Local political business cycles: Evidence from Philippine municipalities☆

Julien Labonne

Yale-NUS College, 28 College Ave West, Singapore

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ABSTRACT

This paper establishes the existence of short-term political business cycles in the Philippines over the period 2003–2009. Examining a balanced panel of 1143 municipalities shows that employment levels increase in the two pre-electoral quarters and drop sharply in the two quarters following elections. Further results are consistent with the cycles being generated by incumbents' attempts to increase their chances of re-election. Cycles are stronger in sectors that incumbents are more able to influence, and when they expect stronger electoral competition. Evidence suggests that these cycles are detrimental to development.

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1. Introduction

It is often speculated that incumbents will manipulate the economy, especially employment, in order to increase their chances of re-election (Alesina et al., 1997; Nordhaus, 1975). These manipulations would create political business cycles.

Despite the fact that the ingredients required for political business cycles have been well documented, evidence for political business cycles themselves is less conclusive. Specifically, voters evaluate incumbents according to economic performance (Lewis-Beck and Paldam, 2000), and incumbents have the ability to affect economic outcomes (Coulomb and Sangnier, 2014; Snowberg et al., 2007a, b). Yet, researchers have been able to identify only moderate cycles in economic policies and, at best, weak cycles in real outcomes (Franzese, 2002).

A plausible reason for the difficulty in identifying political business cycles is the use of data aggregated across time and space. Yearly data obscures the fact that voters seem to be most sensitive to very recent economic outcomes (Fair, 1978, 2002; Healy and Lenz, 2014). However, while early studies were carried out at the national-level, recent analyses of local governments' spending in election years yield similarly mixed results.[1]

Analysis of quarterly data from Philippine municipalities shows the existence of robust political employment cycles. The data comes from 1143 cities and municipalities over the period 2003–2009. The share of the working-age population that is employed increases by 1.5% (0.88 percentage points) in the two quarters before elections, and is 0.49 percentage points lower in the two post-election quarters in election years than in non-election years. This effect is only apparent in quarterly data due to the fact that increases in employment before the election are canceled out by declines after the election.[2]

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[1] See, for example, Brender (2003), Akhmedov and Zhuravskaya (2004), Khemani (2004), Drazen and Eslava (2010), Sakurai and Menezes-Filho (2010), Aidt et al. (2011), Jones et al. (2012) and Sjahrir et al. (2013).

[2] The results presented in this paper suggest that, where possible, future analyses of political business cycles should use monthly or quarterly data. A similar point is implicit in results presented by Akhmedov and Zhuravskaya (2004) for analyzing political business cycles, but it appears that data constraints have prevented researchers from doing so.

The data also contain evidence that the employment cycles described above are caused by incumbents' attempts to increase their, or their family members, chances of re-election. First, there is no evidence of an employment cycle when the incumbent is running unopposed, and thus the incumbent lacks an incentive to manipulate the economy. Second, cycles are particularly strong around elections in which the incumbent is term limited, and one of his or her relatives is running. As strong challengers in the Philippines often wait until the incumbent is term limited, relatives tend to face much more competitive races (Querubin, 2011). Third, cycles are much stronger in private employment than in public employment. This is consistent with the fact that incumbents face legal hiring constraints in the public sector right before elections, but can invest in last-minute infrastructure with private companies.

There is also suggestive evidence that political business cycles are detrimental to development. Philippine municipalities with more pronounced cycles in 2004 and 2007 had lower employment levels in 2009. This is robust to controlling for a number of socio-economic and electoral municipal-level characteristics.

2. Setting

Before turning to the analysis, it is useful to understand details of the political economy of the Philippines. It is important to emphasize that the institutional context varies extremely little across the country, implicitly controlling for differences that may make political business cycles difficult to detect and understand (Drazen and Eslava, 2010).

Most decisions regarding municipal budgets in the Philippines are made by mayors who use available funds with limited oversight. This is despite the fact that the 1991 Local Government Code established municipal councils and gave them decision-making powers. Mayors control both how budgets are spent and hiring decisions in the local bureaucracy (Hodder, 2009; Hutchcroft, 2012). As incumbent mayors are known to exert significant control over the local economy, they are likely to be held responsible for local economic performance. This, in turn, creates incentives for mayors to distort the economy ahead of elections (Anderson, 1995).

The fiscal and calendar years coincide in the Philippines, and mayoral elections take place every three years in May. Elections follow an established schedule set out in the 1987 constitution. As incumbents cannot control election timing, this eliminates concerns that the economy may affect election timing. Two elections were held during the sample period, in May 2004 and May 2007.

Incumbents in the Philippines face legal constraints on increasing public sector employment in the 45 days before an election. They cannot appoint or hire new employees; create or fill new positions; give promotions or increases in salary, other remuneration, or privileges.[3] The Commission on Elections (COMELEC) also bans public works 45 days before elections, but the ruling has a number of exemptions. For example, the maintenance of existing projects is allowed, as well as work allocated through public bidding before the 45-day period. Thus, local politicians can circumvent these restrictions by hiring private contractors to work on existing infrastructure projects.

Qualitative evidence suggests that incumbents attempt to time public spending in order to increase employment just before elections (Hollnsteiner, 1963; Wurfel, 1963). These new jobs are publicized to ensure that voters are aware of their political obligations (Wurfel, 1963).

Local politicians often use the power of their office to increase their local business holdings, which enables them to directly employ

their constituents (Sidel, 1999). Further, in a number of Philippine municipalities, mayors act as employment brokers, helping their constituents find jobs. For example, in a province near Manila, job applicants in local factories were required to provide letters of recommendation from local officials (Sidel, 1999, pp 76–77). There is qualitative evidence that this role intensifies before elections as voters have more bargaining power (Kawanaka, 2002).

3. Data and descriptive statistics

Data largely comes from the Philippine Labor Force Surveys (LFS) collected by the National Statistics Office (NSO). This is used to compute official employment statistics. The surveys are conducted four times a year (January, April, July and October), and the data contains the response to all 26 surveys between July 2003 and October 2009.[4] Each survey has a sample size of approximately 200,000 individuals in 50,000 households, and contains 1143 cities and municipalities, out of 1634 in the country.[5] A person is considered employed if he or she reported to work for at least an hour during the week prior to the survey. In addition, information is collected on the total number of hours worked during the past week, the sector of employment and the daily wage. For each municipality/survey wave, the employment rate is computed as a share of the working-age population.[6]

The employment data is supplemented by annual data on municipal budgets from the Department of Budget and Management.[7] The data are all expressed in 2000 Pesos using regional consumer price indices. Descriptive statistics are available in Table A.1 in the online appendix.

Political employment cycles are easily detectable in the quarterly data. Average employment rate in Q1/Q2 was higher in election years than in non-election years. Specifically, the average municipal employment rate in Q1/Q2 in election years is 59.6 percent, while it is only 58.7 percent in non-election years. Similarly, the average employment rate in Q3/Q4 was lower in election years than in non-election years. The average municipal employment rate in Q3/Q4 in election years is 58.9 percent, while it is 59.3 percent in non-election years. Finally, Fig. 1 shows the difference between Q1/Q2 and Q3/Q4 in election years and non-election years. As shown in the figure, in non-election years between 2003 and 2009, the employment rate in the last two quarters is higher than in the first two. In election years, this pattern is reversed: employment is higher before the elections than after.

4. Estimation strategy

To empirically test for the presence of political employment cycles, we estimate equations of the form:

$$Y_{ijqt} = \alpha E_t + \beta X_{ijt} + u_{ij} + v_q + w_{ijqt} \tag{1}$$

where Y_{ijqt} is employment rate in municipality i in province j in quarter q at time t, E_t is a vector of variables capturing election timing, X_{ijt} is a vector of municipal-level characteristics that vary over time, u_{ij} is a municipality-specific unobservable, v_q is a quarter-specific

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[3] COMELEC resolution no. 6620 (25 November 2003) and COMELEC resolution no. 7707 (30 August 2006).

[4] More information on the survey design is available at http://www.census.gov.ph/data/technotes/notelfs_new.html last visited on March 26, 2012.
[5] http://www.nscb.gov.ph/activestats/psgc/default.asp last visited on July 3, 2014.
[6] The NSO changed the definition of the economically active population in April 2005; individuals now have to be "available to work" in order to be counted as unemployed. This information was not collected previously, and so we are unable to adjust the data for the previous quarters. As a result, estimates in this paper combine the effects of elections on the decision to enter/exit the labor force and of being employed (for those in the labor force).
[7] The data are available from http://www.blgf.gov.ph/#, last visited on March 26, 2012.