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**THE POLITICAL DETERMINANTS OF PUBLIC DEFICITS IN LATIN AMERICA (1980-1998)**

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## **THE POLITICAL DETERMINANTS OF PUBLIC DEFICITS IN LATIN AMERICA**

### **I. Introduction**

Most Latin American economies have performed disappointingly over the last two decades. A combination of negative external shocks in the early 1980s, particularly the external debt crisis and the second oil shock, further undermined the economic development model adopted by the countries of the region. The clearest signs of this crisis were a slowdown in the rate of economic growth and financial imbalance in the public sector — factors that explain the rise in unemployment and high inflation rates experienced throughout the 1980s and much of the 1990s. Significantly, from the political standpoint, these two decades were characterized by a return to democracy in most Latin American countries.

Despite the common roots of the economic crisis in the region, experiences across countries have diverged sharply, especially in the way different democratic political systems have responded to economic problems over the last two decades. This can be clearly seen in the wide diversity of fiscal policies implemented to alleviate the effects of the crisis in the region. For example, Bolivian governments introduced a sharply contractionary policy in the second half of the 1980s while Argentina and Brazil used counter-cyclical fiscal policies. Thus, there is a clear need for a comparative analysis of the political characteristics of each democratic government, and their influence on the design and implementation of economic policy in general, and fiscal policy in particular.

There is a vast theoretical and empirical literature dealing with this topic, but it mainly refers to the developed countries. One of its main findings is that economic performance is related to the ideological orientation of the government: inflation tends to be higher under left-wing

governments, while unemployment tends to rise under right-wing governments (Alesina, 1987; Hibbs, 1977); in the fiscal domain, left-wing governments tend to spend more than their right-wing counterparts (Bosch and Suarez, 1995). In the USA, there is a significant difference between the macroeconomic and fiscal policies of Democratic and Republican administrations (Alesina and Rosenthal, 1995).

As for Latin America, the few comparative studies that exist also show that left-wing governments spend more than those of the right (Ames, 1987), and that unemployment rises less under governments of the left and center than under right-wing ones (Borsani, 2000). There is evidence too that Latin American governments are more inclined to adopt expansionary fiscal policies during electoral periods (Kraemer, 1997). Although still few in number, studies of the influence of political institutions on economic performance in Latin America are now starting to proliferate. Recent works have analyzed the institutional characteristics of the public-sector budget and fiscal deficit (Baldez and Carey, 1999; Alesina, Hausman, Hommes and Stein, 1999; Jones, Sanguinetti and Tommasi 1999) and institutional arrangements and fiscal performance (Stein, Talvi, and Grisanti, 1999); studies have also been made of political factors and the exchange rate (Frieden, Ghezzi and Stein, 2001); and there has been analysis of the macroeconomic effects of electoral cycles and the degree of legislative support commanded by the government (Borsani, 2000). Nonetheless, there are still major gaps in our understanding of the relation between politics and economics in Latin America over the last two decades.

Clearly the existing literature should be the starting point for any study of the influence of the political-institutional system on economic performance. However, previous studies have not fully recognized the economic consequences of the specificity and diversity of institutional structures and governance patterns in Latin America. Institutional specificity basically stems from

the combination of presidentialism with proportional representation — a distinctive feature of the region among contemporary democracies. Diversity, on the other hand, exists not only in the various ways those two institutions are combined, but also in how other institutions vary among these countries, which are linked geographically and have similar socioeconomic development levels. A good example of such variation is provided by the different degrees of public-sector decentralization that exist in Latin America.

As regards particularly the political determinants of public deficits in Latin America, available analyses either have the problem of omitted-variable bias (Kraemer, 1997) or rely solely on comparative statics (Baldez and Carey, 1999; Alesina, Hausman, Hommes and Stein, 1999; Stein, Talvi, and Grisanti, 1999). We are thus short of studies of fiscal behavior that include a comprehensive set of political variables and provide comparative dynamics. This paper will attempt to fill both gaps. We will not only analyze the fiscal performance impact of traditional variables such as government ideological orientation and the electoral cycle, but also the impact of the institutional and political aspects characteristic of Latin American countries, taking into account both cross-national and longitudinal effects. Our comparative analysis of fiscal performance will focus on effects stemming from government attributes, ideological preferences, legislative support of the executive branch, party system fragmentation, electoral cycles, presidential budgetary powers, and degree of public-sector decentralization.

The paper will proceed as follows. The next section reviews the literature, and, based on the main hypotheses of the latter, provides the analytical approach to the political determinants of fiscal policy in Latin America. Section three develops a pooled data analysis of public deficits in ten Latin American democratic regimes in 1980-1998. Section four concludes.

## II. ANALYTICAL FRAMEWORK

The relation between the political system and economic performance has attracted increasing interest in recent years from economists and political scientists alike. For reasons that are easy to understand — several decades of democratic government and wider availability of data — the existing theoretical and empirical studies have tended to focus on the OECD countries. The main lines of research on this topic are the following:

- The influence of majority and minority governments on economic results (Alesina and Rosenthal, 1995);
- Economic performance as a function of governments' ideological orientation and/or type of labor organizations (Garret, 1998; Alt and Lowery, 1994; Blais, Blake and Dion, 1993; Alvarez, Garrett and Lange, 1991);
- The influence of elections on the evolution of (a) macroeconomic results, and (b) fiscal and monetary policy instruments (Alesina, Roubini and Cohen, 1997; Blais and Nadeau, 1992);
- The political, institutional and economic determinants of the public budget and fiscal performance (Alesina 1999; Roubini and Sachs, 1989);
- The relation between political instability and fiscal deficit (Roubini, 1991); and
- The costs arising from the loss of macroeconomic policy control by the central government, which limits its capacity to implement stabilization and macroeconomic adjustment policies (Fukasaku and Mello, 1999; Poterba and von Hagen, 1999; Shah, 1998; Ter-Minassian, 1997; Prud'homme, 1995).

On fiscal policy in particular, the main findings show that coalition governments find it harder to implement fiscal adjustments than single-party governments do, and they respond more slowly to budgetary imbalances. Although fiscal adjustments are made with similar frequency under coalition and single-party governments, in most cases adjustments introduced by coalitions prove

unsuccessful (Alesina, Roubini and Cohen, 1997; Alesina and Rosenthal, 1995; Roubini and Sachs, 1989).

All told, the tenor of the contemporary political economy literature is that the way governments affect economic performance is a function of their motivations and political resources. The question now becomes which factors affect the motivations and resources of Latin American democratic governments as regards fiscal policy? Below we proceed to theorize on such factors.

### *Fiscal Centralization*

A key variable that determines a national government's room for maneuver to implement its own fiscal policy is the degree to which taxation and expenditure decisions are centralized. For example, in highly decentralized countries, the fiscal behavior of subnational governments can completely diverge from the orientation taken by central government. In recent years, there has been a major research effort into the macroeconomic effects of fiscal policy implemented by subnational governments. The most relevant studies show that, first and foremost, fiscal decentralization has meant a loss of degrees of freedom for central government on both the revenue and expenditure sides of the budget (Blanco, 1996; Remmer and Wibbels 2000; Tanzi, 1996; von Hagen, Eichengreen and Hausman, 1996).

The extent of fiscal decentralization varies widely across Latin American countries, and this should be expected to have a major impact on fiscal performance in the countries of the region. Compare, for example, the fiscal discipline of Bolivia, Chile and Uruguay, three unitary states, with that of Brazil; or with the worrying deterioration of the fiscal situation in Argentina associated with that country's increasing decentralization (Dillinger and Webb 1999). So our hypothesis is: *the*

*more centralized fiscal resources are in the hands of the national government, the lower the fiscal deficit.*

#### *Government Attributes*

In presidential regimes executive power is constitutionally invested in the head of the state. Such feature has led some analysts to posit that presidential systems tend to concentrate power in the hands of the president and his party (Jones, 1995; Lijphart, 1992; Linz, 1994). However, contrary to the predictions of these authors, recent studies show that presidents do not govern alone. Coalition governments are quite frequent in Latin America. In the 1980s and 1990s, approximately 50.0% of the governments formed in the region were coalitions, while the rest were single-party or overtly non-partisan administrations (Altman, 2000; Amorim Neto, 1998; Borsani, 2000; Deheza, 1997; Thibaut, 1998). Additionally, coalitions vary widely as regards their type, ranging from minority, through simple-majority to oversized coalitions (Deheza, 1997).

Like in OECD countries, the strength, cohesion, and stability of Latin American cabinets should also affect fiscal policy. We expect that, always *ceteris paribus*, *majority cabinets should be associated with lower deficits*. This is because such cabinets do not have to make fiscally costly side-payments to opposition parties so as to approve their legislative programs. Or they have the strength to enact a fiscal adjustment program when they need to do so.

However, oversized and less cohesive cabinets should have difficulties in generating fiscal balance. For such cabinets to survive, they have to rely heavily on side-payments to coalition partners and face severe coordination problems when it comes to deficit-cutting. *So the larger the government's legislative contingent, the larger the deficit*. Likewise, *the less cohesive the government, the larger the deficit*.

Conversely, stable governments should be associated with lower deficits. The rationale underlying this hypothesis lies in the fact that if ministers do not have a stable tenure in office, the bureaucracy runs amok. It is a principal-agent problem. The less time ministers stay in power, the weaker their ability to control and obtain information about their departments. If unconstrained, bureaucrats have an incentive either to increase their budgets or to avoid budget cuts. So *the more stable the cabinet, the lower agency losses, and the lower the fiscal deficit.*

Note, though, that governmental attributes are intimately linked to the nature of the party system. Here the key issue is the effective number of parties or legislative fragmentation. In Latin America there are well-known differences between the multiparty systems of Brazil and Peru and the two-party systems in Argentina and Costa Rica, and Colombia too until recently (Coppedge, 1998; Mainwaring and Scully, 1995). More fragmented party systems are associated with oversized and unstable governments (Lijphart, 1999). Hence, in our tests we will also check the impact of party system fragmentation on fiscal deficits.

Additionally, the nature of budget institutions has been theorized to have a major impact on fiscal deficits in Latin America (Alesina, Hausmann, Hommes and Stein, 1999). Based on analysis of the average central government surplus of 26 Latin American and Caribbean countries in 1989-1993, these authors have shown that more hierarchical budget institutions are associated with lower deficits than collegial institutions. Thus, we will also check whether this hypothesis holds up when tested on our database.

### *The Impact of Presidents*

In their well-known study of the economic and political determinants of public deficits in OECD countries, Roubini and Sachs (1989, p.924) argue that coalition governments have a clear

tendency to generate larger deficits than single-party governments because coalition partners face a fundamental prisoner's dilemma with respect to budget cuts:

... all of the partners of the coalition may prefer comprehensive budget cuts to a continuation of the large deficits, but each coalition partner may have the incentive to protect its particular part of the budget against the austerity measures. In the absence of strong coordination between members of the coalition to produce the 'cooperative outcome' the noncooperative solution of no-budget cutting is quite likely to arise.

Significantly, the countries Roubini and Sachs have in mind are mostly European parliamentary democracies. Latin American countries, however, all adopt pure presidentialism as a system of government. Does Roubini and Sach's explanation hold up for these countries?

Note first that, theoretically, the coordination problem faced by coalition parties in parliamentary regimes should be less acute in presidential systems because in the latter all executive power is formally invested in the president, thus centralizing executive policy making. Moreover, while cabinet ministers in coalition-ruled parliamentary systems are politically equals to the prime minister and have their own agenda-setting powers, their counterparts in presidential systems are – from a constitutional viewpoint – mere advisers to the president. Therefore, decisions made by cabinet members can be overruled by a president at a lower cost than by a prime minister. So, in principle, a president can provide the strong coordination required for a coalition government to efficiently implement a deficit-cutting program. Actually, Roubini and Sachs show that the change from a pure parliamentary to a semi-presidential system in France in 1958 helps explain why this country had smaller deficits in the 1960s and 1970s than in the 1950s.

However, Latin American presidents' ability to coordinate their governmental partners may vary according to their constitutional prerogatives. Baldez and Carey (1999) contend that the most relevant presidential prerogatives over fiscal policy are four budgetary procedures, namely, whether

the president exclusively has the authority to introduce spending bills; whether president's annual budget proposal establishes maximum spending levels and if so, whether as an aggregate ceiling across the entire budget or item-by-item; whether the president's budget serves as the reversion policy if Congress does not succeed in passing a budget bill; and whether the president has an item veto that allows him to reject specific spending items in legislation. The authors posit that such procedures have an independent impact on fiscal policy. Based on an analysis of the average budget deficit/surplus of 12 presidential countries in 1985-1996, they show that in fact the more extensive presidential budgetary powers, the lower the deficit. So we will also test the Baldez and Carey hypothesis.

As for presidential fiscal policy goals, in general, conservative presidents are more concerned with macro-economic stability than left-wing ones. It is thus safe to say that *the further to the right a president is, the more he is intent on generating lower deficits, ceteris paribus.*

A president's ability to implement his fiscal policy goals is to a great extent a function of the legislative strength of his own party. The stronger the president's party, the less concessions and side-payments the president has to make to other parties to secure legislative support for his governmental program. Accordingly, *we expect that the larger the legislative contingent of the president's party, the more likely he is to achieve his fiscal policy goals.*

In addition, Shugart and Haggard (2001) have posited that a president's ability to pursue his policy goals depends on how well aligned are his electoral incentives with those of the legislature. Presidents whose electoral cycle is nonconcurrent with that of the legislature; who face a legislature whose terms are staggered and whose electoral system is highly candidate-centered; and presidents whose electoral constituency is highly incongruent with that of the legislature are likely to have

great difficulties coordinating his preferences with those of the legislature. So, following Shugart and Haggard, we will check whether countries whose institutional setting favors separation of purpose between the presidency and legislature are associated with higher deficits than countries whose institutional setting favors unity of purpose between the branches of government.

### *The Electoral Cycle*

Finally, a key motivational variable affecting fiscal policy is the electoral cycle. In electoral years the president will have strong incentives to increase public spending so he can boost his electoral fortune or that of his party or coalition. Conversely, in post-electoral years the president is likely to decrease public spending to quell the inflationary tendencies unleashed by the electoral year's spending spree. Therefore, *electoral years should be associated with higher fiscal deficits, while post-electoral years should be associated with lower deficits.*

In brief, progress made in the comparative analysis of Latin American politics, together with the database afforded by the succession of democratic governments over the last two decades, is facilitating a broad, dynamic mapping of the patterns of distribution of preferences and institutional power existing in the region. This now makes it possible to relate these aspects to the fiscal behavior of the countries. The next section will provide econometric tests of our hypotheses.

## **III. METHODS AND DATA**

This section has two parts. The first describes the operational indicators of the variables included in the specification of the equation to be estimated. The last part presents the main results from the econometric analysis.

To analyze the effects of political variables on the fiscal behavior of Latin American

governments we use the central government primary balance as a percent of GDP as the dependent variable. Because it excludes the interest payments on the stock of public debt, the primary balance removes the effects of previous deficits on the budget. It is thus a good measure of the discretion of the current government. This is especially important in high inflationary regimes, so common in most Latin American countries in the last two decades, because monetary correction of public debt leads to high interest payments, making the utilization of the overall deficit an incorrect indicator of the actual fiscal stance.

To control for the structural heterogeneity of Latin American countries, we include six socioeconomic variables: per capita GDP (in dollars), the cycle of real GDP, the degree of openness of the economy, the degree of urbanization, the percent of the population in the labor market, and the interest payments over the public debt as a percent of GDP in the past year.

The first of these variables – per capita GDP – is a measure of socio-economic development. The cycle of the GDP is included to capture the fluctuations of the activity level on fiscal accounts. We use the Hodrick-Prescott filter to decompose the GDP in its trend and cycle. While the fiscal budget deficit affects aggregate demand, the business cycle also affects the budget deficit. For example, income tax revenue and indirect taxation are expected to be lower when the level of activity is lower. Also, benefits transfers are higher in recession periods. Thus, it is expected that the higher activity level, the better the fiscal balance.

As for the degree of urbanization, although its effect on fiscal deficit is undetermined, it allows us to control for heterogeneity in socioeconomic development. Likewise, the percent of the population in the labor market is a proxy of the age structure of the population. A higher percent of the population in the labor market implies that more people are able to pay taxes. Thus, it is plausible

to expect a positive correlation of this variable with fiscal balance.

Additionally, in the last decade most Latin American countries implemented policies designed to promote economic liberalization, albeit to a varying degree. The increase of the degree of openness of the economy was a key result of such policies. Openness, in turn, affects the constraints on fiscal policy. So we expect that greater openness must lead to fiscal discipline.

Finally, the interest payment over the stock of public deficit as a percent of GDP is a variable that measures the effect of the past on current fiscal behavior. To preserve debt sustainability, governments suffering from fiscal stress (characterized by a high public deficit/GDP ratio) must implement a fiscal adjustment. So we expect that the higher interest payments, the lower the deficit.

The following are the measures of the 7 socioeconomic variables:

- 1) Central government primary balance as a percent of GDP: Central government non-financial revenues minus central government non-financial expenditures as a percent of GDP;
- 2) Per capita GDP: per capita GDP in dollars as of 1990 (logged);
- 3) Cycle of real GDP: Actual GDP minus Hodrick-Prescott trend (logged);
- 4) Degree of openness: Exports as a percent of GDP (logged);
- 5) Urbanization rate: Urban population as a proportion of total population (logged);
- 6) Labor market rate: Active economic population as a proportion of the labor force (logged); and

- 7) Interest payments: Interest payments over public debt in the past year as a proportion of GDP (logged). As of the writing of this paper, data on debt was not available for most of the countries in the sample. We thus used interest payment as a proxy for debt burden. In the next iterations of the paper, we expect to use debt/GDP ratios to capture the influence of past fiscal actions on current behavior.

The following are the operational indicators of the 13 political variables:

- 1) Fiscal Centralization: central government revenue as a proportion of public sector revenue;
- 2) Majority Status: 1 if the parties represented in the cabinet command a majority of lower chamber seats; 0 otherwise;
- 3) Government's Legislative Contingent: % of lower chamber seats held by the parties represented in the cabinet;
- 4) Government Cohesion: the number of parties represented in the cabinet;
- 5) Cabinet Stability: average duration in office of the ministers serving on the cabinet in a given year (in days);
- 6) Fragmentation: it is the conventional Effective Number of Parties (Laakso and Taagepera, 1979), whose formula is: 
$$N = \frac{1}{\sum_i^n x_i^2}$$
, where  $x_i$  is the percent of lower chamber seats held by  $i$ -th party represented in the lower chamber;

- 7) The nature of fiscal institutions: The Alesina et al (1999) index of budget institutions.

The index varies between 0 and 80, and measures whether in a given country (1) there are laws or binding constraints limiting the permissible size of deficits; (2) there are top bottom voting procedures; and (3) there is budget transparency and control. The higher a country's score on the index, the more hierarchical its fiscal institutions;

- 8) Presidential Budgetary Powers: it is an ordinal scale of the budgetary powers listed by Baldez and Carey. A country receives 1 point for each of the four budgetary prerogatives its president has. The maximum value a country can score on the scale is thus 4, the minimum is 0;
- 9) President's ideology: it is a set of dummies, one for each position on the ideological spectrum, that is, left, center-left, center-right, and right (based on the classification developed by Coppedge [1997]; note that there is no left president in our sample);
- 10) Separation of Purpose between Presidency and Legislature: Shugart and Haggard generated an ordinal scale that varies from 0 to 8 according to a country's scores on four measures that capture the divergence of president's and legislature's electoral incentives. The measures are related to: (1) electoral cycle, (2) staggering of assembly elections, (3) electoral formula, and (4) legislative congruence with president's constituency. The higher the value, the more institutions favor separation of purpose between the branches of government;
- 11) President's Legislative Contingent: % of lower chamber seats held by the president's party;
- 12) Electoral year: 1 if it is a presidential succession year; 0 otherwise; and

13) Post-electoral year: 1 if it is a post-presidential succession year; 0 otherwise.

To estimate the influence of the political variables on the fiscal behavior of Latin American countries we used pooled data analysis. Our sample of observations includes the following 10 Latin American democratic regimes in 1980-1998 for which we were able to obtain the necessary economic and political data: Argentina (1984-1997), Bolivia (1983-1997), Brazil (1985-1998), Chile (1990-1997), Colombia (1980-1998), Costa Rica (1980-1997), Ecuador (1980-1996), Peru (1980-1991), Uruguay (1985-1998), and Venezuela (1980-1998). The sample has 151 data point observations, thus allowing us to test a large set of explanatory variables reducing the collinearity among them and without problems of small degrees of freedom.

Besides the variables described above, the estimation includes dummy variables for each country in order to capture the effect of omitted variables that are country-specific and that are assumed constant over time. Thus a fixed effect (or Least Square Dummy Variable) method was postulated. In addition, the Generalized Least Square (GLS) method was used to correct for heteroscedasticity.

The results are reported in Table 1 below. The estimated equation presents a very good adjustment that results from the utilization of the fixed effects method. In some cases, the explanatory variables have the expected sign and a high degree of significance.

Among the socioeconomic variables, the activity fluctuation, the urbanization and labor force rates, and the past interest payments have significant effects on the primary balance. Surprisingly, the business cycle and the labor market rate have negative effects on fiscal results.

The most interesting result comes from the effect of debt burden on current fiscal behavior.

The positive sign on the interest payment coefficient indicates that the government financial situation is a key factor in the definition of the fiscal stance. Thus, this result confirms that fiscal adjustments were the common response to financial stress on the part of Latin American governments.

The findings on the variables reflecting the political resources of Latin American presidents confirm that the political structure is an important determinant of fiscal policy. Three points must be highlighted: the role of fiscal centralization and the importance of cabinet stability.

The positive effect of fiscal centralization on primary balance corroborates a classical result in the literature: centralized states tend to have better fiscal behavior because centralization allows the federal government to perform a tighter control over expenditure and revenue decisions.

Cabinet stability also has a positive effect on the primary result. It implies that with stable tenure ministers are able to rein over the bureaucracy, thus moderating the latter's tendency to increase the budget. Such a finding corroborates Roubini's (1991) hypothesis that fiscal deficits in developing countries are to a great extent determined by political instability.

Why were majority status, government's legislative contingent, government cohesion, and fragmentation not found significant? First of all, they are all correlated with cabinet stability. However, cabinet stability remained significant in the presence of these four variables. Why? Because cabinet stability captures much more information than the other four variables. Besides varying every year, something that the four variables do not, cabinet stability reflects not only how ministers deal with bureaucrats but also the actual behavioral cohesion of the government. That is why cabinet stability was bound to be a highly significant variable tapping the political resources available to the government.

Additionally, the analysis of the impact of political preferences on fiscal behavior shows the importance of electoral cycles on the definition of the fiscal stance. The results observed in Table 1 reveal that in electoral years incumbents adopt expansionary fiscal policies: the fiscal deficit worsens by approximately 1.0% in such years. However, it is not possible to identify a significantly different behavior in post-electoral years.

In regard to the ideological position of the president weighted by the legislative size of his party, Table 1 does not confirm that the more conservative the president, the more fiscally conservative his government tends to be because the coefficients do not have the expected positive sign. Such a result shows that political ideologies matter little in Latin America as far as fiscal policy is concerned, probably due to the ideological convergence of parties promoted by globalization.

Summing up, the results presented in Table 1 show the importance of fiscal centralization and cabinet stability as the two main conditions for fiscal discipline. On the side of preferences, it is possible to state that only electoral years constitute a strong incentive for fiscal expansions. The sign and significance of the electoral years dummy did not change with alternative specifications, denoting a good deal of robustness. However, the sign and significance level of the variables associated with the ideological orientation of the president and political resources have proved unstable under different specifications. For example, in specifications that did not include fiscal centralization and cabinet stability, ideological orientation could explain differences in fiscal stance in the correct direction, that is, rightist presidents are more fiscally conservative and leftist presidents tend to follow a loose fiscal policy. When we include political resources, the variables tapping presidents' ideological orientation lose explicative power. Thus, we conclude that electoral

years and differences in fiscal centralization and cabinet stability and not differences in president's ideological orientation can explain differences in fiscal behavior.

Table 1

Dependent Variable: PRIMARY BALANCE: (+) SURPLUS (-) DEFICIT AS A PROPORTION OF GDP

Method: Generalized Least Square (Cross Section Weights)

Period: 1980-1998

Included years: 19

Total panel (unbalanced) observations 151

VARIABLE	COEFFICIENT	T-STATISTIC	P-VALUE
PER CAPITA GDP	-0.19	-0.26	0.80
CYCLE OF REAL GDP	-5.52	-2.13	0.04
DEGREE OF OPENNESS	0.36	0.25	0.81
URBANIZATION RATE	18.80	1.90	0.06
PARTICIPATION IN THE LABOR MARKET	-34.40	-2.99	0.00
INTEREST PAYMENTS	0.94	2.16	0.03
FISCAL CENTRALIZATION	0.09	2.99	0.00
MAJORITY STATUS	-1.32	-1.50	0.14
GOVERNMENT LEGISLATIVE CONTINGENT	0.05	1.60	0.11
GOVERNMENT COHESION	0.02	0.80	0.43
CABINET STABILITY	0.01	2.71	0.01
FRAGMENTATION	0.51	1.04	0.30
RIGHTIST PRESIDENT*SIZE OF HIS PARTY	-0.05	-0.62	0.54
CENTER-RIGHT PRESIDENT*SIZE OF HIS PARTY	-0.04	-3.59	0.00
CENTRIST PRESIDENT*SIZE OF HIS PARTY	-0.09	-5.80	0.00
PRESIDENT'S LEGISLATIVE CONTINGENT	0.05	1.60	0.11
ELECTORAL YEAR	-0.64	-2.37	0.02
POST-ELECTORAL YEAR	0.45	1.03	0.31

## Weighted Statistics

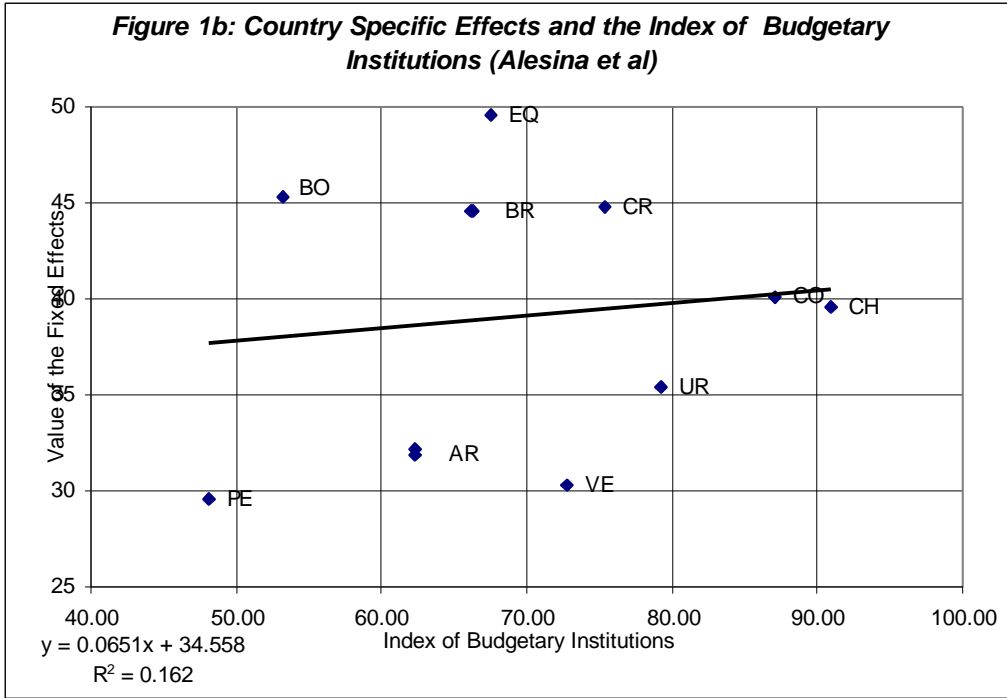
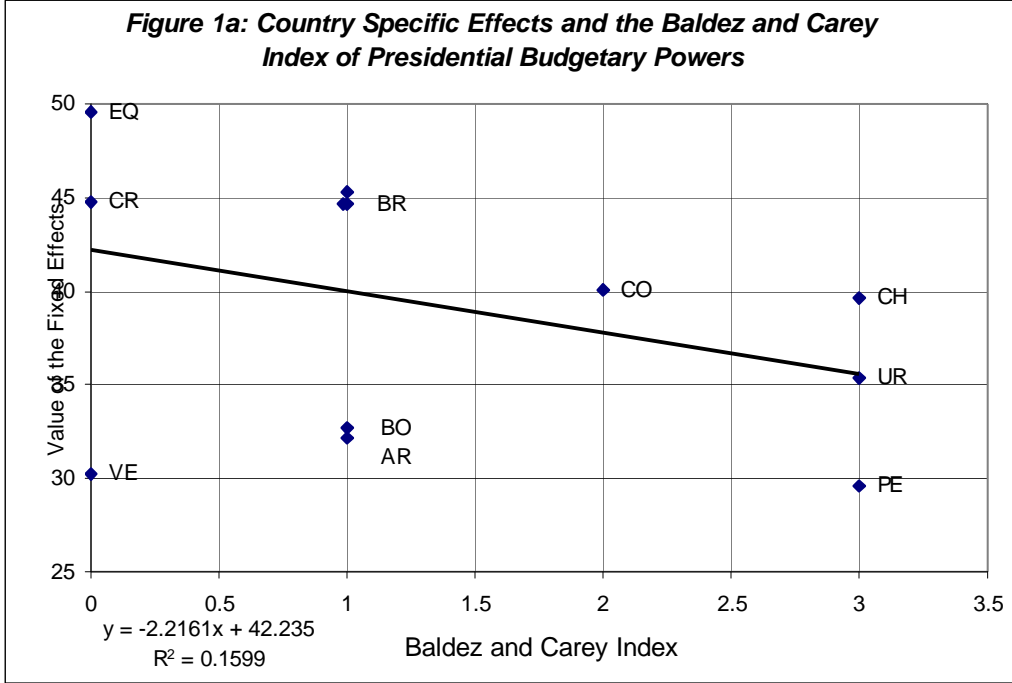
R-squared	0.87	Mean dependent var	1.19
Adjusted R-squared	0.83	S.D dependent var	4.40
S.E. of regression	1.82	Sum squared resid	257.33
Log likelihood	-128.83	F-statistic	33.25
Durbin-Watson stat	2.11	Prob (F-statistic)	0.00

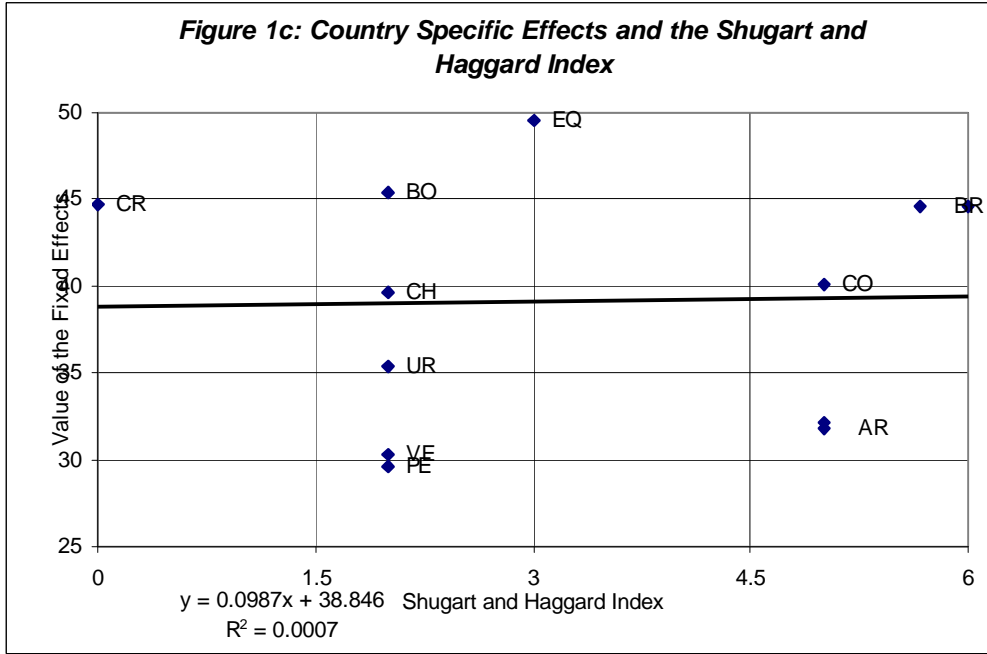
Finally, to determine the relationship of fiscal behavior with presidential budgetary powers, fiscal institutions, and the convergence/divergence of incentives between presidency and legislature, we plot the Baldez-Carey (1999), the Alesina et al (1999), and the Shugart and Haggard (2001) indices against the country fixed effects, which are drawn from the regression presented in

Table 1. Given that the values of the three indices are basically constant in time, it is possible to analyze their relations with the fixed effects because the latter constitute the mean of the primary balance for each country. In other words, we are interested in examining how the three indices influence the fiscal balance.

Figure 1 below plots the country coefficients drawn from the regression presented in Table 1 against the three indicators. In panel A of this figure, the country fixed effects are plotted against the Baldez and Carey index of presidential budgetary powers; in panel B we use the index of fiscal institutions proposed by Alesina et al; and, finally, panel C shows the relationship between the specific fixed effects and the Shugart and Haggard index of institutional factors favoring unity or separation of purpose between the presidency and the legislature.

Figure 1 shows that only the index of Alesina et al is compatible with our results. Panel B shows a positive relationship between primary balances unexplained by the model in Table 1 and fiscal institutions. The good result obtained by the index of Alesina et al is probably due to the fact that it focuses on many institutional aspects affecting fiscal policy implementation, while the Baldez and Carey index deals with only one aspect of budgetary policy (presidential powers) and the Shugart and Haggard index offers a distant proxy of how presidential and legislative incentives regarding policy converge or diverge.





#### IV. CONCLUSION

This paper attempted to adjust well-known hypotheses regarding the political determinants of public deficits to the context of Latin American politics in the 1980s and 1990s. Our findings confirm to a great extent the notion that governments are able to generate lower public deficits when the former have the motivation and resources to do so. Motivations depend on the electoral cycle. Resources are a function of the degree to which power is dispersed in the political system or on the stability of the government. To be more precise, our main findings are that centralized polities are associated with lower deficits; stable governments generate lower deficits; electoral years increase the deficit; and countries with hierarchical fiscal institutions decrease the deficit.

Those findings shed new light on the fateful interlocking of economy and politics in Latin America in the 1980s and 1990s. In the 1980s most Latin American countries were transiting to democracy. Transitions to democracy often require the formation of broad-based coalition governments so as to accommodate the newly emerging democratic forces. While such formula maximizes the political support of incoming governments, it cripples them as far as economic policy-making is concerned because it renders governments too unstable, particularly in times of economic crises. Moreover, some countries like Brazil, Ecuador, Peru, and Venezuela have witnessed an increasing fragmentation of their political systems over the last two decades. Fragmented polities also require broad-based coalition governments so the executive can obtain legislative majorities. Such governments also tend to very unstable, which, in turn – as our test reveals – leads to higher deficits.

Additionally, our test also corroborates the views of those who are skeptics about the virtues of decentralization. Attempts at decentralization promote more fragmentation of political resources, and, thus, higher deficits.

The paper also shows that there is evidence to say that Latin American parties matter less than their OECD counterparts as far as fiscal policy is concerned, thus confirming the view of those who think that globalization has rendered party ideologies ineffective in developing countries.

Finally, a normative note is in order. On the evidence of this paper, political reforms designed to increase fiscal centralization and increase government stability are likely to bear good economic fruits.

**Appendix I: Sources of government attributes data**

Argentina: data provided by Ana Maria Mustapic, and *Keesing's Record of World Events On Line*.

Bolivia: data provided by Carlos D. Mesa Gisbert, and *Keesing's Record of World Events On Line*.

Brazil: *Istoé* (Brazilian weekly magazine), January 4, October 7, 1992, p. 34-49; *Keesing's Record of World Events*, vol. 31, no. 6, 1985, p. 33643-33650; *Veja* (Brazilian weekly magazine), February 12, 1986, p. 16-21; March 14, 1990, p. 26-31; October 7, 1992, p. 34-49; and data provided by Antônio Octavio Cintra and José Luciano de Mattos Dias.

Chile: data provided by Daniel Kaufman, and *Keesing's Record of World Events On Line*.

Colombia: *Keesing's Record of World Events On Line*.

Costa Rica: data provided by John Carey, Judith Schultz, and Michelle Taylor, and *Keesing's Record of World Events On Line*.

Ecuador: data provided by Andrés Mejia Acosta, and *Keesing's Record of World Events On Line*.

Peru: data provided by Barbara Geddes, and *Keesing's Record of World Events On Line*.

Uruguay: data provided by David Altman, and *Keesing's Record of World Events On Line*.

Venezuela: data provided by Valia Pereira, and *Keesing's Record of World Events On Line*.

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