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REVISITING POLITICAL BUDGET CYCLES IN LATIN AMERICA

by

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PREFACE

One of the unexpected by-products of the current global financial crisis is that it has placed fiscal policy back at the centre of the public policy debate. In Latin America, political and fiscal cycles have been intrinsically linked, with fiscal deteriorations prior to elections. This paper contributes to ongoing debates on the interplay of politics and economic policies, and provides some policy options aimed at minimising potential disruptions of fiscal policy ahead of elections.

Revisiting the political budget cycles in Latin America seems also very timely at a moment when no less than 17 presidential elections are due to take place between October 2009 and December 2012, starting with Uruguay and Chile by the end of 2009 and ending with Mexico and Venezuela by the end of 2012. This research also provides some insights regarding the re-election systems and fiscal policy, a crucial aspect for the region nowadays. Out of 2006's ten presidential elections, seven took place in countries allowing re-election. In six of those seven elections of that year, the candidate for re-election was successful. More importantly, the current trend in election reform in Latin America is moving towards a less restrictive system of re-election.

This analysis highlights, from a governmental and political perspective, the need to avoid fiscal deteriorations around elections in Latin America. Several policy recommendations may be derived from this: First, fiscal rules that stabilise the fiscal balance may help "immunise" the fiscal situation to electoral disturbances. Moreover, around elections, better transparency and disclosure of the major components of fiscal balance could be valuable for the region. Second, in the current debate on electoral systems in some countries, moving away from immediate re-election systems would reduce the risks of fiscal deterioration ahead of and during election years. Alternatively, establishing special bodies within Ministries of Finances to instil a long-term perspective on fiscal policy could strengthen the independence of fiscal policy from short-term incentives of politicians. A final policy implication may be related to a strategy of risk mitigation during political electoral cycles. A consensus among major political parties, by reducing the menu of options to a range of credible commitments in the fiscal area, could reduce the uncertainty traditionally generated by upcoming presidential elections.

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RÉSUMÉ

L'objectif de cet article est de tester l'impact des élections sur la politique budgétaire dans les pays d'Amérique Latine par rapport aux pays de l'OCDE pendant la période 1990-2006. Nos résultats montrent qu'en moyenne le solde primaire diminue de près de 0,7 pourcent du PIB pendant l'année électorale, ce qui confirme l'hypothèse d'une détérioration de la discipline budgétaire pendant le cycle électoral en Amérique Latine. Une grande partie de ce mouvement s'explique par une croissance des dépenses publiques qui trouve son origine dans les dépenses courantes (près de 0,8 pourcent du PIB) plus que dans les dépenses en capital. En revanche, dans les pays de l'OCDE, le solde primaire et les dépenses courantes évoluent peu pendant l'année électorale. Notre analyse suggère également que les réélections des candidats en exercice en Amérique Latine ont un impact considérable sur les dépenses budgétaires. Enfin, la comparaison du cycle électoral de 2005-2006 aux cycles passés fait apparaître une amélioration, bien qu'encore réduite, de la discipline budgétaire de la région en période électorale. Nous analysons les implications politiques de ces résultats et proposons des recommandations.

Mots clés: Candidats en exercice, Cycle politique et budgétaire, Élections, Pays d'Amérique Latine.

Classification JEL: D72; E62; H62; P16.

ABSTRACT

In this paper we test the impact of elections on fiscal policy in Latin American economies in comparison to OECD countries over the period 1990-2006. We find that in Latin American countries, the average primary balance declines by an amount close to 0.7 per cent of GDP during an election year, confirming the hypothesis of fiscal deteriorations during the election cycle. Most of this movement is due to the expenditure component and within this it is current (close to 0.8 per cent of GDP) rather than capital expenditure that is most affected. By contrast, in OECD countries, the observed changes in the primary balance and current expenditures during election years are minimal. Our analysis also suggests that re-elections of incumbent candidates in Latin America have a considerable impact on the expenditure side of the fiscal balance. Finally, by comparing the 2005-2006 electoral cycle with respect to prior electoral cycles, we note a slight improvement of fiscal management around elections in the region. We derive policy implications and recommendations from our findings.

Keywords: Political budget cycle, Elections, Incumbent candidates, Latin American countries.

JEL classification: D72; E62; H62; P16.

I. INTRODUCTION

Elections matter and can affect economic policies. Specifically, some components of fiscal policy may be expanded around elections in order to attract voters. As underlined by Alesina *et al*. (1997), "certain more visible and politically sensible programs may be more easily and productively manipulated than others" with a view to ensuring election.

Political systems permitting re-election of officials can also influence politicians' behaviour once they become incumbent candidates. The core idea is that incumbents artificially expand economic activity during election years to improve their chances of re-election. However, empirical evidence shows that expansionary fiscal policy of incumbent candidates around elections does not always "pay off" in terms of a victory in the re-election (Brender and Drazen, 2008).

These observations have important implications regarding the efficiency of economic policies around elections. This is particularly evident when there is a risk that expansionary fiscal policy could undermine the effectiveness of monetary policy (i.e. fiscal dominance). Moreover, under some circumstances, monetary policy alone cannot control its main target and fiscal discipline is then a priority. Such was the case of Brazil following the 2002 elections: the most important tool to reduce the inflation rate was a credible fiscal policy and not an increase in interest rates (Blanchard, 2004)[1].

In this paper we revisit the impact of elections on fiscal policy in Latin American countries and we pose the following questions: To what extent do Latin American governments expand fiscal expenditures around elections to attract voters? And, especially significantly in the current political context, do different types of electoral systems have different impacts on fiscal policies around elections? Behind these questions, of course, lies a basic issue: fiscal irresponsibility during elections.

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1 Following on from this, the political cycle is also crucial to capital markets, which have in the past been acutely sensitive to political developments in Latin American democracies, be they cabinet reshuffles or elections. Bankers and financial markets react to elections (Jensen and Schmith, 2005; Whitehead, 2006; Chang, 2007; Nieto-Parra and Santiso, 2008), re-allocate money after democratic transitions (Rodríguez and Santiso, 2008) or react to political announcements and events (Santiso, 2003; Hays, Freeman and Nesseth, 2003; Frieden, Leblang and Valev, 2008). While this phenomenon is not specific to emerging economies, it remains especially strong there (Campello, 2007).

The purpose of this paper is therefore to answer these questions for Latin American countries. To do this, we first compare the impact of elections on fiscal policy in Latin American economies with respect to OECD countries. More precisely, we analyse the most important components of the expenditure side of the fiscal balance of these economies over the period 1990-2006. Second, in the current debate regarding the electoral system in some Latin American countries, we study the impact that the re-election system could have on the management of fiscal policy in Latin America, and in particular the role that *immediate* re-elections (i.e. there is the possibility of one or more successive terms for the president elected) could have on the behaviour of fiscal components during elections. Third, we provide some stylised facts comparing the electoral cycle of 2005-2006 with previous electoral cycles in Latin American countries.

The remainder of this article is organised as follows. In section II, we provide a review of the literature on the impact of elections on fiscal policy. Section III, the core of this paper, presents the most important stylised facts and analyses the results of the econometric model that analyses the impact of elections on fiscal policy. Finally, section IV provides concluding remarks and outlines the major policy implications that follow on from this research.

II. REVIEW OF THE LITERATURE

The expansionary monetary and/or fiscal policies adopted during elections could potentially affect economic regimes and then capital markets (Ames, 1987; Schuknecht, 1996; Alesina *et al*., 1999; Block and Vaaler, 2004).

Increases in public expenditure around elections do not necessarily imply a deteriorating fiscal situation[2]. As pointed out by Drazen and Eslava (2005), in an examination of municipal elections in Colombia, incumbents tend to increase expenditure in ways which maximise the impact on voters without affecting the fiscal deficit. In turn, Eslava (2005) finds that voters indeed reward pre-election increases in targeted spending, but punish incumbents who run high deficits prior to an election. For the case of Mexico over the period 1957-1997, González (2002) finds that governments make ample use of public spending on infrastructure and current transfers in order to attract voters. More generally, for the case of Latin American countries, Rodríguez (2006) finds that during the period 1990-2004, governments tend to increase public investment one year prior to elections and current transfers during the election year. Other authors also show that newly elected governments tend to be rather frugal, reducing spending in the inaugural year of their mandate (see Barberia and Avelino, 2009). The findings related to increasing deficits and spending in the year prior to elections has also been corroborated in more recent specific country studies, in particular for Brazil (Sakurai and Menezes-Filho, 2008) or for Argentina (Jones, Meloni, and Tommasi, 2009). In this last paper, the authors show that Argentine voters reward those governors who provide higher spending, rewarding their capacity to extract more resources from the federal government. The same pattern has also been found under non-democratic regimes like Mubarak's Egypt (Blaydes, 2008).

The results presented above for the case of Latin American countries contrast with developed economies. Peltzman (1992) finds that US voters penalise federal and state spending growth, qualifying voters as "fiscal conservatives". Shi and Svensson (2006) analyse elections in 58 developing and 27 developed countries during the period 1975-91, finding that fiscal deficits did not increase during elections in OECD developed countries. Similar results were found by Brender and Drazen (2005) over the period 1960-2001 when differentiating among old and new democracies and using as fiscal variables government balance, total expenditure and total revenue. Indeed, expansionary fiscal policies around elections are particularly likely in developing countries. In a recent analysis including quarterly data from 1975 to 2000 in 116 countries, Krieckhaus (2009) finds that political business cycles are particularly widespread and

2 For a review of the literature regarding voters and fiscal policy around elections, see Eslava (2006).

influent in Latin America, this phenomenon being more pronounced in this region than in other developing regions like Asia or Africa[3].

More precisely, the expansion of fiscal policy during elections depends on the capacity of voters to monitor government policies. The main factors that influence the ability of voters to understand the government's budget balance are often associated to government accounting practices, media transparency and the education of voters. In particular, the role of informed voters on fiscal outcomes around elections is crucial. Shi and Svensson (2006) find that the negative effect of election periods on the deficit is weaker when voters are better informed.

Empirical evidence for legislative elections in developed countries supports the idea that the probability of being re-elected, measured by opinion polls, has no significant effect on the fiscal budget[4]. However, concerning municipal elections in developed countries, there is no systematic result showing that elections do not have an impact on the fiscal items by which voters could be influenced. For the cases in which elections have an impact on government expenditures see Kneebone and McKenzie (2003) for the case of Canada and Veiga and Veiga (2004) for the case of Portugal.

Finally, depending on the re-election system, the effect of elections on economic policies will tend to be different. Empirical research suggests that incumbent parties facing re-election, particularly incumbents from left-wing parties, face strong incentives to engage in unsustainable expansionary economic policies (Leblang, 2002). Voters and incumbent parties are, of course, playing a dynamic game and rational voters should not be expected to make such systematic mistakes. However, there exists information asymmetries between the two groups regarding the competence of politicians and the conduct of fiscal policy, and rational voters may well prefer incumbent candidates that run fiscal deficits (Rogoff, 1990). This view has been recently challenged by Brender and Drazen (2008), who, by using a sample of 74 countries over the period 1960-2003, find no evidence that deficits promote re-election in either developed or developing countries. In this paper, we analyse the impact of re-elections on fiscal policy in Latin American countries by differentiating between two key regimes (non immediate re-elections and immediate re-elections).

The results presented above give important insights concerning the management of fiscal policy around elections as well as the differences that exist across countries and depending on the type of elections. In line with these analyses, our comparative analysis of Latin American and developed country governments' management of fiscal policy may be a useful contribution to the field. More importantly, we provide useful insights on the impact that different electoral systems could have on the management of fiscal policy.

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3 A recent example of expansionary fiscal policy around elections in developing countries refers to Ghana, in which macroeconomic conditions deteriorated substantially during 2008, in the run-up to the elections.

4 Additionally, there is no evidence that more conservative governments spend more on defence and more liberal governments spend more on social security and welfare (Lambertini, 2003).

III. EMPIRICAL EVIDENCE

III.1. Elections and Fiscal Policy: A comparative analysis between OECD and Latin American countries

In this section, we present some empirical evidence on the relation between elections and fiscal policy outcomes over the period 1990-2006. The source of the database used for this study is ECLAC ILPES, the Public Finance database for Latin American countries and an OECD database, the General Government Accounts for OECD countries[5].

By studying the period 1990-2006 for 28 OECD countries and 19 Latin American countries[6], our results suggest that general elections are indeed associated with much greater changes to fiscal policy in Latin America than in high-income countries[7]. Figure 1 summarises the development of four fiscal variables during election periods: the fiscal deficit before interest payments (primary balance), public expenditure excluding interest payments (primary expenditure), current expenditure, and capital expenditure.

In Latin American countries, the average primary balance declines by an amount close to 0.7 per cent of GDP during an election year. Most of this movement is due to the expenditure component and within this it is current (close to 0.8 per cent of GDP) rather than capital expenditure that is most affected. There is little change in capital expenditures during election years themselves, but an increase of more than 0.3 per cent of GDP is observed in the year prior to the election. By contrast, in OECD countries, observed changes in the primary balance and current expenditures during election years are minimal, less than 0.1 per cent of GDP for either measure.

This difference between Latin American and OECD countries is all the more remarkable considering the relatively small size of governments in Latin American democracies. According

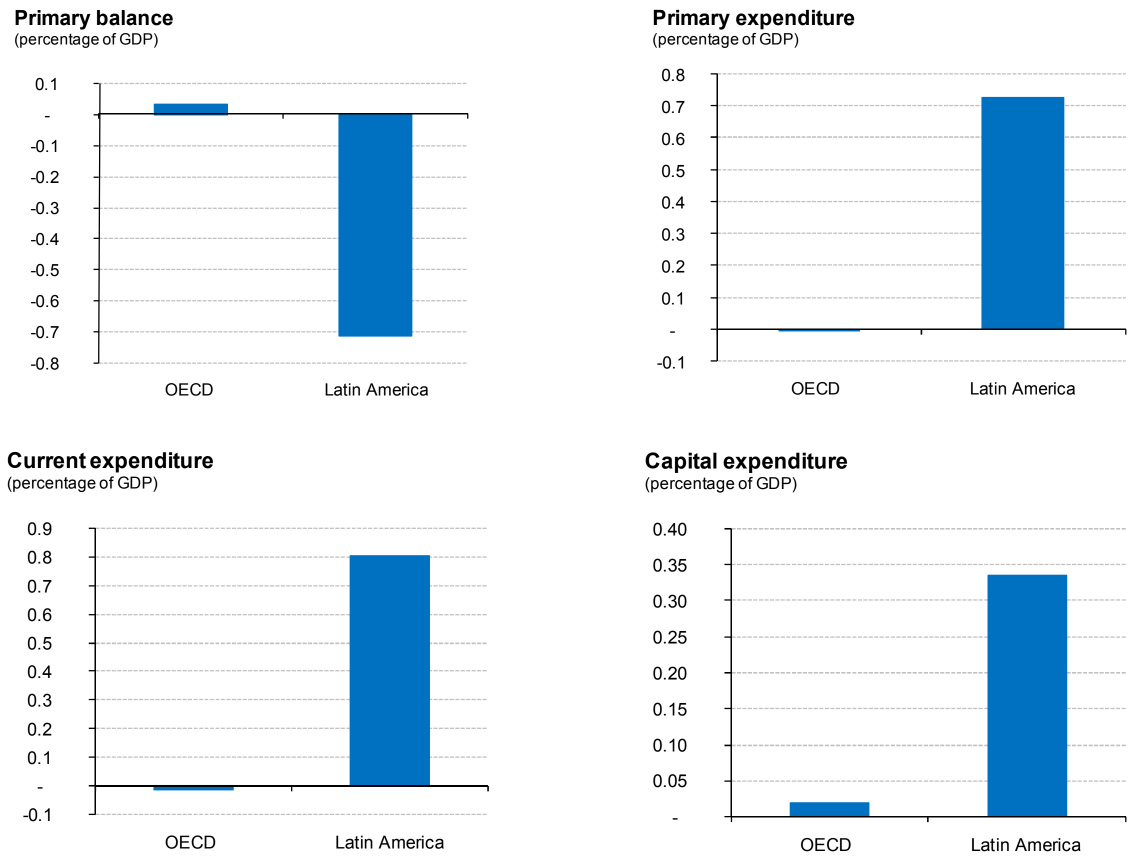
5 The exception is Brazil for which we use as source of information the Secretaria do Tesouro Nacional.

6 The OECD countries are Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Hungary, Iceland, Ireland, Italy, Japan, Korea, Luxembourg, Mexico, Netherlands, New Zealand, Norway. Poland, Portugal, Slovak Republic, Spain, Sweden, Switzerland, United Kingdom and United States. The Latin American countries are Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Haiti, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Uruguay and Venezuela. Mexico is the only country belonging to these two groups of countries.

7 Legislative elections are used for countries with parliamentary political systems and executive elections for countries with presidential systems. OECD countries, other than Mexico, Poland and the United States, have been treated as parliamentary systems (see Keefer, 2007).

to OECD (2008), over the period 1990-2006, primary expenditure accounts for 22 per cent of GDP in Latin America, against 40 per cent in OECD countries[8]. These differences are still evident when upper middle income countries are distinguished from lower middle income countries in Latin America (24 per cent of GDP and 21 per cent of GDP respectively). Similar results are found when the total expenditures to GDP ratio is compared for OECD and Latin American countries (44 per cent and 25 per cent respectively). Similarly, over the period 1970-1995, Gavin and Perotti (1997) report that total expenditures to GDP represent 45 per cent for OECD countries against 23 per cent for Latin American countries.

Figure 1. **Impact of elections on fiscal policy in Latin American and OECD countries**
(Changes in selected fiscal indicators, percentage of GDP)



Notes: The impact of elections on fiscal policy is calculated as the difference between the fiscal variable (as percentage of GDP) during the election year and non-election years. The exception is capital expenditure which is assumed to lead the election by one year.

Legislative elections are used for countries with parliamentary political systems and executive elections for countries with presidential systems.

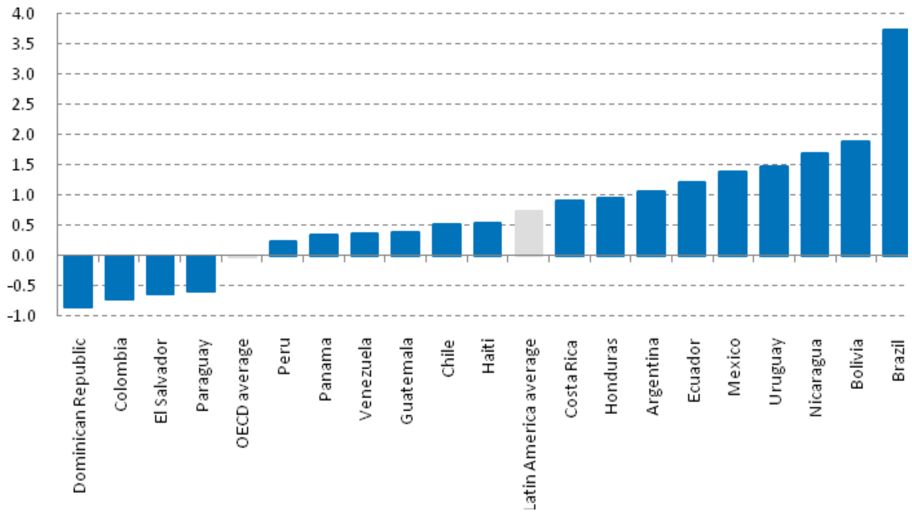
Given the availability of the data, data on fiscal policy refers to Central Government for Latin American countries and Consolidated General Government for OECD countries. Simple Averages are used for the calculation.

Source: The authors, based on Secretaria do Tesouro Nacional (for the case of Brazil); ECLAC ILPES, Public Finance database (for other Latin American countries) and OECD, General Government Accounts (for OECD countries), 2009.

8 OECD data refer to the consolidated general government sector. In Latin America coverage corresponds to the non-financial public sector (OECD, 2008).

Figure 1 identifies the importance of primary expenditure among the fiscal variables affected by electoral politics. Figure 2 analyses this across individual Latin American countries, showing the impact of elections on primary expenditure as a share of GDP, and exposing considerable variation between countries. In Brazil, Bolivia and Nicaragua, for example, primary expenditure increases by more than 1.5 per cent of GDP relative to non-election periods. By contrast, in Paraguay, Peru, Panama, Venezuela, Guatemala and Chile primary expenditure is apparently unaffected by the electoral process. Moreover, Annex 1 exhibits the four fiscal variables over GDP presented above for Latin American countries over the period 1990-2006[9]. By analysing these variables at and around election periods, we note considerable differences among countries but also regards time. For instance, for the case of Brazil, the impact of elections on primary expenditure as well as on capital expenditure prior to elections seems to be more important in the election of 1998 (1.7 per cent of GDP and 5 per cent of GDP respectively) than in the election of 2002 (0.1 per cent of GDP and 0.9 per cent of GDP respectively). For the case of Venezuela, in the last two presidential elections, primary expenditure over GDP increased (i.e. 4.6 per cent of GDP in 2000 and 2.3 per cent of GDP in 2006) more than in earlier elections (i.e. 0.5 per cent of GDP in 1993 and 1.8 per cent of GDP in 1998). By contrast, in Chile, these stylised facts suggest that the impact of elections on fiscal policy appears limited.

Figure 2. **Impact of elections on Latin American countries, 1990-2006**
(Changes in primary expenditure, percentage of GDP)



Notes: The impact of elections on fiscal policy is calculated as the difference between the fiscal variable (as percentage of GDP) during the election year and non-election years.

Legislative elections are used for countries with parliamentary political systems and executive elections for countries with presidential systems. Data on fiscal policy refers to Central Government.

Source: The authors, based on *Secretaria do Tesouro Nacional* (in the case of Brazil); *ECLAC ILPES*, Public Finance database (for other Latin American countries) and *OECD*, General Government Accounts (for OECD countries), *2009.*

9 The four fiscal variables are: fiscal deficit before interest payments (primary balance), the public expenditure excluding interest payments (primary expenditure), the current expenditure, and the capital expenditure.

However, in order to confirm the stylised facts presented above, it is necessary to use an empirical model to control for other macroeconomic variables that may explain the behaviour of fiscal variables around elections. By estimating components of government balance and political cycles using a method similar to that employed by Shi and Svensson (2006), we confirm the results showed in Figure 1. The empirical specification takes the following form:

$$Fiscal\ variable_{i,t} = \sum_{j=1}^{2} \alpha_j Fiscal\ variable_{i,t-2} + \alpha_k GDPgrowth_{i,t} + \alpha_k LogrealGDP capita_{i,t} + \\ + \beta_0 electiondummy_{i,t} + \varepsilon_{i,t}$$

Where *Fiscal variable* is the fiscal item we study in this paper (i.e. primary balance, primary expenditure, current expenditure and capital expenditure). The election dummy variable takes the value of 1 when there is an election and 0 otherwise[10]. The control variables are the logarithm of real GDP per capita, GDP growth rate and the lagged dependent fiscal variable in periods one and two.

Since OLS regressions are known to deal inadequately with time series and cross-section heterogeneity, we start the estimation technique with a Fixed Effect regression (FE estimators). We then include the lagged dependent variables in FE estimation. We adopt the GMM (Generalized Method of Moments) estimator developed for dynamic panel data by Arellano and Bond (1991) in order to avoid the bias caused by the inclusion of lagged dependent variables. Results obtained in the GMM estimation do not change significantly with respect to the FE (Fixed-Effects) model. These results are presented in Table 1 for the case of FE regressions without lagged dependent variables. Table 2 reports FE regressions with lagged dependent variables. Table 3 presents FE regressions with lagged dependent variables and with time-effect, and finally Table 4 presents GMM estimates with time effect specification (see tables at the end of the paper).

Differentiating among developed and emerging democracies and using as fiscal variables government primary balance, primary expenditure, current expenditure and capital expenditure, our estimations find the same results. Fiscal variables are not affected during elections for OECD countries. By contrast, for Latin American economies, primary balances decrease during election years due to an increase of the primary expenditure, caused above all by an expansion in current expenditure.

Figure 3 summarises the most important results exposed in Table 4 (GMM estimation with time-effect). The election dummy variable is not significantly different from 0 for OECD countries. This is true for the primary balance as well as for the most important components of the expenditure side. Indeed, for OECD countries, fiscal balances do not deteriorate, neither do important components of expenditure increase.

In contrast, for Latin American countries, the impact of elections on fiscal policy is high and statistically significant. In particular, practically all the decrease of the primary balance around elections is explained by an increase in primary spending (which rises by close to 0.45

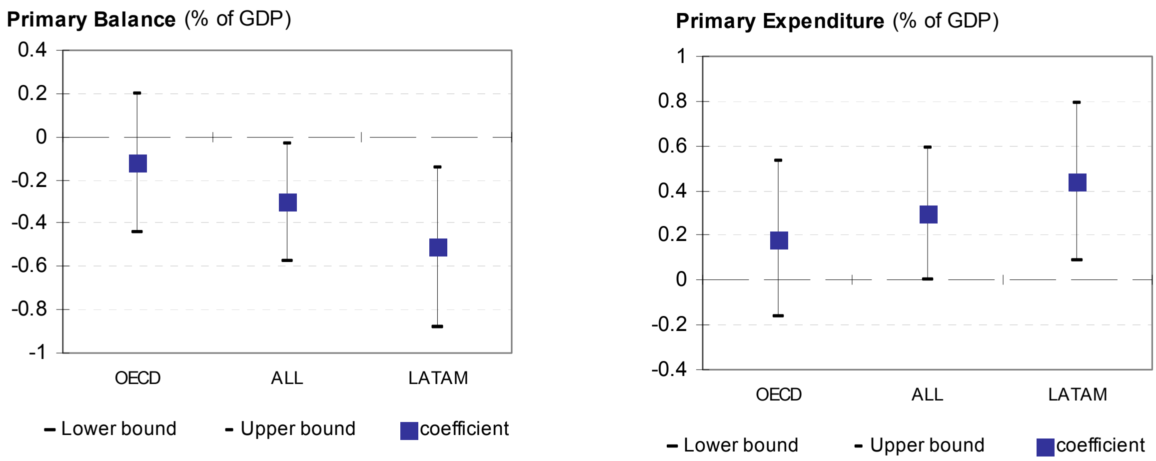
10 The impact of elections on fiscal variables is calculated from the contemporaneous election year. The exception is capital expenditure which is assumed to lead the election by one year.

percentage points during election years). In turn, most of the increase in primary spending is due to rises in current expenditure, which, as a share of GDP, increases by over 0.5 per cent for the region[11].

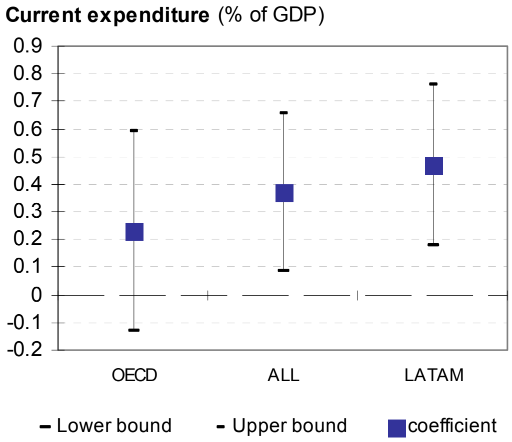
In the case of Latin American countries, the increase in current expenditure is partially compensated by a reduction in public investment. Results suggest that Latin American governments expand in the election year components in which there is a direct impact on voters, as is the case for current expenditures. Indeed, current expenditures have two key characteristics that may serve this purpose: first, they are flexible (i.e. they can be manipulated relatively easily by politicians) and second, voters can rapidly quantify and observe them (e.g. social transfers). Finally, the impact of elections on capital expenditure is observed one year prior to elections. More precisely, particular items that are observed by voters, such as public investment (infrastructure), increase considerably one year before elections. For all countries of the sample (Latin American and OECD countries), capital expenditures increase 0.11 per cent, with yet again a stronger rise for Latin American countries (0.21 per cent).

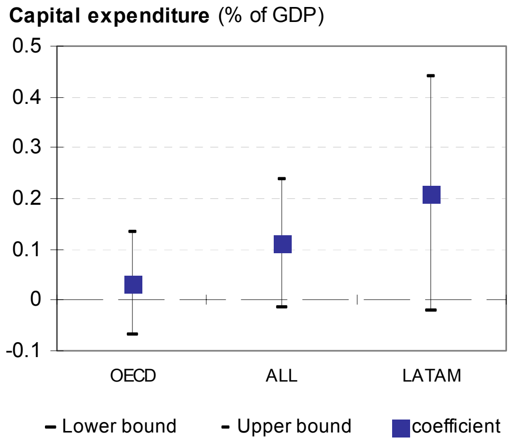
These results confirm earlier studies in the research literature, which found that developed countries are not sensitive to political cycles. This result contrasts with the case of Latin American countries in which current expenditure and public investment as a share of GDP, increase during and prior to an election year respectively. Clearly, behind this finding lies the poor governance performance and legitimacy of Latin American economies, in comparison with OECD countries (see Marshall and Cole, 2008 for a ranking of state fragility in the world).

Figure 3. Significance of elections in OECD countries, Latin American countries and the total sample. 1990-2006



11 When all (Latin American and OECD) countries are analysed, fiscal policy tends to be expansionary. Our estimation suggests that, for the full sample, primary expenditure over GDP is close to 0.3 percentage points higher during an electoral year, and current expenditure as a share of GDP increases 0.4 per cent.





Notes: This figure reports results presented in Table 4. More precisely, the significance of elections on fiscal variables is estimated from GMM estimation. Time-specific fixed effects are included as regressors. The significance is at the 5 per cent level.

The impact of elections on fiscal variables is calculated from the contemporaneous election year. The exception is capital expenditure which is assumed to lead the election by one year.

Legislative elections are used for countries with parliamentary political systems and executive elections for countries with presidential systems. Data on fiscal policy refers to Central Government.

Source: the authors, based on Secretaria do Tesouro Nacional (for the case of Brazil); ECLAC ILPES, Public Finance database (for other Latin American countries) and OECD, General Government Accounts (for OECD countries), 2009.

Expansionary fiscal policy before elections does not necessarily increase the probability that an incumbent candidate remains in power (see Eslava, 2006 for a review of the literature). However, the efficiency of economic policies is affected. Given these factors, an agreement among political parties could avoid fiscal disruptions around elections. Concretely, a consensus among major political parties limiting the menu of options to a range of credible commitments in the fiscal area could reduce the uncertainty traditionally generated by upcoming presidential elections. The 2002 presidential elections in Brazil provide an example of such a multi-party agreement (Chang, 2007).

III.2. Re-elections and fiscal policy in Latin American countries

The previous section showed that elections have an impact on fiscal policy in Latin American countries. Incumbent politicians can expand fiscal policy before elections in order to increase the probability that they or their political party will be re-elected. However, a question remains: does the re-election system in place affect candidates' propensity to use fiscal policy to attract votes? In other words, are incumbent candidates more likely to increase public expenditure before elections when they can be re-elected?

In order to answer these questions, this section tests the impact that immediate re-elections have on fiscal policy in Latin American countries. More precisely, we examine whether or not countries with re-elections of incumbent candidates raise fiscal expenditures.

Latin American countries may be classified according to their re-election procedure (Payne *et al*, 2006). Table 5 shows the re-election system and the year terms for the largest Latin American countries. As of 2009, seven countries (Argentina, Brazil, Colombia, Dominican

Republic, Ecuador, Haiti and Venezuela) allow immediate re-election. In eight countries (Bolivia, Chile, Costa Rica, El Salvador, Nicaragua, Panama, Peru and Uruguay) non-immediate re-election is allowed, and in four countries (Guatemala, Honduras, Mexico and Paraguay) re-election is forbidden. Out 2006's 10 presidential elections, seven took place in countries allowing re-election (immediate or non-immediate). In six of those seven elections of that year, the candidate for re-election was successful (immediate re-election in the case of Brazil, Colombia and Venezuela and non-immediate re-election for Costa Rica, Nicaragua and Peru). Most recently in 2009, President Correa was re-elected in Ecuador. In Chile, where re-election is allowed but not immediately after a first mandate, former president Frei is one of the candidates for the elections of end 2009. More important, the 2009 Honduran *coup d'état* to the president Manuel Zelaya occurred in the context of an ongoing dispute concerning a new constitution that would allow the president Zelaya to be re-elected, which is prohibited under the present constitution.

The current trend in election reform in Latin America is moving towards a less restrictive system of re-election. Venezuela (1998), Dominican Republic (2002), Colombia (2005) and Ecuador (2008) have adopted immediate re-election in recent years, as it exists in some OECD presidential regimes such as the United States, for example. Moreover, the debate in some Latin American countries has been focused on promoting immediate re-election (e.g. Bolivia, Honduras, Nicaragua) and in some countries on allowing re-election for more than two mandates (e.g. Colombia, Venezuela). It is clear that the recent trend in a large majority of Latin American countries towards immediate re-election will be a crucial element of upcoming electoral cycles.

Immediate re-election can be associated with high incentives for incumbent candidates to increase the components of government expenditure that are observed by voters, who can then be influenced by these fiscal measures.

In order to study the impact of immediate re-election on fiscal variables, the basic regression is of the form:

$$Fiscal\ variable_{i,t} = \sum_{j=1}^{2} \alpha_j Fiscal\ variable_{i,t-2} + \alpha_k GDPgrowth_{i,t} + \alpha_k LogrealGDPcapita_{i,t} +$$
$$+ \beta_0 immediate\_re-election_{i,t} + \beta_0 non-immediate\_forbidden_{i,t} + \varepsilon_{i,t}$$

In particular, instead of using the election dummy variable (as we did in the previous section), we compare immediate re-elections ($immediate\_re-election$) with the opposite case ($non-immediate\_forbidden$): non immediate re-elections are allowed and re-elections are forbidden.

Table 6 analyses the impact of immediate re-elections on fiscal policy. The estimation techniques reported are FE and GMM with time effect. Results suggest that immediate re-elections have a considerable impact on the expenditure side of the fiscal balance. In particular, immediate re-elections increase primary expenditure by more than 1.2 per cent of GDP (significant at 1 per cent). This result contrasts with the case in which immediate re-election is not allowed (less than 0.2 per cent of GDP and not significant). Moreover, the impact of immediate re-elections on primary expenditure is more than twice the impact in the case of elections as a whole (more than 1.2 per cent of GDP for immediate re-elections according to Table 6 vs. less than 0.5 per cent of GDP for total elections and reported in Table 4).

Similarly, the expansion of current expenditure during the electoral year (more than 1.0 per cent of GDP and significant at 1 per cent) and the increase of capital expenditure one year prior to elections (more than 0.5 per cent of GDP and significant at 5 per cent) are considerable in the case of immediate re-elections. Again, these results contrast with the case in which there is no immediate re-election, as well as with the case in which we analyse elections without differentiating according to electoral system (according to Table 4 the impact of elections on capital expenditure is close to 0.2 per cent of GDP and significant at 10 per cent). Finally, the impact on the primary balance is high. The primary balance is reduced by close to 0.6 per cent of GDP during the electoral year, but this is not significant. This last result shows that the impact on the primary balance varies considerably across countries. A possible explanation for this phenomenon is that some Latin American countries that allow immediate re-election expand the expenditure component of the fiscal balance during elections and during a context of high economic growth, which can attenuate (through high revenues) the impact on the primary balance.

The findings presented above suggest that incumbent candidates in Latin American democracies increase considerably the components of government expenditure which may be observed by voters. Where there is non-immediate re-election and when re-election is forbidden, the opposite is true.

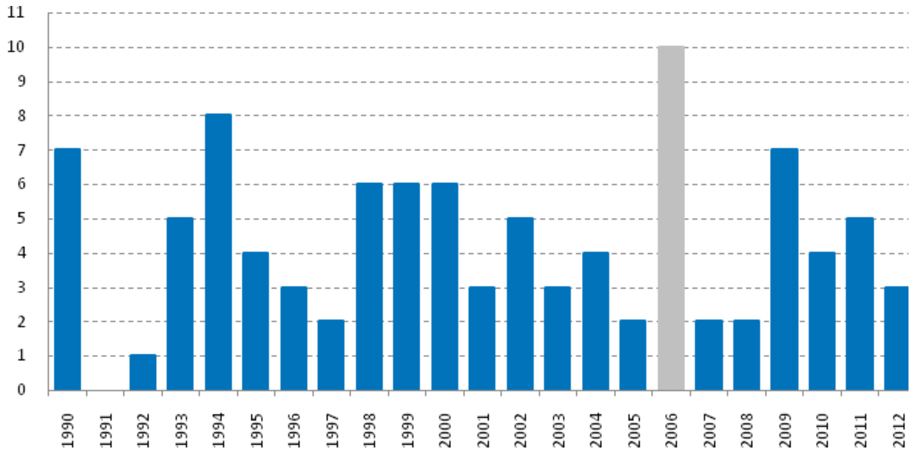
III.3. Is Latin American fiscal policy maturing?

The empirical study presented above analyses Latin America during the period 1990-2006. Results suggest that during this period the region expanded fiscal policy around elections (in contrast to OECD countries). As also stressed in a previous paper (Nieto-Parra and Santiso, 2008), such critical electoral junctures tend to have significant impacts on banks' recommendations and financial variables, which are negatively affected by the uncertainty surrounding elections. All major financial crises during the period studied have coincided with elections. 1994, a year in which no less than eight presidential elections took place, saw a major financial crisis known as the "tequilazo", which originated in Mexico some months after the presidential election of mid 1993. Since 1994, all of the major financial crises affected the region were coincident with presidential election years that saw the fiscal deteriorations already underlined.

However, a question remains: Is Latin American democracy maturing in the context of fiscal policy around elections? It is particularly notable that in 2006, a record year of presidential elections in Latin America (more than in 1994, with 10 presidential run offs and over 80 per cent of the region's population heading to the polls) no major financial disruption took place (Figure 4).

In spite of such political effervescence, financial markets in the region did not experience major disruptions. This was a marked contrast to previous cycles and we are led to wonder whether this was a one-off or perhaps evidence of a permanent change in the historic jitteriness of financial markets towards the democratic cycle in Latin America.

Figure 4. **Number of presidential elections by year, Latin America**



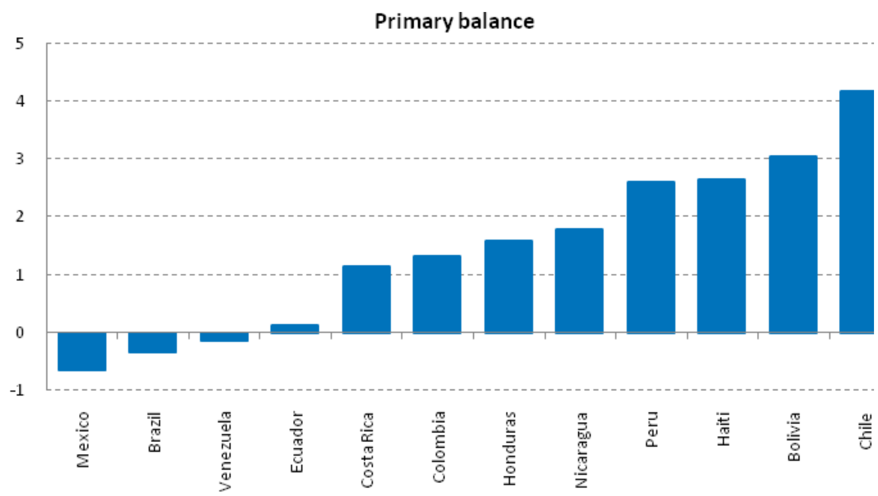
Notes: The Latin American countries covered are Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Haiti, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Uruguay and Venezuela.

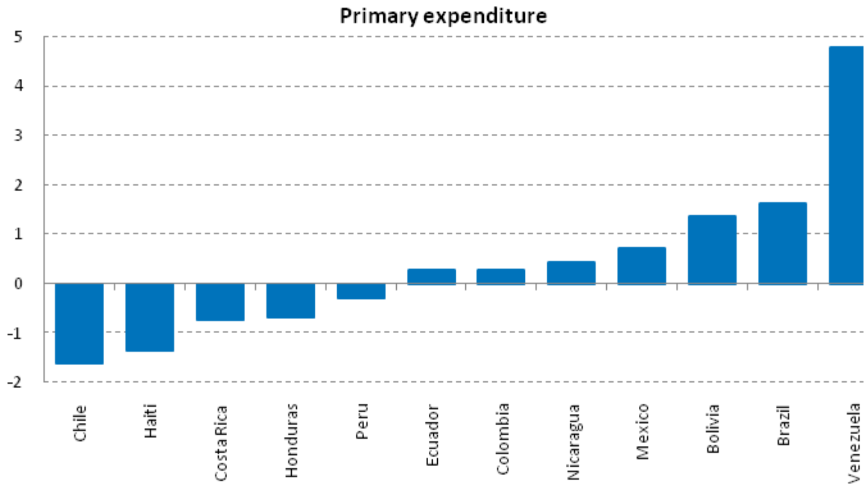
For elections with a second (run-off) round, the date of the final round is used.

Source: the authors based on *on www.electionguide.org*, 2009.

A changed attitude on the part of the markets would certainly have some justification if we look only at the primary balance in Latin American countries. Figure 5 compares the effect of elections in 2006 on the primary surplus and on primary expenditure. Strikingly, primary surpluses tended to grow rather than shrink in countries for which 2006 was an election year.

Figure 5. **Impact of presidential elections on fiscal variables**
(Percentage of GDP, 2005 and 2006 presidential elections against prior non election years).





Note: The impact of 2005 and 2006 elections on fiscal policy is calculated as the difference between the fiscal variable (as a proportion of GDP) during the election year and prior non-election years.

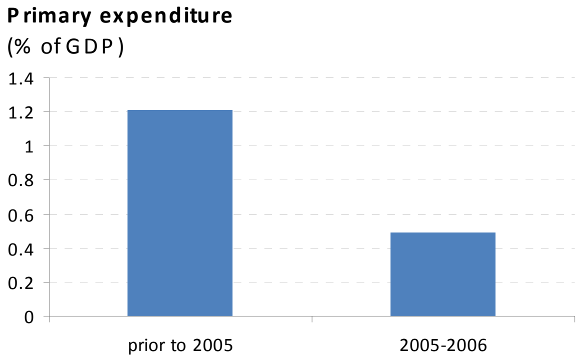
Source: The authors, based on Secretaria do Tesouro Nacional in the case of Brazil and ECLAC ILPES, *Public Finance database* for other Latin American countries, 2009.

There is no doubt that part of this fiscal discipline can be ascribed to the more forgiving conditions of high real GDP growth. Certainly, as the second panel of Figure 6 shows, spending restraint was not driving low deficits. Many of those same countries witnessed some increases in primary expenditure as a share of GDP. This is the case for Venezuela, Brazil and Mexico, in which primary spending booms stimulated fiscal deficits, and is in sharp contrast to Chile, Costa Rica or Peru. That said, with the exception of Venezuela that experienced a considerable jump in primary expenditure during its election year, in cases such as Mexico or Colombia the increase was moderate. As already underlined, fiscal policies have been improving in Latin America over the 2000s and particularly since the mid 2000s (OECD, 2008). Structural revenues have improved as a share of GDP, and structural primary balances are currently in surplus in many Latin American countries (see Vladkova and Zettelmeyer, 2008), the case of Chile being particularly impressive, with fiscal surpluses that increased significantly in the years 2006 and after again in 2007-2008.

It is clear that Latin America's governments have taken enormous strides to put their fiscal houses in order. The OECD's *Latin American Economic Outlook 2009* shows that, since the end of the debt crisis of the 1980s, governments have assiduously tightened their belts. Fiscal deficits have fallen from 11 per cent of public revenues in the 1970s and 1980s, to 8 per cent since 2000. The year-to-year volatility of taxes, spending and deficits – long a feature of fiscal policy-making in the region, with harmful effects for economic performance – has likewise fallen: an index of deficit volatility calculated for the 2009 Latin American Economic Outlook shows a fall of a third from 1990-94 to 2000-06, with Latin America standing just 6 per cent above the volatility levels in OECD countries in the latter period.

A closer look at the statistically significant fiscal variables studied in the previous sections shows a relative change in the pattern between fiscal policy and elections. Prior to 2005, primary expenditures were increasing significantly while for 2005-2006 the rise is on average much more moderate for the region (Figure 6). Similarly primary fiscal balances tend to be negative prior to 2005 and positive in the year 2005-2006 (Figure 7)[12]. Lastly, current expenditure increases has been cut by nearly half in the year 2005-2006 when compared to prior 2005 (Figure 8). However, even today we note that Latin American countries still increase public expenditure during elections, a result which still contrasts with OECD countries (Figure 1), showing that fiscal discipline around elections remains an issue for the region[13].

Figure 6. **Changes in primary expenditure prior 2005 and for the year 2005-2006**
(Percentage of GDP)



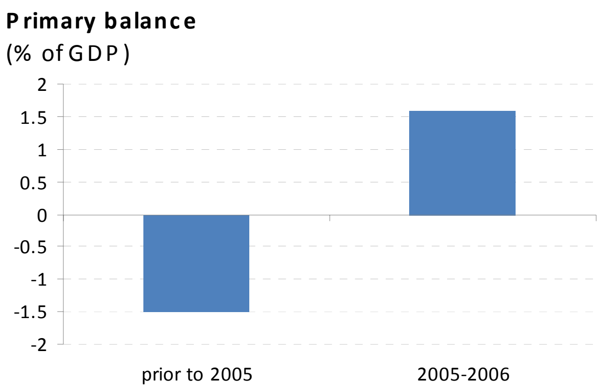
Note: The impact of 2005 and 2006 elections on fiscal policy is calculated as the difference between the primary expenditure (as a proportion of GDP) during the election year and prior non-election years. The impact of elections prior to 2005 on fiscal policy is calculated as the difference between the average of the primary expenditure during elections and the average of the primary expenditure for non-elections years.

Source: The authors based on Secretaria do Tesouro Nacional in the case of Brazil and ECLAC ILPES, *Public Finance database* for other Latin American countries, 2009.

12 Moreover, by analysing FE and GMM regressions with time effects (presented in Tables 3 and 4), we note that for Latin American countries the 2006 time dummy variable is positive and statistically significant for the model that uses as dependent variable the primary balance.

13 Moreover, by analysing FE and GMM regressions with time effect (presented in Tables 3 and 4), we note that for Latin American countries the 2006 time dummy variable is positive and statistically significant for the model that uses current expenditure as the dependent variable. When we analyse the model with primary expenditure as the dependent variable, results are also positive and significant in the FE specification.

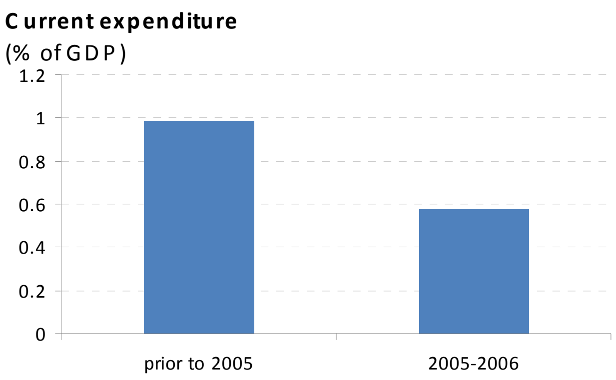
Figure 7. **Primary balance prior 2005 and for the year 2005-2006**
(Percentage of GDP)



Note: The impact of 2005 and 2006 elections on fiscal policy is calculated as the difference between the primary balance (as a proportion of GDP) during the election year and prior non-election years. The impact of elections prior to 2005 on fiscal policy is calculated as the difference between the average of the primary balance during elections and the average of the primary balance for non-elections years.

Source: The authors based on Secretaria do Tesouro Nacional in the case of Brazil and ECLAC ILPES, *Public Finance database* for other Latin American countries, 2009.

Figure 8. **Current expenditure prior 2005 and for the year 2005-2006**
(Percentage of GDP)



Note: The impact of 2005 and 2006 elections on fiscal policy is calculated as the difference between the current expenditure (as a proportion of GDP) during the election year and prior non-election years. The impact of elections prior to 2005 on fiscal policy is calculated as the difference between the average of the current expenditure during elections and the average of the current expenditure for non-elections years.

Source: The authors, based on Secretaria do Tesouro Nacional in the case of Brazil and ECLAC ILPES, *Public Finance database* for other Latin American countries, 2009.

Of course there are some caveats and selection bias problems with the stylised facts presented above for the comparison between the electoral cycle of 2005-2006 and prior electoral cycles. First, the size of the sample is much smaller in 2005-2006, with a limited number of countries voting. Second, the number of elections between these two periods differs considerably (12 for 2005-2006 vs. 59 prior to 2005). These last stylised facts are not tested, however. Indeed, one may also justify the result presented above with the boom of commodity prices and argue that the positive shock to the terms of trade has also been a key driver influencing these results.

IV. CONCLUSIONS

This paper compares the impact that elections could have on the deterioration of the fiscal positions and in particular on the public expenditure components in Latin American countries with respect to OECD countries.

Our study of 28 OECD countries and 19 Latin American countries during the period 1990-2006, suggests that general elections are indeed associated with much greater changes to the major components of fiscal policy in Latin America than in high-income countries. In particular, we find that in Latin American countries, the average primary balance declines by an amount close to 0.7 per cent of GDP during an election year, confirming the hypothesis of fiscal deteriorations during the election cycle. Most of this movement is due to the expenditure component and within this it is current (close to 0.8 per cent of GDP) rather than capital expenditure that is most affected. Our analysis also suggests that immediate re-elections in Latin America have a considerable impact on the expenditure side of the fiscal balance. Finally, by comparing the 2005-2006 electoral cycle with respect to prior electoral cycles, we note a slight improvement of fiscal management around elections.

Several policy recommendations can be derived from our findings. First, in order to avoid fiscal deterioration, fiscal rules focusing on the stability of the major components of fiscal balance may be an appropriate policy measure for Latin American countries. Moreover, around elections, higher transparency and disclosure of the major components of fiscal balance could be valuable for the region. Second, in the current debate on electoral systems in some Latin American countries, immediate re-election systems may be avoided in order to minimise the risks of fiscal deterioration ahead of and during election years. Alternatively, special bodies at the Ministries of Finances aiming to look at a long-term perspective on fiscal policy can be established. This recommendation is associated with the independence of fiscal policy from short-term incentives of politicians, a crucial aspect for Latin American countries studied in previous research (Eichengreen, Hausmann and Hagen, 1999). A final policy implication has to do with the strategy of risk mitigation during political electoral cycles. Following the example of Lula in 2002, presidential candidates, could, for example, signal responsible and credible commitments ahead of elections. A consensus among major political parties aiming to reduce the menu of options to a range of credible commitments in the fiscal area could be a way to reduce the uncertainty traditionally generated by upcoming presidential elections, as already exemplified by Brazil in 2002 (Chang, 2007).

This research contributes to ongoing debates on the influence of politics on economic policy in Latin America. The policy options put forward may serve to mitigate the potential fiscal disruptions ahead of elections, which are, after all, regular and normal events in democracies.

TABLES

Table 1. Impact of elections on Fiscal variables, 1990-2006

FE estimation

	Primary Balance			Primary Expenditure		
	Latam	OECD	All	Latam	OECD	All
GDP growth	1.48956e-01***	3.46741e-01***	2.05938e-01***	-0.0485	-2.91941e-01***	-8.25982e-02**
	[5.60]	[6.42]	[7.17]	[1.58]	[4.19]	[2.18]
log GDPpercapita	-2.96178***	5.40090***	3.27884***	8.65440***	-15.01481***	-7.70128***
	[3.06]	[6.21]	[4.83]	[7.57]	[13.22]	[8.13]
Election dummy	-6.30263e-01***	-6.67E-02	-2.95E-01	4.52574e-01*	8.84E-02	3.28E-01
	[2.86]	[0.27]	[1.65]	[1.74]	[0.29]	[1.35]
Constant	23.02620***	-53.53851***	-29.55381***	-51.40074***	188.19048***	98.61837***
	[3.09]	[6.28]	[4.87]	[5.83]	[16.92]	[11.70]
Observations	307	445	735	317	414	714
R-squared	0.14	0.18	0.11	0.18	0.35	0.1
Number of country	19	27	45	19	28	46

Absolute value of t statistics in brackets
* significant at 10%; ** significant at 5%; *** significant at 1%

	Current Expenditure			Capital Expenditure		
	Latam	OECD	All	Latam	OECD	All
GDP growth	-9.46377e-02***	-2.62932e-01***	-1.01712e-01**	0.00961	-0.0135	0.00505
	[3.07]	[3.10]	[2.28]	[0.57]	[0.94]	[0.44]
log GDPpercapita	7.01026***	-22.48073***	-13.16378***	0.54838	-0.08879	0.12499
	[6.10]	[16.29]	[11.80]	[0.87]	[0.36]	[0.42]
Election dummy	5.22594e-01**	1.29E-01	4.31E-01	3.06659e-01**	1.46E-02	1.44032e-01*
	[2.00]	[0.34]	[1.51]	[2.11]	[0.23]	[1.94]
Constant	-39.36847***	261.94742***	147.33459***	-1.34547	3.84113	1.82749
	[4.44]	[19.39]	[14.84]	[0.28]	[1.59]	[0.69]
Observations	317	414	714	317	390	690
R-squared	0.14	0.43	0.19	0.02	0	0.01
Number of country	19	28	46	19	28	46

Absolute value of t statistics in brackets
* significant at 10%; ** significant at 5%; *** significant at 1%

Notes: This table reports results of FE estimation (country-specific effect). The impact of elections on fiscal variables is calculated from the contemporaneous election year. The exception is capital expenditure which is assumed to lead the election by one year. Legislative elections are used for countries with parliamentary political systems and executive elections for countries with presidential systems. Data on fiscal policy refers to Central Government.

Source: the authors based on Secretaria do Tesouro Nacional (for the case of Brazil); ECLAC ILPES, Public Finance database (for other Latin American countries) and OECD, General Government Accounts (for OECD countries), 2009.

Table 2. **Impact of elections on Fiscal variables, 1990-2006**
FE estimation with lagged dependent variables

	Primary Balance			Primary Expenditure		
	Latam	OECD	All	Latam	OECD	All
GDP growth	7.79747e-02***	3.07529e-01***	1.31166e-01***	9.99E-03	-3.67655e-01***	-7.15291e-02***
	[3.03]	[7.82]	[5.87]	[0.43]	[8.78]	[3.27]
log GDPpercapita	-0.03372	1.69043**	1.90120***	1.43842	-2.43077***	-2.22595***
	[0.03]	[2.48]	[3.22]	[1.29]	[2.82]	[3.38]
Election dummy	-0.47460**	-0.14697	-0.25483*	0.35534*	0.21847	0.23935*
	[2.35]	[0.90]	[1.90]	[1.85]	[1.31]	[1.75]
Fiscal variable (-1)	5.03949e-01***	8.50491e-01***	7.59023e-01***	5.88921e-01***	7.70417e-01***	7.57572e-01***
	[7.77]	[19.28]	[20.06]	[9.61]	[16.83]	[19.63]
Fiscal variable (-2)	-0.06756	-0.20528***	-0.16312***	0.05109	0.01328	-0.00467
	[1.13]	[4.77]	[4.53]	[0.89]	[0.31]	[0.13]
Constant	0.33128	-17.25029**	-17.24180***	-5.42534	33.29401***	27.29445***
	[0.04]	[2.58]	[3.25]	[0.65]	[3.59]	[4.41]
Observations	267	391	643	279	358	622
R-squared	0.3	0.67	0.54	0.49	0.8	0.69
Number of country	19	27	45	19	28	46

Absolute value of t statistics in brackets
* significant at 10%; ** significant at 5%; *** significant at 1%

	Current Expenditure			Capital Expenditure		
	Latam	OECD	All	Latam	OECD	All
GDP growth	-4.38277e-02**	-3.99953e-01***	-1.23071e-01***	1.94E-02	-1.57E-02	1.03E-02
	[2.38]	[8.97]	[5.85]	[1.32]	[1.23]	[1.02]
log GDPpercapita	0.91727	-3.14174***	-2.35051***	-0.60077	0.20997	-0.16938
	[1.06]	[3.23]	[3.55]	[0.90]	[0.93]	[0.57]
Election dummy	0.56541***	0.26828	0.37908***	0.23032*	0.02874	0.13353**
	[3.66]	[1.53]	[2.90]	[1.88]	[0.54]	[2.08]
Fiscal variable (-1)	6.72954e-01***	8.35205e-01***	8.44688e-01***	5.80896e-01***	4.27444e-01***	5.50533e-01***
	[11.81]	[18.51]	[23.01]	[9.51]	[7.62]	[13.06]
Fiscal variable (-2)	0.09382*	-0.00393	-0.01606	-0.10784*	0.17515***	-0.0517
	[1.73]	[0.09]	[0.46]	[1.83]	[3.24]	[1.28]
Constant	-3.41673	38.42785***	26.20471***	6.16578	-0.90563	2.93618
	[0.52]	[3.72]	[4.22]	[1.20]	[0.40]	[1.11]
Observations	279	358	622	279	334	598
R-squared	0.66	0.87	0.82	0.3	0.33	0.29
Number of country	19	28	46	19	28	46

Absolute value of t statistics in brackets
* significant at 10%; ** significant at 5%; *** significant at 1%

Notes: This table reports results of FE estimation (country-specific effect) with lagged dependent variables. The impact of elections on fiscal variables is calculated from the contemporaneous election year. The exception is capital expenditure which is assumed to lead the election by one year. Legislative elections are used for countries with parliamentary political systems and executive elections for countries with presidential systems. Data on fiscal policy refers to Central Government.

Source: the authors based on Secretaria do Tesouro Nacional (for the case of Brazil); ECLAC ILPES, Public Finance database (for other Latin American countries) and OECD, General Government Accounts (for OECD countries), 2009.

Table 3. **Impact of elections on Fiscal variables, 1990-2006**
FE estimation with lagged dependent variables and time effect

	Primary Balance			**Primary Expenditure**		
	Latam	OECD	All	Latam	OECD	All
GDP growth	3.09E-02	2.14500e-01***	1.03380e-01***	4.53537e-02*	-3.00458e-01***	-5.07424e-02**
	[1.17]	[4.95]	[4.42]	[1.84]	[6.60]	[2.20]
log GDPpercapita	-3.69249***	0.76836	-0.71306	-0.99374	0.99231	-1.75552*
	[2.71]	[0.53]	[0.74]	[0.74]	[0.65]	[1.66]
Election dummy	-0.48822**	-0.12756	-0.26872**	0.34213*	0.20617	0.24946*
	[2.54]	[0.79]	[2.04]	[1.80]	[1.26]	[1.82]
Fiscal variable (-1)	4.31882e-01***	8.09204e-01***	7.45398e-01***	5.04143e-01***	7.35907e-01***	7.63378e-01***
	[6.73]	[16.98]	[19.32]	[7.91]	[15.42]	[19.56]
Fiscal variable (-2)	-0.05289	-0.15808***	-0.11861***	-0.00065	0.06252	0.00994
	[0.89]	[3.40]	[3.20]	[0.01]	[1.38]	[0.27]
Constant	28.66246***	-8.32585	5.94233	14.67901	-0.72457	22.14948**
	[2.74]	[0.58]	[0.69]	[1.43]	[0.05]	[2.29]
Observations	267	391	643	279	358	622
R-squared	0.44	0.7	0.58	0.55	0.82	0.7
Number of country	19	27	45	19	28	46

Absolute value of t statistics in brackets
* significant at 10%; ** significant at 5%; *** significant at 1%

	Current Expenditure			**Capital Expenditure**		
	Latam	OECD	All	Latam	OECD	All
GDP growth	-2.44E-02	-3.48925e-01***	-1.13813e-01***	3.73034e-02**	-5.25E-03	1.84392e-02*
	[1.21]	[7.19]	[5.14]	[2.27]	[0.35]	[1.70]
log GDPpercapita	-1.55808	0.90538	-1.73683*	-1.42364	1.45190***	-0.20657
	[1.41]	[0.55]	[1.68]	[1.58]	[2.69]	[0.44]
Election dummy	0.53938***	0.27243	0.39104***	0.19722	0.03234	0.12176*
	[3.46]	[1.58]	[2.98]	[1.57]	[0.62]	[1.88]
Fiscal variable (-1)	5.95543e-01***	8.18607e-01***	8.51479e-01***	5.65159e-01***	3.87403e-01***	5.59156e-01***
	[9.69]	[17.54]	[22.93]	[9.03]	[6.61]	[13.12]
Fiscal variable (-2)	0.07735	0.0154	-0.00982	-0.13896**	0.16849***	-0.05399
	[1.36]	[0.35]	[0.28]	[2.27]	[2.96]	[1.31]
Constant	16.51774*	-0.12823	20.04490**	12.43684*	-12.58157**	3.08677
	[1.93]	[0.01]	[2.13]	[1.79]	[2.38]	[0.73]
Observations	279	358	622	279	334	598
R-squared	0.7	0.88	0.82	0.35	0.4	0.31
Number of country	19	28	46	19	28	46

Absolute value of t statistics in brackets
* significant at 10%; ** significant at 5%; *** significant at 1%

Notes: This table reports results of FE estimation (country-specific effect) with lagged dependent variables and time-specific fixed effects are included as regressors. The impact of elections on fiscal variables is calculated from the contemporaneous election year. The exception is capital expenditure which is assumed to lead the election by one year. Legislative elections are used for countries with parliamentary political systems and executive elections for countries with presidential systems. Data on fiscal policy refers to Central Government.

Source: the authors based on Secretaria do Tesouro Nacional (for the case of Brazil); ECLAC ILPES, Public Finance database (for other Latin American countries) and OECD, General Government Accounts (for OECD countries), 2009.

Table 4. Impact of elections on Fiscal variables, 1990-2006

GMM estimation with time effect

	Primary Balance			Primary Expenditure		
	Latam	OECD	All	Latam	OECD	All
GDP growth	5.12E-03	2.06001e-01***	9.42426e-02***	9.15E-03	-3.26826e-01***	-4.85E-02
	[0.18]	[4.08]	[3.21]	[0.36]	[5.73]	[1.64]
log GDPpercapita	-1.89634	1.39508	-6.12286***	1.4848	3.47551	-0.24641
	[1.06]	[0.54]	[3.06]	[0.81]	[1.27]	[0.11]
Election dummy	-0.51189***	-0.12043	-0.30359**	0.44077**	0.18493	0.29636**
	[2.72]	[0.73]	[2.18]	[2.46]	[1.04]	[1.97]
Fiscal variable (-1)	4.28951e-01***	8.06338e-01***	8.10756e-01***	3.83635e-01***	7.41707e-01***	8.25724e-01***
	[6.54]	[16.16]	[18.85]	[5.17]	[13.49]	[16.97]
Fiscal variable (-2)	-0.06464	-0.13777***	-0.07263*	-0.03015	0.04836	0.00541
	[1.11]	[3.03]	[1.90]	[0.51]	[0.98]	[0.13]
Constant	15.22207	-14.71758	53.28168***	-0.73396	-23.18899	7.08513
	[1.10]	[0.59]	[3.01]	[0.05]	[0.87]	[0.36]
Observations	247	364	597	260	330	576
Number of country	19	27	45	19	28	46

Absolute value of t statistics in brackets
* significant at 10%; ** significant at 5%; *** significant at 1%

	Current Expenditure			Capital Expenditure		
	Latam	OECD	All	Latam	OECD	All
GDP growth	-2.67E-02	-3.84402e-01***	-1.17039e-01***	2.61E-02	-1.67E-02	1.77E-03
	[1.26]	[6.43]	[4.04]	[1.47]	[1.01]	[0.14]
log GDPpercapita	-1.94253	4.20896	-0.05032	1.24878	1.24345	2.32860***
	[1.14]	[1.47]	[0.02]	[1.04]	[1.54]	[2.86]
Election dummy	0.46948***	0.23074	0.36999**	0.20925*	0.03176	0.11070*
	[3.16]	[1.25]	[2.56]	[1.77]	[0.62]	[1.72]
Fiscal variable (-1)	4.11416e-01***	8.17835e-01***	9.01717e-01***	4.98095e-01***	2.81691e-01***	4.94675e-01***
	[5.31]	[15.63]	[19.79]	[7.73]	[4.29]	[9.90]
Fiscal variable (-2)	0.06392	0.00338	-0.02006	-0.18220***	0.0943	-0.10253**
	[1.17]	[0.07]	[0.51]	[3.13]	[1.61]	[2.44]
Constant	21.94886*	-32.44865	4.00135	-7.64304	-9.9869	-18.44196***
	[1.66]	[1.16]	[0.20]	[0.84]	[1.28]	[2.59]
Observations	260	330	576	260	306	552
Number of country	19	28	46	19	28	46

Absolute value of t statistics in brackets
* significant at 10%; ** significant at 5%; *** significant at 1%

Notes: This table reports result of GMM estimation with two lags of the dependent variables and time-specific fixed effects are included as regressors. The impact of elections on fiscal variables is calculated from the contemporaneous election year. The exception is capital expenditure which is assumed to lead the election by one year. Legislative elections are used for countries with parliamentary political systems and executive elections for countries with presidential systems. Data on fiscal policy refers to Central Government.

Source: the authors based on Secretaria do Tesouro Nacional (for the case of Brazil); ECLAC ILPES, Public Finance database (for other Latin American countries) and OECD, General Government Accounts (for OECD countries), 2009.

Table 5. **Re-election system and year-terms in Latin America (2009)**

	Re-election			Year term
	Immediate	No-immediate	Forbidden	Nb. Years
Argentina	X			4
Bolivia		X		5
Brazil	X			4
Chile		X		4
Colombia	X			4
Costa Rica		X		4
Dominican Republic	X			4
Ecuador	X			4
El Salvador		X		5
Guatemala			X	4
Haiti	X			5
Honduras			X	4
Mexico			X	6
Nicaragua		X		5
Panama		X		5
Paraguay			X	5
Peru		X		5
Uruguay		X		5
Venezuela	X			6

Source: The authors, based on Payne *et al*. (2006) and IFES Election guide (*www.electionguide.org*), 2009.

Table 6. **Impact of re-elections on Fiscal variables, 1990-2006**
FE and GMM estimation with time effect

	Primary Balance		**Primary Expenditure**	
	FE	GMM	FE	GMM
GDP growth	2.47E-02	3.20E-03	3.05E-02	7.32E-03
	[0.89]	[0.11]	[1.14]	[0.27]
log GDPpercapita	-3.67295**	-2.17356	-0.72679	1.82436
	[2.41]	[1.11]	[0.49]	[0.86]
immediate re-election	-0.66202	-0.65945	1.34151***	1.23740***
	[1.49]	[1.48]	[3.21]	[3.11]
non-immediate forbidden	-0.45249**	-0.49033**	0.07944	0.17532
	[2.07]	[2.28]	[0.37]	[0.86]
Fiscal variable (-1)	4.29848e-01***	4.39313e-01***	5.14023e-01***	4.05921e-01***
	[6.54]	[6.61]	[7.88]	[5.39]
Fiscal variable (-2)	-0.05723	-0.05422	0.00155	-0.02527
	[0.94]	[0.91]	[0.03]	[0.42]
Constant	28.92510**	17.50399	12.81875	-5.02496
	[2.45]	[1.16]	[1.10]	[0.31]
Observations	256	238	264	246
Number of country	18	18	18	18
R-squared	0.43		0.57	

Absolute value of t statistics in brackets
* significant at 10%; ** significant at 5%; *** significant at 1%

	Current Expenditure		**Capital Expenditure**	
	FE	GMM	FE	GMM
GDP growth	-5.04687e-02**	-5.37335e-02**	3.36256e-02*	2.92E-02
	[2.38]	[2.46]	[1.79]	[1.48]
log GDPpercapita	-1.09131	-2.75076	-1.38515	1.74098
	[0.90]	[1.51]	[1.30]	[1.17]
immediate re-election	1.34955***	1.04569***	0.55727*	0.55294**
	[4.05]	[3.27]	[1.94]	[1.99]
non-immediate forbidden	0.32599*	0.33903**	0.11563	0.15402
	[1.92]	[2.13]	[0.78]	[1.09]
Fiscal variable (-1)	6.21954e-01***	4.05022e-01***	5.30566e-01***	4.74616e-01***
	[10.03]	[5.12]	[8.10]	[7.00]
Fiscal variable (-2)	0.06215	0.04504	-0.14040**	-0.18754***
	[1.08]	[0.82]	[2.20]	[3.06]
Constant	13.21684	30.50117**	12.47231	-11.39582
	[1.38]	[2.07]	[1.51]	[0.99]
Observations	264	246	246	228
Number of country	18	18	18	18
R-squared	0.73		0.32	

Absolute value of t statistics in brackets
* significant at 10%; ** significant at 5%; *** significant at 1%

Notes: This table reports result of FE and GMM estimation with two lags of the dependent variables and time-specific fixed effects are included as regressors. "Non immediate and forbidden" refers to all elections in which there is no immediate re-election (e.g. re-election is forbidden, re-election is not immediate). The impact of re-elections on fiscal variables is calculated from the contemporaneous election year. The exception is capital expenditure which is assumed to lead the election by one year.

Source: the authors based on Secretaria do Tesouro Nacional (for the case of Brazil); ECLAC ILPES, Public Finance database (for other Latin American countries), 2009.

ANNEX

Fiscal Variables (Percentage of GDP) in Latin America. Period 1990-2006

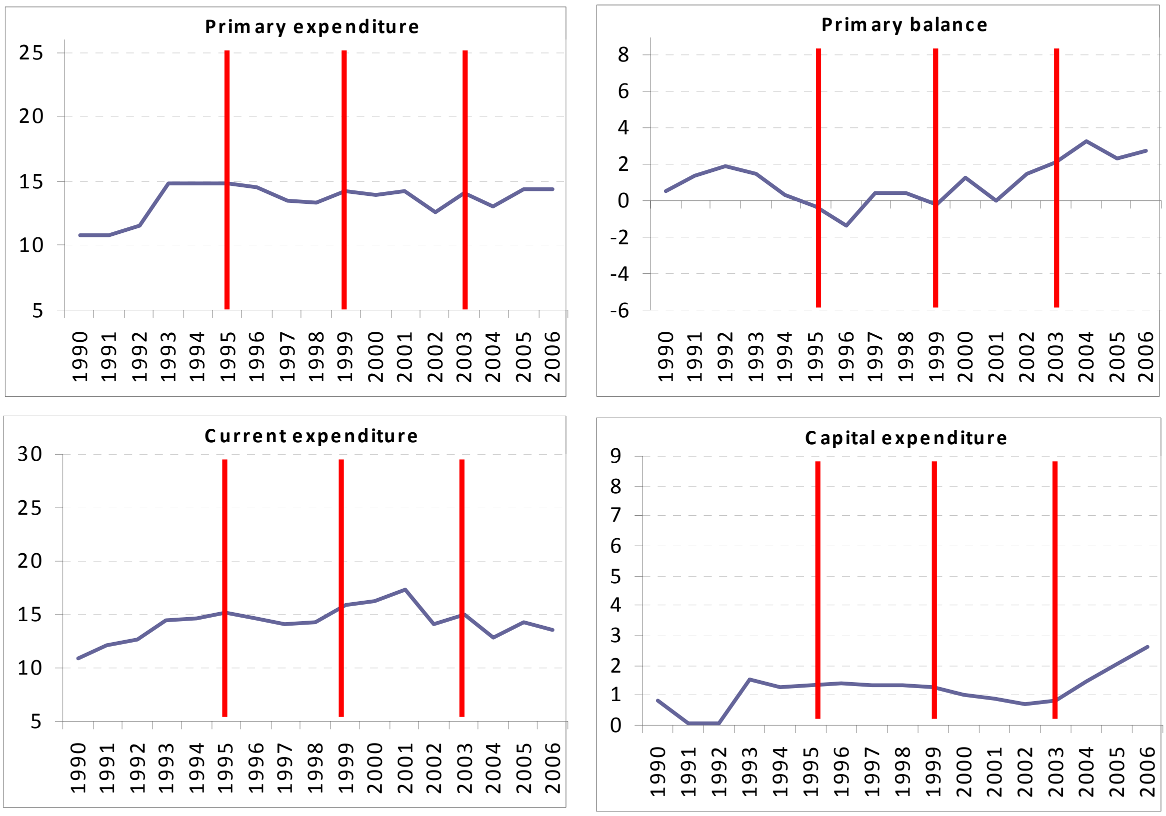
Source: The authors, based on Secretaria do Tesouro Nacional in the case of Brazil and ECLAC ILPES, *Public Finance database* for other Latin American countries, 2009.

Notes:

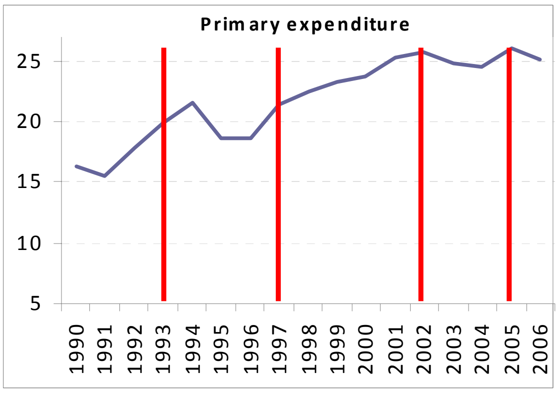
1. Fiscal Variables (percentage of GDP) are: The fiscal deficit before interest payments (primary balance), the public expenditure excluding interest payments (primary expenditure), the current expenditure, and the capital expenditure.

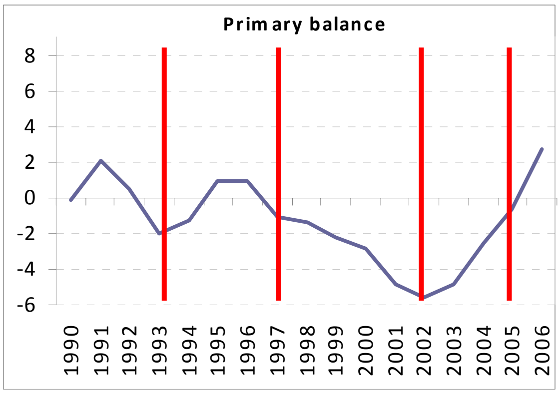
2. Red vertical line represents the election date

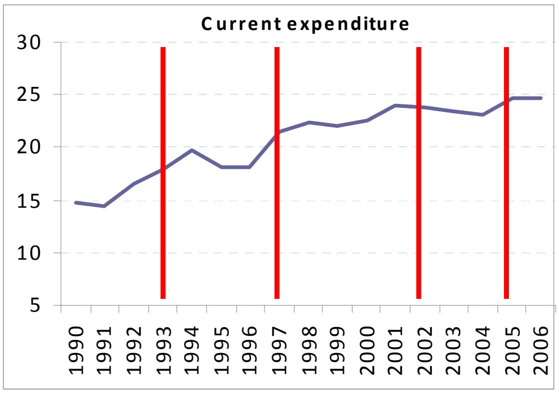
Argentina

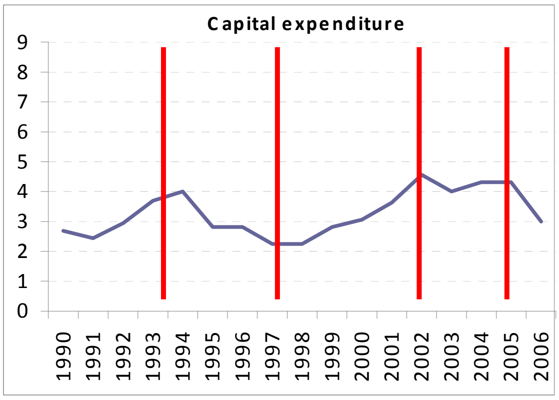


Bolivia

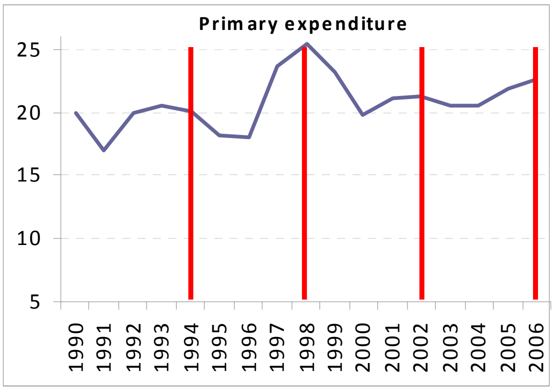


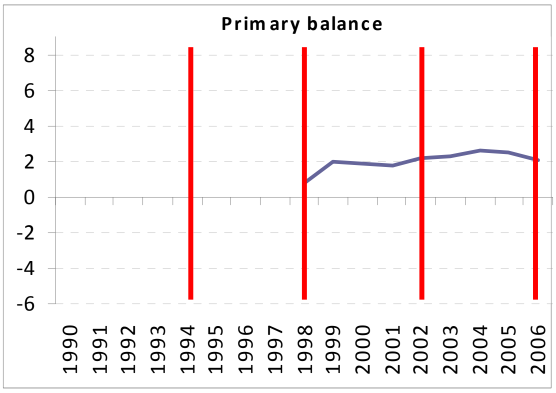


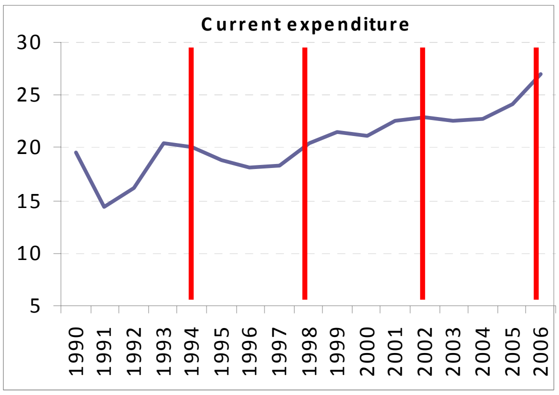


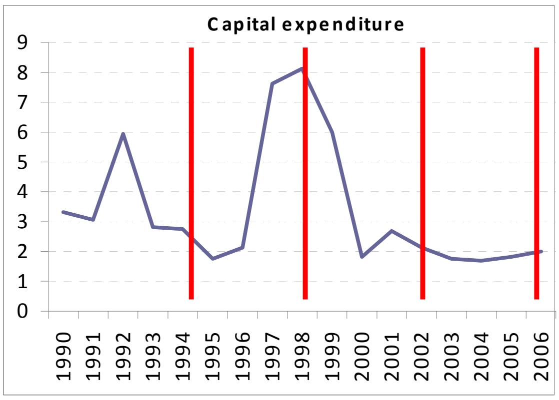


Brazil









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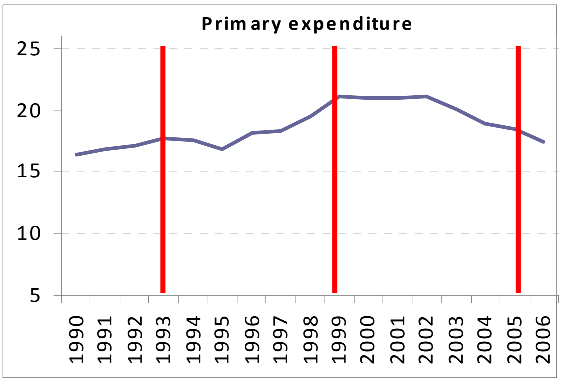

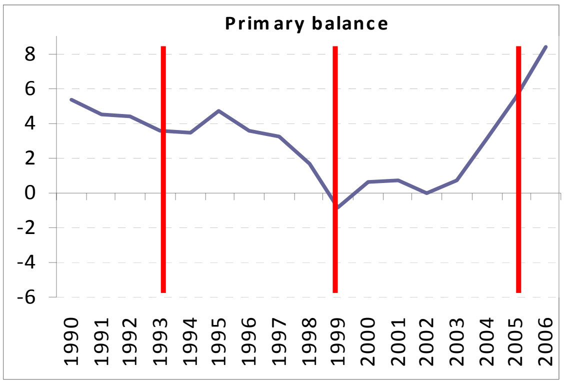

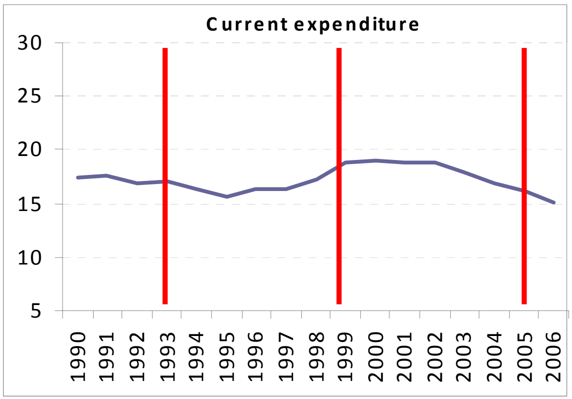

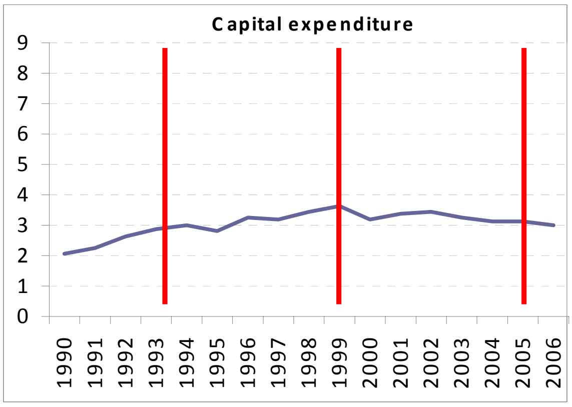

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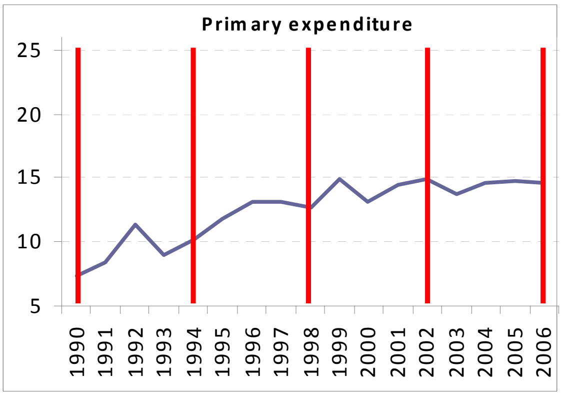

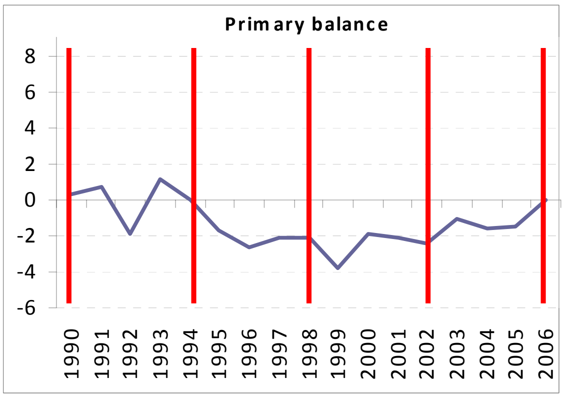

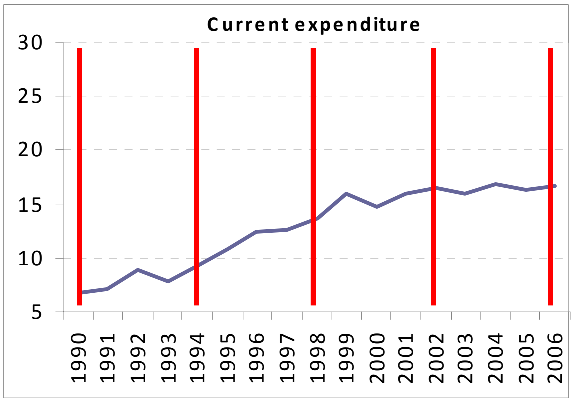

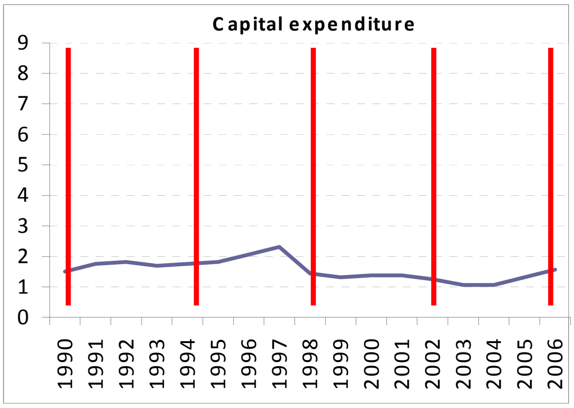

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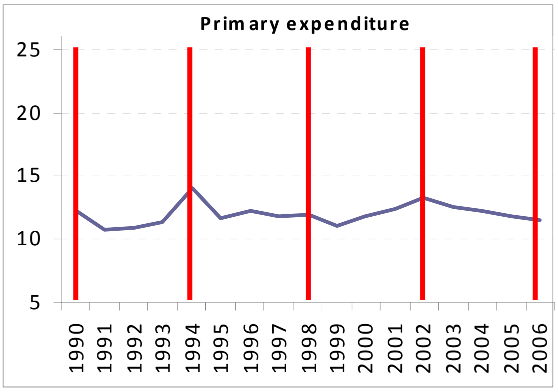
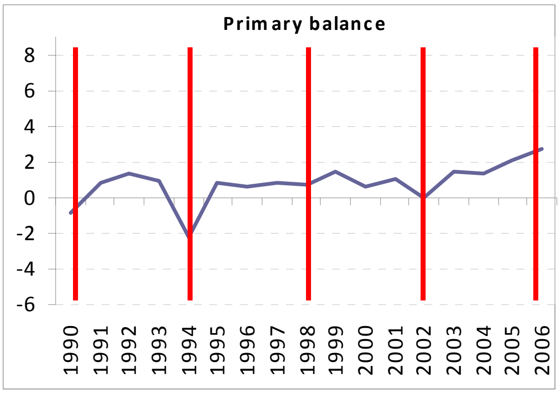
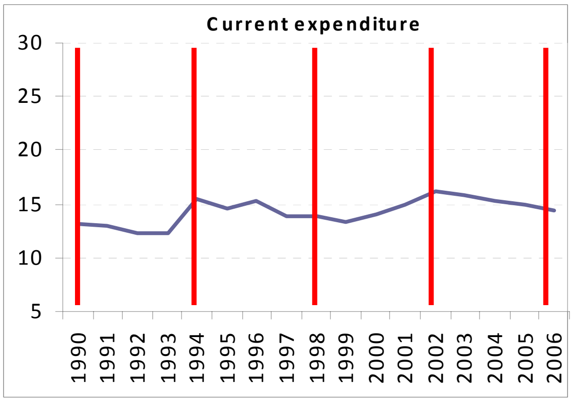
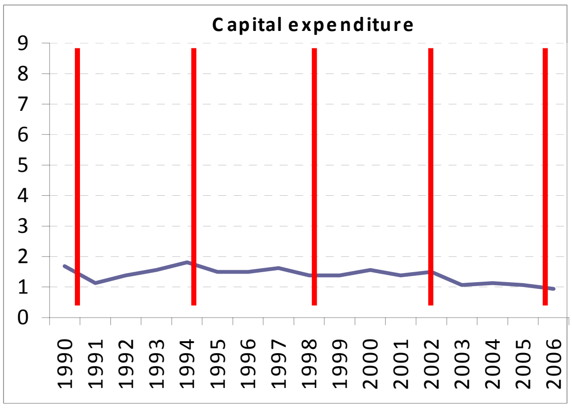
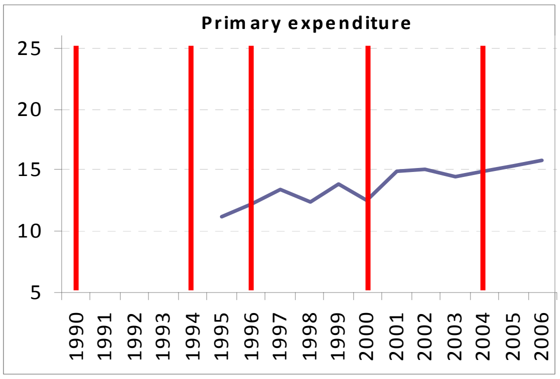


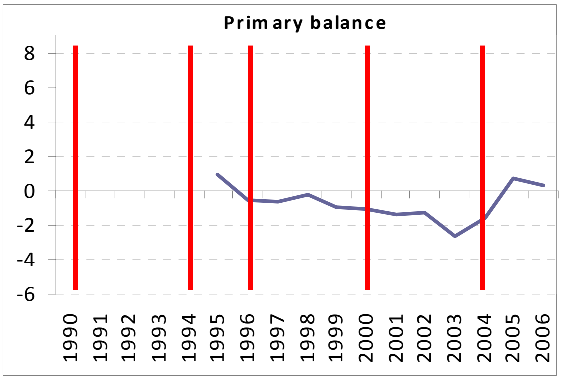


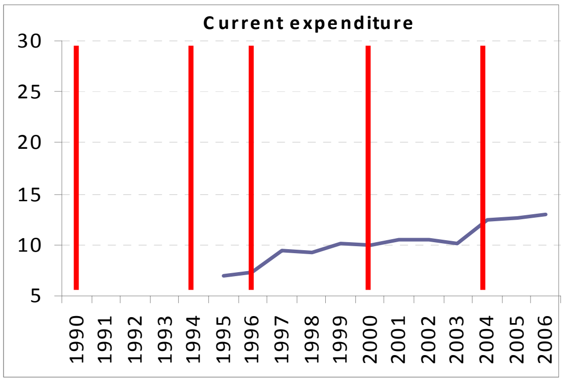


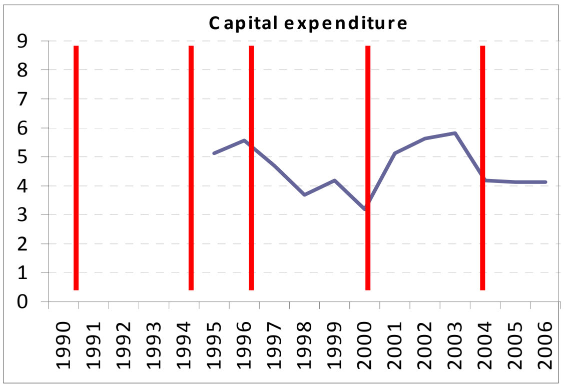


Dominican Republic









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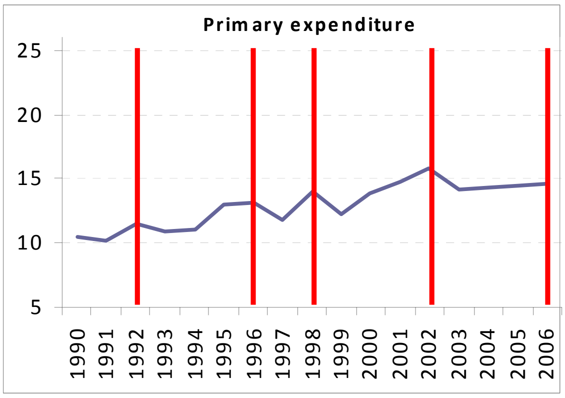

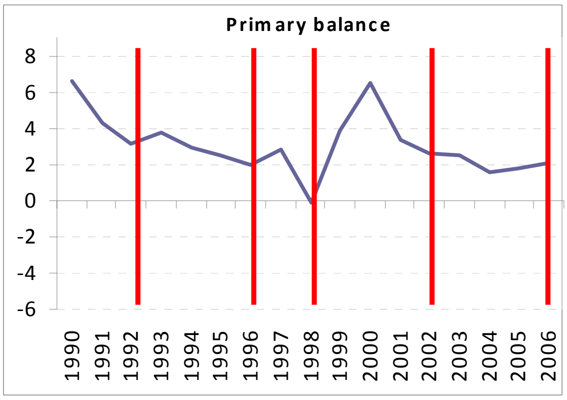

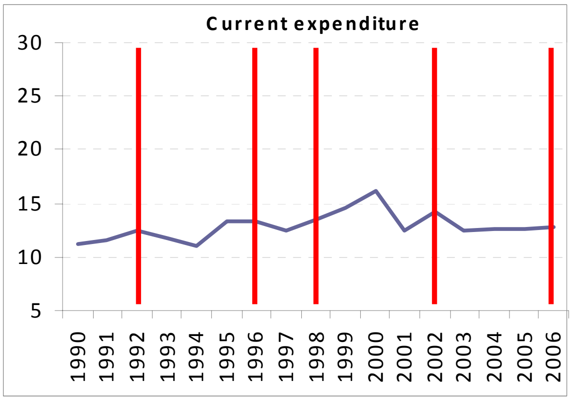

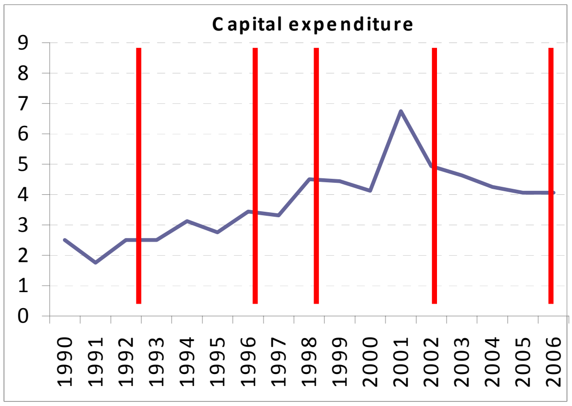

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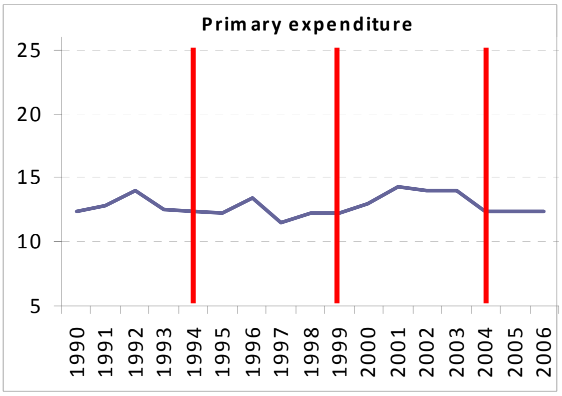

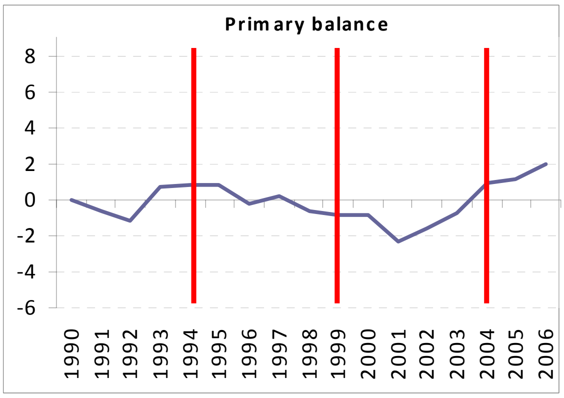

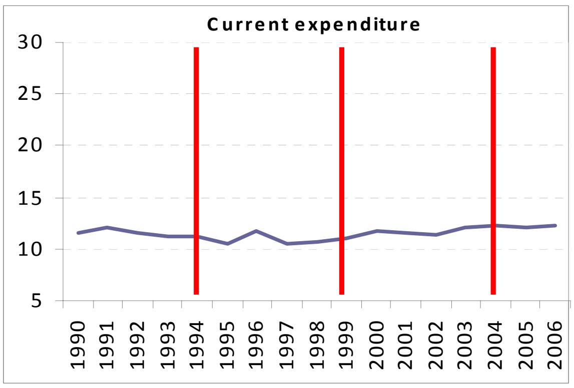

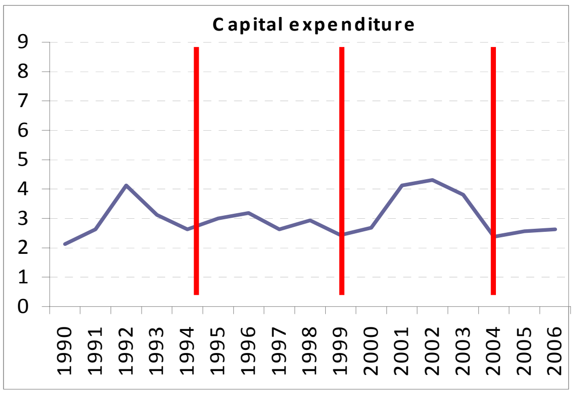

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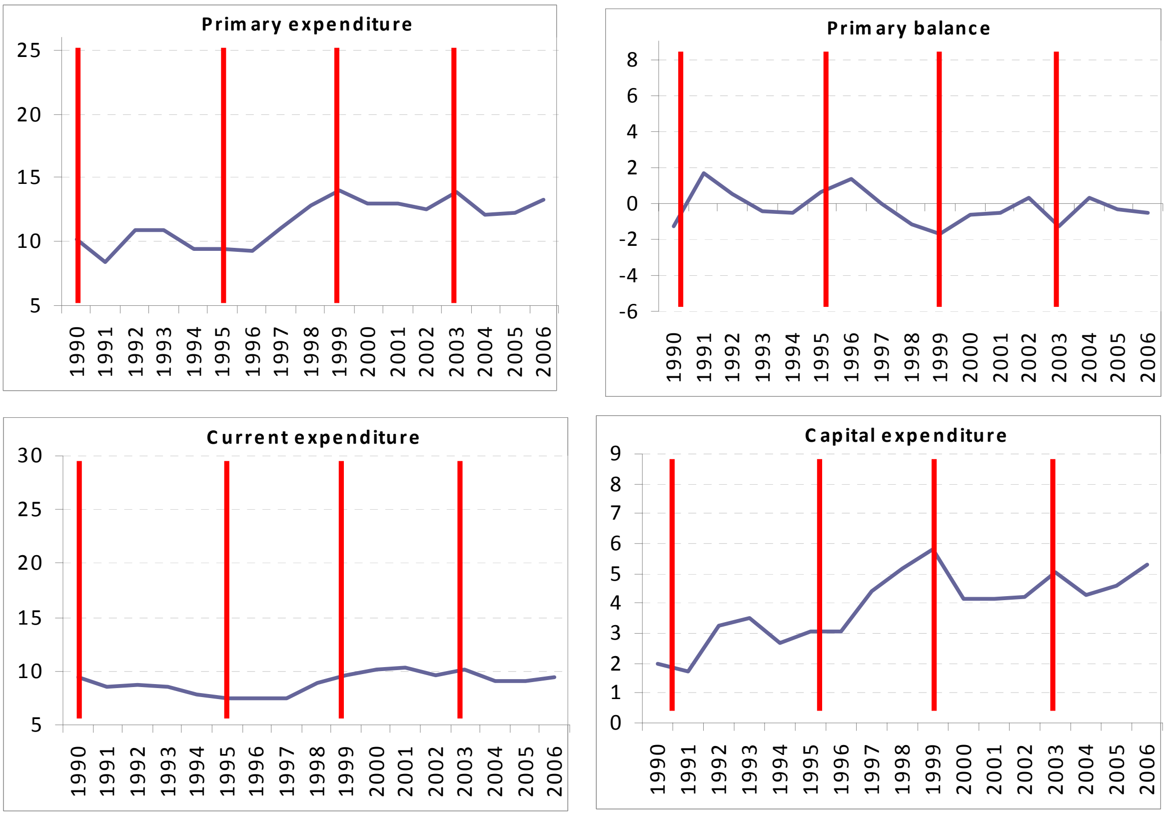
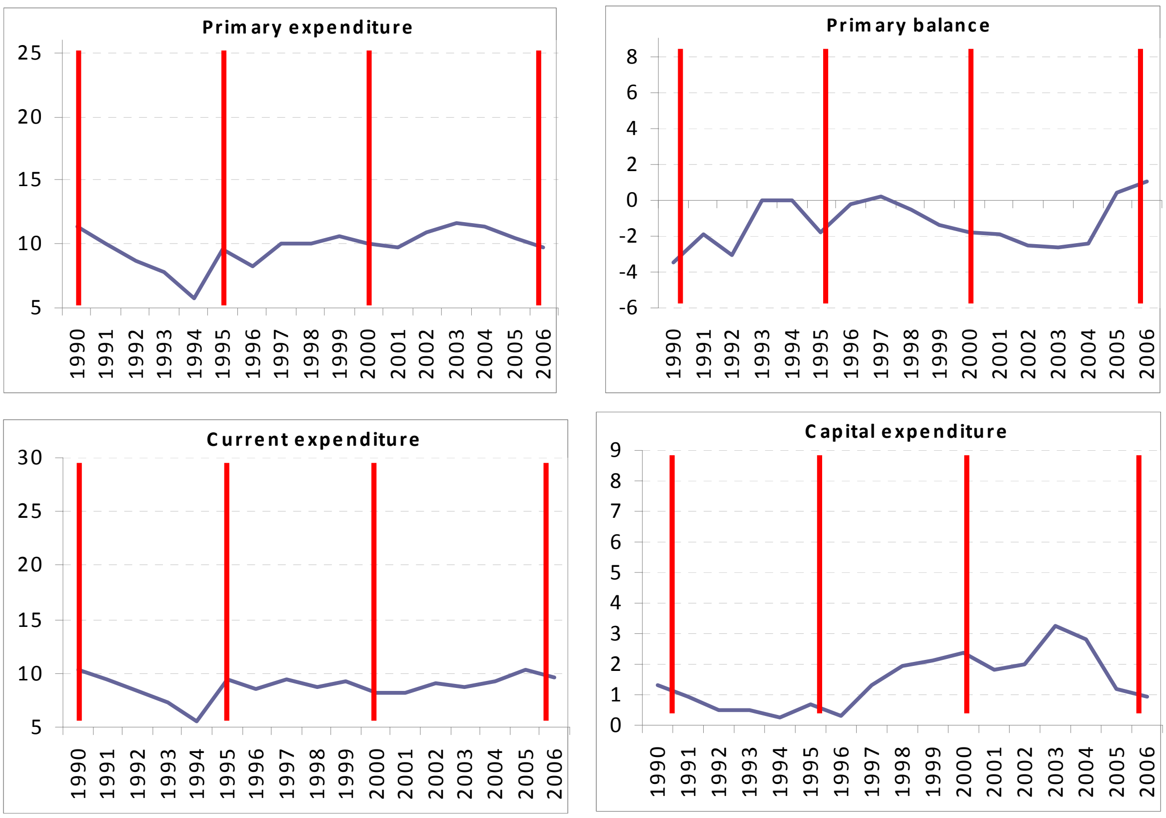


Haiti



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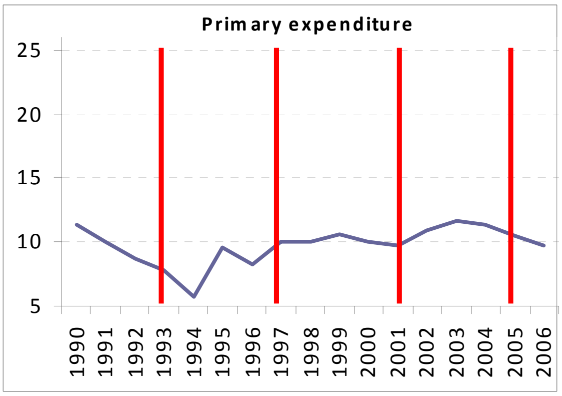

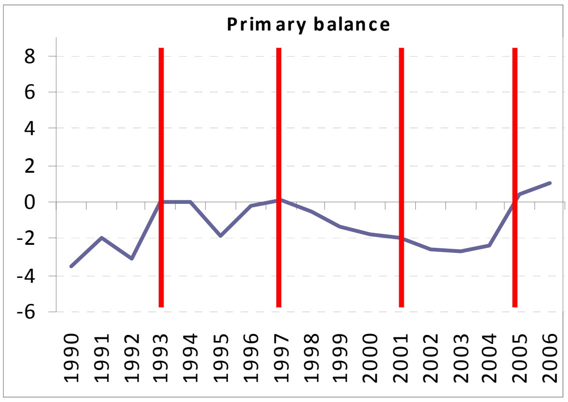

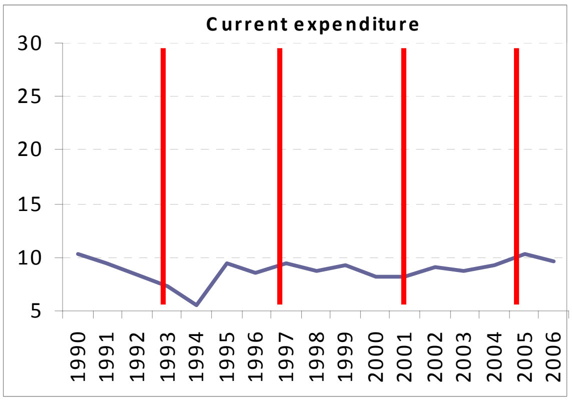

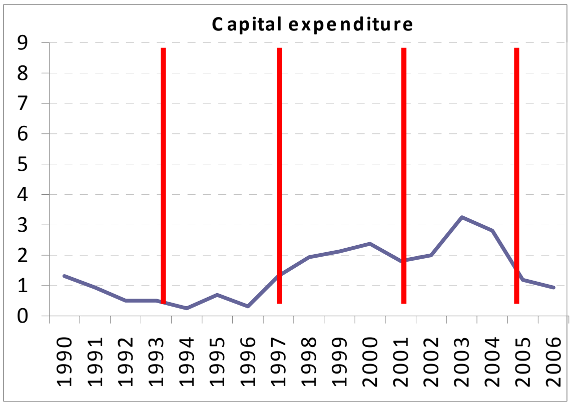

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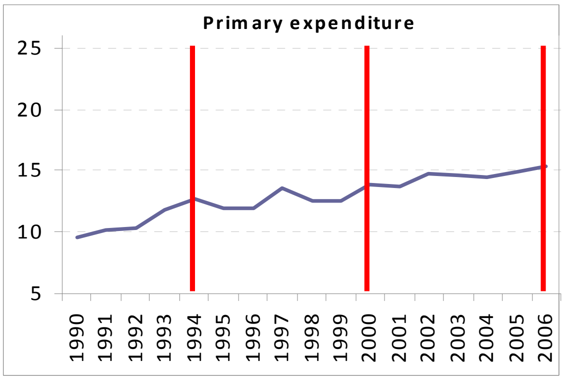
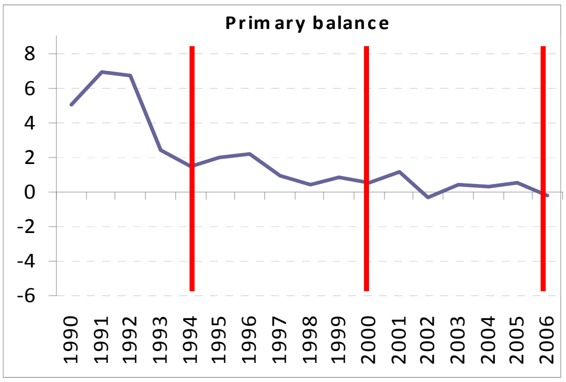
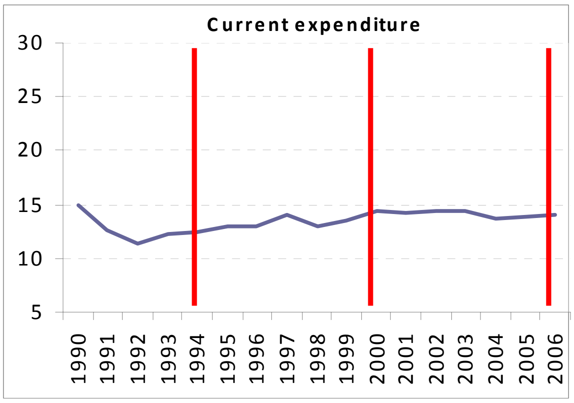
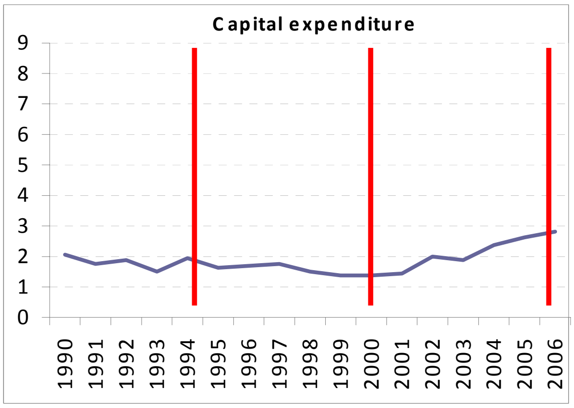
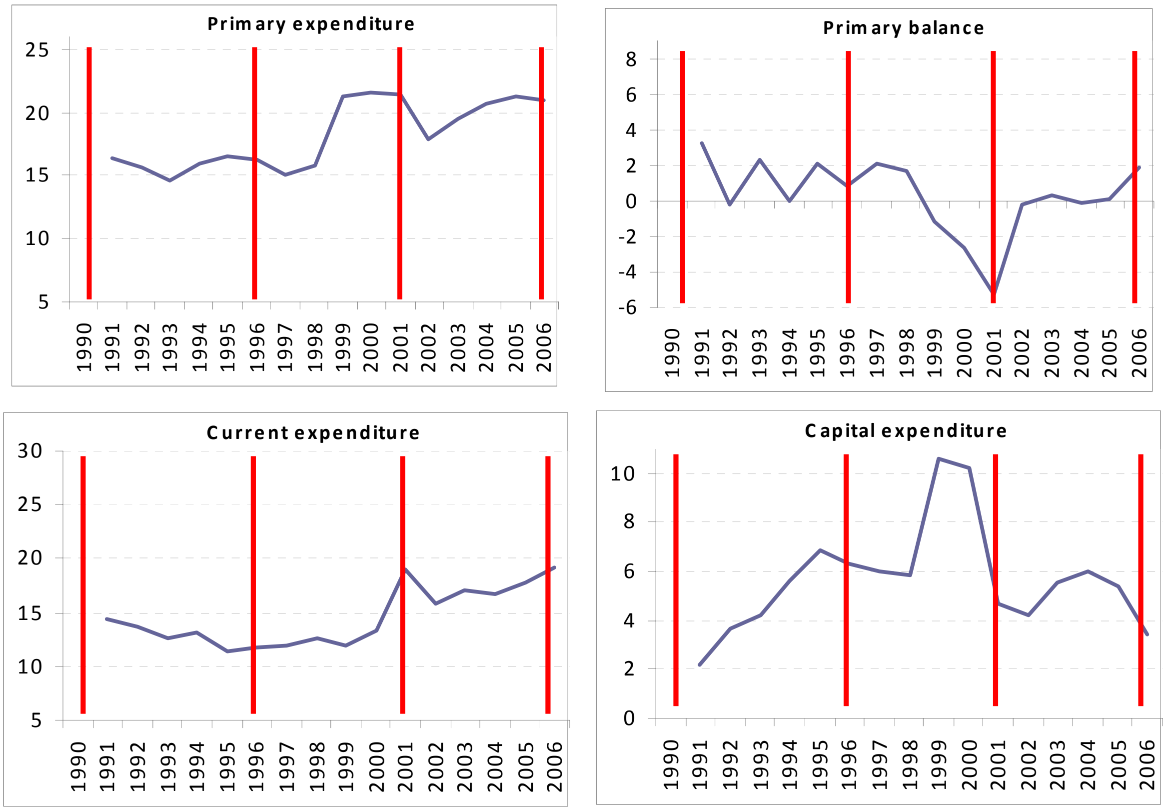






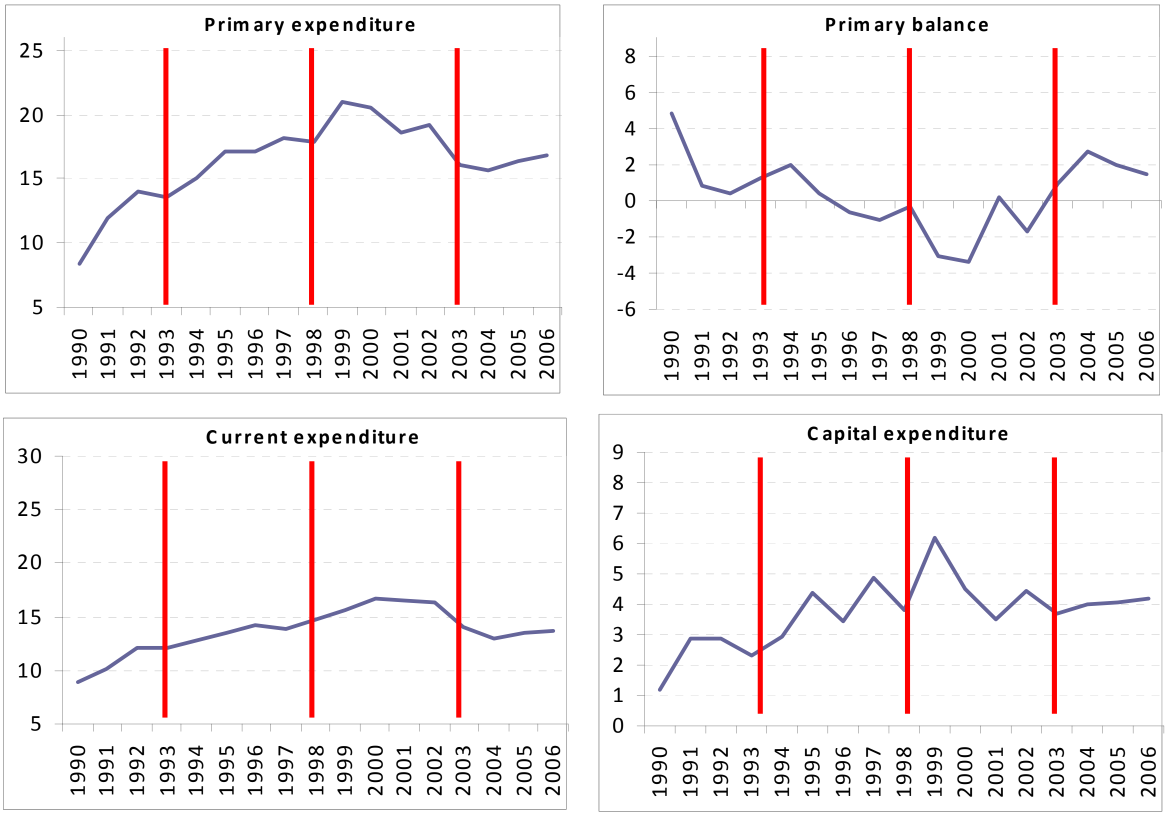


Nicaragua

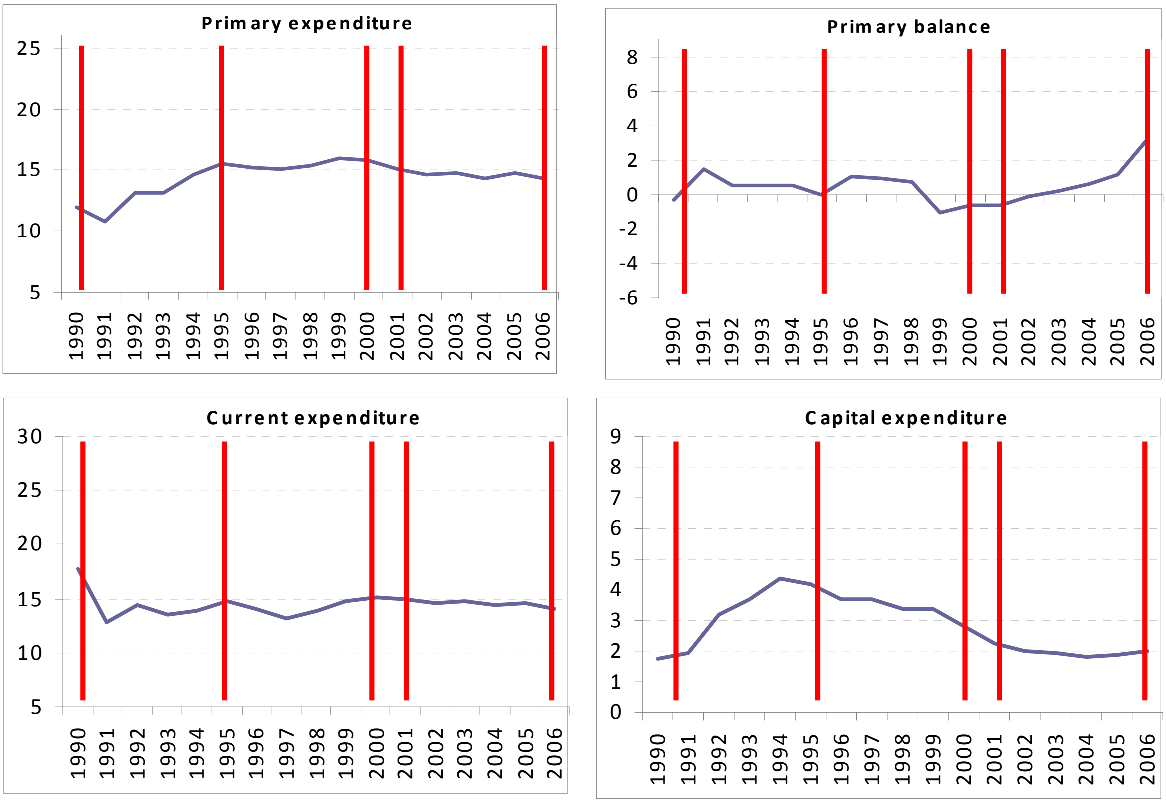


Panama

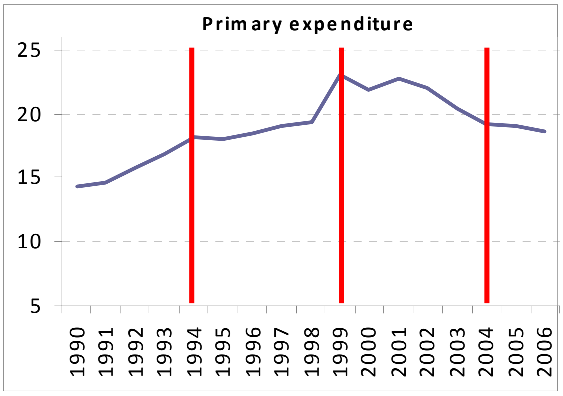
Paraguay

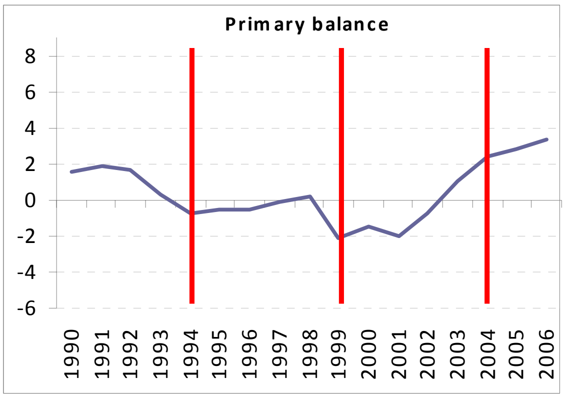


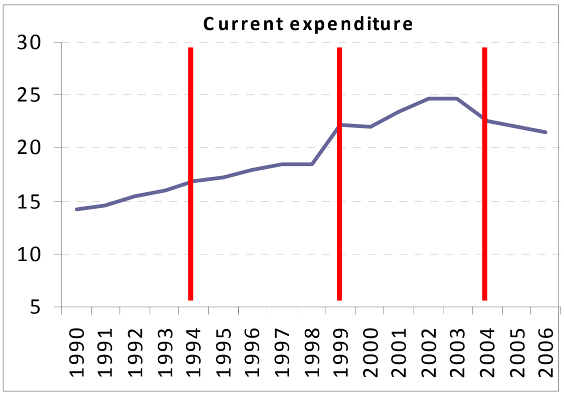
Peru

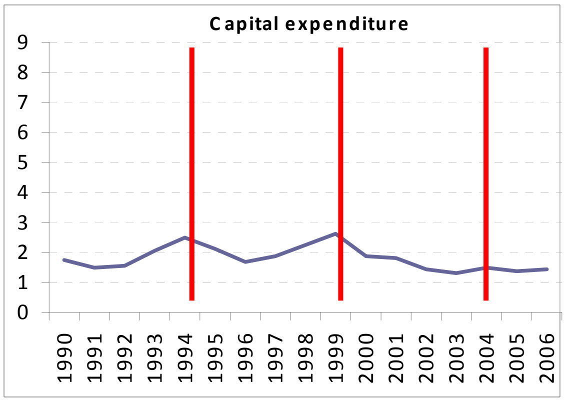


Uruguay









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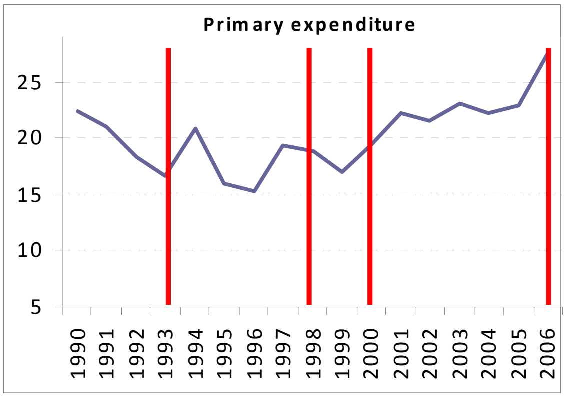

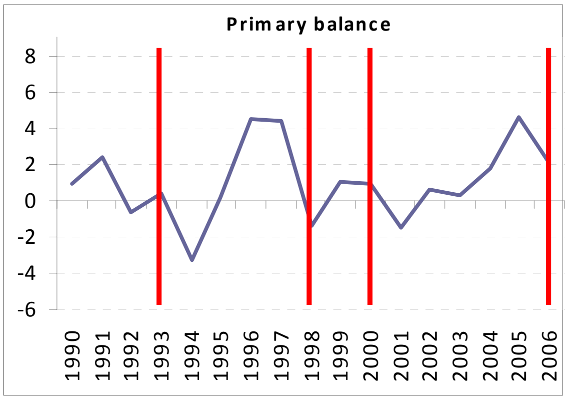

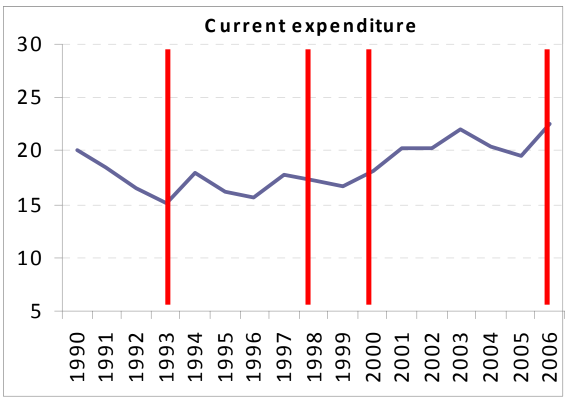

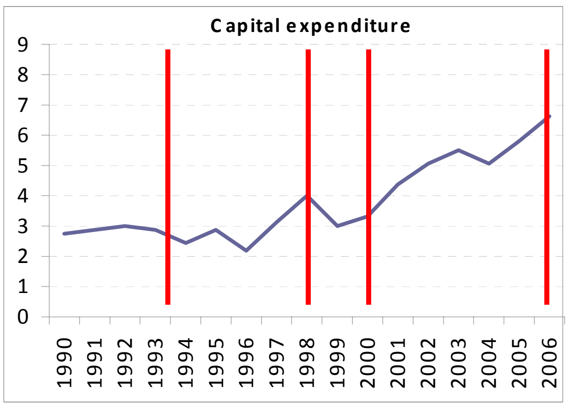

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