



Political budget cycles and reelection prospects in Greece's municipalities

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ARTICLE INFO

Article history:

Received 11 March 2015

Received in revised form 6 February 2016

Accepted 8 February 2016

Available online 23 February 2016

JEL classification:

D72

H7

C23

Keywords:

Political budget cycles

Reelection

Municipalities

Greece

Panel data

ABSTRACT

This paper considers the presence of political budget cycles in Greece's municipalities. We construct a new dataset from primary sources and we find strong evidence of pre-electoral manipulation through increased expenditures and excessive borrowing. We use a dynamic panel data approach producing evidence of opportunistic behavior in local government finances. Our results are robust in the face of a series of controls including mayors running for reelection, their political alignment with the central government, and prolonged terms. Moreover, the results are robust to the exclusion of small sized municipalities and to the restriction of the time range of our investigation to the post-Maastricht period. We also consider whether opportunistic policies influence incumbents' reelection prospects finding that increased expenditures and election year opportunistic excesses are electorally rewarding. Our findings provide a characterization of opportunistic public finance management in Greek municipalities where electorally motivated budgetary decisions appear impervious to the various municipal reform attempts.

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1. Introduction

Greece's economic and political environment is characterized, inter alia, by weak institutions, extensive opportunistic behavior by incumbents, substantial rent-seeking (Pelagidis and Mitsopoulos, 2009), clientelism, and cronyism (Phelps, 2015). Such concerns may also afflict local government politics, which in Greece are closely associated with national politics. This paper focuses on Greek municipal budgets and pre-electoral manipulation of public finances as one manifestation of such phenomena. It considers the presence of politically induced opportunistic cycles in municipal fiscal policies. In addition, it examines how these electorally motivated budgetary policies affect mayors' reelection prospects. We construct a new dataset from primary sources, which covers 109 municipalities from 1985 to 2004 and corresponds to half of Greece's population. To our knowledge, this is the first attempt to identify political budget cycles (PBCs) in Greece's municipalities and to consider the expenditures' impact on mayors' reelection prospects.

Our focus on Greek municipalities provides some unique insights in Greece's political economy. First, our newly collected data allow us to investigate the presence of PBCs at the municipal level in the context of an advanced economy with a long history of

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political instability, weak institutions and high levels of political polarization. Second, studying Greece allows us to test if changes in the institutional framework, in this case the constraints implied by the country's effort to join the Economic and Monetary Union, had any effect on the opportunistic policies at the municipal level. Third, our data allow us to study the impact of elections on borrowing by the municipalities, a budget element absent from many other relevant studies. Although the magnitude of municipal borrowing is very limited in the case of Greece, it is nevertheless indicative of incumbents' opportunistic behavior. Fourth, given that local and national politics in Greece are closely related, we are able to systematically investigate how the interactions (alignment) between the different layers of government affect the size of the opportunistic cycle. Fifth, since no term limits apply for Greek mayors, we study the previously unexplored effects that a prolonged incumbency may have on the magnitude of municipal PBCs. Finally, as a key element of all reforms pertaining to local government in Greece over the last two decades has been the reduction in their number on the grounds of efficiency, we explicitly test whether small municipalities are more conducive to the presence of PBCs or not.

Our evidence suggests that mayors in Greece manipulate fiscal policy prior to elections as the budget balance deteriorates during election years, while total expenditures, its highly visible investment component and municipal borrowing all increase. The electoral effects on investment expenditures appear more pronounced when the mayor is aligned to the central government ruling party or when he is running for another term, while no evidence exists that the magnitude of the PBC is affected by prolonged incumbency. Our analysis also shows that PBCs are present in the post-Maastricht era and that their existence is robust to the exclusion of small-sized municipalities from our sample.

We also examine how the electorally motivated budgetary policies affect mayors' reelection prospects. Our evidence shows that both increased expenditures over the full term and election year opportunistic deviations have a positive effect on mayors' reelection prospects. This finding can explain both the emergence of political budget cycles and the persistent mismanagement of local public finances.

The rest of the paper is organized as follows. The next section briefly reviews the relevant literature for PBCs at the local government level and the effects of opportunistic policies on incumbents' reelection possibilities. [Section 3](#) provides some highlights on Greece's local government institutions and political framework. [Section 4](#) discusses our newly constructed dataset and estimation strategy for the detection of PBCs, while [Section 5](#) presents and discusses the results of our analysis. [Section 6](#) considers whether municipal expenditures affect mayors' reelection prospects. Finally, [Section 7](#) concludes.

2. Literature survey

2.1. Political budget cycles at the local government level

Political budget cycles emerge due to opportunistically motivated incumbents who try to enhance voters' economic well-being before elections ([Franzese and Jusko, 2006](#)) as evidence suggests that economic conditions influence government support. This link, known as "economic voting", has been studied with the help of voting and popularity functions (VP-functions) that explain government support (either in elections or polls) as a function of political and economic outcomes ([Nannestad and Paldam, 1994](#)).³

While recent research identifies several PBC determinants at the national level,⁴ there is a growing literature considering political cycles at the local level where greater homogeneity in government structure, available policy instruments ([Veiga and Veiga, 2007a](#)) and uniformity in electoral rules and dates ([Sakurai and Menezes-Filho, 2011](#)) are present. For instance, [Blais and Nadeau \(1992\)](#) show that in Canada provincial governments' spending on social services and infrastructure construction increases during election years. Similarly, [Galli and Rossi \(2002\)](#) document the presence of election year increases in total expenditures and various spending categories like health care, education and road construction in Germany's federal states. In the setting of a young, recently established democracy, [Akhmedov and Zhuravskaya \(2004\)](#) report evidence of PBCs in Russia's regional elections, identifying electoral effects on public spending, financed by deficit and federal transfer increases. Along the same lines, [Sjahrir et al. \(2013\)](#) uncover evidence of opportunistic cycles in Indonesia's districts with electoral effects being present in direct elections and of a larger magnitude when the incumbent runs for reelection. Evidence on the presence of politically induced cycles at the subnational level finances is not solely confined to the post-WWII period. [Aidt and Mooney \(2014\)](#) focus on London Boroughs for the early part of the 20th century documenting the presence of political budget cycles that are conditional on the suffrage regime, either taxpayer or universal suffrage. Under the former election year tax cuts are observed while under the latter capital spending increases during election years.

A number of other papers study explicitly the emergence of PBCs at the level of municipal administrative entities. [Veiga and Veiga \(2007a\)](#) produce evidence of electoral effects in Portuguese municipalities. Their results show that elections have a negative

³ [Kramer \(1971\)](#), [Fair \(1978\)](#), [Madsen \(1980\)](#) and [Lewis-Beck \(1988\)](#) are among the first who provide evidence in support of the economic voting hypothesis. [Nannestad and Paldam \(1994\)](#) review early evidence and conclude that VP-functions can explain government support when voters hold the government responsible for the economic conditions. Evidence from recent studies is also consistent with the economic voting hypothesis. See for example [Swank and Eisinga \(1999\)](#), [Feld and Kirchgässner \(2000\)](#), [Chappell et al. \(2000\)](#) and [Tucker \(2001\)](#). For a review of recent evidence see [Lewis-Beck and Stegmaier \(2013\)](#).

⁴ For instance, [Shi and Svensson \(2006\)](#) focus on the level of economic development, [Persson and Tabellini \(2003\)](#) on constitutional features, [Brender and Drazen \(2005\)](#) on the age of democracy, [Alt and Lassen \(2006\)](#) on the transparency of fiscal institutions, [Streb et al. \(2009\)](#) on the effectiveness of checks and balances, while [Rose \(2006\)](#) on fiscal rules. For a review of the literature see [Drazen \(2000\)](#), [Franzese and Jusko \(2006\)](#), and [De Haan and Klomp \(2013\)](#).

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