

Why is Economic Policy Different in New Democracies?

Affecting Attitudes About Democracy*

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This Draft: March 9, 2007

Abstract

When democracy is new, it is often fragile and not fully consolidated. We investigate how the danger of a collapse of democracy may affect fiscal policy in comparison to countries where democracy is older and often more established. We argue that the attitude of the citizenry towards democracy is important in preventing democratic collapse and expenditures may therefore be used to convince them that “democracy works”. This contrast with much of the literature that concentrates on policy directed towards anti-democratic elites. We consider the inference problem that citizens solve in looking at economic outcomes and forming their beliefs about the efficacy of democracy. We argue that the implications of the model are broadly consistent with the empirical patterns generally observed, including the existence of political budget cycles at the aggregate level in new democracies that are not observed in old democracies.

JEL classification: D72, H30, P16

Keywords: democratic consolidation, transition, fiscal policy, elites, citizens

*We thank Peter Murrell, Razvan Vlaicu, and seminar participants at at George Mason University, George Washington University, and the University of Maryland for helpful comments. Amir Marchak, Lior Gallo and Sagie Dagan for superb research assistance.

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1 Introduction

The 1990s saw a wave of democratization (Huntington's [1993] "third wave") as numerous countries moved from non-democratic to democratic regimes. These new democracies faced many challenges, among which were coping with the large structural changes that accompanied the change in political regime. Surely one of the largest challenges these new democracies faced was the possible fragility of the new regime and the need to consolidate democracy itself. Whereas "established" democracies can (and do) take the stability of basic political structures for granted, such is not the case in countries where democracy is a new (or even a "renewed") phenomenon, where the survival of the new political institutions is far from guaranteed.

Fragility or lack of consolidation of democracy refers to a situation in which some crucial political groups, including perhaps the general public, lack full commitment to the democratic process. Such a lack of widespread commitment to democracy makes it more vulnerable to anti-democratic elites. As Linz and Stepan (1996, p.5) put it, consolidation refers to

a political situation in which, in a phrase, democracy has become 'the only game in town.' Behaviorally, democracy becomes the only game in town when no significant political groups seriously attempt to overthrow the democratic regime . . .

The fragility of democracy in countries that have recently made the transition to democracy raises an obvious question for economists: *What economic policies can a government choose to try to help consolidate democracy?* We find it useful, following the literature¹, to organize our discussion around class interests, concentrating on the "elites" versus the "masses". Hence the question of what policies should be followed in consolidating democracy becomes, as in many political economy questions, one of whose interests should be addressed.

A standard view of the problem of democratic fragility is that the threat to democracy comes from anti-democratic elites – the army, groups such as the wealthy who benefitted most under the old regime, the "oligarchs". These are the groups who are seen as basically anti-democratic and who have the power to overthrow the new democratic regime. Focussing on the elites leads to a simple answer to the basic question posed above. Democratic consolidation requires economic policies that induce the anti-democratic elites not to overthrow democracy. That is, economic policy consistent with democracy must placate the elites, or, colloquially but not inaccurately, to "buy them off."

The best worked-out example of this is in a recent book by Acemoglu and Robinson (2005)

In building our theory of coups, we will emphasize the same economic and political incentives that featured prominently in understanding the creation of democracy. So

¹Moore (1966) is the pathbreaking work on class conflict and the origin of democracy in England, France, and the United States. Rueschemeyer, Stephens, and Stephens (1992) is a key reference in putting class interest at the center of the analysis of democratization. The recent book by Acemoglu and Robinson (2005) follows in this tradition.

far we have emphasized that in democratic societies the majority of citizens are able to alter policies in their favor and against the interests of elites. This makes the citizens pro-democratic while simultaneously giving the elite an incentive to oppose democracy. ... The same basic forces will also determine the incentives for coups. Since the elite prefer nondemocracy to democracy, they may, under certain circumstances, support a coup against democracy, which would lead to policies more favorable to themselves in the future.

The key assumption here is that the citizenry is unambiguously in favor of democracy, with the implication being that policy should focus on the elites. In studying the political economy of democratic consolidation, Acemoglu and Robinson then focus on the constraints that preventing the elites from trying to overthrow democracy putt on fiscal policy.

In this paper we argue that the assumption that the citizenry unambiguously supports democracy (and the focus of analysis this assumption implies) is incomplete and hence potentially misleading. It is not consistent with the data on attitudes of citizens in new democracies. Moreover it misses a key problem that policymakers face in addressing problems of democratic consolidation in many new democracies, namely initial skepticism that democracy is appropriate (that is, that it “works”) in addressing economic problems. A challenge of policy may then be affecting public attitudes about democracy, especially at critical points of vulnerability of the democratic system, such as in the period before elections. We further argue that looking at public perceptions of democracy as one of the key challenges of policy in new democracies may help us better understand some aspects of the evolution of fiscal policy in new democracies than a sole focus on the elites. We stress that we are not saying that the arguments made by Acemoglu, Robinson, and others who focus on the elites in the consolidation process are incorrect or uninformative, but that this focus needs to be supplemented by consideration of the citizenry to better understand the policy implications of democratic fragility.

The plan of the paper is as follows. In the next section, we set out in greater detail the importance of public attitudes towards democracy in the consolidation process. In section 3 we present a formal model concentrating on the importance of affecting public perceptions of democracy and derive some implications for both the timing and magnitude of fiscal policy actions in new democracies. Specifically, government spending and deficits will increase in times of democratic vulnerability and this increase may be quite substantial, depending on underlying parameter values. Section 4 presents evidence on fiscal policy consistent with the focus on affecting public attitudes. Among other things, we show that election years are points of democratic vulnerability, so that the democratic consolidation could imply a political budget cycle, but not because they help incumbents get re-elected (which other research of ours suggest they do not). We therefore suggest that problems of democratic consolidation may shed light on the empirical finding of Brender and Drazen (2005a)

that political budget cycles are a phenomenon of new democracies but not established ones, but that increases in election-year deficits do not appear to help incumbents get re-elected. We also consider the composition of large election-year expenditure increases to argue that they are not directed solely at elites. Section 5 presents conclusions.

2 Democratic Consolidation and Public Perception of Democracy

2.1 The importance of the citizenry in the survival of democracy

Our argument on importance of the citizenry is that their attitudes towards the new democratic system may be crucial in determining whether democracy withstands anti-democratic pressure and survives. Though anti-democratic elites may have the *interest* in overthrowing democracy, their *ability* to do so depends on the attitudes of the citizenry to democracy. Anti-democratic elites may be generally unable to successfully overthrow democracy without support from the citizenry (if only their lack of active opposition to reversion). Or, public unrest and dissatisfaction may provide the pretext for military intervention, supported by anti-democratic elites, to overthrow democracy and “restore order”. The classic case in which lack of public commitment to democracy played a major role in its collapse is the Weimar Republic, but it is not the only example where public attitudes were important.²

This perhaps simple observation, when combined with the possibility that the masses may not be unambiguously convinced of the value of democracy, implies a quite significant change in how one should think about the use of economic policy to ensure the survival of democracy. It is no longer the case that policy should be aimed simply at “buying off” the elites. If some degree of support from citizens is crucial to the overthrow of democracy, policy must also be aimed at ensuring their support for democracy, thus making a coup and a democratic collapse less likely or perhaps impossible.

This approach thus forces a reconsideration of the assumption that the interest of the masses is unambiguously in favor of democracy. Conditional (rather than unconditional) support on the part of the citizenry is consistent with the focus in the literature on the importance of *public attitudes* about the efficacy of democracy.³ Efficacy clearly has economic dimensions and if citizens do not believe that democracy is able to solve economic problems, this may be fatal for democracy. In new democracies the efficiency of the new political system, and not just its legitimacy, becomes a crucial issue. As Linz and Stepan (p. 80) put it

²Bermeo (1993) offers a large number of case studies, both where public support was a major factor and where it was less so.

³See, for example, the wide-ranging survey of Linz and Stepan (1996).

The key question for the democracies is whether their citizens believe that, in the circumstances, the democratic government is doing a credible job in trying to overcome economic problems. It is important to stress that the political economy of legitimacy will produce severe and perhaps insoluble challenges to democratic consolidation in those cases where the democratic system itself is judged to be incapable of producing a program to overcome the economic crisis.

While belief in efficacy by the citizens is crucial, beliefs can change over time. In summarizing the experience of the new democracies of Southern Europe, Linz and Stepan write (p. 144)

... the overwhelming majority of consolidated democracies did not actually begin their transition to democracy with a majority of members of the polity or even many of the key agents of the transition being either convinced democrats or citizens who rejected everything about the past regime. Rather, a democratic majority emerges *when elites and ordinary citizens alike* begin to evaluate, for the societal problems they then face and the overall world within which they then live, that democratic procedures of conflict regulation are better or less dangerous than any other form of governance. Thus, for many key elites democratic behavior emerges before democratic attitudes because elites may make the calculation that breaking the democratic rules of the game – whether they like them or not – will not yield a positive outcome for their interests. Democracy becomes the “only game in town” partly by belief and partly by elite calculation of the cost of compliance versus the cost of mobilization for other governing alternatives. (italics ours)

Note further that the transition to democracy is often associated with large structural changes in the economy. This was particularly noticeable in the formerly socialist economies of Eastern Europe but also in Southern Europe and in some Latin American countries. The twin transitions may thus imply an especially great need to show that the economic system functions under the new arrangements. (In order to concentrate on the fiscal implications of showing that democracy works, in our modeling we abstract away from any *direct* effect of the economic transition on fiscal policy.)

2.2 Evidence on public attitudes

Recent data from the World Values Survey (Inglehart, 2004) support the view that ordinary citizens in new democracies are not unconditional supporters of democracy. We tabulated differences in the responses between new and old democracies (as defined in Brender and Drazen [2005a]) and after controlling for characteristics such as per-capita income and the age-structure of the population, investigated what significant differences remained in answers to the survey questions. These results from equations based on the mean values for each country are summarized in Table 1. We note three differences between the responses in new and old democracies that we think should be reflected in the modeling of why policy in new democracies may be different than in established democracies. In new democracies: 1) democracy is less consolidated; 2) people appear to be more tolerant of manipulation; and, 3) people care more about good economic performance. (This last difference is consistent with the empirical work in Brender and Drazen [2005b] on the stronger effect of economic growth on re-election probabilities in new versus old democracies.) Our main point here is the first, but the second and third suggest how policy may be used to consolidate democracy.

These results are confirmed in Table 1A where we estimate similar equations at the individual level, looking for differences between individuals who live in new and old democracies. In addition to country characteristics we also control in these equations for various individual characteristics such as age, gender, the individual's income level in his country and religion.

[Put Tables 1 and 1A Here]

Other studies find a relation between economic performance and regime survival. Basically, the survival of new democracies is seen to be quite sensitive to economic performance. Przeworski, et al.(2000) find empirically that better growth performance makes a democracy more likely to survive, while poor economic performance makes both presidential and parliamentary systems more vulnerable. Bernhard, Reenock, and Nordstrom, (2003) find this to be true especially prior to the third legislative election. Many other authors make similar observations (see, for example, Linz and Stepan [1978] or Remmer [1996].)⁴

2.3 Information about policies

We also note that there was *no* significant difference between new and old democracies in the World Values Survey in responses on people's exposure to politics or news at the country level, as seen in Table 1 (though there may be less "fiscal content" in the news). In fact, the results at the individual level in Table 1A suggest that people in new democracies tend to follow politics in the media more than those in old ones. The similarity in the exposure to politics and news does not however mean, in our opinion, similar information about how well the economy works – in fact, such a difference is crucial to our approach. We argue that the difference is in the quality of information individuals receive, rather than in their exposure to or interest in the news.⁵

To make this idea more concrete, we argue that in new democracies, citizens have less information about fiscal outcomes, as well as less understanding of the political process generating fiscal policy. This would reflect experience with the electoral process by voters, the establishment of the institutions that would collect and provide the relevant data, and experience by media in disseminating and analyzing this information. The combination of limited experience with democracy and limited fiscal information make it more difficult for citizens in new democracies to see through fiscal policies meant to convince them democracy is working.

⁴It is often argued that the survival of *authoritarian* regimes is also sensitive, perhaps even more so, to perceptions of their ability to deliver good economic performance. This observation in no way invalidates the sensitivity of democratic regimes to economic performance, our subject of interest.

⁵Brender (2003) shows that the development of information sources about fiscal performance and the means to deliver them to the public had a substantial effect on the response of citizens to such information.

We want to stress quite strongly that in our approach fragility alone is not sufficient to explain the use of fiscal policy to affect attitudes about democracy; it is the combination of fragility and newness that is key to political deficit cycles in new democracies. Newness implies incomplete information about how the economic system will function under democracy (and how democracy itself works). Hence, running deficits to pay salaries to government workers (for example), that is, to strengthen the public's perception of a well-functioning system, will not be identified as manipulation as easily as when voters have more experience with democracy and "election-year" economics. As voters gain more experience with the democratic system and as information improves, using fiscal policy to "grease the wheels" of the economic system may be increasingly less effective in affecting voter perceptions, and hence may be less likely to occur. That is, an "old" democracy may be fragile, but the public's experience means that fiscal manipulation will be seen as such and hence be ineffective.

The distinction between newness and fragility of democracy leads to another distinction, namely between use of fiscal policy in critical periods to try to show that the system works and genuine reform. The general view is that new democracies can survive social strife and economic instability for some years, but are likely to break down in the medium to long run unless they can address problems of poverty and inequality through reforms that provide the basis for sustainable growth. Our focus on the role of fiscal policy in reducing the vulnerability of democracy to breakdown should not be read as contradicting this view. Quite the contrary. Our argument is applied to new democracies, rather than any fragile democracy, precisely because we believe that such policies can only be effective when the democratic regime is young, after which fiscal manipulation will be seen as such and hence will not reduce (and may well increase) the vulnerability of democracy to breakdown. In this paper our motivation is positive, not normative, in exploring the implications of newness for fiscal policy. Expenditures to show the system works are not a substitute for true reform; they may be a temporary attempt to bridge a particularly crucial breakpoint of democracy.

3 A Framework of Analysis

We now turn to modeling the relation between fiscal policy and fragility of democracy. We ask how fiscal policy may differ in new than established democracies because democracy is not fully consolidated when democracy is new. We focus on the effect of economic policy on support for democracy is via the *probability* that citizens or elites assign to democracy being superior to non-democracy, rather than on the utility they associate with one system or the other. That is, we view the key problem that citizens face as an inference problem of deciding whether democracy "works",

depending on their observation of economic outcomes. Government expenditures can therefore increase public support for democracy primarily by inducing citizens to increase the probability they assign to democracy “working” (in short, is “good”). This does not mean that citizens have not formed beliefs about democracy but that, given their attitudes, their willingness to support (defend) democracy would depend on their perception of its ability to deliver a functioning economy in the particular country.

We consider a simple two-period framework in which the periods differ in the vulnerability of democracy to collapse, embedded in a multiperiod framework. (Based on data on the incidence of democratic collapse in new democracies, we will subsequently consider election years as periods of highest vulnerability.) By “embedded”, we mean that in each period there is a continuation value depending on whether or not democracy survives. The government budget must be balanced over the two periods. The government has two types of expenditure – spending on items that will affect public perception of democracy, denoted h_t and spending on items that will affect a citizen’s utility in period t directly, denoted g_t . Though these are not always mutually exclusive (the government paying salaries on time, for example, will have both effects), for clarity of exposition, we assume that they are. There is an election at the end of the first period, but for clarity of exposition, it is assumed that there are no “standard electoral motives” that would influence fiscal policy. (Specifically, it is assumed that the incumbent cannot influence the probability that he wins re-election in a regular competitive election via fiscal policy.)

The sequence of events in a period is as follows. The government chooses g_t and h_t , after which an event Z_t is realized. The probability of a good outcome is increasing in h , though citizens in new democracies are unaware of this connection, due to their lack of experience with democracy and imperfect information about fiscal policy. On the basis of this event, citizens update their beliefs about the efficacy or appropriateness of democracy, as summarized by a common posterior probability P_t that democracy is “good” for economic outcomes. Given the distribution of utilities associated with their perceptions of democracy and autocracy in the population, the probability P_t induces support for democracy by a fraction ϕ_t of the citizenry, where ϕ is increasing in P . In the first period an election is held. Based on ϕ_t , anti-democratic elites whether to stage a coup, where the likelihood of a coup succeeding is decreasing in ϕ_t . (This will imply that the probability σ_t of survival of democracy is increasing in ϕ_t , including the case where ϕ_t is high enough that no coup is even attempted.) If democracy survives, a similar set of decisions is made in the second period. If not, the economy remains as a non-democracy in the second period.

3.1 Citizens' Perceptions of Democracy

3.1.1 Individual utility

We assume that citizens differ from one another in the utility they assign to different regimes, that is, when they perceive democracy as superior to nondemocracy (“good” for outcomes), to it being inferior to the (previous) non-democratic regime (“bad” for outcomes), and in the utility they associate with a reversion to nondemocracy. For modeling simplicity, we assume that all citizens are influenced by the same expenditures in forming their inferences about democracy. In practice, different citizens will be affected by different programs. This may reflect numerous factors – geographic differences, rural versus urban allocations, and the socioeconomic, demographic, and ethnic distribution of the population. Since our basic argument may be illustrated using only a single type of expenditure, we abstract from this for now, but return to the conceptual point in section 3.4.2 below.

A citizen i 's perceived utility under democracy in any period t may be written

$$U^i(g_t, h_t) \equiv \sigma_t(h_t) [P_t(h_t) V_t^{Gi}(g_t) + (1 - P_t(h_t)) V_t^{Bi}(g_t)] + (1 - \sigma) V_t^{Ai} \quad (1)$$

where

σ_t = probability that democracy survives in period t

V_t^{Gi} = i 's expected welfare under democracy in t if he perceives democracy is good for outcomes;

V_t^{Bi} = i 's expected welfare under democracy in t if he perceives democracy is bad for outcomes;

V_t^{Ai} = i 's expected welfare under autocracy (non-democracy);

P_t = probability that citizens assign to democracy being good for good *based on* outcomes in t .

The dependence of σ and P on h will be discussed below. Perceived utility over both periods is $U^i(g_1, h_1) + U^i(g_2, h_2)$, where for simplicity the discount factor is assumed equal to unity.

3.1.2 The decision rule

A citizen's only decision is whether or not to support democracy. Non-support may take many forms: not voting; demonstrating against democracy or the government; not opposing coup attempts, or even general civil unrest induced by skepticism about the political and economic regime.

Citizen i supports democracy in t if and only if

$$P_t V_t^{Gi}(g_t) + (1 - P_t) V_t^{Bi}(g_t) \geq V_t^{Ai} \quad (2)$$

The crucial, but reasonable assumption is that $V^{Gi} > V^{Ai} > V^{Bi}$ for some citizens i . (If $V^{Bi} \geq V^{Ai}$, then a citizen supports democracy for sure for any value of P . If this holds for all i , then all citizen support democracy no matter what is inferred about P , so that democracy is fully consolidated.)

Equation (2) with equality defines a critical value \hat{P}_t^i for citizen i such that he supports democracy in t if

$$P_t \geq \hat{P}_t^i \equiv \frac{V_t^{Ai} - V_t^{Bi}}{V_t^{Gi} - V_t^{Bi}} \quad (3)$$

and does not support if $P_t < \hat{P}_t^i$. We note the possibility that the values of V_t^{Gi} , V_t^{Ai} , and V_t^{Bi} may evolve over time as people become more experienced with democracy. Specifically if V_t^{Gi} is rising as a democracy matures while V_t^{Ai} is falling for all individuals, then the citizen-specific critical value \hat{P}_t^i will fall over time, so that support for democracy will rise over time for any inferred P_t . We return to this point below.

3.1.3 The basic inference problem for P

Since citizens update their prior on the unobserved efficacy of democracy on the basis of observed economic outcomes, a natural framework is to use Bayesian updating. Suppose that individuals form the posterior $P_t(\cdot)$ that democracy is good for outcomes on the basis of observed economic performance (“salaries and allowances are paid”, “electricity works”, etc.) and their prior using Bayes’ rule.⁶ We consider a simple “2x2” example, but this can be easily extended to multiple outcomes or levels of democracy.

Consider an “event” Z_t that can have two outcomes: $Z_t = S$ consistent with democracy “working” or $Z_t = X$ consistent with democracy “not working”. Let $\gamma_t = \Pr(Z_t = S | \text{democracy is “good”})$ and $\beta_t = \Pr(Z_t = S | \text{democracy is “bad”})$, where $\gamma > \beta$. Let $\pi_t =$ prior in period t that democracy is “good” prior to observing the event S or X . The posterior $P_t(Z_t)$ that democracy is good conditional on the observed outcome may then be written:

$$P_t(Z_t = S) = \frac{\pi_t \gamma_t}{\pi_t \gamma_t + (1 - \pi_t) \beta_t} \quad (4a)$$

$$P_t(Z_t = X) = \frac{\pi_t (1 - \gamma_t)}{\pi_t (1 - \gamma_t) + (1 - \pi_t) (1 - \beta_t)} \quad (4b)$$

We interpret “events” or “outcomes” not simply as general macroeconomic outcomes, but as specific events, such as government meeting its financial obligations.

Equations (4) have a number of implications, which we summarize in

PROPOSITION 1 Relation of perceptions of democracy to observed outcomes:

In an unconsolidated democracy ($\pi < 1$) a bad outcome will lower the posterior probability P that citizens assign to democracy being good for outcomes, while a good outcome will have the opposite effect. In an established democracy ($\pi = 1$), outcomes have no effect on perceptions of or support for democracy.

⁶Note the discussion on the applicability of Bayes’ rule in section 3.3.2.

Proof: The effect of a good or bad outcome on P follows from (4) as long as $\gamma > \beta$, which follows from the definition of γ and β . The lack of effect of outcomes on P when $\pi = 1$ is obvious from (4). ■

This is the essence of the individual inference problem which will play a key role in determining government's choice of fiscal policy in a new democracy.

3.1.4 Public support for democracy

The common value P_t can then be translated into support for democracy in the population as a whole. The distribution of values of V_t^{Gi} , V_t^{Bi} , and V_t^{Ai} in the population induces a distribution of \hat{P}_t^i via equation (3). Denote the CDF of \hat{P}_t^i by $F(\hat{P}_t^i, t)$. The time argument in $F(\cdot)$ is meant to represent the possible shift in the distribution due to a shift in the distributions of V_t^{Gi} , V_t^{Bi} , and V_t^{Ai} , as discussed in section 3.1.2 above. For future use we denote by V_t^G , V_t^B , and V_t^A as population averages of the individual utility indicators V_t^{Gi} , V_t^{Bi} , and V_t^{Ai} .

The fraction of citizens ϕ_t who support democracy at t for a value P_t is then simply

$$\phi_t \equiv F(P_t, t) \tag{5}$$

that is, the fraction of citizens with $\hat{P}_t^i \leq P_t$. The key observation here is that the higher is P_t for any $F(\cdot)$, the greater is the fraction ϕ_t of citizens who support democracy.

3.2 Survival of Democracy

How is citizen support of democracy connected to democratic survival? It seems natural to argue that the probability that democracy survives at any point in time, call it σ_t , is increasing in the fraction ϕ of citizens who support democracy. It would be nonsensical to argue that the chances of democratic survival are decreasing in ϕ . Hence, the essential point is that the probability that democracy survives, that is, that there is not a reversion to autocracy, is *not independent* of public support for democracy. This may seem obvious as well, though focussing solely on anti-democratic elites in discussing problems of democratic consolidation implicitly assumes that public support for democracy is not an important factor.

3.2.1 Anti-Democratic Elites

To make the argument more specific, we consider an antidemocratic elite, which will attempt to overthrow democracy if it believes such an attempt is in its interest. What stops the elite from attempting to overthrow democracy is the perception of low probability of success (and high cost of failure), where probability of success is inversely related to ϕ , the fraction of the public who support

democracy.⁷ Hence, democracy survives if the elite finds it preferable not to attempt to overthrow it when comparing the expected costs and benefits of trying to overthrow it, or when a attempted coup is unsuccessful.

More formally, consider the decision problem of the elites. Denote by ξ_t the probability of successful overthrow in period t , where

$$\xi_t = \xi(\phi_t, t) \quad (6)$$

where $\frac{\partial \xi}{\partial \phi} < 0$, $\lim_{\phi \rightarrow 0} \xi(\cdot) = 1$ and $\lim_{\phi \rightarrow 1} \xi(\cdot) = 0$. The time argument in the function $\xi(\cdot)$ reflects our argument that the threat to democracy for a given value of ϕ , need not be identical at all points in time. This is a simple representation of our point above that the vulnerability of democracy will vary over time.

The elite support democracy at t if and only if

$$W_t^D \geq \xi(\phi_t, t) W_t^A + (1 - \xi(\phi_t, t)) W_t^{FC} \quad (7)$$

where

W^D = welfare of elite under democracy⁸

W^A = welfare of elite under nondemocracy (“autocracy”)

W^{FC} = welfare of elite with failed coup.

We assume that $W^A > W^D$ (for any feasible policies followed by a democratic government), so that if the anti-democratic elite was sufficiently sure that it could overthrow democracy ($\xi \rightarrow 1$), it would always find it optimal to do so. We also assume that $W^D \gg W^{FC}$, representing the great cost to the elite of a failed coup.

Equation (7) is the key constraint a government must satisfy if it is to prevent an attempt to overthrow democracy.⁹ We may summarize this in:

PROPOSITION 2 Survival of Democracy Condition:

No coup will be attempted if and only if there is sufficient public support for democracy, that is,

$$\phi_t \geq \hat{\phi}_t \equiv \xi(\cdot, t)^{(-1)} \left(\frac{W^D - W^{FC}}{W^A - W^{FC}} \right) \quad (8)$$

where $\hat{\phi}_t > 0$. *If a coup is attempted, democracy survives with probability $1 - \xi(\phi_t, t)$. The probability*

⁷This argument may be made in *any* democracy, new or old, fragile or consolidated. That is, in a consolidated democracy, anti-democratic elements may have the desire to substitute a democratic system with an alternative that favors them, but realize that public support for democracy is sufficiently strong, that any attempt to do so is totally fruitless and hence is not attempted. This is fully consistent with Linz and Stepan’s ‘only game in town’ definition given in the introduction,

⁸As indicated above, we could make W^D a function of economic policy, but the assumption that fiscal policy can have only a limited effect on W^D implies that ϕ will still be the critical variable.

⁹Note that this approach allows for democracy to survive even if there is a coup attempt, as long as it fails. In reality, governments may want to buy off elites so that they make no attempt. Using policy to ensure that ϕ is high enough that a coup is not attempted would have a similar effect.

that democracy survives may then be written as

$$\sigma(\phi_t, t) = \begin{cases} 1 & \text{if } \phi_t \geq \hat{\phi}_t \\ 1 - \xi(\phi_t, t) & \text{if } \phi_t < \hat{\phi}_t \end{cases} \quad (9)$$

If for two dates s and s' , $\xi(\cdot, s') > \xi(\cdot, s)$ uniformly (that is, for all values of ϕ), then $\hat{\phi}_{s'} > \hat{\phi}_s$ and $\sigma(\cdot, s') < \sigma(\cdot, s)$ uniformly.

Proof: The condition (8) follows immediately from (7). The non-negativity of $\hat{\phi}_t$ follows from $\lim_{\phi \rightarrow 0} \xi = 1$ and $W^A > W^D$. The specification of $\sigma(\phi_t, t)$ if a coup is attempted comes simply from the definition of ξ . The probability of survival σ in (9) follows from these. The inequality condition on $\sigma(\cdot, t)$ follows from the characteristics of $\xi(\phi_t, t)$ and the definition of $\hat{\phi}_t$. ■

The function $\sigma(\phi_t, t)$ will play a central role in the analysis of government choices.

3.3 Government

3.3.1 The government budget constraint

The government is assumed to choose fiscal policy subject to an intertemporal budget constraint

$$g_1 + g_2 + h_1 + h_2 = 1 \quad (10)$$

We assume that citizens in new democracies observe neither h_t directly, nor can they infer it. This is consistent with the view (discussed further below) that in a new democracy citizens have quite imperfect information about fiscal policy, especially around election years.

3.3.2 Affecting perceptions in a new democracy

As indicated, the key characteristic of a new democracy in which democracy is not fully consolidated is that the government can devote resources to increasing the probability of a good outcome of event Z , that is, showing “democracy works”. We model this simply by assuming that the probability μ of a good economic outcome is monotonically increasing in government expenditure h . That is:

$$\mu(h_t) \equiv \Pr(Z_t = S | h_t) \quad (11)$$

(so that $\Pr(Z_t = X) = 1 - \mu(h_t)$), where $\mu'(h) > 0$.

In order for Bayes’ rule to be applicable in a citizen’s inference problem and decision rule, a crucial assumption is that citizens are unaware of the fiscal “manipulation” represented by (11). That is, the public takes its observations as representing the true process generating economic outcomes, rather than as government manipulation. This assumption is consistent with our argument that citizens in new democracies have relatively imperfect information about and understanding of fiscal

policy, as well as limited experience with “election-year economics”. (We will argue that election years are points of high democratic vulnerability and hence times of higher use of h_t .) This is also consistent with what has been argued about many new democracies after transition. Assuming that citizens attach some probability to outcomes being manipulated would complicate the modeling of the citizens’ inference problem, but not affect the basic result.

On the basis of the argument in the previous paragraph, one can use (11) to derive the probability that citizens assign to democracy being good conditional on the government’s choice of h_t . One obtains:

$$P_t(h_t) = \mu(h_t) P_t(Z_t = S) + (1 - \mu(h_t)) P_t(Z_t = X) > 0 \quad (12)$$

From (4), one has (where we suppress time subscripts)

$$P(h) = \mu(h) \frac{\pi(1-\pi)(\gamma-\beta)}{(\pi\gamma + (1-\pi)\beta)(\pi(1-\gamma) + (1-\pi)(1-\beta))} + P(Z = X) \quad (13)$$

so that $P_t(h_t)$ in (12) is monotonically increasing in h .

The dependence of P_t on h_t implies that the probability of democratic survival σ is a function of h_t via (5) and the definition of $\sigma(\phi_t, t)$ in (9). Since the CDF $F(P)$ is monotonically increasing, then σ at any date is (weakly) monotonically increasing in h . These results may be summarized in

PROPOSITION 3 Effect of fiscal policy on the survival of democracy:

The effect of fiscal policy on democratic survival may be summarized by a function $\sigma(h_t, t)$. This function is increasing in h_t for $\sigma < 1$, that is, higher h increases the probability of democracy surviving when democracy is not fully consolidated. The dependence of $\sigma(h_t, t)$ on t follows directly from the dependence of $\sigma(\phi_t, t)$ on t and has the same properties as summarized in Proposition 2.

Proof: Immediate. ■

3.3.3 The government’s objective

The incumbent government’s objective is a weighted sum of the expected value of being in office and the expected utility of the average citizen, both taken over σ_t . When democracy survives, it is assumed that the government evaluates utility as V_t^G , that is, average utility when democracy is good for outcomes (which is the belief of the government). The government’s utility in any period may then be written

$$\begin{aligned} & [\sigma(h_t, t) \chi + (1 - \sigma(h_t, t)) \psi] + \eta [\sigma(h_t, t) V_t^G(g_t) + (1 - \sigma(h_t, t)) V_t^A(g_t)] \\ & + \sigma(h_t, t) E_t \Omega_{t+1}^D + (1 - \sigma(h_t, t)) E_t \Omega_{t+1}^A \end{aligned} \quad (14)$$

where

χ = utility from holding office (“office rents”);
 ψ = an incumbent’s utility if thrown out of office in a coup;
 η = relative weight on citizens utility;
 V_t^G = utility of the representative citizen under democracy according to the government;
 V_t^A = utility of the representative citizen under autocracy;
 $E_t\Omega_{t+1}^D$ = the government’s expected continuation utility under democracy
 $E_t\Omega_{t+1}^A$ = the government’s expected continuation utility under autocracy.

(For future ease of exposition we write the sets of terms in the “[]” – government rents and citizen utility – as Y_t and Z_t .)

In an election period the expected continuation utility is lower than in a non-election period since the probability of re-election $\rho < 1$. To make clear that election-year changes in fiscal policy do *not* come from trying to win votes, we assume ρ is exogenous.¹⁰ Why might good outcomes increase support for democracy, but have less effect on electoral support for the incumbent? One reason might be that the events which shore up support for democracy are those which benefit a population wider than the incumbent’s political supporters, that is, including voters favorable to the opposition. In fact, outcomes that are perceived as being of primary benefit to the narrower group (and hence perhaps more electorally advantageous to the incumbent), may weaken support for democracy *per se*, in that they would reinforce the perception of some that democracy is simply a way to channel resources to specific special interests.

We further assume that a failed coup attempt imposes no costs on anyone other than the elites who staged it. This simplifying assumption is in no way crucial to our main argument. For simplicity we also assume that the government’s discount rate is zero.

A key observation in interpreting government utility is the difference in the incumbent’s utility depending on whether he loses office in an election or in a successful coup. The former is normalized to zero, while the latter is assumed to be below the utility associated with a peaceful democratic transition (that is, ψ is negative), perhaps much below ($\psi \ll 0$) due to the personal implications to a leader who is deposed in a coup. Hence, an incumbent may perceive a quite high benefit to showing that the system works, even if he is primarily self-interested rather than concerned with the survival of democracy *per se*. The magnitude of ψ will be important in determining a leader’s choice of fiscal policy.

3.3.4 Reference case – consolidated and old democracies

In a consolidated democracy, the prior probability the public puts on democracy being good for outcomes is $\pi_t = 1$. This implies the posterior P_t and the fraction who support democracy is 1, so

¹⁰Brender and Drazen [2005b] find that good economic outcomes do affect re-election probabilities in a new democracy. However, we abstract from that effect, as discussed in the text.

that the probability of democracy surviving is one even if $h_t = 0$. The government's maximization problem would be

$$\underset{g_1, g_2}{Max} \chi + \rho\chi + V^G(g_1) + V^G(g_2) + E_2\Omega_3 \quad (15)$$

Since, by assumption, fiscal policy cannot affect ρ and the budget must be balanced over the two periods (so that current fiscal decisions cannot affect $E_2\Omega_3$), the optimal solution is expenditure smoothing: $g_1 = g_2 = \frac{1}{2}$, reflecting utility $V(\cdot)$ being concave in g .¹¹ In other words, there is no electoral cycle in either expenditure or deficits in an established democracy.

When democracy is not fully consolidated, but the government cannot affect public perceptions via current expenditures h_t , σ will be unaffected by h . The government's problem is then also simply to maximize $V^G(g_1) + V^G(g_2)$, so that here too $g_1 = g_2 = \frac{1}{2}$. This would be the case where citizens have more experience with fiscal manipulation than in a new democracy (an "old, fragile" democracy). We take the absence of a political cycle in old democracies as our reference case.

3.3.5 Government fiscal choices

We may now return to the newly democratic government's maximization problem. Writing this as a two period problem, the government's objective at of $t = 1$ would be (where we write $\sigma(h_t, t)$ as simply $\sigma(t)$)

$$\begin{aligned} \Omega_1 = & \sigma(1)\chi + (1 - \sigma(1))\psi + \eta [\sigma(1)V^G(g_1) + (1 - \sigma(1))V^A(g_1)] + \\ & \sigma(1)(\rho[\sigma(2)\chi + (1 - \sigma(2))\psi] + \eta [\sigma(2)V^G(g_2) + (1 - \sigma(2))V^A(g_2)]) \\ & + (1 - \sigma(1))(\psi + \eta V^A(g_2)) + \sigma(1)\sigma(2)E\Omega_3^D + (1 - \sigma(1)\sigma(2))E\Omega_3^A \end{aligned} \quad (16)$$

The first-order conditions for g_1 and g_2 imply

$$\sigma(1)\frac{dV^G(g_1)}{dg_1} + (1 - \sigma(1))\frac{dV^A(g_1)}{dg_1} = \sigma(1)\sigma(2)\frac{dV^G(g_2)}{dg_2} + (1 - \sigma(1)\sigma(2))\frac{dV^A(g_2)}{dg_2} \quad (17)$$

For the general case where both $\sigma(1)$ and $\sigma(2)$ are between 0 and 1 ($0 < \sigma(1)\sigma(2) < \sigma(1) < 1$), the relative values of g_1 and g_2 depend on the relative magnitudes of the derivatives of $V^G(g)$ and $V^A(g)$ with respect to g , that is the marginal utility value of government spending to the average citizen under democracy and autocracy. If $\frac{dV^G(g)}{dg} > \frac{dV^A(g)}{dg}$, then $g_1 > g_2$, while if $\frac{dV^G(g)}{dg} < \frac{dV^A(g)}{dg}$, then $g_1 < g_2$, with $g_1 = g_2$ if the marginal utility of government spending is equal. Our presumption is that

¹¹Brender and Drazen [2005b] find that running deficits significantly *lowers* the probability of re-election in old democracies.

the former is true (government spending in a democracy is of more value to ordinary citizens than in a non-democracy), though we suppose arguments could be made in either direction. Since our interest is more in the implications of democratic fragility for spending meant to affect perceptions of democracy, we will assume a neutral reference case, namely $\frac{dV^G(g)}{dg} = \frac{dV^A(g)}{dg}$, so that $g_1 = g_2 = (1 - h_1 - h_2)/2$. As we shall see, the effects we find on the timing of fiscal expenditures will only be strengthened if $\frac{dV^G(g)}{dg} > \frac{dV^A(g)}{dg}$.

When $g_1 = g_2 = (1 - h_1 - h_2)/2$, we may substitute this into (16) and maximize with respect to h_1 and h_2 . On the assumption that the continuation values are the same after period 1 (that is, in non-election periods), the resulting first order conditions for h_1 and h_2 may be written (after some algebra)

$$[I_t(\chi - \psi) + \eta(V^G(\cdot) - V^A(\cdot))] \frac{d\sigma(h_t, t)}{dh_t} \geq \frac{dV\left(\frac{1-h_1-h_2}{2}\right)}{dg} \quad (18)$$

for each h_t , where $\frac{dV(g)}{dg}$ represents the common value of $\frac{dV^G(g)}{dg}$ and $\frac{dV^A(g)}{dg}$. and $I_1 = 1$ while $I_2 = \rho$, the probability of being in office in the absence of a coup. The term in “[]” multiplying $\frac{d\sigma(\cdot)}{dh}$ is the loss to the incumbent government from a successful coup in the period, which is unambiguously positive and likely to be large. It consists of two parts: 1) $\chi - \psi$, the direct loss to the incumbent losing power by being deposed in a coup rather than by losing a regular election; and 2) $V^G\left(\frac{1-h_1-h_2}{2}\right) - V^A\left(\frac{1-h_1-h_2}{2}\right)$, the loss to the average citizen associated with living in an autocracy rather than a democracy, multiplied by η , the weight the incumbent puts of citizen welfare.

The inequality sign reflects the fact that if the loss to the incumbent government from a successful coup is large enough, then it may decide to choose h_t high enough so that $\sigma(h_t, t) = 1$ (that is, the fraction ϕ_t of the public that supports democracy equals $\hat{\phi}_t$, the fraction that ensures democracy survives.) .More specifically, consider the level of h_t just sufficient to make $\phi_t = \hat{\phi}_t$. Denoting this by \hat{h}_t , one has

$$\hat{h}_t = P_t^{(-1)} \left[F^{(-1)}(\hat{\phi}_t, t) \right] \quad (19)$$

where the function $P_1^{(-1)}[\cdot]$ is defined by (12) and similarly $F^{(-1)}(\cdot)$ is defined by (5). Government choice of h_t is then summarized by:

PROPOSITION 4 Optimal choice of h_t :

- a) if $[I_t(\chi - \psi) + \dots] \frac{d\sigma(h_t, t)}{dh_t} \geq \frac{dV(\cdot)}{dg}$ when evaluated at \hat{h}_t , then $h_t = \hat{h}_t$ so that $\phi = \hat{\phi}_t$ and $\sigma(h_t, t) = 1$;
- b) if $[I_t(\chi - \psi) + \dots] \frac{d\sigma(h_t, t)}{dh_t} < \frac{dV(\cdot)}{dg}$ when evaluated at \hat{h}_t , then h_t is determined by (18) with equality, so that $0 < h_t < \hat{h}_t$, $\phi_t < \hat{\phi}_t$ and $\sigma(h_t, t) = 1 - \xi(\phi_1, 1)$.

Proof: Immediate. ■

Inspection of the loss to the incumbent government from a successful coup (the term in “[]”) in (18) suggests that if at least one of the inequalities $-\psi < \chi$ or $V^A(\cdot) < V^G(\cdot)$ – is large (as seems likely) then part a) of the Proposition is will be the relevant case. The following corollary will be useful in discussing the pattern of fiscal policy.

COROLLARY TO PROPOSITION 4 The effect of parameters on the solution:

If the function $\sigma(\cdot, 1) = \sigma(\cdot, 2)$, then $h_1 > h_2$, including at $h_1 = \hat{h}_1$ and $h_2 = \hat{h}_2$. For high enough values of $\chi - \psi$ or $V^G(\cdot) - V^A(\cdot)$, the term in brackets in (18) will be sufficient positive that condition a) will hold and $h_t = \hat{h}_t$. For any parameter values for which $h_2 = \hat{h}_2$, it must be the case that $h_1 = \hat{h}_1$, but the converse is not true (that is, parameter values for which $h_1 = \hat{h}_1$ do not necessarily imply $h_2 = \hat{h}_2$.) If the loss from a successful coup were the same across periods and high enough so that $h_1 = \hat{h}_1$, then $\sigma(\cdot, 1) < \sigma(\cdot, 2)$ implies that $h_1 > h_2$.

Proof: The first statement follows from $\rho < 1$. and inspection of (18). The second is an immediate implication of the first. The third statement may be simply shown as follows. If $h_2 = \hat{h}_2$, then $\sigma(\cdot, 1) > \sigma(\cdot, 2)$ implies $\hat{h}_2 < \hat{h}_1$ by the definitions of $\hat{\phi}_t$ and \hat{h}_t . If $h_2 < \hat{h}_2$, then obviously $h_2 < \hat{h}_1 = h_1$. ■

This corollary is meant to draw attention to the following likely results. First, given the high magnitude of a loss to a successful coup, one might expect expenditures h_t to have a far higher marginal utility than regular expenditures g_t , so that they will be high enough to prevent a coup. This will be especially true in periods of high democratic vulnerability ($\sigma(\cdot, st) < \sigma(\cdot, s)$). Moreover, even if vulnerability is the same across periods, the possibility of not being in office in the second period due to losing the election means the incumbent has less of an incentive to allocate spending to consolidate democracy in the second than in the first period. We now turn to further investigation of the timing and magnitude of expenditures meant to consolidate democracy.

3.4 The pattern of fiscal policy in a new democracy

On the basis of Proposition 4 we can ask how the attempt to affect public perceptions of democracy to prevent democratic collapse will affect the pattern of fiscal policy relative to an established democracy. Remember that in an old democracy, $g_1 = g_2 = \frac{1}{2}$ and $h_1 = h_2 = 0$.

3.4.1 The timing of fiscal expenditures

We consider first the timing of h_t . The corollary to Proposition 4 summarized some timing issues from a technical point of view. Here, we consider the timing of h_t from a more conceptual perspective.

Comparison of the first-order condition (18) in the two periods suggests two key possible differences between periods. First, and most importantly in our view, the function $\sigma(h_t, t)$ may differ across periods. This may be due to a secular effect, with democracy becoming more consolidated (the function $\sigma(\cdot, t)$ shifting up over time). In terms of our simple intertemporal model, some periods or

dates may be periods of higher vulnerability of democracy, so that resources would be shifted towards those periods. In other words, if, for example, $\sigma(h, 1) > \sigma(h, 2)$ uniformly, then $h_1 > h_2$. We present evidence below that democracy is much more likely to collapse in election years in new democracies, so that this example seems the empirically relevant case.

The second difference between the two periods is the probability I_t of being in $t = 1$ versus $t = 2$ when there is not an overthrow of democracy. Since the incumbent will not be re-elected for certain ($I_2 = \rho < I_1 = 1$), he will devote more resources to consolidating democracy in the election than in the post-election period, even if the threat to democracy is the same and such expenditures have no direct effect on his re-election. If democracy is in fact more vulnerable in the election period, these two effects work in the same direction.

We summarize this as

PROPOSITION 5 Political budget cycles in new democracies due to fragility:

Suppose democracy is fragile (that is, the prior π that democracy is good is less than unity) and government expenditures h can affect public perceptions. Fiscal policy will be characterized by higher expenditures in election than non-election years if the former are points of greater vulnerability of democracy to collapse. The greater the differential, the larger the political budget cycle

Proof: If $\sigma(h, 1) > \sigma(h, 2)$ and $\rho \leq 1$, $h_1 > h_2$ unambiguously from Proposition 4. Since ordinary expenditures are smoothed (that is, $g_1 = g_2$), then $g_1 + h_1 > g_2 + h_2$. ■

Note that an electoral cycle emerges even though we have eliminated any effect of fiscal policy on re-election probabilities.

3.4.2 The magnitude of fiscal expenditures

Proposition 4 also suggests what are some of the determinants of the magnitude of fiscal expenditures meant to affect public perceptions of democracy. Two factors stand out. The first are the characteristics of the function $\sigma(h_t, t)$. Second, from (8) (and the underlying (7)) we see that the level and sensitivity of ξ , the probability of a successful overthrow of democracy as perceived by the elites, to ϕ , support for democracy by the masses, is important. A low level of ϕ (that is, a high level of ξ) in the absence of government action, as well as a low sensitivity of ξ to ϕ (so that a large increase in ϕ is needed to reduce ξ significantly) will lead to higher level of expenditures h . Intuitively, if the public begins with a weak belief in democracy and this implies that anti-democratic elements think an anti-democratic coup has a large chance of success, government expenditure on consolidation will be high.

Second, comparing incentives in new, fragile democracies versus consolidated democracies, the key difference is ψ , the high cost of losing office in a fragile than a consolidated democracy. As Proposition 4 makes clear, the higher is ψ , the higher will be h .

A third point, as yet not fully modeled is the sensitivity of good versus bad outcomes to fiscal policy is crucial. In terms of our specific model, how does the probability μ that a good outcome will be observed rise as expenditure h increases? Intuitively, how costly is it for the regime to produce good outcomes, that is, outcomes that will induce citizens to support democracy? In practice this would depend, inter alia, on the magnitude of the problems facing the economy before the election year and on “luck” - *e.g.*, global developments. A negative external shock - such as a global slowdown or an increase in import prices - after democratization would make it more difficult - and costly - for the government to persuade the public that democracy can coexist with a functioning economy. Though we did not model it, a crucial characteristic of new democracies is that voters do not see fiscal policy directed toward this end as manipulative. To the extent they learn about election-year manipulation, this sort of fiscal policy will be ineffective and hence less likely to be used.

To conclude this section, the magnitude of expenditures to consolidate democracy depend of course on where they are directed. This is a further reason for looking at expenditures directed at the masses and not solely (or primarily) at the elites. This is not to say that such expenditures may not be part of the process of democratic consolidation, but that looking only at elites misses a crucial aspect of consolidation. To go a step further, we would argue that expenditures directed at elites would not be of sufficient magnitude to explain the magnitude of fiscal effect we discuss in the next section.¹²

4 Some Supportive Evidence

We now present a number of findings about new democracies that are consistent with our approach and that we think are supportive of our arguments on fiscal implications of democratic fragility in new democracies.

4.1 Election years as points of vulnerability

Our discussion of the problem of democratic consolidation suggests that new democracies may face certain “critical points” at which democracy may be especially vulnerable. It makes sense that if democracy is fragile, the most obvious time for this to have implications is in an election year. It is not simply that dissatisfaction can be expressed at ballot box, but also, almost “by definition” the democratic system is being tested at election time: a leader may cancel elections; turnover of

¹²We note however that when buying off elites is seen as critical to democracy surviving, the amount that needs to be given to elites to secure their support need not be proportional or correlated with their size. That is, a very powerful elite may be able to extract a disproportionate amount of resources from the government in order that they to secure their support for the regime.

parliament is time of mechanical fragility. In fact whether the first elections take place after the transition to democracy is generally seen as crucial to the legitimacy of a newly democratic system (See, for example, O'Donnell and Schmitter (1986) and Linz and Stepan(1978).)

In Table 2, we present the probability of democracy collapsing in both new and old democracies. We see that democracy is almost three times more likely to collapse in election years than non-election years in new democracies. It is also evident from the table that in old democracies the probability of a collapse of the democratic regime is very small, with similar values in election and non-election years.

[Put Table 2 Here]

4.2 Election-year effects in new and old democracies

If democratic fragility induces significant expenditures to help consolidate democracy at times of democratic vulnerability, then this should show up in the data. To the extent that these points of especially high vulnerability are election years, we should a political budget cycles with expenditures being higher in election than non-election years, though such an effect would not represent electoral manipulation in the standard sense. The absence of problems of democratic consolidation in old democracies (or the ineffectiveness of expenditures in affecting beliefs about democracy), combined with the absence of any apparent difference in the likelihood of democratic collapse between election and non-election years says that there should be no similar effect in old democracies.

In Brender and Drazen (2005a), we in fact find that increases in the government expenditures and deficits (relative to GDP) in election years take place predominantly in new democracies, with no statistically significant cycle in older democracies as a group.¹³ In the period 1960-2001, the election year in the first elections (up to the first four) after the transition to democracy in 36 new democracies is characterized by an increase in public expenditure and the deficit of 0.8% of GDP. In contrast, in elections after the first four, as well as in established democracies, there is no statistically significant increase in the deficit relative to non-election years. We reproduce in Table 3 the first table of our earlier paper, showing this result. In the earlier paper, we also show that the significant difference between new and established democracies remains even after controlling for the strength of the democracy, the level of economic development, endogeneity of election dates, the electoral system and whether a country has a Presidential or a Parliamentary system.

[Put Table 3 Here]

¹³ "New" democracies in our paper referred to up to the first four elections in a country after the transition to democracy, whereas elections after the first four are taken to refer to old or established democracies.

Of course the finding of a significant election-year effect on government expenditures in new but not old democracies does not prove that these expenditures are motivated by the desire to prevent reversion to non-democracy at a critical point. However, Brender and Drazen (2005b) look at voter response to deficit spending in new democracies over the period 1960-2003 and find no evidence that high government expenditures or deficits affect the probability that the incumbent gets re-elected. In Table 4 we present some of the results from that paper. The point of the table is that while there is a significant increase in central government expenditures in election years, they do not serve to help an incumbent's re-election. This suggests that the increase in expenditures reported in Table 3 reflects something else.

[Put Table 4 Here]

4.3 The composition of election-year expenditures

Unfortunately, in a large panel it is impossible to disaggregate the data to the level where one can identify expenditures as clearly aimed at affecting public attitudes about democracy. One can however ask whether the data are consistent with high election-year expenditures in new democracies going primarily to elites or being spread more broadly. Towards this end we looked at the cases of the large increases in election-year government spending in new democracies to get a sense of where expenditures are going. This is summarized in Table 5. where we look at the composition of the increase in expenditures in the election year in the 20 new democracies that had the largest such increase in the sample used by Brender and Drazen (2005a). Countries are ordered by the overall growth in expenditure in the election year (in percent of GDP) relative to the previous year, indicated by the number in parentheses after the election date. For each country the table compares the fraction of the *increase* in public expenditures that was due to each of 4 spending categories (with the share of each category in total spending in the year before the election in the left-hand column in each category). A larger figure in the right-hand column than in the left-hand column in each category indicates a more than proportional share of that item in the election-year spending expansion. Overall, it seems that the increase in public spending in election years tended to be proportional to the composition of spending before the election year with the share of social spending (welfare transfer payments, education and health) unchanged on average.¹⁴ The detailed composition of the increase in spending suggests that it was mostly transfer payments, agricultural subsidies to restore food supplies, or payment of arrears to utility suppliers that accounted for the increased

¹⁴The noticeable outlier Ethiopia reflects the combined effects of the war with Eritrea and famine which required higher military spending and agricultural subsidies.

spending in the election years. While not offering an unequivocal proof, these expenditures can more intuitively be classified as spending on the masses than on elites.

[Put Table 5 Here]

4.4 Fiscal manipulation

For high expenditures to be consistent with the government trying to show that “democracy works”, we argued that they cannot be perceived as such. To buttress this claim, we argued that fiscal manipulation is less observable in new democracies. A somewhat rough indication of this can be drawn from Table 6. In this table we compare the data on public expenditure as reported in the IFS in the year subsequent to the one for which the data are reported with the latest available data for the same year.¹⁵ We find that in new democracies the level of expenditure reported immediately after the election year were 1.6 percent lower than finalized data; it was lower by only 0.3 percent in non-election years. In contrast, in established democracies initial reports for election years were 0.1 percent higher than the final data, compared to 0.4 percent in non-election years. While a comprehensive analysis of the differences in the quality of reporting in various groups of countries is beyond the scope of this paper, these figures are suggestive that new democracies provide a lower quality of data to their citizens in election years.

[Put Table 6 Here]

5 Concluding Comments

There are many countries where democracy is new and hence often not fully consolidated. The purpose of this paper was to explore how the danger of a collapse of democracy may affect fiscal policy in comparison to countries where democracy is older and often more established. The question of the implications of democratic fragility for economic policy has received considerable attention from political scientists, though formal modeling is far more recent and less common. A common theme of much of the literature is that elites play a crucial role both in the transition to democracy and in the possibility of reversion of a democracy to autocracy. While this is uncontroversial, this view has lead many researchers to focus primarily on policies aimed at anti-democratic elites in consolidation of democracy with far less attention paid to policies aimed at the mass of citizenry.

In this paper we concentrate on the citizenry and on policies meant to affect their attitudes towards democracy, more specifically, at policy meant to convince a possibly skeptical citizenry that

¹⁵For example, we compare the data for Spain in 1982, as reported in the 1983 IFS, with the data for Spain in the same year as reported in the 2005 IFS.

“democracy works”. Our focus therefore is on the inference problem that citizens solve in looking at economic outcomes and forming their beliefs about the efficacy of democracy. Our interest is not in analyzing very specific policies, but in the general implications of the need to address the concerns of citizens for patterns of fiscal policy in new democracies. We argued that the implications of the model are broadly consistent with the empirical patterns generally observed, including the existence of political budget cycles in new democracies that are not observed in the aggregate budget level in a panel of old democracies.

We further hope that this paper serves as a contribution to the more general question of determinants of economic policy in states or polities where democracy is not consolidated. Formal modeling of the political economy of weak states is relatively recent. Much good work has already been done, some of which we have discussed here. Like others, we think that this is an especially important area of research. Our focus on the importance of public attitudes toward democracy in explaining policy choices in fragile democracies is a step in that more general research program.

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Table 1: Differences in Attitudes and Preferences Between Citizens in New and Established Democracies¹

	New Democracy	GDP per capita (1,000\$)	Share of population in ages 15-64	Share of population over age 64	Constant	N	of which: new democracies	Adj. R ²
Significance of economic performance:								
Growth is important ²	0.049** [0.028]	-0.005*** [0.005]	-0.005* [0.073]	0.007** [0.010]	1.088*** [0.000]	91	47	0.32
Stable economic progress is important ³	0.110*** [0.000]	-0.003 [0.226]	0.005 [0.152]	0.001 [0.839]	0.35 [0.108]	92	48	0.302
Attitudes toward democracy and politics:								
Democracy is good ⁴	-0.171*** [0.004]	0.006 [0.126]	-0.028*** [0.001]	0.004 [0.561]	5.104*** [0.000]	86	47	0.342
Maintaining order is important ⁵	0.077** [0.012]	-0.004* [0.062]	-0.005 [0.250]	0.006 [0.120]	0.703*** [0.006]	137	62	0.144
Freedom of speech is important ⁶	-0.052*** [0.001]	0.004*** [0.001]	-0.001 [0.718]	0 [0.813]	0.161 [0.223]	137	62	0.322
Evaluation of democracy's progress ⁷	-0.203** [0.048]	0.018*** [0.002]	-0.041*** [0.003]	-0.013 [0.299]	5.087*** [0.000]	50	26	0.519
Superiority of democracy ⁸	-0.208*** [0.002]	0.006 [0.179]	-0.016* [0.079]	0.005 [0.517]	4.257*** [0.000]	85	47	0.319
Honesty and Government								
Cheating to get government benefits ⁹	0.584*** [0.000]	0.012 [0.272]	0.019 [0.437]	-0.042* [0.057]	1.129 [0.431]	134	59	0.152
Avoiding fares on public transport ¹⁰	0.650*** [0.000]	-0.002 [0.851]	0.012 [0.603]	0.015 [0.456]	1.3 [0.321]	121	53	0.171
Following politics on the media¹¹	0.215 [0.160]	-0.002 [0.787]	0.017 [0.424]	0.038** [0.047]	1.158 [0.367]	48	23	0.205

¹ Based on the mean responses of citizens' in various countries to the World Values Survey (Inglehart (2004)). The figures in the first row for each question are regression coefficients and the figures in the second row are P values.

² The share of respondents stating that a "high level of economic growth" is one of the two most important goals their country should aim for in the

next 10 years. The other options were "making sure that the country has strong defense forces", "seeing that people have more say about how things are done at their jobs and in their communities" and "trying to make our cities and countryside more beautiful".

³ The share of respondents stating that a "stable economy" is one of the two most important goals their country should aim for in the next 10 years. The other options were "progress toward a less impersonal and more humane society", "progress toward a society in which ideas count more than money" and "the fight against crime".

⁴ The means of respondents' opinions of the democratic system as a way of governing their country. The possible answers (on a scale of 4) ranged from "very bad" to "very good".

⁵ The share of respondents stating that "maintaining order in the nation" is the most important goal their country should aim for in the next 10 years. The other options were "giving people more say in important government decisions", "fighting rising prices" and "protecting freedom of speech".

⁶ The share of respondents stating that "protecting freedom of speech" is the most important goal their country should aim for in the next 10 years. The other options were "giving people more say in important government decisions", "fighting rising prices" and "maintaining order in the nation".

⁷ The means of respondents' satisfaction with the progress of democracy in their country. The possible answers (on a scale of 4) ranged from "not at all satisfied" to "very satisfied".

⁸ The means of respondents' agreement with the statement "Democracy may have problems but it's better than any other form of government". The possible answers (on a scale of 4) ranged from "strongly disagree" to "agree strongly".

⁹ The means of respondents' opinions on how justifiable it is to claim government benefits to which one is not entitled. The possible answers (on a scale of 10) ranged from "never justifiable" to "always justifiable".

¹⁰ The means of respondents' opinions on how justifiable it is to avoid a fare on public transport. The possible answers (on a scale of 10) ranged from "never justifiable" to "always justifiable".

¹¹ The means of respondents' answers to the question "How often do you follow politics in the news on television or on the radio or in the daily papers". The possible answers (on a scale of 5) ranged from "never" to "every day".

* - Significant at the 10 percent level; ** - Significant at the 5 percent level; *** - Significant at the 1 percent level.

Table 1A: Differences in Attitudes and Preferences Between Citizens in New and Established Democracies¹

	Living in New Democracy	GDP per capita (1,000\$)	Gender (male = 0)	Age	Income level ²	N	of which: in new democracies	R ²
Significance of economic performance:								
Growth is important ³	0.092*** [0.000]	-0.028*** [0.000]	-0.092*** [0.000]	0.003*** [0.000]	0.033*** [0.000]	106,451	51,746	0.027
Stable economic progress is important ³	0.315*** [0.000]	-0.015*** [0.000]	-0.133*** [0.000]	0.005*** [0.000]	0.024*** [0.000]	108,656	53,125	0.028
Attitudes toward democracy and politics:								
Democracy is good	-0.098*** [0.000]	0.009*** [0.000]	-0.057*** [0.000]	0.000*** [0.003]	0.023*** [0.000]	95,652	47,537	0.052
Maintaining order is important ³	0.253*** [0.000]	-0.016*** [0.000]	-0.041*** [0.000]	0.008*** [0.000]	0.007*** [0.000]	153,309	68,467	0.026
Freedom of speech is important ³	-0.332*** [0.000]	0.019*** [0.000]	-0.073*** [0.000]	-0.006*** [0.000]	0.029*** [0.000]	153,309	68,467	0.05
Evaluation of democracy's progress	-0.100*** [0.000]	0.024*** [0.000]	-0.032*** [0.000]	-0.000** [0.034]	0.008*** [0.000]	56,345	29,918	0.104
Superiority of democracy	-0.207*** [0.000]	0.007*** [0.000]	-0.040*** [0.000]	0.001*** [0.000]	0.011*** [0.000]	88,397	46,557	0.046
Honesty and Government								
Cheating to get government benefits	0.573*** [0.000]	0.009*** [0.000]	-0.122*** [0.000]	-0.016*** [0.000]	-0.025*** [0.000]	150,129	63,971	0.04
Avoiding fares on public transport	0.566*** [0.000]	-0.017*** [0.000]	-0.126*** [0.000]	-0.021*** [0.000]	-0.018*** [0.000]	136,216	60,116	0.071
Following politics on the media								
	0.284*** [0.000]	-0.008*** [0.000]	-0.315*** [0.000]	0.011*** [0.000]	0.048*** [0.000]	55,355	26,675	0.097

¹ Based on the responses of citizens' in various countries to the World Values Survey (Inglehart (2004)). The detailed questions appear in Table 2. Controls also included the age composition of the country, marital status, employment status and religion (in a 7 groups distribution). The figures in the first row for each question are regression coefficients and the figures in the second row are P values.

² The income level of the individual in his country on a scale of 1-10, where 1 is the lowest level.

³ Probit equations.

* - Significant at the 10 percent level; ** - Significant at the 5 percent level; *** - Significant at the 1 percent level.

Table 2: The Fall of Democracies in Election and Non-Election Years

		New Democracies ¹			Old Democracies ¹		
		(Percent of all the years in the column)					
		Election Years	Other years	Total No. of Observations	Election Years	Other years	Total No. of Observations
Fall of Democracy²	yes	8.5	3.0	37	0.4	0.7	10
	no	91.5	97.0	974	99.6	99.3	1,419
Sharp decline in the level of democracy³	yes	10.8	3.5	45	0.4	0.7	9
	no	89.2	96.5	966	99.6	99.3	1,420
A decline of 2 or more points in the level of democracy⁴	yes	12.3	3.9	50	0.4	1.2	16
	no	87.7	96.1	961	99.6	98.8	1,413
Total Years		130	881	1,011	228	1,201	1,429

¹Countries are defined as new democracies until the 4th democratic election campaign.

²A downfall of a democracy is defined as a shift from a positive score in the democracy/autocracy scale in the POLITY IV dataset of the University of Maryland.

³Defined as a decline of 5 or more points in the democracy/autocracy scale, starting with a positive level.

⁴Starting from a positive level.

Table 3: The Political Budget Cycle Across Countries, Fixed Effects Estimates.

Estimation period Dependent variable ¹	All Democracies			All "New Democracies"			"New Democracies" Excluding "Transition Economies" ³			"Old Democracies"		
	(1)			(2)			(3)			(4)		
	1960-2001			1960-2001			1960-2001			1960-2001		
	balance	texp	trg	balance	texp	trg	balance	texp	trg	balance	texp	trg
Elect²	-0.352*** (0.123)	0.085 (0.193)	-0.251 (0.171)	-0.868*** (0.273)	0.747** (0.292)	-0.153 (0.236)	-0.684** (0.290)	0.434* (0.260)	-0.237 (0.247)	-0.109 (0.135)	-0.131 (0.146)	-0.223* (0.118)
Adjusted R²	0.683	0.905	0.915	0.461	0.937	0.954	0.504	0.928	0.920	0.764	0.959	0.969
F- Statistic	47.96	211.63	239.87	9.42	150.57	203.18	11.62	140.19	120.61	94.937	693.30	928.81
DW Statistic	1.955	1.562	1.455	1.821	2.051	2.114	1.682	1.925	2.134	1.900	1.987	1.872
No. of countries	68	68	68	36	36	36	26	26	26	32	32	32
No. of obs.	1616	1631	1640	415	423	415	336	344	336	1105	1112	1128
Avg. time series length	23.8	24.0	24.1	11.5	11.8	11.5	13.0	13.3	13.0	34.5	34.8	35.3

This table is Table 1 of Brender and Drazen (2005a) In that paper we also presented GMM estimates of these relations, with basically identical results. The covariates include one lag of the dependent variable, the log of per-capita GDP, the ratio of international trade to GDP, the fraction of the population over age 65, the fraction of the population between ages 15 and 64, and the log difference between real GDP and its (country specific) trend, estimated using a Hodrick- Prescott filter.

¹Variable definitions (all in percent of GDP): balance-central government surplus; texp-total expenditure by the central government; trg-total revenue and grants of the central government.

²Elect - a dummy variable with the value 1 in the election year and 0 otherwise.

³The "new democracies" among the transition economies are listed in Table A1.

* - Significant at the 10 percent level; ** - Significant at the 5 percent level; *** - Significant at the 1 percent level.

Table 4: The Effects of Budget Balances and Growth on the Probability of Reelection in New and Old Democracies

Dependent variable: Probability of Reelection ¹	
SURPLUS_term * old ²	10.709** [0.018]
SURPLUS_term * new_democracy ²	0.559 [0.956]
SURPLUS_ey * old ²	10.373* [0.078]
SURPLUS_ey * new_democracy ²	6.702 [0.361]
GDPPC_gr * old ²	6.330 [0.170]
GDPPC_gr * new_democracy ²	22.064*** [0.002]
Developed Countries	0.468** [0.020]
Majoritarian Electoral System	0.489** [0.011]
Constant	-0.674*** [0.002]
Pseudo R²	0.075
Akaike's criteria	344.97
Schwartz's criteria	376.84
Observations	255

¹ This table is taken from Brender and Drazen (2005b), The figures in the table are probit coefficients and the figures in the parantheses are P-values. An asterisk (*) indicates multiplication by the binary variable that follows. **new_democracy** - A binary variable with a value of 1 for new democracies, **old** - A binary variable with a value of 1 for old democracies.

² **SURPLUS_term** - The change in the ratio of the government deficit to GDP in the two years preceding the election year, relative to the two previous years. **SURPLUS_ey** -The change in the government deficit ratio to GDP In the election year, compared to the previous year. **GDPPC_gr** - The average growth rate of real per-capita GDP during the leader's current term.

* - Significant at the 10 percent level; ** - Significant at the 5 percent level; *** - Significant at the 1 percent level.

Table 5: The composition of Expenditure increase in Election years

Country (Expenditure Growth in percent)	Social Expenditure		Services and Infrastructure		Agriculture		Other	
	Expenditure in the year before the elections (out of total expenditure)	Fraction of total election-year expenditure growth accounted for by this category	Expenditure in the year before the elections (out of total expenditure)	Fraction of total election-year expenditure growth accounted for by this category	Expenditure in the year before the elections (out of total expenditure)	Fraction of total election-year expenditure growth accounted for by this category	Expenditure in the year before the elections (out of total expenditure)	Fraction of total election-year expenditure growth accounted for by this category
Brazil_1989 (8.85)	31.3	37.4	4.1	-3.1	2.0	0.7	62.6	65.0
Turkey_1977 (7.91)	28.3	24.0	29.8	26.9	3.2	2.1	38.6	47.0
Greece_1981 (3.83)	51.6	66.3	7.2	0.0	5.3	14.5	36.0	19.2
Bolivia_1993 (3.76)	37.5	57.0	12.4	26.0	1.8	1.4	48.3	15.6
Turkey_1991 (3.62)	26.3	12.1	12.9	17.1	2.0	2.0	58.7	68.8
Hungary_2002 (3.56)	42.7	30.1	2.2	83.9	4.0	10.3	51.1	-24.2
Cyprus_1973 (3.47)	35.8	20.8	11.1	-5.2	14.8	62.1	38.3	22.2
Estonia_1995 (3.15)	59.6	-1.8	7.1	2.4	1.6	58.7	31.7	40.7
Spain_1982 (3.08)	68.8	104.7	3.4	9.6	3.3	1.5	24.4	-15.8
Ethiopia_1999 (2.67)	26.3	-22.6	12.0	10.5	8.1	42.9	53.5	69.2
Jamaica_1976 (2.59)	39.4	44.8	10.0	4.2	6.3	24.3	44.4	26.7
Cyprus_1983 (2.46)	41.8	14.4	4.7	24.1	14.4	26.6	39.1	35.0
Mongolia_1997 (2.44)	31.9	39.1	8.8	-4.4	2.2	3.0	57.2	62.2
Brazil_1998 (2.29)	57.5	89.7	1.7	0.2	2.6	1.6	38.2	8.4
Uruguay_1994 (1.96)	73.6	65.6	4.3	3.9	1.1	1.2	21.0	29.3
Fiji_1977 (1.90)	37.9	73.2	17.2	0.3	8.0	3.0	36.9	23.5
Argentina_1999 (1.59)	60.8	38.8	4.6	-4.1	0.9	-1.2	33.6	66.5
Nepal_1995 (1.53)	24.1	8.5	13.3	16.4	11.0	-4.5	51.6	79.6
Spain_1979 (1.50)	67.9	83.9	3.2	10.9	3.6	-5.9	25.3	11.1
Fiji_1982 (1.42)	31.6	52.3	26.3	1.2	6.5	0.2	35.5	46.2
Average	43.7	41.9	9.8	11.0	5.1	12.2	41.3	34.8

Social Expenditure: Education, Health, Social Security & Welfare, Housing & Community Amenities

Services and Infrastructure: Economic Services: Fuel & Energy, Transportation & Communicator

Agriculture: Economic Services: Agriculture, Forestry, Fishing, Hunting

Table 6: The Accuracy of Reported Expenditures in New and Old Democracies¹
(In percent of the initially reported expenditures)

		All Years	Election Years	Non-election Years
All Countries	deviation	-0.03	-0.42	0.11
	Number of available years	561	150	411
New Democracies	deviation	-0.38	-1.43	-0.04
	Number of available years	161	39	122
Old Democracies	deviation	0.11	-0.06	0.17
	Number of available years	400	111	289
Developed countries	deviation	0.22	0.15	0.25
	Number of available years	280	86	194

¹ Figures are the difference between the first figure for the level of central government expenditure that appeared in the IFS within a year after the end of the reported fiscal year and the latest available figure for the same year. Countries that did not have a published figure in the IFS within a year from the end of the fiscal year are excluded. A negative figure indicates that the initial figure was smaller than the final one.

Data cover the years 1960 -2000.