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Do political budget cycles work? A micro-level investigation of pre-electoral budgeting and its electoral consequences

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ABSTRACT

One of the most puzzling empirical patterns in political economy is the disconnect between the regular use of fiscal instruments for re-election purposes by incumbents (otherwise known as political budget cycles) on the one hand and their relative electoral ineffectiveness on the other. This article engages with this puzzle by shifting the analysis from the macro to the micro-level. It shows that when taking into account individual-level heterogeneity in the electoral response, one can gain a more nuanced understanding of the political consequences of pre-electoral budgeting. By relying on a set of multi-level random-effects regressions using data from the Comparative Study of Electoral System surveys, it points to two such sources of heterogeneity: social status and ideology. In particular, higher status individuals are considerably less responsive to pre-electoral deficits, though the effects depend on the composition of fiscal measures. Results for ideology are somewhat less consistent across different operationalizations of ideology as well as model specification.

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1. Introduction

The broad relationship between fiscal policy and electoral outcomes lies at the heart of the democratic process in advanced capitalist economies in general and of the notion of government accountability in particular. If governments are to be held accountable for the economic and redistributive consequences of their decisions, understanding this relationship is of primary importance for scholars of political economy and electoral politics. Yet, the growing body of empirical works tapping into this relationship have failed to offer a coherent and systematic account of how political parties fare electorally as a function of their fiscal record in government. This article seeks to fill this gap in the literature by undertaking a micro-level analysis on the electoral impact of the pre-electoral changes in fiscal policy in a large sample of OECD countries over recent decades.

Pre-electoral budgeting has been predominantly analyzed in the context of the literature on *political budget cycles* with their theoretical roots dating back to the seminal works of Nordhaus (1975), Lindbeck (1976) and Tufte (1978). Later readapted to a world characterized by rational expectations (Barro and Gordon, 1983; Kydland and Prescott, 1977), increased trade and financial globalization (Clark and Hallerberg, 2000) and independent and conservative central banks (Cukierman, 1992), these political business cycle models predicted pre-electoral booms as opportunistic incumbents sought to maximize their re-election chances (Rogoff and Sibert, 1988; Rogoff, 1990).

The empirical record of such pre-electoral economic booms, however, has been very limited (Alesina et al., 1992, 1997:6). More recent generations of scholars, have therefore turned away from economic aggregates to policy instruments as the main dependent variable of interest. These scholars of political budget put forward a simple intuition: pre-electoral spending increases and/or tax cuts can deliver material benefits to important voting blocs who in turn will reward incumbents in the ballot box. Political budget cycles may thus occur with or without a discernible impact on the real economy.

Governments, however do not always have the desired room for manoeuvre to always act upon their first preferences from a vote-maximizing perspective. As the recent sovereign debt crisis in the Eurozone has manifested with full force, inherited debt burdens, unforeseen exigencies and external shocks have often pushed governments to a point where their future solvency have come under close scrutiny by international creditors and markets. In such circumstances, large corrections in public sector balances were required, often trumping electoral considerations when upcoming elections were near. A generation of scholars thus began to investigate the economic and political consequences of fiscal adjustment

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episodes (Alesina et al., 1998, 2011; Mulas-Granados, 2006).

While conceptually located on two sides of the same coin, the often disconnected literature on political budget cycles and fiscal adjustment share a common premise. Voters are typically characterized by "fiscal illusion" (Alesina and Perotti, 1995, p.9) whereby the current impact of fiscal decisions weighs heavily against the past and the future. If this premise holds, while fiscal adjustment is likely to be detrimental for re-election prospects, pre-electoral fiscal expansions should shore up government support.

As the review of the empirical literature will show below, however, such straightforward electoral responses don't stand up to empirical scrutiny in large-n samples. Moreover, the macro-level focus of this literature had little to say on individual vote choices. This is a crucial omission given the potentially erroneous inferences from aggregate-level findings to individual considerations, a problem generally referred to as the ecological fallacy (Kramer, 1983). To address this shortcoming, this article makes two broad and important contributions to the current state of the literature on political budget cycles and fiscal adjustments. First, by analysing pre-electoral fiscal changes and disaggregating them into spending and tax measures in a large sample of elections, I am able to reach generalizable conclusions on the electoral impact of both fiscal expansions and contractions. Second, by moving beyond aggregate level analysis, I am able to model individual-level heterogeneity in the electoral response, To anticipate the main findings from a set of random-intercept multi-level binary choice logit models based on 4 waves of the *Comparative Study of Electoral Systems*, this article shows that individuals' propensity to support incumbent parties, on average, tend to increase with pre-electoral deficits, spending increases and tax cuts, in line with conventional wisdom. However, this effect greatly varies according to individuals' ideological leaning and socioeconomic position.

The rest of this article is structured as follows. Section 2 reviews evidence on the electoral impact of political budget cycles and fiscal adjustment, respectively. Section 3 puts forward my main theoretical contention to the extant literature and provides a number of testable empirical hypotheses derived from that. Section 4 discusses my data characteristics and my empirical strategy. Section 5 presents my findings and Section 6 concludes.

2. Political budget cycles and fiscal adjustments: do they matter electorally?

The gradual metamorphosis of political business cycles into *political budget cycles* in empirical research starting from the early 1990s has been subject of numerous reviews of the literature (see, de Haan and Klomp, 2013 for a recent one). The empirical gist of this change in research paradigm is that while real economic variables show very weak co-movement with the electoral cycle, there is considerable evidence that fiscal show systematic changes before elections (Alesina and Roubini, 1992; Alesina et al., 1997; Franzese, 2000, 2002) though the effect may vary according to important "context-conditionalities" (Alt and Rose, 2009) such as the transparency of the budget process (Alt and Lassen, 2006) and the maturity of democracies (Brender and Drazen, 2005). Incumbents seem eager to run expansionary fiscal policies, increase discretionary spending or cut the tax burden on the electorate that is expected to reward them either because the costs are borne by others (Alesina and Drazen, 1991; von Hagen and Harden, 1995) or because they suffer from fiscal illusion (myopia) and heavily discount both the past and the future (Alesina and Perotti, 1995).

The empirical link between political budget cycles and electoral outcomes appears less than straightforward, however. One group of studies investigated the relationship on the country-level. By using separate estimations for the occurrence of political budget cycles and their electoral impact, Klomp and de Haan (2013) find positive, but small effects for re-election chances. Contrary evidence is provided, however by Brender and Drazen (2008) who show that election-year deficits lower re-election chances and government popularity. Likewise, Kraemer (1997) and Enkelmann and Leibrecht (2013) document electoral budget cycles in a sample of Latin American and Eastern European countries, respectively, but find no evidence that they are effective means for government re-election.

One important contention to these studies is that institutional settings that may blur or reinforce responsibility attribution (Powell and Whitten, 1993) - forms of government, fiscal rules, endogenous elections etc. — are simply too diverse to pool them in one study for empirical investigation. Scholars therefore also studied subnational settings where many of these institutional features are automatically controlled for and a sufficient degree of sample homogeneity is thus ensured. Results from these studies are more in line with conventional expectations: Aidt et al. (2011) find positive electoral effects for pre-electoral fiscal expansions in Portuguese municipalities. Drazen and Eslava (2010) take one step further by allowing for changes in spending composition towards visible expenditure items in the pre-electoral period in Columbian municipalities and find that voters respond positively to such subnational fiscal electioneering. By contrast, however, Arvate et al. (2009) find that fiscal surpluses may actually increase re-election chances of Brazilian governors.

The American political context fared no better in yielding consistent results. By focusing on the revenue side, Kone and Winters (1993) find a negative electoral impact of certain types of tax hikes on the re-election chances of American governors. Kim and Kwon (2015), by contrast, finds no significant effect of tax changes; voters, however, seem to reward debt reduction in the pre-electoral periods, weighing against the general intuition behind PBC models.

If pre-electoral fiscal changes are poor predictors of re-election chances, perhaps a longer-term view of governments' fiscal record is warranted. By identifying fiscal adjustment episodes based on large changes in cyclically adjusted budget balances in OECD countries over the entire electoral cycle, Alesina et al (1998; 2011) fail to find systematic punishment effects on either re-election probabilities or government popularity. Likewise, by focusing on sub-national settings, Peltzman (1992) contribute to the view of the "fiscal conservative" voter: American governors presiding over falling debt levels and reduced welfare spending fare electorally better than their "big government" counterparts. Cuts in welfare programs do not deliver the harsh electoral punishment predicted by the pioneers of welfare retrenchment literature (see Pierson, 2001 for instance) on central governments either. Giger and Nelson's landmark study (2011)[1] finds no systematic electoral impact of the supposedly unpopular measures of social policy cutbacks.

The contrary view, in line with conventional expectations, is confirmed by other studies that look at fiscal adjustment episodes in EU countries. Mulas-Granados (2004, 2006) present empirical results that cast doubt on findings above: prime-ministers' re-election probabilities drop significantly after fiscal adjustment. Illera and Mulas-Granados (2008) take a slightly different approach by looking at the duration of fiscal adjustment episodes, an indirect proxy for their political impact. The findings show that strong adjustments and ones that occur closer to electoral periods are more likely to terminate casting doubt on their political viability.

Overall, therefore, our understanding of the electoral impact of fiscal policy is limited despite the large body of empirical literature on this issue. This leaves us with a conundrum. If pre-electoral

[1] See Giger (2012) for a micro-level counterpart arriving to similar conclusions.

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