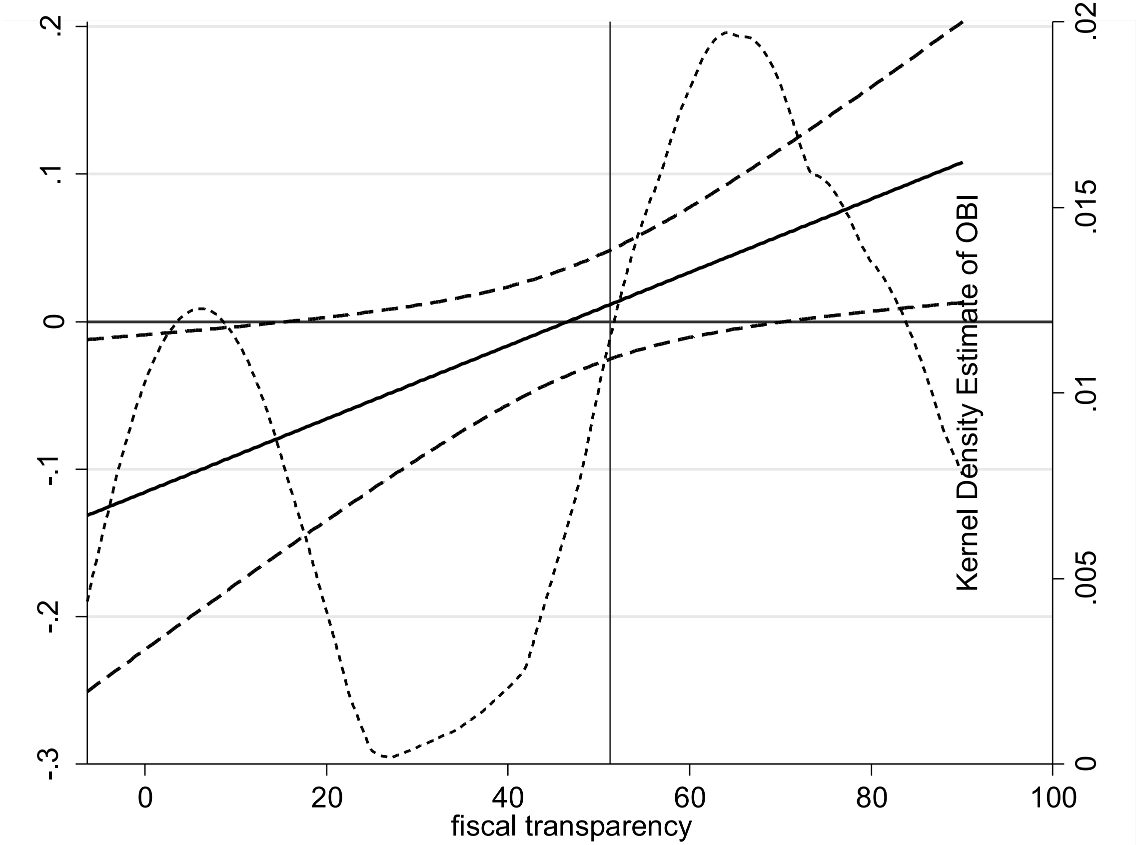
Political budget cycles persist in developed economies, but in different forms

Governments always have an incentive to provide pre-electoral gifts

To increase voters’ welfare before elections and thus boost the probability of staying in office they choose between alternative fiscal strategies

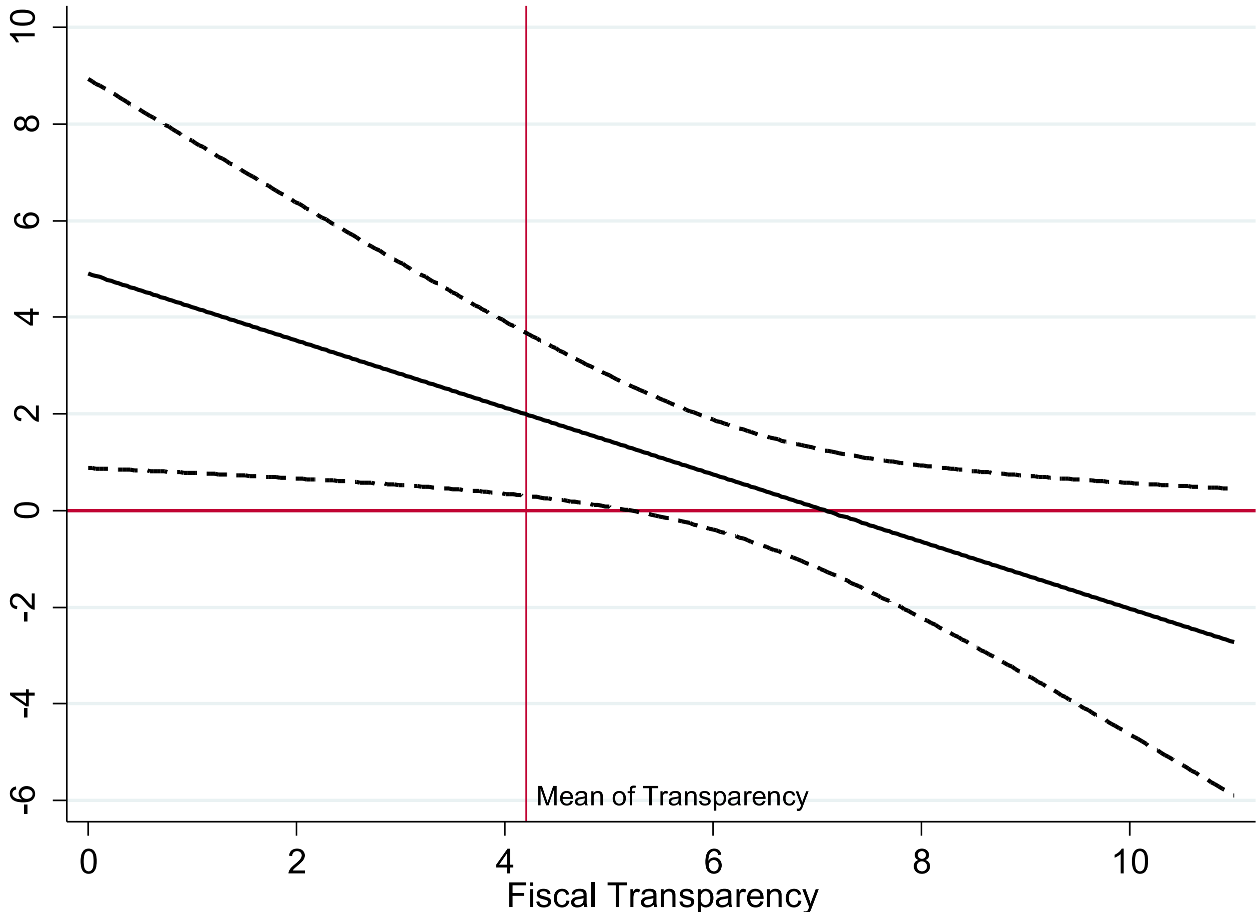
- ⇨ Deficit Spending is most attractive but less likely if fiscal transparency is high
- ⇨ Governments redirect resources from long-term investment to short-term public good provision especially if elections are highly contested

Additional Graphs

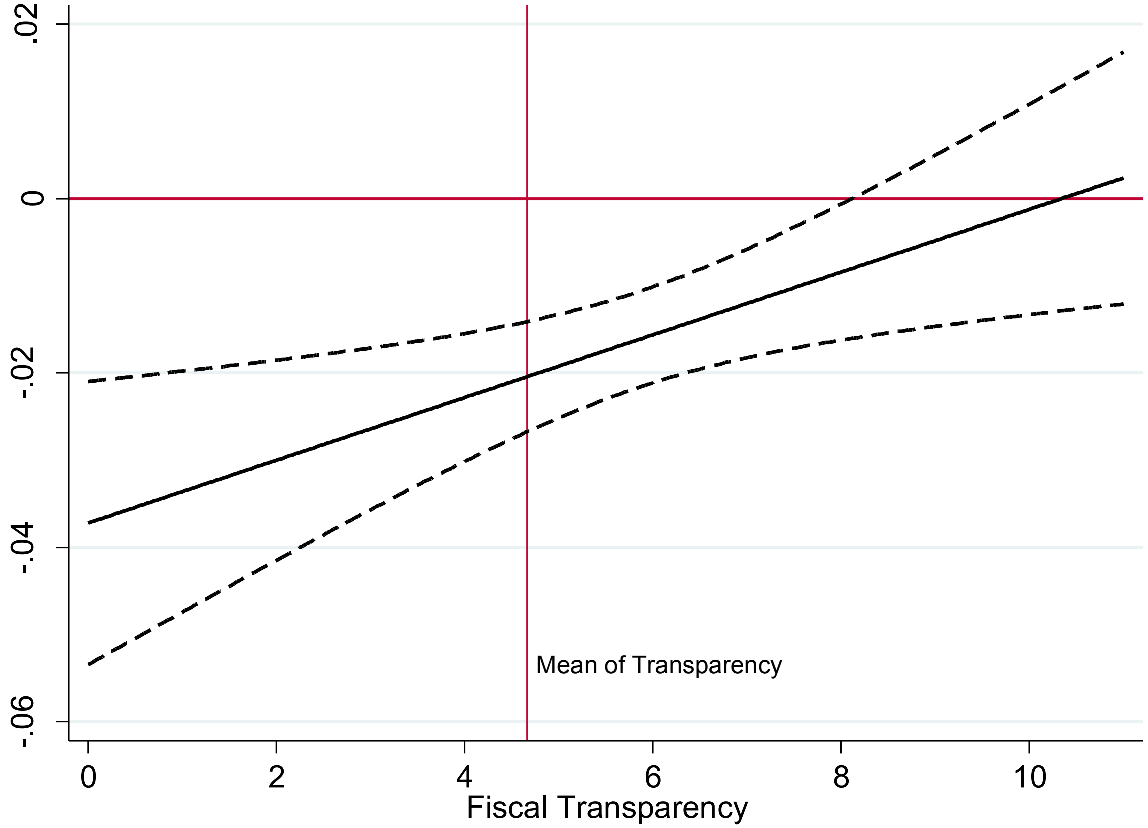


Preelectoral Effect on Consumption/Investment Ratio

Expenditure Item	Description	Longterm/ shortterm
1	General Public Services	
2	Defense	Longterm
3	Public Order & Safety	Longterm
4	Education	Longterm
5	Health	Longterm
6	Social Security & Welfare	Shortterm / non-targeted
7	Housing & Community Amenities	Shortterm
8	Recreational, Cultural & Religious Affairs	
9	Fuel & Energy	Shortterm/ Targeted
10	Agriculture, Forestry, Fishing & Hunting	Shortterm/ Targeted
11	Mining, Manufacturing & Construction	Shortterm/ Targeted
12	Transportation & Communication	Shortterm/ Targeted
13	Other Economic Affairs & Services	
14	Other Expenditures	
15	of which: Interest Payments	
16	Adjustment to Total Expenditure	
17	Economic Affairs & Social Services (9-13) (only if 9-13 not available)	Shortterm
18	Environmental Protection	Longterm
19	Electricity, Steam, Water	
20	Roads	Shortterm
21	Inland & Coastal Waterways	
22	Other Transport & Communication	Shortterm
23	Other Economic Services	

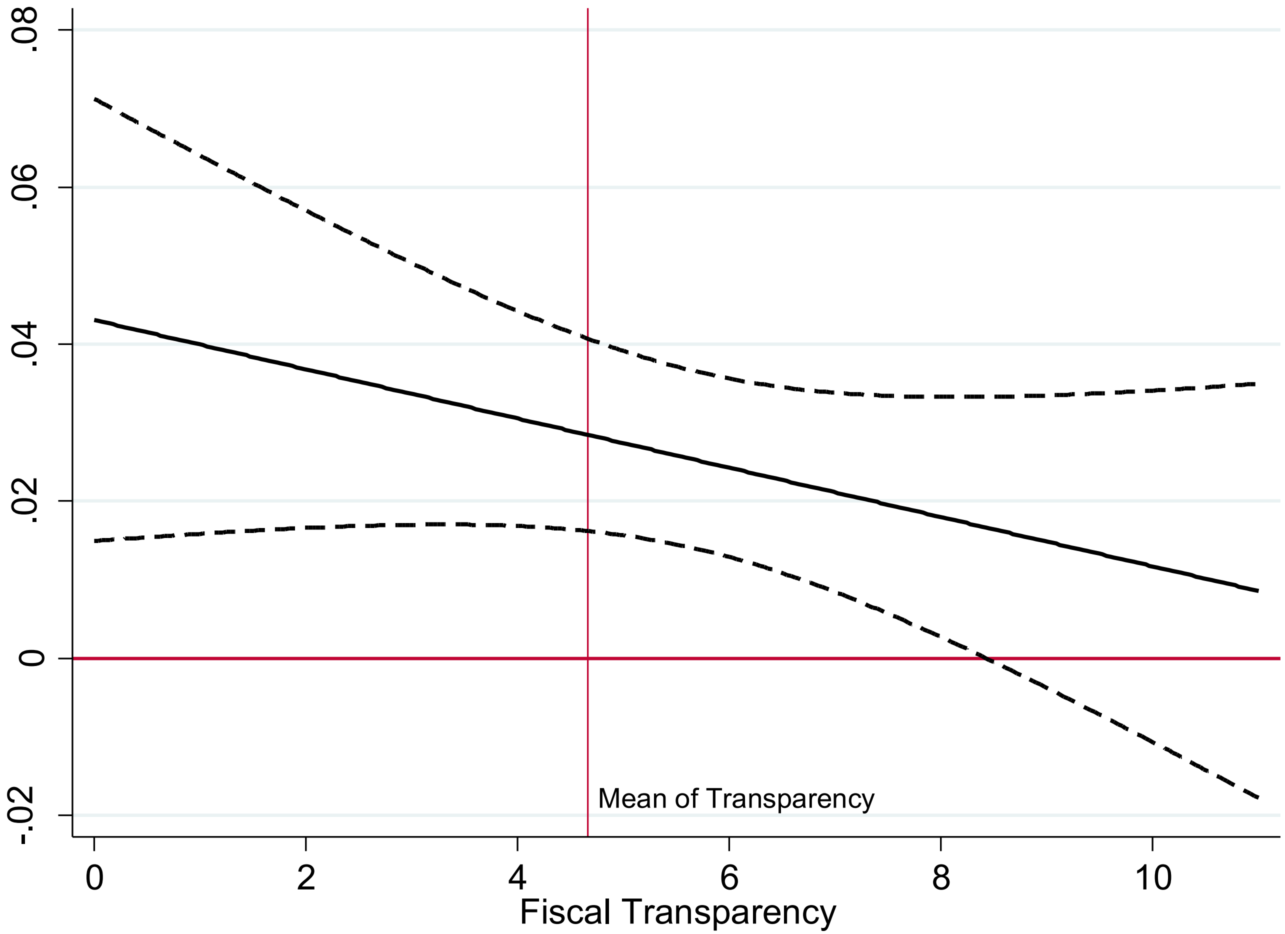

10
8
6
4
2
0
-2
-4
-6
Mean of Transparency
0
2
4
6
8
10
Fiscal Transparency

Deficit



.02
0
-.02
-.04
-.06
Mean of Transparency
0
2
4
6
8
10
Fiscal Transparency

Investment



Consumption