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Political cycles in public expenditure: butter vs guns

Vincenzo Bove^a, Georgios Efthyvoulou^{b,*}, Antonio Navas^c^a Department of Politics and International Studies, Social Sciences Building, The University of Warwick, Coventry, CV4 7AL, United Kingdom^b Department of Economics, University of Sheffield, 9 Mappin Street, Sheffield, S1 4DT, United Kingdom^c Department of Economics, University of Sheffield, 9 Mappin Street, Sheffield, S1 4DT, United Kingdom

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ABSTRACT

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This paper explores, theoretically and empirically, how governments may use the trade-off between social and military expenditure to advance their electoral and partisan objectives. Three key results emerge. First, governments tend to bias outlays towards social expenditure and away from military expenditure at election times. Second, the size of this tradeoff is larger when we exclude countries involved in conflict, where national security plays an important role on voter choice. Third, while certain categories of social expenditure are higher during left administrations, military expenditure is higher during right administrations. *Journal of Comparative Economics* 000 (2016) 1–23. Department of Politics and International Studies, Social Sciences Building, The University of Warwick, Coventry, CV4 7AL, United Kingdom; Department of Economics, University of Sheffield, 9 Mappin Street, Sheffield, S1 4DT, United Kingdom; Department of Economics, University of Sheffield, 9 Mappin Street, Sheffield, S1 4DT, United Kingdom.

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1. Introduction

Politicians, when in office, have strong incentives to choose policies that will maximise their re-election prospects and promote their partisan agenda. The influence of government incentives on policy choices has been explored by the political cycle theories. The opportunistic (or electoralist) theories argue that all governments, regardless of ideological orientation, will manipulate economic policies around elections to raise their chances of being re-elected. The partisan theories claim that left-wing governments will engage in more income re-distribution and more expansionary policies than right-wing governments during their time in office. Opportunism and partisanship are often perceived as competing arguments and studied separately in the literature. Furthermore, despite the voluminous empirical studies, the evidence regarding which policy tools are actually preferred by governments for meeting their political aims is still inconclusive. Our paper contributes to this literature by providing a theoretical framework and empirical evidence on the role of social and military expenditure in generating political cycles, when politicians are motivated by both opportunistic and partisan considerations. The interactive relationship between the two types of expenditure has been extensively discussed in studies considering the economic implications of military spending, but has never been systematically analysed within a political cycle framework.

* Corresponding author. Tel.: +4401142223412.

E-mail addresses: v.bove@warwick.ac.uk (V. Bove), g.efthyvoulou@sheffield.ac.uk (G. Efthyvoulou), a.navas@sheffield.ac.uk (A. Navas).<http://dx.doi.org/10.1016/j.jce.2016.03.004>

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Why should we expect political cycles to differ in timing and direction across social and military expenditure? A strong motivation can be found in a line of research arguing that the government faces a tradeoff between “butter” and “guns”: if it devotes more resources to military activities without increasing the total budget, civilian sectors of the economy must pay by foregoing benefits they would otherwise receive, and vice versa (Russett, 1982). Since expenses for social programs have a more direct and more immediate political influence on voters during peace time than do military expenditure, increased allocations to “butter” in election years can partly occur at the expense of “guns” (Mintz, 1988). Central to “butter-vs-guns” thesis is also the role of government ideology in shaping budget priorities. Following the partisan theory claims, we would expect that left-wing governments will spend more than right-wing governments. However, given that right-wing parties tend to be more pro-military and in favour of a strong national defence (Klingemann et al., 1994; Whitten and Williams, 2011), we should also expect ideology to have the opposite effect on military spending.

Rogoff (1990) was the first to predict that electoral cycles can take the form of changes in the composition (rather than the level) of government spending. According to his model, each politician has a competence level, which is considered to be private information, and voters use the part of government spending they observe to make inferences about post-electoral competence. As a result, the incumbent tries to signal his competence before the election by shifting government outlays towards the more “visible” public goods and away from investment. Following the competence argument, Shi and Svensson (2006) show that electoral cycles can emerge even if most voters observe all government expenses, as long as some voters are uninformed. Thus, electoral cycles are more likely in developing countries (Shi and Svensson, 2006) or in “young democracies” (Brender and Drazen, 2005), due to lower access to free media or lack of familiarity with electoral politics. In a recent study, Drazen and Eslava (2010) support the existence of election-year fiscal manipulation in countries with sophisticated, well-informed voters, who are averse to high overall government spending. According to their model, citizens value government spending on some goods but not others, and rational, forward looking voters use the composition of public expenditure to make inferences about the incumbent’s preferences. Electoral manipulation thus takes the form of shifting spending towards the goods that voters prefer in the attempt to convince them that the incumbent shares their spending priorities.

In this paper, we build a theoretical model to analyse how governments use the tradeoff between “butter” and “guns” as a means of advancing their electoral and partisan objectives. As in Drazen and Eslava (2010), the model relies on information asymmetries regarding how much politicians care about voters’ utility, and focuses on a society with rational and forward-looking voters, who observe all government expenses; that is, the case of developed established democracies. Unlike the existing literature, the model rationalises the role of social and military expenditure in generating electoral compositional budget cycles and identifies the factors that shape the tradeoff between the two types of expenditure. It also shows that these electoral cycles can emerge in an environment in which governments have also partisan motivations. In particular, we argue that in all democratic countries voters tend to favour welfare spending (such as, old age, housing and health programs) and reward incumbents with the same spending choices. In addition, they assign low priority to military spending, as they consider it to be less important in periods of peace.¹ Politicians, on the other hand, differ in the value they assign to the two types of spending (which cannot be observed by voters), and, regardless of ideology, they all prefer to spend more on the military and less on social programs compared to voters. The latter is consistent with the argument that national defence is perceived by politicians as a general measure of status and prestige.² Voters cannot (ex ante) distinguish between politicians who manipulate the budget composition to attract votes and those whose spending preferences are consistent with what voters want. Hence, they form expectations regarding the type of politician (and thus the post-electoral spending) by observing the pre-electoral allocation to the two goods. Before the election, an incumbent politician will shift the composition of spending towards social welfare and away from defence to signal that his preferences are close to those of voters, which, in turn, will produce an electoral compositional budget cycle. The size of this cycle in our model changes when countries are involved in conflicts. In such economies, voters assign a relatively higher value to military spending due to security considerations, and their spending priorities become more aligned with those of politicians. As a result, a butter-vs-guns tradeoff becomes a less effective signal of the politician’s type and the electoral cycle is now less pronounced. Finally, according to our model, politicians’ spending decisions are also influenced by their ideological positions: left-wing governments tend to favour generous welfare policies and dovish foreign policies, whereas right-wing governments tend to favour austere welfare policies and hawkish foreign policies. This leads to the appearance of partisan cycles in the two types of expenditure, which can coincide with the compositional budget cycle of electoral-calendar timing.

We then test the main predictions of the theoretical model. Using data from a panel of 22 OECD countries from 1988 to 2009, we provide robust empirical evidence in line with these predictions. Our findings can be summarised as follows. First, governments tend to bias outlays towards social expenditure and away from military expenditure at election times, lending support to a “butter-vs-guns” tradeoff within an electoral competition setting. Second, these effects become more

¹ Wlezién (1996) shows that voters respond rather quickly to defence appropriations decisions and that policymakers respond directly to public preferences for defence spending and adjust its appropriations accordingly.

² Scholars of international relations almost unanimously agree that leaders are very concerned about the reputation and status of their state (see for example, Snyder and Diesing, 1977; McMahon, 1991; Mercer, 2010; Dafoe et al., 2014). Although the main factor determining a country’s military expenditure is what it can afford, “status and prestige are certainly important and to be a proper state is thought to require armed forces” (Smith, 2009, p. 97). Ambition is a main motive for increasing military spending, as leaders are inherently ambitious and their forward-looking foreign policies require high investment in military spending (Castillo et al., 2001).

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