Popular protest and political budget cycles: A panel data analysis

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HIGHLIGHTS

- Do governments facing popular protest use fiscal policy for re-election purposes?
- Popular protest is measured by anti-government demonstrations and general strikes.
- We find that the magnitude of PBCs depends on the popularity of the government.
- The effect of protest on the manipulation is strongest in young democracies.

ARTICLE INFO

ABSTRACT

We test the hypothesis that governments facing popular protest are more likely to use fiscal policy for re-election purposes, employing data of 65 democratic countries – both developed and developing – over the period 1975–2005. Using the number of anti-government demonstrations and general strikes in pre-election years as measures of popular protest, our results lend support to this hypothesis. The effect of protest on the manipulation of fiscal policy for re-election purposes is strongest in young democracies.

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1. Introduction

As voting behaviour is to some extent based on voters' material wellbeing and the country's economic performance (Franzese, 2000), incumbents have powerful incentives to use fiscal policy for re-election purposes (Nordhaus, 1975). Several recent studies suggest that political budget cycles (PBCs) exist (Shi and Svensson, 2006; Alt and Lassen, 2006), but these studies differ in their assessment of the circumstances that make election-motivated budget deficits more likely.[1] For instance, Brender and Drazen (2005) argue that in young democracies, where the electorate does not have much experience with elections, voters are more likely to 'fall' for the trick of making the economy look good right before elections.

There is evidence that the popularity of the incumbent matters. If the polls suggest that the incumbent is likely to win the election, there is little need to manipulate fiscal policy for re-election purposes (Frey and Schneider, 1978; Golden and Poterba, 1980; Lewis-Beck and Stegmaier, 2000; Kayser, 2005; Baleiras, 1997). A related issue that has received limited attention so far is the role of popular protest. In line with the view that the incumbent's popularity matters for the occurrence of PBCs, we hypothesize that governments facing mass popular protest will be more inclined to use fiscal policy to please the electorate. We employ data of 65 democratic countries – both developed and developing – over the period 1975–2005. Using the number of anti-government demonstrations and general strikes in pre-election years as measures of popular protest, our results lend support to our hypothesis. The effect of protest on the occurrence of PBCs is strongest in young democracies.

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[1] See de Haan and Klomp (2013) for an extensive survey of this literature. For a more general survey on the political economy of budget deficits, we refer the reader to Eslava (2011).

The remainder of this paper is structured as follows. The next section gives a description of the methodology and data used. Section 3 presents our empirical findings and the final section concludes.

2. Data and methodology

We use a large unbalanced panel dataset of 65 developed and developing countries over the period 1975–2005. As the PBC theory presumes that competitive elections take place, we only include country-years with a Polity IV democracy score of at least six. Table A.1 in the Appendix lists all countries and years included. The fiscal data are taken from the *International Financial Statistics* and the *Government Finance Statistics* of the IMF, while the election data come from electionsource.org and various issues of the Political Handbook of the World. Table A.2 in the Appendix provides a detailed description of all data used and their sources. The model can be specified as:

$$FISC_{it} = \alpha_i + \beta FISC_{it-1} + \gamma X_{jit-1} + \mu POP_{it-1}$$
$$+ \lambda ELEC_{it} + \eta(ELEC_{it} \times POP_{it-1})\varepsilon_{it}. \quad (1)$$

The variable $FISC_{it}$ is a fiscal policy indicator (budget balance or total spending) in country i in year t, X_{jit-1} is a vector of (lagged) control variables with j elements, $ELEC_{it}$ is our election variable as described below, POP_{it} is our measure of popular protest, α_i is a country specific intercept, and ε_{it} is an error term. We use an election variable suggested by Franzese (2000) that takes the timing of an election in the course of the year into account. It is calculated as $M/12$ in an election year and $(12 - M)/12$ in a pre-election year, where M is the month of the election. In all other years its value is set to zero.

We only include elections if the government has sufficient time to change its fiscal policies. It usually takes some time before the impact of election-motivated fiscal policies becomes visible. For instance, the incumbent may have little opportunity to use expansionary fiscal policy in elections that take place shortly after the fall of government. That is why an election is included if the election is held in the fixed date (year) specified by the constitution, or if the election occurs in the last year of a constitutionally fixed term for the legislature. Also when an election is announced more than one year in advance, it is taken up in the analysis.[2]

We use a popular protest indicator based on the number of anti-government demonstrations and general strikes taken from Data-banks International (2005). An anti-government demonstration is defined as any peaceful public gathering of at least 100 people for the primary purpose of displaying or voicing their opposition to government policies, while a strike is defined as work suspension of 1000 or more industrial or service workers that involves more than one employer and that is aimed against national government policies. On average, there are about 1.2 public protests (demonstrations and/or strikes) in a certain country-year, with a maximum of about 5 in India. So, the number of protests varies greatly across countries. We allow for the possibility that the strength of an individual protest diminishes with the total number of protests by using the natural logarithm of the number of protests.[3]

As public protests may not be exogenous, we use an instrumental variables approach suggested by Newey (1987). We in-

Table 1
Estimation results of the first-stage IV model.

	Total protest (1)	Demonstrations (2)	Strikes (3)
First stage			
Interest groups	0.409 [2.75]**	0.587 [3.05]**	0.305 [2.89]**
Urban population share	0.225 [1.98]**	0.351 [2.05]**	0.074 [1.82]*
Fractionalization	0.562 [1.88]*	0.785 [1.91]*	0.345 [1.41]
Number of countries	65	65	65
Number of observations	1412	1412	1412

Note: Estimates of Eq. (1). *t*-values are shown in square brackets.
* Indicates significance at 10%.
** Indicates significance at 5%.

clude variables related to the culture of and opportunities for anti-government protest. First, the effect of protest is arguably stronger if the protest is organized by special interest groups, such as labour unions.[4] Second, mass demonstrations or strikes are more easily to organize in more densely populated areas. To measure this, we use urban population share reported in the World Bank Development Indicators. Finally, some countries may have more protest than others because interests are much more fractionalized. We use the index of ethnolinguistic fractionalization from Alesina et al. (2003) to proxy this.

The correlation between these variables and government spending or the budget balance is about zero. We check the validity of our instruments by the Sargan test, which illustrates that our instruments are valid ($p > 0.05$). The results of the first-stage regression are reported in Table 1 and support our idea that popular protest is driven by the variables chosen. We use the fitted values of the first-stage regression as our instrumental variable in the second-stage.

The vector X_{jit-1} contains control variables suggested by previous studies. The controls are included with a one-year lag. As suggested by Brender and Drazen (2005), we include real GDP per capita to control for the level of development of a country as this could influence voters' preferences for public goods as well as the size of the tax base. The growth rate of real GDP captures the influence of the business cycle. A high dependency ratio may reduce the tax revenue and increase spending on, for instance, social security (Klomp and de Haan, forthcoming). Inflation may affect government receipts and expenditures through nominal progression in tax rates and tax brackets, and via price-indexation of receipts and expenditures. On the other hand, unexpected inflation erodes the real value of nominal government debt so that the overall effect of inflation on the budget balance is not clear a priori (Mink and de Haan, 2006). Finally, we include a dummy variable that is one when a country is a member of a monetary union at time t. Most monetary unions apply a constraint on the government balance, such as the Stability and Growth Pact within the European Economic and Monetary Union (EMU).

We also include several political control variables suggested by previous studies. Persson and Tabellini (2002) argue that elections may have a different effect on fiscal policy under proportional and majoritarian electoral rules. Proportional elections induce politicians to seek support from larger groups in the electorate. It is then plausible to expect larger expansions under proportional electoral rules than under majoritarian electoral rules. Likewise, there may be differences between parliamentary vs. presidential systems. In

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[2] Some government in our sample have the possibility to call elections endogenously within one year. So, these governments have the incentive to schedule new elections when they believe to have enough support among the voters to win the next election. However, to test the robustness of our results on this issue, we re-estimate the model including also the endogenous elections. The results do not differ substantially from those reported (results are available upon request).

[3] We use ln(0.0001 + actions) for all countries to avoid losing observations with zero actions.

[4] Measured by the number of special interest groups reported in various issues of the World Guide to Trade Associations (Zils, 2013).