



**The role of political business cycles (PBCs) and its influence on
the credit rating action that countries receive: A BRICS
perspective**

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1. Abstract

Existing empirical literature on political business cycles focused primarily on developed economies before it began considering a basket of both developed and developing economies. This study seeks to expand the existing literature by pursuing two objectives using Brazil, Russia, India, China and South Africa (BRICS) as locations of the study. The first objective is to examine the presence (lack thereof) of political business cycles in the BRICS trading block for the period 1994 to 2014. The second objective of this study is to examine the effect that political business cycles (if present) have on the sovereign credit ratings that the BRICS countries receive from credit rating agencies. Credit rating agencies make use of a combination of political, social and economic factors to determine the ratings assigned to various countries. The credit ratings assigned to countries by these agencies play an important role to international lenders as they use these ratings to make decisions on the interest rates they charge to different sovereigns. Based on the first objective, the findings from this study show that there is weak evidence of electorally timed interventions in BRICS economies over the period of 1994 to 2014. These findings are inconsistent with the predictions of political business cycle theory which suggests that incumbent politicians take advantage of the information gap between them and voters by implementing economic changes closer to an election year in order to exude competence and to increase their chances of reelection. However, further analysis based on the second objective shows that elections in BRICS countries are not viewed negatively by credit rating agencies. Hence, unlike in other developing countries, the BRICS countries are not likely to be downgraded during or after election years. Consequent to these findings, this study supports the notion that the government's influence on the fiscal and monetary policy variables across BRICS is not concentrated nor overly exerted around election periods and that the BRICS countries' institutions are regarded by rating agencies as independent and up to relevant international standards.

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Table of Contents

Abbreviation List	6
Chapter 1 – Introduction	7
1.1 Limitations from prior research	8
1.2 Research Objectives	9
1.3 Research Questions	10
1.4 Research Motivation	11
1.5 Contribution to the body of knowledge	14
1.6 Overview of the study	16
Chapter 2.....	17
2.1. Background to the BRICS Countries	17
2.2. Brazil.....	21
Table 1: Summary of election outcomes in Brazil between 1994 and 2014.....	23
2.3 Russia.....	25
Table 2: Summary of election outcomes in Russia between 1994 and 2014.....	28
2.4 India	30
Table 3: Summary of election outcomes in India between 1994 and 2014	32
2.5 China.....	35
Table 4: Summary of election outcomes in China between 1994 and 2014	37
2.6 South Africa.....	39
Table 5: Summary of election outcomes in SA between 1994 and 2014	41
Chapter 3 – Theoretical Framework	44
3.1 Introduction.....	44
3.2 Traditional PBC Theory.....	44
3.3 Opportunistic PBC Theory.....	45
3.4 Partisan PBC Theory.....	50
3.5. PBC theories that apply to the BRICS	53
Chapter 4 - Literature Review.....	55
4.1 Introduction	55
4.2 Evidence from single industrialized developed economies	55
4.3. Empirical evidence of PBC based on a group of industrialized developed economies	59
4.4 Evidence of PBC from single developing economies.....	63
4.5 Evidence of PBC from a group of developing economies	66
4.6 Evidence of PBC from a mix of both developed and developing economies.....	69
4.7 Evidence on the possible link between PBC and sovereign credit rating action	72

Chapter 5 – Data and Methodology	78
5.1 Introduction.....	78
5.2 Data.....	78
5.2.1 Macroeconomic Data	78
5.2.2 Electoral Data.....	79
5.2.3 Credit Rating Data	81
Table 6: Summary of credit rating levels as set by the 3 main CRAs in the World	82
Table 7: Credit rating levels from the 3 main CRA presented in a 17-point scale	83
5.3 Hypothesis development.....	83
Chapter 6 – Findings.....	88
6.1 Introduction.....	88
6.2 Descriptive statistics	88
Table 8: Descriptive statistics for the macroeconomic variables for Brazil, Russia, India, China and South Africa (1994 – 2014)	88
6.3 Political Business Cycle Results.....	90
Table 9	91
Table 10	91
Table 11	92
Table 12	93
Table: 13	93
Table 14	94
Table 15	94
Table 16	95
Table 17	96
Table 18	96
Table 19	97
Table 20	97
6.4 Sovereign Ratings Model Results	98
Table 21: Summary of results on how ratings are affected by macroeconomic variables in election years	99
Chapter 7 – Conclusion and suggestions for future research.....	103
References.....	106
Appendix.....	121

Abbreviation List

ANC	African National Congress
ARMA	Auto-Regressive Moving Average
BEAC	
CFA	Banque des États de l'Afrique Coopération financière en Afrique Centrale
BRICS	Brazil, Russia, India, China and South Africa
CCP	Chinese Communist Party
CPIA	Country Policy and Institution Assessment
CRAs	Credit Rating Agencies
DPI	Database of Political Institutions
DV	Dummy Variable
EU	European Union
EVM	Electronic Voting Machine
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GEAR	Growth, Employment And Redistribution
GFI	Gross Factor Income
GLS	Generalised Least Squares
GMM	Generalized Method of Moments
GNP	Gross National Product
IEC	Independent Electoral Commission
JSE	Johannesburg Stock Exchange
IMF	International Monetary Fund
LDV	Lagged Dependent Variable
LSP	Lucas-Sargent Proposition
NAFC	North Atlantic Financial Crisis
NDB	New Development Bank
NDP	National Development Plan
NGP	New Growth Plan
NPC	National People's Congress
OECD	Organisation for Economic Co-operation and Development
OLS	Ordinary Least Squares
OPEC	Organization of the Petroleum Exporting Countries.
PBCs	Political Business Cycles
PMC	Political Monetary Cycles
PMG	Pooled Mean Group
RDP	Reconstruction and Development Programme
S&P	Standard & Poor
SADC	Southern African Development Community
SARB	South African Reserve Bank
SGP	Stability & Growth Pact
SIC	Schwarz Information Criterion
SOE	State Owned Enterprises
UN	United Nations
WB	World Bank
WDI	World Development Indicators

Chapter 1 – Introduction

Political business cycles (PBCs) are business cycles that manifest because of the manipulation of policy tools (monetary and/or fiscal) by incumbent politicians with the goal of stimulating the economy just prior to the elections in order to improve their own and their party's chances of re-election. In this vein, politicians turn to expansionary fiscal and monetary policies in the lead up to elections because of their short term benefits such as tax cuts, falling unemployment, falling interest rates, increased government spending etc. The problem with such measures is that they have contractionary effects on the economy in the medium to long run, right after elections. The new government finds itself having to counter the effects of the prior expansionary measures by allowing interest rates to rise, cutting spending, raising taxes and slowing the growth of money supply amongst other measures. Elections are therefore considered to bring about an artificial boom and bust cycle in the economy in line with the regularity of elections (Johnson, 1998).

PBCs can be observed through changes in macroeconomic variables such as output, unemployment and inflation, which are also susceptible to government's actions. As explained above, these cycles occur as a result of the manipulation of either fiscal or monetary policy. The cycles that are attributed to manipulation of fiscal policies are often referred to as Political Budget Cycles while those that are caused by monetary policy manipulation are called Political Monetary cycles. However, the focus of this study is not on the two aforementioned cycles separately, but on the PBCs which are caused by the incumbent government's manipulation of both fiscal and monetary variables. To begin with, it is important to note that PBC theory can be classified into two fundamental models, namely opportunistic PBC and partisan PBC. Opportunistic PBC theory states that expansionary measures are used by incumbents in an opportunistic manner before an election to increase their chances for a re-election. The Partisan PBC theory, on the other hand, states that macroeconomic fluctuations influenced by politicians are dependent on the objectives of the leaders' party which could be either left or right wing (Drazen A. , 2001).

Owing to the role that PBC can play in an economy, it is important to understanding how prevalent PBC is in the five-member states of **Brazil, Russia, India, China and South Africa (BRICS)** in order to provide evidence of how high or low political risk is in the BRICS bloc. Political risk is one of the factors alongside social and economic factors that Credit Rating Agencies (CRAs) factor into account when determining the credit ratings that they allocate to

sovereigns. As a result, this study seeks to examine if the factors that cause PBC also have a significant contribution towards the credit ratings that the sovereigns receive.

1.1 Limitations from prior research

Research on PBC dates back to 1975 when the traditional PBC models were introduced and defined by Nordhaus William, an economist and professor at Yale University. His model formed the foundation for PBC research and got analysed further, hence, leading to the present two models of PBC theory mentioned above and which are discussed further in this study. Before delving into too much detail on the two models of PBC theory, this study conducted an extensive review of literature to determine the limitations that could be present in this field. These limitations were then used to formulate research objectives, questions and motivation for this current study. Some of the notable limitations observed during an examination of the extant literature are presented below as follows:

- Earlier PBC research focused mainly on individual and groups of developed economies and the motivation for that choice of countries was that their macroeconomic and political data was readily available and well documented for use. Most of the developed economies that were investigated had and still have well established electoral systems and institutions in place that were designed to anticipate and counter electorally induced behaviour that could lead to PBCs (Nordhaus, 1975; Lindbeck, 1976; Tufte, 1978).
- A substantial amount of prior research is based on individual countries. However, although this is of informative value to the country's policy makers, it does not inform them of how the country fairs in relation to its peers or trading partners in a bloc, cooperation or monetary union. An insight into how a group of countries with similar characteristics and economic capabilities could foster policy choice that is beneficial not only to a single country but also to the trading partners within the union or bloc owing to the importance of policy stance by one country within a globalised market.
- Studies that looked at a group of countries focused on blocs of industrialised economies with strong institutions such as OECD countries (Alesina, 1987), Euro zone nations, the G8 and the G20 with scant research focusing on the developing and emerging economies. Therefore, a focus on the large and key players of the global economy ignores the small and upcoming players, many of whom experience the effects of political manipulation in their already weak institutions and poor electoral systems.

- Existing research shows that, it was only until the 1990s that some studies began to cover developing countries and at this point, the focus was on countries in Latin America and Asia. Their role in the global economy began to catch the attention of academics (Block, 2002). Coincidentally, literature with a specific focus on African nations followed as democratization began to spread and dictatorships, military rule and apartheid regimes were halted (Block, 2002).
- Prior research also began to look at a mix of both developed and developing economies but without a clear set of criteria for their choice of countries. The shortcomings of such analysis are that it provides findings that would lack concrete informational value due to being heavily weighted and biased by the data and output of some countries more than others.
- No prior research to this study was found to have been conducted with a direct focus on PBC across the BRICS trading bloc. Prior research that included the five-member nations of the BRICS did so alongside other countries. A possible explanation for this gap in research, especially for South Africa (SA), could be that SA is a nascent democracy, which made it a less desirable location to conduct research on.
- Studies that looked at a combination of developed and developing countries, did so for a considerably finite time frame (2 to 10 years) which may not have been sufficient to provide in depth and substantiated findings. This served as a motivation for this current study to adopt a 20-year time frame.

1.2 Research Objectives

The objectives that this study aims to achieve are to:

- Contribute to the existing literature on PBCs in emerging markets, specifically economies that are very similar to BRICS member nations or that collaborate with them the most, be it for trade or other reasons.
- Enhance the understanding of political risk as explained through the evidence or lack thereof of PBC in BRICS from both a single country's perspective and as a group of countries.
- Clearly illustrate the various models of PBC and present the literature upon which they are founded. This also entails, zoning in on the model(s) that apply to each of the five countries and how their electoral systems are affected by the specific models.

- Identify the macroeconomic variables that are of most significance in providing evidence of PBC in the BRICS member nations and to the bloc through statistical analysis.
- Scrutinize political happenings and policy changes effected in member nations in years leading up to elections over the period from 1994 to 2014 and determine their contributions (if any) to the presence of PBCs.
- Analyse a set of macroeconomic variables via a statistical model with the aim of determining how significant they are as factors that CRAs use when assigning credit ratings for the trade bloc members.
- Compare the findings from the statistical analysis to actual ratings that were allocated by CRAs. This will provide insight on how macroeconomic variables that are affected by policy changes and electoral cycles can also be vital in determining the credit ratings assigned to the sovereigns
- Inform future policy changes and political actions, specifically pertaining to election periods based on the findings of this study. Obtain lessons that the member nations can learn from and perhaps use in aiding them to design policies that will strengthen the bloc in future.

1.3 Research Questions

This study aims to answer two broad questions, which are then split into various sub questions as listed below.

1. How strong is the evidence of political business cycles amongst BRICS member nations?

1.1 Which model of PBC is applicable to the (specific) countries in the BRICS bloc?

1.2 What type of government regimes and electoral systems alike are in place in the countries that make up BRICS and how do they contribute to the presence of PBC?

1.3 What factors and political happenings over the period of 1994 to 2014 may have contributed to the increase in political risk across BRICS?

1.4 How have the member states' governments been dealing with monetary and fiscal policy changes especially in periods leading up to and after general presidential elections?

1.5 How much impact do the PBC effects in a member nation have on the other countries on the bloc and how does this affect the overall risk of BRICS as a trading bloc?

2. How significant is the role of political risk as explained through PBC evidence in influencing the credit rating action for BRICS?

2.1 What is the rating history for BRICS over the period 1994 to 2014?

2.2 What have been the determinants of ratings that the CRAs have been using in allocating ratings to BRICS?

2.3 How significant are the variables that provide evidence for PBC in BRICS in determining the ratings for the member nations?

2.4 What is the difference between assigned sovereign ratings by CRAs and ratings obtained through statistical analysis? What are the reasons for the observed difference?

2.5 What influence do the member nations have on the ratings that either receives and what effect does this have on BRICS as a trading bloc?

1.4 Research Motivation

The motivation for this study is manifold. Firstly, the political landscape in emerging markets especially Africa is one that is continually scrutinized not only by the continent's residents but also by the rest of the World. For example, the African political landscape transformed between 1989 and 1994, with thirty-five sub-Saharan Africa countries re-introducing multiparty elections and as such bringing political openings to around five hundred million people (Cheeseman, 2014). Democracy brings with it a broad range of outcomes to any nation, a reasonable number of them being destructive than others. However, democratisation is also associated with a lot of risk given that past observations of political turmoil are caused by power struggles (Cheeseman, 2014). Evidence provided by Cheeseman shows that the power struggles are most prevalent during election periods, with 80% of African elections being associated with eruptions of war crimes, ethnic clashes and the loss of many lives (Cheeseman, 2014). Political leaders contesting election outcomes tend to either use their current positions of power to strong arm their opponents or rally their supporters to cause chaos as a sign of disagreeing with the results. This behaviour not only has a high human cost, in certain countries more than others, but it also has a detrimental effect on the economic welfare of the nations. Economic growth is hampered as investors react negatively to these mishaps, hence, leading to large capital outflows and minimal foreign direct investments flowing into countries facing these power struggles. Owing to a high prevalence of these mishaps in many developing and

emerging economies, this study aims to examine how the BRICS countries have been dealing with the transition of power issues and the measures they have in place to effectively manage and minimise the negative effects that these could have on their economies if mishandled.

Secondly, it is important that governments of sovereigns get an understanding of the impact that their political actions have on the people they serve. Politicians are viewed to be self-centred people and the electorate often overlooks this point and are swayed by the numerous and at times, empty promises that they make when seeking their votes. Shedding light on the outcomes of electoral mismanagement will be informative to political leaders and drive innovation from their end when seeking office. BRICS member countries have an unpopular feature, discussed below, that is likely to come in the way of them realising economic equivalence to that of other developed and developing economies. The prominent feature within the BRICS countries, is that wealth is concentrated in relatively few hands, individuals or families. Hence, as economies continue to grow, there will be a pressing need for even distribution of wealth to the majority of the population who are impoverished and governments will be expected to spearhead this change. One efficient means of achieving this redistribution of wealth would be through policy change, a tool that governments have substantial control over and which they tend to manipulate for their benefit. Following this view, this study should provide guidance to the BRICS countries towards designing an agreement on policy changes if they seek to maximise on the potential of the economic bloc (Financial Times, 2006).

Thirdly, citizens of a sovereign are never fully aware of the immense power that is possessed in the democratic right to vote. People tend to be very short sighted and do not ponder on the impact that their leaders will have on the economy and the nation in the medium to long term. This lack of foresight is what politicians take advantage of when elections come about. Voters need to be informed of the consequences that politicians' actions have on the state of the nation be it positive or negative. They need to be provided with as much information as possible to inform their decisions and consequently their choice of leaders. The findings from this current study will provide insight on what changes voters should look out for in the lead up to elections and after so as to assess the competence of the candidates and newly elects respectively.

Fourth, highlighting the effects of PBC should drive governments to make efforts to reduce the controversy around elections. This could be through technology innovations that are driven by social entrepreneurs such as devices to register voters and transmit election results from the polling stations to an online platform in real time. This approach should be considered with

caution as it is the very same governments that may use their position to find ways to go around the innovations to get an edge over their opponents and misdirect voters. Moreover, this study will enable us to identify if there are any noticeable changes in PBC evidence in between the time frame before BRICS was formed and then after. It will offer insight on whether there was a behaviour change in BRICS leaders as a result of getting into an economic bloc or if their actions got worse as they now have access to greater political influence and more financial resources.

Fifth, there is continual emphasis and demand for good governance reforms by international donors. Governments seeking funds from the International Monetary Fund (IMF) and World Bank (WB) need to exhibit economic and political stability. Unfortunately, depending on how manifested PBCs are in some countries, governments find themselves impeded by limited access to financial backing or high interest rates for any external debt that they are provided with. Some governments go to the extent of looting state funds to fund election campaigns as was observed in Kenya during the period from 1992 to 1997 and this ended up costing the country up to about 10% of its GDP (Cheeseman, 2014). It is through this study that governments can gain insight on what it is that they need to do to address PBC and as such lower their political risk levels and open up channels of funding and financing partnerships.

Sixth, an aura of scepticism exists around the validity of credit rating action by agencies such as Moody's, S&P and Fitch Ratings. A major reason behind this is the fact that these agencies get their fees from sovereigns and companies that pay them for credit ratings. A conflict of interest arises as countries could stop paying for the CRAs' services if they believe that the rating they receive is not justifiable (Hanusch and Vaaler, 2013). Conversely, more countries will pay for the ratings because of the numerous benefits associated with a positive outlook or upgrade to their credit rating. This study will play a role in eroding the scepticism by trying to prove that CRAs do indeed consider the influence of political risks on the creditworthiness of a sovereign and that their findings are close to or in line with what the findings of this study reveal. Furthermore, this study should strengthen the current relationship between CRAs and sovereigns, the result of which will enhance the international investor community's reliance on the ratings when making investment decisions.

Seventh, BRICS as a trading bloc of emerging markets has only been in existence since 2010 when South Africa joined as the final member. Extensive research has been conducted on the member countries separately for evidence of PBCs and in some cases the member states were

included in a larger pool (ranging from ten to twenty-five) of countries. The political risk of the bloc has not been studied from the PBC point of view and this study will give insight to the weightings that each member brings to the overall risk of the bloc given different government regimes, electoral systems and periods of independence. It will inform decision making going forward especially on ways in which electoral reform can be enhanced in countries where it is lacking and lessons that can be learnt from member states where PBCs have been maintained at a minimum. Agreements can be made that result in consequences for facilitating PBCs and as such not only heightening an individual country's political risk but also that of the bloc. Ratings for the bloc will be vital for the success of initiatives that they have in place such as the New Development Bank, should they need to borrow funds from International lenders and prove that that institution is credible and attractive to investors.

1.5 Contribution to the body of knowledge

This study contributes to the existing body of literature in many ways. Firstly, this study depends on and validates the historical information available on the types of government regimes that prevail among BRICS. It distinguishes each of them by their features and explains thoroughly the role that these government systems have played in the social and political welfare of the respective countries. In addition, it identifies the differences and similarities in varying government systems as well as the disadvantages and advantages of either. It also provides clarity about which government system is dominant in BRICS and the effect it has had on the bloc.

Secondly, complimentary to understanding the government systems present in BRICS, this study also highlights the electoral systems that are in place in the countries under study. It focuses on how elections were conducted over the period 1994 to 2014 and how authentic they were and free from foul play. The most important elections for the purpose of this study are general presidential elections because they represent a greater shift of power and that they tend to be more contested though it is worth mentioning that in countries such as SA and India, the stakes tend to be high even in local government and Lok Sabha elections respectively. In this view, this current study contributes immensely to the growing literature on elections in BRICS by investigating and documenting methods and tactics that politicians (those in power and their opposition) used over the said time period to win over voters. This study also provides a critique on electoral systems that lack independence and prevent voters from fully exercising their

democratic right. In the same light, the study highlights electoral systems that are efficient and whose results have yielded in little to no disputes and successful handover of power.

Third, this study contributes to literature on policy action with specific focus on fiscal and monetary policy. It makes inferences based on notable fiscal and monetary policy changes that were conducted by governments in periods leading to and after general elections between 1994 and 2014. The study makes the foresaid possible through its reliance on the observed changes in a number of macroeconomic variables that are indicative of the fiscal and monetary policy changes implemented in the BRICS countries. The timing of these changes in relation to elections will also be of interest for the purposes of this study as it paves way for the possibility of PBCs.

Fourth, the pooling together of the contributions discussed above extends the existing PBC literature to economies that have previously received little to no attention from researchers. Furthermore, this study utilises a specific theoretical framework that identifies the type of PBCs that are applicable to BRICS countries. It does so by building on the existing literature that has identified mixed evidence of PBCs in member states for different time periods. In this vein, this study informs literature on which macroeconomic variable changes best provide evidence of PBCs in BRICS. It further illustrates if there is a correlation between political behaviour by incumbents during elections and economic stability changes that come into effect, before and after elections.

Fifth, this study also leads to a better understanding of the determinants of credit ratings that are used by CRAs such as Moody's, S&P and Fitch. It focuses on a mix of social and economic variables that would have been analysed with the aim of finding evidence of PBCs in BRICS. The goal is to observe which of the above-mentioned factors have a significant impact on the rating levels that the countries receive. This enables this current study to then conduct an analysis, which entails the inputting of these variables into a model and getting its own set of credit ratings for BRICS. Thereafter, this study conducts a comparison between the ratings found in this study to those issued by CRAs (factoring in that this study does not use a wide range of macroeconomic variables as they do). This comparison enables this study to prove the hypothesis that credit ratings as awarded by CRAs are indeed justified and are an accurate indicator of the credit risk associated with a sovereign.

1.6 Overview of the study

In order to achieve the set objectives of this study, the study is organised as follows: Chapter 2 presents an overview of the BRICS bloc and its member countries. The chapter focuses on a mix of political happenings, social and economic activities that the countries experienced over the period of 1994 to 2014, the factors that could be instrumental in providing evidence relating to PBCs. In addition, chapter 2 discusses the government systems, electoral protocols and procedures that are in place in the BRICS as this will shed light on the extent to which political leaders and the government influence economic growth and stability. Chapter 3 provides the theoretical framework around PBCs as well as identifying the models that apply to the BRICS bloc. Chapter 4 presents a review of the literature on PBC theory, evidence of PBC and determinants of credit ratings. Chapter 5 explains the methodology that is applied, while chapter 6 presents a discussion of the findings of this study. Thereafter, chapter 7 provides a conclusion and a suggestion for possible future research.

Chapter 2

2.1 Background to the BRICS Countries

The BRICS is an association that comprises of economies that have repeatedly featured in the WB's list of the largest and fastest growing economies in the world. It initially started with four members namely Brazil, Russia, India and China and by then the association was known as BRIC, a term that was coined by Jim O'Neill in a publication (O'Neill, 2001) and which became official after the foreign ministers from the four states met in 2006 and later conducted the first BRIC summit in 2009. BRIC became a topic of discussion over time and Goldman Sachs released a series of economic papers whose projections were that the BRIC would be the most dominant economies by the year 2050 (Times, 2006). O'Neill (2001) predicted that through economic development and political cooperation between BRIC members, there would be a shift in global economic power from developed to emerging economies who were exhibiting double digit growth figures and had spectacular balance of payment figures. In 2007, a Goldman Sachs report produced a list called the Next 11 (N-11) economies comprising of a mix of developing economies and newly industrialized economies. The countries that made up this list are Bangladesh, Egypt, Indonesia, Iran, South Korea, Mexico, Nigeria, Pakistan, the Philippines, Turkey and Vietnam (Eghbal, 2008). These countries were seen to be similar to BRIC in terms of population sizes, strong economic growth rates driven by manufacturing, importing and exporting, improving business environments and regulation, rapid urbanization, technology adaption and attractive for foreign direct investment (FDI) inflows. There has been speculation as to which of the N-11 economies would be a likely addition to BRIC but that has yet to materialize (Wilson & Stupnytska, 2007).

Despite BRIC comprising of strong emerging markets, there was no African representation. South Africa's formal admission to the association was officiated in December 2010 leading the acronym, BRIC to be changed to BRICS. The South African President, Jacob Zuma attended the first BRICS summit in 2011, which was also the first-time leaders of all five-member countries convened together. South Africa's addition was considered a political move more than anything given the small size of its population and economy in comparison to its BRIC counterparts. However, it was a welcomed addition because South Africa is the largest and most developed African economy and therefore it was aimed that it would give the bloc

access to other African economies (with emphasis being on SADC), a four continent scope, global influence and trade opportunities (Why is South Africa included in the BRICS?, 2013).

The BRICS bloc makes up about 43% of the world's population, has 30% of the world's GDP and contributes up to a 17% share in world trade (Bawa, Bohler-Muller, Fikeni, Zondi, & Naidu, 2014). It has had eight summits since its formation in 2009 that were held in member countries to foster the commercial, political and cultural cooperation among the nations on issues such as climate change, energy, poverty, terrorism, agriculture and development. Besides the abovementioned issues, there are certain matters the summits had to discuss and state their stance on. This study shall now look at the major takeaways from the summits held up to 2015.

The first BRIC summit of 2009 held in Russia was right after the global financial crisis and it focused on advancing reform of international financial institutions and addressing the need for a stable and more diversified international monetary system. BRIC called for cooperation among energy states and support for the poorer countries that were hardest hit by the financial crisis (BRIC, 2009). The second summit held in 2010 in Brazil discussed global governance, recognizing the role of bodies such as the G20 in International economic coordination, the United Nations (UN) in dealing with global challenges and threats and emerging economies in championing the resumption of global economic growth. Furthermore, the BRIC pledged to contribute funds to the IMF alongside the G20 so that they could have more resources to supply needy developing countries (BRIC, 2009).

The third summit held in 2011 took place in China and it was the first ever BRICS summit with South Africa as an official member of the economic bloc. This summit reiterated the call for the comprehensive reform of the UN, including its Security Council in order to make it more representative of all the participating members and to serve them accordingly. It also highlighted the possible risk that excessive volatility in commodity prices would pose to the recovery of the World economy. In addition, future nuclear energy projects were seen to be a pivotal area in the energy of BRICS members and that the energy projects needed thorough vetting. In a similar vein, there was also a call for further infrastructural development in Africa and cooperation in areas such as science, technology and innovation (BRICS, Sanya Declaration, 2011).

The fourth summit was held in 2012 in India at a time when the recovery of the world economy faced the challenges of market instability in the Eurozone and the escalation of the Arab Israeli conflict in the Middle East. This summit pointed out how excessive volatility in capital flows and commodity prices due to the euro crisis were trickling down to emerging economies and how that would hamper growth and development. The BRICS called on the WB to give greater priority to flows of development finance to emerging and developing economies. Furthermore, this summit led to the mooting of the formation of a New Development Bank (NDB) among BRICS as well as the delegation of the respective finance ministers to examine the feasibility and viability of such a project. There was emphasis on the commitment to achieve Millennium Development Goals (MDG) especially amongst developing countries as well as for member states to jointly work towards combating public health challenges faced by most BRICS countries. The first ever BRICS Report by India was published in 2012 and its focus was on synergies within the BRICS economies (BRICS, 2012).

The fifth summit was held in 2013 in South Africa and it stressed on the need for the provision of support to African countries by developed economies as they go through their industrialization process. In this meeting, the BRICS' promised to provide closer cooperation with African countries. In the same meeting, further investigation and progress on the likelihood of a development bank for BRICS was discussed and it received further support from the proposal of a Contingent Reserve Arrangement (CRA) valued at about US\$ 100bn. The CRA was meant to provide a financial safety net for BRICS. The summit also reiterated the bloc's concern on issues such as Afghanistan's stability, the Iranian nuclear issue and slow progress in the Middle East Peace Process and deteriorating situations in Syria, Central African Republic (CAR) and the Democratic Republic of Congo (DRC) (BRICS, 2013).

The sixth summit was held in 2014 in Brazil and it started on a high note with the signing of an agreement that led to the establishment of the NDB for infrastructure and sustainable development projects. Respective finance ministers had to work out the modalities of its operationalization. There was also a conclusion of agreements relating to BRICS Export Credit and Guarantees Agencies as well as Innovation within the BRICS Interbank Cooperation Mechanism. The role of State Owned Companies and Small and Medium Sized Enterprises in the economy as creators of wealth and jobs was highlighted. In addition, an effort was made on how to deal with tax administration issues that could negatively impact state owned companies and small and medium sized enterprises. However, there was also a concern

expressed over unresolved issues in Iraq and Ukraine alongside some of the nations mentioned in the previous summit. The summit also held a discussion on the importance of education, fighting corruption and cybercrimes, agricultural cooperation, promoting Information and Communication Technologies in a bid to foster economic growth and social inclusion among BRICS and other developing economies (BRICS, 2014).

The final summit of potential relevance to this study took place in 2015 in Russia. It began by recognizing that there are persisting risks to the global economy, majority of which the previous summits had covered extensively. The BRICS was nearing the commencement of operations with the NDB and the leaders called for it to cooperate closely with new financing mechanisms such as Asian Infrastructure Investment Bank (AIIB). The BRICS also called upon the UN to deal timeously with the sovereign debt restructuring process, which was becoming a barrier to access of funds and economic development for most of the developing economies. There was also a call for cooperation in preventing and developing responses to emergencies caused by natural disasters, terrorist attacks or other unprecedented occurrences. The leaders reiterated their concern about the escalated armed conflict in Libya, South Sudan, DRC, Burundi and CAR. BRICS welcomed feedback from a vast range of sub councils that met before or during the duration of the summit to address specific issues directed to them (BRICS, 2015).

Despite that the BRICS are associated with high risk, they are closely monitored by investors that are looking for high growth investments. Their high-risk nature led to a Morgan Stanley analyst in 2013 to coin the term “Fragile Five” referring to the economies of Brazil, India, Indonesia, South Africa and Turkey that were getting too reliant on FDI to finance economic growth (Thomas Jr., 2014). The problem with such reliance is that should the Federal Reserve decide on fiscal tightening then the lines of credit available to these nations would decline, a situation that was argued to aggravate these economies, as they shared a common feature in the form of running large current account deficits (Grater, 2017).

Apart from the brief overview of the origins of the BRICS and its objectives over the years, the ensuing sub sections of this chapter present the defining characteristics of the BRICS countries as well as events that could have influenced their levels of political risk over the period of 1994 to 2014. Therefore, the next sub sections provide an overview of events that could have influenced the levels of political risk in Brazil, Russia, India, China and South Africa respectively as explained below.

2.2 Brazil

2.2.1 Government Type

Brazil is a decentralized federal and constitutional republic with three branches of the government, namely the executive, legislative and judicial. The **president** serves a four – year term with a chance for re-election for another 4 years. Its congress is comprised of the Senate, which is made up of 81 members who are elected for 8-year terms, and the House of Deputies, made up of 513 members elected for 4-year terms. The number of deputies directly relates to the population of the representatives from various states. The representatives come from 15 different major political parties, which represent everything from democrats to communists (Bonnal, n.d.).

2.2.2 Electoral System

Brazil has four types of majority elections: absolute majorities elect the president, governors and mayors while senators are elected by simple majorities. In the event of no absolute majority in the first round in cities with more than 200 000 voters, a runoff is required between the top two candidates until one gets 50 percent plus at least 1 vote. For the purpose of this study, the focus is on the presidential elections. The president has his/her respective vice president elected on unified slates.

Election Day is a national holiday in Brazil with the first round elections being held on the first Sunday in October and runoff second elections on the last Sunday of October. Election laws are detailed and dictate the fulfilling of certain requirements. One is that all candidates that hold executive positions should resign six months before the election and that only candidates officially represented by a registered political party may run for election. Political parties elect their presidential candidates in national conventions.

Voting is a right and duty in Brazil and thus registration and voting are compulsory for all between the ages of eighteen and seventy. However, the constitution of 1988 lowered the voting age to sixteen, increasing the turnouts for elections in Brazil. Generally, the voter turnout in Brazil is as high as more than 85 percent. In addition, the electoral system has transitioned from using individual paper ballots for each office (before 1966) to unified single ballots (until 1996) to electronic voting which was used in 1996 in 51 of Brazil's largest cities. In 2000, it became the first country to hold elections completely by an electronic system and it has remained at the forefront of the electronic voting movement (Lin & Espinoza, 2007).

Candidates' names are randomly listed on the ballot for majority elections and the voter is required to mark the respective box. In a presidential election, each Brazilian gets to vote for the president, the voter's state governor, one or two senators, one federal representative and one state representative (Utsumi, 2014). Voter education in this case is paramount as some voters were not aware of the abovementioned and as such they would only vote for the first two and leave the rest blank. In terms of campaign resources, there used to be few restrictions on campaign finances in the past but that changed in 1994 after the passing of Law No. 8,713 that legalized contributions from individual businesses towards campaigns and the issuance of electoral bonus receipts to contributors. Alongside the new law that was put in place, a further requirement was that parties and candidates were required to submit to the electoral court a detailed balance sheet that listed the contributors and expenses incurred. These reports were supposed to be timeously made public and analyzed in the press so that the voters were well informed. To make sure of this, the 1994 constitution was revised in May 1994. The revision led to the reduction in the presidential term from five to four years, the unification of the terms of the president, state governors and congress and to the limitation of their re-election to only one subsequent term (The Electoral System, 2016).

In terms of party representation, Brazil has a highly fragmented political party system, which has seen no fewer than eighteen parties represented in the Chamber of Deputies since 1990. However, there are four major parties namely: The Workers' Party (PT), the Brazilian Social Democracy Party (PSDB), the Brazilian Democratic Movement Party (PMDB) and the Democrats (DEM), previously the Liberal Front Party (PFL). The PT is a left wing, PSDB a centre-to-centre-left party, PMDB is a centre party while PT is considered right of centre (Alvarez-Rivera, 2015). Table 1 below shows that the presidential elections since 1994 were dominated by the PT party as it achieved more success than the other parties as shown below.

2.2.3 Election History over the period from 1994 to 2014

Table 1: Summary of Presidential election outcomes in Brazil between 1994 and 2014

Election Year	President elected	Party	Margin of Win	Incumbent Contesting
1994	Fernando Henrique Cardoso	Brazilian Social Democracy Party (PSDB)	27.3%	No
1998	Fernando Henrique Cardoso	Brazilian Social Democracy Party (PSDB)	21.4%	Yes
2002	Luiz Inácio Lula da Silva	The Workers' Party (PT)	22.4%	No
2006	Luiz Inácio Lula da Silva	The Workers' Party (PT)	21.6%	Yes
2010	Dilma Rousseff	The Workers' Party (PT)	12.2%	No
2014	Dilma Rousseff	The Workers' Party (PT)	3.2%	Yes

2.2.4 Brazil's policy changes and macroeconomic outlook over the 1994 to 2014 period

Brazil was going through a period of hyperinflation in the lead up to the 1994 elections. A condition termed as “short-termism”, which turned out to be most detrimental to the poor who could not protect themselves against inflation. With an overvalued Real and Brazil having high interest rates in place, it was hard to attract foreign capital and this resulted in the deterioration of their fiscal accounts. In response to rampant inflation, the Plano Real was launched in 1994 as part of a strict anti-inflation approach that was put in place by the new president, Henrique Cardoso. This policy led to a decline in inflation from about 2477% in 1993 to just under 7% in 1997 (The echoes of 1994, 2014).

In 1999, the Real was floated and the government began a transition from an exchange rate targeting regime to an inflation-targeting regime with the goal of price stabilization. This was followed by tightening of monetary and fiscal policy, which led to the implementation of the

Fiscal Responsibility Law in 2000. The reasoning for the law was to control public spending, which is a contractionary measure that was effected right after the completion of elections in 1999 – a move which according to PBC theory is expected post-elections. In addition, the IMF approved a loan package to assist Brazil with the debt crisis and to supplement the government's efforts to adjust fiscal and external imbalances (IMF, 2007). Economic growth in this period was driven mainly by the commodity super-cycle, mineral exports (particularly iron ore) to China (one of Brazil's largest export market) and agricultural commodities that did well on the back of both domestic and international demand (Dwyer, 2014)

However, in the build up to the 2002 elections, there was an increase in economic tensions as investors were concerned about Brazil's energy crisis and the possible default on the national debt (Holland, 2015). The Worker's Party (PT) secured electoral victory and got into office. Lula da Silva, the new president, was swift to calm investors by vowing to maintain the current macroeconomic policies (The Economist, 2015). As a result, Brazil's economic state improved greatly over the period from 2003 to 2006. During this period, the government implemented cash transfer programs, higher minimum wages and facilitated credit growth, which all drove consumption and led to higher stocks of foreign reserves, a large primary surplus and a reduced public debt to GDP ratio (Loman, 2014). In addition to that, the middle class of Brazil grew exponentially due a social security program called Bolsa Familia- a program that led to "the rise of a new, consuming middle class" (Dwyer, 2014).

The Brazilian economy did relatively well until the 2008 global financial crisis which led to a deceleration of global economic growth, specifically in China. The deceleration in the global economic growth led the Brazilian government to enact countercyclical policies during this crisis period when most countries were implementing contractionary policies necessary to preserve confidence. The Brazilian government used quasi-fiscal expansionary policies to re-ignite growth by "intervening in industries through price controls and tax adjustments and extending credit in public banks" (Dwyer, 2014), amongst a host of other measures. However, there is no surprise that the government implemented these measures as this was a time leading up to the 2009 elections. As a result of the measures put in place, the recovery of commodity prices and discovery of oil reserves in the Atlantic Ocean - an increase in GDP was observed from 0.9% in 2009 to 7.5% in 2010. The GDP growth rate was, however, unsustainable and thus ended up declining to 2.7% in 2011 (Loman, 2014). The decline in the GDP growth rate observed was likely due to the central bank raising interest rates to bring economic growth to

a sustainable rate and avoid hyperinflation. However, the move did not yield the desired result as it instead led to a further deterioration of the GDP growth to 0.9% in 2012 (Loman, 2014) .

In 2013, an increase in inflation led to a new round of monetary tightening, as interest rates were raised to levels above 10% p.a., which in turn restricted investment and growth prospects for 2014 due to the high cost of borrowing. The growth prospects were hurt further by the worsening labour market in Brazil which was caused by a mix of lack of job creation and the falling of the labour market participation rate due to more young people pursuing full time education (a result of the Bolsa familia program of 2003). As a result of these events, Brazil was downgraded by the rating agencies with S&P highlighting that fiscal deterioration was the main factor that led the rating agency to assign Brazil its lowest investment grade rating in March 2013 (The Economist, 2015).

Brazil's leadership and their high level of government intervention was blamed for the country being on the verge of a recession by the end of 2014. This was evidenced by its levels of public sector debt that was up to about 60% of GDP as well as a widening gap between government spending and savings rates. As a result of the aforementioned, economists had to revise down their 2015 growth projections for Brazil especially given that its fundamental economic indicators were beginning to partly resemble those of developed economies and straying from the higher growth rates associated with healthy developing economies (Giavazzi, Goldfajn, & Herrera, 2005).

2.3 Russia

2.3.1 Government Type

After the dissolution of the Union of Soviet Socialist Republic (USSR) in 1991, Russia began adapting to self-rule as the Russian Federation (adopting its own constitution in 1993). The Federation has three branches of government namely: executive, legislative and judicial. The **President** represents the executive branch and is voted in for a six-year term, up from four years after the constitution was changed in 2008 (Gilbert, 2012). The president holds significant power in that he serves as the commander-in-chief of the armed forces, appoints the prime minister and can dissolve parliament. Russia does not have a vice president and in the event

that the president cannot perform his/her role then the **Premier** (chair of Government) takes his place. The president cannot serve more than two consecutive terms in office.

The legislative branch (considered subordinate to the executive branch) is the Federation's Assembly consisting of a 178 seat Federation Council and 450 seat State Duma representing the 21 Russian Republics and 66 independent regions and territories. There are a number of active political parties in Russia (CIA, 2017).

2.3.2 Electoral System

It was not until 1996 that Russia had to elect its head of State in a democratic election. Before then, elections were not free and voting was limited to a privileged few. Currently, it is possible for any Russian citizen over the age of 18 to vote. Presidential elections are a direct vote by the people based solely on popularity. If no candidate attains an over 50% majority, then there is a runoff election between the two top candidates with the most votes. Electoral associations (political parties), voters (through collecting two million voter signatures) or election blocs (made up of two or more electoral associations) are the various ways to nominate Russian presidential candidates (Gilbert, 2012).

There is a multiparty system present in Russia although it does not play a major role in presidential elections where only one candidate can win. As such, it creates incentives to consolidate alliances and narrow the field before the vote, which pushes the system to mirror bipolarity or majoritarianism system. These alliances come in play during the runoff elections as then voters have to pick between two candidates (Herrington, n.d.). When Vladimir Putin came to power in 2000, he put policies in place that led to a significant drop in the number of parties with nationwide influence to compete in general elections. By 2007, there were only 10 parties with such capability in comparison to 43 in 1995, 26 in 1999 and 23 in 2003. Four elements were over time put in place to make sure that there is a limited number of parties and a dominant 'party of power'. First, there was efficient manipulation of the parties and electoral law to limit opportunities for smaller parties and hamper the creation of new ones. Second, there was presidential support and affiliation to certain parties. Thirdly, mass media (national broadcasting) was forced to focus on respective 'suitable' parties and lastly, limits were set on the regional aspect of power (regional governors are selected by the president and not directly elected) (Mikkil, 2006).

The main political party in Russia is United Russia (UR), founded in April 2001 as a coalition of several political parties. It reveres itself as centrist although it is perceived to be a creation

of Vladimir Putin to retain power. The main opposition party is the Communist Party of the Russian Federation (KPRF) that “remains attached to Marxist-Leninist dogma and advocates State ownership of the economy” (Russell, 2014, p. 1). Other parties that still hold seats in the Duma (lower house in the Assembly) are A Just Russia (JR) with a social democratic agenda, Liberal Democratic Party of Russia (LDPR), which is neither liberal nor democratic though its leader has extreme right-wing views and Yabloko (a liberal party) (Darlington, 2016).

Some of the factors that affect the organization of elections and the voting system in Russia are its huge territory that spans a number of time zones and an uneven distribution of people across various regions that have differing levels of infrastructure and transport development. There are about 105 million voters who go out to the 90 000 voting centers set up during election time. The electoral commission requires labor of up to one million staff to prepare and conduct transparent democratic elections (ACE Project, 2016). The use of modern technology was deemed necessary to reduce complications during elections that could lead to dire political and economic consequences.

In 1994, Yeltsin, who was by then the president of Russia, passed an order for the establishment of an election State Automated System (SAS). The use of the first component of this system was in elections of deputies to the State Duma in 1995 and in 1996 for the Presidential elections (with 80% of voters using it). The main function of the system was to prepare voter lists and summarize preliminary results of voting (ACE Project, 2016). In 2009, there was a call for an upgrade to the system in order to enhance transparency of the electoral process and strengthen public oversight. In 2010, a state program for introducing electronic vote counting was launched in order to establish a secure network for data transfer and storage and to construct an infrastructure for remote voting via mobile phones for those that could not make it to polling stations. A major technological innovation that followed was the Optical Scan Voting System that scans and records all the information on a voter’s ballot onto a Russia-wide data network. The switch to an optical scan voting system increased processing speed and it also prevented possible fraud at polling stations. By 2011, the SAS had served more than 20000 election campaigns at various levels without significant technological failures (Morozov, 2011). Voters, especially the older generation, and the Central Election Commission (CEC) of Russia still trust the paper-based system but they have not been opposed to the integration of new technologies in the process of monitoring results. The end goal is towards the adoption of mobile phones as part of the whole election process and recognizing the most favored means of communication amongst majority of the citizens (Harris & Vincent , 2009).

2.3.3 Election History over the period from 1994 to 2014

Russia has held five presidential elections in the period from 1994 to 2014 and these are presented in Table 2 below.

Table 2: Summary of Presidential election outcomes in Russia between 1994 and 2014

Election Year	President elected	Party	Margin of Win	Incumbent Contesting
1996	Boris Yeltsin	Communist Party (KPRF)	13.7%	Yes
2000	Vladimir Putin	United Russia (UR)	23.12%	No
2004	Vladimir Putin	United Russia (UR)	57.6%	Yes
2008	Dmitry Medvedev	United Russia (UR)	53.2%	No
2012	Vladimir Putin	United Russia (UR)	45%	No

2.3.4 Russia's policy changes and macroeconomic outlook over the period from 1994 to 2014

The 1990s represented a period of major transitions for Russia. The government was in the process of realigning the central planned economy to a capitalist order based on markets, free enterprise and private property. The first measure put in place was the mass privatization of state entities – which resulted in the transfer of shares in most of the government entities to managers, workers and the public. According to a 2014 Global Wealth Credit Suisse report, privatization led to the creation of Oligarchs (Russia's richest 1%) who got ownership of 30% of the nation's personal assets. This caused huge disparities in income and living standards among Russians (Stewart, 2013) and because it was a transitional phase, no one paid taxes nor did the government have an idea of how much people earned. A recent study found that by end of 2015, the amount of offshore wealth amassed by wealthy Russians stood at a staggering 75% of the national income with half of it not expected to return to Russia (Novokmet, Picketty, & Zucman, 2017). Other economic reforms administered alongside privatization were sharp reductions in government spending and targeting outlays for public investment projects, defense, producer, and consumer subsidies.

In 1996, an election year, president Yeltsin embarked on a political campaign to balance the budget through a “loans-for-shares” program. The program involved turning over valuable natural resource enterprises to major businesspersons in exchange for loans to the government

– this can be considered to be an electorally timed measure. By the end of 1997, South East Asia was hit by the Asian Financial Crisis, better known as the “Asian Contagion.” This crisis saw the devaluation of currencies by about 38% in Thailand, South Korea, Japan and Indonesia. The Asian Contagion also sparked an outflow of capital in Russia that was partly driven by oligarchs stripping assets from the companies they had recently acquired from the government. The outflow of capital coupled with drop in demand for crude oil and low oil prices led Russia to end its fixed exchange rate regime in 1995. The consequential effect of abandonment of the fixed exchange regime was that the Ruble got devalued four times and several banks declared bankruptcy in 1998 (Smirnov, 2015).

The government instituted a flat 13% income tax in 2001, a move viewed as a policy reversal to enable the government to generate revenue from the extremely wealthy beneficiaries of the privatization that took place between 1991 and 1995 (Novokmet, Picketty, & Zucman, 2017). The years that followed until about 2004 saw Russia’s economy recover and it was driven mainly by pretax profits of large oil and resources companies. Market competition coupled with responsible macroeconomic policy (maintaining a balanced budget) saw increased economic efficiency and a steady growth in foreign currency reserves. The four years after 2004 saw Russia experience a rise in household expenditures that was a product of fast growing personal income and a large expansion of personal credit. Economic growth was further boosted by oil prices that were still increasing as was production in Russia (Aven, 2013).

The global financial crisis of 2008 struck in the same period that Russia was having an election and modifying its tax administration so that it could appropriately tax residents based on their respective income levels. The effects of the two events were evident in 2009 when GDP growth slumped from 5.2% in 2008 to -7.8% in 2009 (World Bank, 2009). This low growth was short lived as economic growth recovered in 2010 and 2011, largely due to the recovery in oil prices. 2012 and 2013 were periods of dismal stagnation due to above average inflation rates (6% – 8%) that prevented the Central Bank from lowering the relatively high interest rates (Aven, 2013). The high interest rates made the investment climate for private businesses worse as banks were lending at very high costs. The Russia economy was still paternalistic – this means that the population was constantly depending on the government to help and support them. This dependency caused a spike in social expenditure by the government in the years leading to 2014.

The Russian government came under pressure to cut down its military spending so as to reduce its trade deficit that was burgeoning (Korsunskaya & Fabrichnaya, 2014). The budget came under more constraint due to dropping oil prices alongside sanctions from the EU and US for Russia's role in the Ukrainian crisis. The effects of this was that very little FDI made its way into Russia and capital outflows increased, amounting to about 7% of GDP (Smirnov, 2015).

Credit rating action in Russia only began when the federation began transition towards modern capitalism. The country's sovereign rating was speculative but got bolstered into investment grade on the back of prudent fiscal and monetary policy, debt rescheduling and a decline in the disparity between the political and economic discourse. This upward trend was not without any challenges, with the most notable one being in 1998 when Russia defaulted on its sovereign debt, as did other countries affected by the 1997 Asian financial crisis. Rising oil revenues, a growth of foreign reserves and large capital inflows brought the sovereign rating levels back up though they posed new challenges such as corruption. Economic dependence on the oil and gas sector posed a risk to the sovereign rating levels as it raised the nation's susceptibility to event risk (Moody's, 2017).

2.4 India

2.4.1 Government Type

India is a federal democratic republic that has one national government that exists independently over several other smaller state governments. The government is divided into 3 distinct arms namely, executive, legislature and judiciary. The **President** is the head of state while the **Prime Minister** is the head of government in India. The president's role is largely ceremonial while full governing authority vests with the prime minister who is a presidential appointee. The appointment of the Prime Minister follows a designation made by the legislators in the lower house of the Indian Parliament, better known as the **Lok Sabha** (House of the People) (GlobalEdge, 2016).

2.4.2 Electoral System

The democratic system in India states that any citizen over the age of 18 can vote in an election unless they are deemed to have an unsound mind or have been convicted of certain criminal offences. All who are eligible and registered to vote are included in the Electoral roll, which gets updated annually to add those that turn 18 on 1 January and remove those that may have

passed away over the past year. The electoral roll of all 620 million voters in India was computerised in 1998 and it is provided to national and state parties for free after the annual revision and is also available for sale to the general public. The computerised electoral roll is cross-linked to Electors' Photo Identity Cards (EPIC) that India had ordered to be made in 1993 as a way to improve the accuracy of the electoral roll and to prevent electoral fraud (ECI, 2016).

The elected members of the Vidhan Sabhas (legislative assemblies), Lok Sabha and Rajya Sabha (Council of States) elect the President. The President serves for a period of 5 years and can stand for re-election. "A formula is used to allocate votes so that there is a balance between the population of each state and the number of votes assembly members from a state can cast, and to give an equal balance between State Assembly members and National Parliament members" (ECI, 2016). Should there be no clear winner, a system is used to eliminate the losing candidates and their votes transferred to top candidates until one gains a majority. The Vice President is elected by a direct vote by all the nominated and elected members of the Lok Sabha and Rajya Sabha (ECI, 2016).

The Lok Sabha is the main legislative body along with the Rajya Sabha. The Lok Sabha is limited to 550 elected members whose election happens using a first-past-the-post electoral system. The country is split into constituencies, voters can cast one vote each for a candidate, and winners are the ones that get maximum votes. Elections for the Lok Sabha take place every five years unless the President dissolves it and calls for a general election before the end of five years. Any Indian citizen registered as a voter and over the age of 25 can contest elections to the Lok Sabha (ECI, 2016).

The Rajya Sabha are elected indirectly and not by the entire voter population. Each State Vidhan Sabha using the single transferrable system elects them. This system is used to elect 233 members while the President is responsible for nominating another 12 as representatives of literature, science, art and social services. Rajya Sabha members can serve for six years. Any Indian citizen registered as a voter and over the age of 30 can contest elections to the Lok Sabha (ECI, 2016).

The Vidhan Sabhas are directly elected bodies whose duty is to carry out the administration of the government in the 28 States of India. Election into this assemble is also carried out using the first-past-the-post electoral system after the states and unions are split into single-member

constituencies. The assemblies vary in size with the largest one having about 403 members and the smallest with 30 members. Elections for the Vidhan Sabhas take place after every 5 years. Any Indian citizen registered as a voter and over the age of 25 can contest elections to the Vidhan Sabha (ECI, 2016).

The Electronic Voting Machines (EVMs) manufactured around 1990 were used for the first time in 16 Assembly constituencies and at the general legislative assemblies' elections that were held in 1998. Since these machines run on a battery, they have an advantage that they are usable even in areas without power connection and thus all across India. All the votes recorded are stored in the memory of the Control unit of the EVM. The other advantage is that these machines made voting counting quicker and brought about savings by way of cost of paper, printing, transportation, storage and distribution. As of 2014, there were 814m voters registered in India to vote at 930 000 polling stations. The Electoral Commission of India monitored the use of EVMS in polling stations. Amazingly, voters in India have an option to reject all candidates using a “none of the above” button on the machines (BBC, 2014).

2.4.3 Election History over the period from 1994 to 2014

India has held five presidential elections in the period from 1994 to 2014 (Venkatraman, 2015).

Table 3: Summary of Presidential election outcomes in India between 1994 and 2014

Election Year	President elected	Party	Margin of Win	Incumbent Contesting
1992	Dr Shanker Dayal Sharma	Indian National Congress	32.1%	No
1997	Shri K.R. Narayanan	Indian National Congress	90%	No
2002	Dr APJ Abdul Kalam	Bhartiya Janta Party	79.2%	No
2007	Smt. Pratibha Devisingh Patil	Indian National Congress	31.6%	No
2012	Dr Pranab Mukherjee	Indian National Congress	38.6%	No

2.4.4 India's policy changes and macroeconomic outlook over the period from 1994 to 2014

India considers itself as a “Democratic Market Economy”. The government monopoly prior to 1994 had a negative effect on efficiency and growth than a private sector monopoly would have

due to the ease with which regulatory capture occurred. The year 1994 kicked off with the full convertibility of the current account after an integrated market-oriented exchange rate was introduced in 1993. The result of this conversion was a rise in industrial production, exports of agricultural products and non-oil imports. India saw a decline in its current account deficits, external debt was shrunk by about \$300m Dollars and foreign currency reserves increased by about \$19.5 billion (Virmani, 2005). The country's GDP growth rate got to a peak of 7.8% p.a. during the 1995 to 1997 period, after the government exercised fiscal restraint and implemented reforms in tax and trade policies. Removal of policy measures in the form of bans and controls on production, investment, capital imports and intermediate goods improved GDP growth. It was part of a shift from an import substituting to export promotion strategy spreading across Asian countries (Basu, 2004). Tax reforms of the 1990s alongside policy reforms led to the decline in the growth rate after 1997 as their impact on growth would only be felt in the long term. The public-sector deficits were rising faster than the national productivity and it got to almost 10% of GDP; paving way for an inflation crisis should lenders decide that the country's debt-to-GDP ratio was out of control (DeLong, 2001).

However, India's economy was not exempt from the effects of the post-Phokran sanctions and the South East Asia financial crisis on world import demand and on international capital markets that hit a majority of developing economies. Inflation spiked in the 1988 – 99 periods due to a jump in prices of agricultural commodities that also caused a deceleration in the growth of both exports and imports. The government was cautious in its actions and managed to still increase its foreign currency reserves though at a slower rate than the years before (Finance Ministry, 2000). The economy recovered before the new millennium with inflation dropping to dramatically low levels of about 2.9% in January 2000 while the construction and manufacturing sectors contributed the most to economic growth. The government's implementation of a stable tariff structure in place of the import and export controls, made the economy more open and competitive (Finance Ministry, 2001)

Over the period from 1994 to early 2000, India saw the poverty levels decline alongside the improvement in income distribution levels that resulted in the poorest 10% in India having a larger share of the national income than in comparable nations (Virmani, 2005). However, the effects of a socialist legacy hindered the improvement of literacy and mortality over the same period. The country also had to deal with cases of corruption in the government and its role in hindering the government from fulfilling its traditional functions such as public safety and security, public health care, sanitation facilities and building roads among others (Basu, 2004).

Resumption of high economic growth rates from 2003 until 2008 when the global financial crisis occurred was because of fiscal consolidation in the form of increased public savings and spending cuts that prompted increased efficiency and improved corporate profitability and investments. Progressive deregulation saw a sustained increase in exports of goods and services (Kapur & Mohan, 2014). Services contributed about 68.6% of the overall average GDP growth in India in the years from 2002 and 2007. The government also actively partook in the price monitoring of agricultural produce, hence, making sure to balance the necessary imports alongside periodic restrictions of exports to stabilize demand and supply levels (Finance Ministry, 2008)

In response to the global financial crisis, India's government used both monetary and fiscal policy to stimulate the economy, which led to exceptionally high growth rates of about 9% in the 2009 to 2011 period (DeLong, 2001). The consequential effect of the fiscal stimuli (tax cuts and increased revenue expenditure) was high inflation and current account pressure. This prompted a switch from financial savings towards savings in the form of gold, causing higher gold imports, which exacerbated the current account deficit problem. A spike in oil and coal imports and drop in iron exports due to domestic policy bottlenecks saw the current account deficit rise to 4.7% of GDP in 2012 – 13. It then dropped to about 2.3% of GDP in 2013-14 due to market turbulence and government policy response in the form of introducing a direct tax code bill and countrywide goods and services tax and containing subsidies (Kapur & Mohan, 2014).

In 2017, officials from India came out lashing at credit rating officials this year for failing to upgrade their sovereign rating from BBB- despite economic growth and fundamentals improving. The country's finance minister and chief economic officer called to question the methodology applied by the rating agencies and how well they understand emerging markets to provide them with justifiable ratings. (Goyal, 2017). Fitch countered their argument by stating that their levels of government deficit is still too high, relative to peers, especially in the states relative to the central government level (Shinate, 2017). The above sentiment is an indicator of the impact that CRAs have had on India which has seen its rating levels sway between investment grade and speculative grade (between Baa3 and Ba1 or BBB- and BB+). The current BBB- rating has remained unchanged since 2006 which adds up to 8 years for the purposes of this study and forms a basis for the frustration expressed by government officials who have been making an effort to have it upgraded. India's credit rating history over the 20 years from 1994 to 2014 has been stable with the largest drop being to 2 levels below its current

level to BB/Ba2 in 2001 which was a period marred by bailouts of failed government controlled institutions such as the 3rd largest lender, Industrial Finance Corporation of India (IFCI) and India's biggest equity savings scheme managed by Unit Trust of India (UTI) (Slaves of the state, 2001).

2.5 China

2.5.1 Government Type

China's government is a one-party communist state. This means that the state strives for all citizens to be equal in class and economic conditions. It has three branches: executive, legislative and judicial. The government is in place to implement the policy goals of the Chinese Communist Party (CCP). The executive branch of the government has two components: the chief of state, called a **President** and the head of the government called a **Premier**. The President is appointed by the National People's Congress and he/she is responsible for appointing the Premier (also known as Prime Minister). Regional and local People's Congresses indirectly elect the National People's Congress (CONSTITUTION OF THE PEOPLE'S REPUBLIC OF CHINA, 1982).

The CCP is China's ruling party, which means that it has effective control over the government as it approves all candidates for office and selects the country's leadership. The Chinese government drives the economy and owns most of the country's economic infrastructure (Criminal Intelligence Agency, 2017).

2.5.2 Electoral System

China is divided into five central and local levels of people's congresses. They are:

- a.) The National People's Congress (NPC)
- b.) The people's congresses of provinces (23), autonomous regions (5) and municipalities (4) ruled by the Central government
- c.) The people's congresses of cities divided into districts and autonomous prefectures,
- d.) The people's congress of cities not divided into districts, municipal districts, counties and autonomous counties
- e.) The people's congresses of townships, ethnic minority townships and towns.

All the congresses at the various levels constitute through democratic elections for a term of 5 years (NPC, 2007).

All the citizens of China that are above the age of 18 have the right to vote and to stand for election. An annually updated list contains everyone that is eligible to vote in an election year and the election committee publicizes it 20 days before the day of voting. All elections take the form of a secret ballot. The National Treasury provides for the expenses of the election of the NPC and the local peoples' congresses. The CCP maintains a close watch on electoral democracy at grassroots levels (determining who can or cannot be nominated for office) and controls the outcomes of elections at the higher levels (Baker, 2007).

The deputies to the first two levels of the people's congresses in China are elected through **indirect** elections while deputies to the remaining three levels are elected by means of **direct** elections.

Direct elections are presided over by the election committees of the same level. In these types of elections, voters directly cast votes to elect deputies. Voters are split into groups that form a constituency which can be either rural or urban and adhering to the principle that a constituency may only have one to three deputies. Candidates are nominated according to constituencies and this can be either jointly or independently by political parties, mass organizations or by more than 10 voters (with voters limited to nominating only the authorized number of deputies in their constituency). A candidate wins when he/she receives more than half of the votes and in the event that two candidates tie for the top votes, another election is held to get one winner. By elections are held when the post of a deputy falls vacant due to death, suspension of qualification or any other valid reason that results in a vacancy before the end of term (China.org.cn, 2008).

Indirect elections are presided over by the standing committees of the people's congress of the same level. In these types of elections, deputies to the peoples' congress at the next lower level elect the deputies at the next higher level. Candidates are nominated according to election units and by political parties or mass organizations jointly or independently or by more than ten deputies. Candidates are introduced at deputies' group meetings up to the day before voting and voting begins when more than half of the deputies are present at the occasion. A by election is conducted when the post of a deputy falls vacant as a result of circumstances similar to those of a direct election and can adopt the competitive election or equal number method (China.org.cn, 2008).

The NPC has about 3000 delegates and they are empowered to elect China's president, premier, vice president and the Chair of the Central Military Commission using a plurality voting system

with a ballot consisting of three options to choose from namely; the for, against or abstain (Baker, 2007). It also elects the NPC Standing Committee that approves routine and admin issues (Chiu, 2016).

2.5.3 Election History over the period from 1994 to 2014

China has held two presidential elections in the period from 1994 to 2014, see Table 4 below.

Table 4: Summary of Presidential election outcomes in China between 1994 and 2014

Election Year	President elected	Party	Margin of Win	Incumbent Opposing
1993	Jiang Zemin	Communist Party of China	49.3%	No
2003	Hu Jintao	Communist Party of China	56.9%	No
2013	Xi Jinping	Communist Party of China	40.5%	No

2.5.4 China’s policy changes and macroeconomic outlook over the period 1994 to 2014

The Chinese economy has had two eras that have vastly influenced economic growth. The first era (pre-1990) saw growth driven by allocative efficiency and productive efficiency while capital deepening, investment-led industrialisation drove post 1990s growth (Lardy, 2015). The period right before the transition of eras i.e. 1980 – 1990 saw a prolonged stagnation termed as the “lost decades of development” as evidenced by the worst levels of income distribution. China underwent a capitalist transformation, with part of the rapid growth they experienced being due to “super-exploitation” of Chinese labour, and thus a reform was necessary. The level of industrialization in China used to be significantly lower and growth in the first era was achieved through labour transfer from rural-agricultural jobs to industrial jobs. Mass consumption (with expanded demand for products spiking both domestically and internationally) also vastly drove growth in the first era. Consumption fostered the growth of the industries of mass-production, especially that of new consumer durables.

The second era saw a switch from labour-intensive growth towards capital deepening growth (financed by large domestic savings and foreign investment). An improvement in productive efficiency and specifically in production of investment goods played a role in the transition. The East Asian financial crisis hit in the 1997 – 1998 period but it did not affect the Chinese market, which had just come from a phase of privatisation of state owned entities (transforming

large SOEs into modern corporations) from 1995-97. However, the consequent result of the above-mentioned privatisation was felt in the period 1998 to 2002 when unemployment rose by close to 100 basis points from 3.1% (1998) to 4% (2002) while consumption and investment dropped. China found itself in a state of deflation. The government had to implement policies that facilitated fiscal stimuli, welfare-state measures and revitalization of SOEs (Lo & Zhang, 2011).

GDP growth and inflation were on the rise from 2002 all through to 2004 but at unsustainable levels of 9% of GDP and inflation averaging about 3.5%. High investment growth spurred by select sectors growing too fast, drove GDP growth alongside structural reforms implemented in the banking sector, SOEs and labour market. Furthermore, the government turned to monetary policy tools such as increasing benchmark interest rates and reserve requirements to lower growth to sustainable levels of about 8.5% in 2005 but this did not help as GDP growth again rose to about 14.2% in 2007 (Barnett, 2005).

However, similar to other players in the global economy, China was hit by the global economic crisis of 2008 that led to a decline in exports, imports and FDI. GDP growth dropped from 14.7% to 9.6% and a lot of workers lost their jobs. The government responded with a \$586bn stimulus package and loosening monetary policies that increased bank lending, boosted domestic investment and consumption. The Chinese economy recovered to see it take the title of the World's largest manufacturer by 2013 (Morrison, 2015). Favourable policy environment that supported funding investments in science and technology, employee education and infrastructure development facilitated China's competitiveness in the global economy.

Real GDP growth had been on a decline from 10.4% in 2010, to 7.8% in 2012 and eventually to 7.3% in 2014. China's large population and low wage rates that drove the economy before were affected by changes due to the implementation of economic reforms. Chinese wages increased by 309% from 2005 to 2014, a measure the government supports as it sought to boost the nation's innovation and productivity levels (Barnett, 2005). Officials still view China as a "socialist-market economy" with SOEs accounting for over 50% of GDP and a weak banking sector controlled by the central bank that works in favour of SOEs (Wooldridge, 2012). Officials want the government to use policy reform to transform it to a free market economy.

China is the one country in BRICS that has enjoyed a consistent high credit rating history over the period from 1994 to 2014. The lowest rating China received in this period was by S&P in 1999 and the reason for the downgrade was the negative effect that the East Asia crisis of 1997

and 1998 had on GDP growth, foreign trade and foreign investment in China. China recovered from that and over time got its rating levels up again with all three CRAs showing consistency and uniformity with how they arrive at China's sovereign rating (Keidel, 2007).

2.6 South Africa

2.6.1 Government Type

SA is a constitutional democracy that has a three-tier system of government and an independent judiciary. The National, Provincial and Local levels of government all have legislative and executive authority in their own spheres. The **legislative** authority at the national level is Parliament which is made up of the National Assembly (400 seats) and the National Council of Provinces (90 seats) while the provincial legislature is the authority at the provincial level. The National Assembly is constituted in accordance with the votes cast in the General elections while the National Council of Provinces is comprised of delegates nominated by each provincial legislature. The **executive** authority at the national level is the Cabinet, which comprises of the **President**, Deputy President and Ministers while at the provincial level it is the Provincial Executive Councils made up of the Premier and members of the executive council (South African Government, 2017).

2.6.2 Electoral System

South Africa's 'proportional representation' system was selected for its inclusiveness, simplicity and tendency to encourage a coalition government. In national elections, SA citizens cast a vote for a single party of their choice; the country is split into 10 large multi-member district regions, which are the nine provinces and one national district for the country as a whole. A proportional representation system ensures that the allocation of seats in parliament is in direct proportion to the number of votes a party received (Lodge, 2003).

The Independent Electoral Commission (IEC) facilitates general elections that take place every 5 years. It ensures that they are free and fair. In these elections, voters elect the national and provincial legislatures simultaneously on two separate ballots by selecting the political party of their choice based on the list of parties contesting on either level (national or provincial). It is up to the parties to decide whom they want in their legislatures and they present this in the form of (ranked) lists to the IEC, which then publicises this information countrywide.

Upon completion of elections and tallying of votes, the seats allocated to each party are filled as per the ranked lists. The National Assembly's constitution is based on the National ballot and is done in two tiers: half are regional seats and the others are national and it is based on the lists submitted. A Droop Quota method is used to determine the number of seats a given number of votes is worth. This method involves dividing the number of votes by the total number of seats for each region (for region seats) and for the nation (for national seats). Seats are then allocated proportionally depending on how many times the party meets the full quota calculated by "dividing each party's share of the vote, regionally and then nationally, by the quotas determined at those levels." (Alvarez-Rivera, 2015). If the process ends with unallocated seats then, these seats are allocated to the parties that had the largest remainders based on the calculation above.

South Africa has just over 26 million registered voters. One needs to be an SA citizen and should be 18 years and older to be eligible to vote. All registered voters are recorded in a voter's roll that is used for verification purposes on the day of elections to make sure voters only vote once.

2.6.3 Election History over the period from 1994 to 2014

Elections in South Africa are held after every 5 years. South Africa had its first non-racial democratic election in 1994 and Nelson Mandela was unanimously elected as the first democratic president with Thabo Mbeki and F.W. De Klerk as his deputies. Nelson Mandela and Thabo Mbeki were both part of the African National Congress (ANC), which won the national elections with a 54% majority. Nelson Mandela resigned as president of the ANC in 1997 and Thabo Mbeki, his deputy, succeeded him. When the country held elections in 1999, the ANC had an even stronger victory, scooping 266 seats in parliament, which equated to 65.7% majority. Thabo Mbeki was sworn in as the country's second post-apartheid president and he appointed Jacob Zuma, chairperson of the ANC as his deputy.

In the elections of 2004, the ANC had another resounding victory with 67.7% majority over their opponents and Thabo Mbeki became president for a second term. In June 2005, President Mbeki dismissed his deputy, Jacob Zuma due to his implication in a corruption scandal. He appointed Phumzile Mlambo – Ngcuka as Zuma's replacement. In a turn of events in 2007, ANC delegates elected Jacob Zuma to be the party's leader over acting president, Thabo Mbeki. This led to Thabo Mbeki handing in his resignation letter in parliament in 2008, 9 months before his second term of office expired. Parliament then elected Kgalema Motlanthe,

a former trade unionist, freedom fighter and deputy leader of the ruling ANC, as interim president when Mbeki left office.

ANC had another victory in the 2009 elections with a 65.9% majority. Jacob Zuma, the party leader was elected as the president of the republic. The fifth democratic elections were held in 2014 and the ANC won again with a 62.15% majority, paving way for Jacob Zuma to pursue a second term in office (SA History Online, 2016).

Table 5 below presents the summary of the elections history in a democratic South Africa from 1994 to present.

Table 5: Summary of Presidential election outcomes in SA between 1994 and 2014

Election Year	President elected	Party	Margin of Win	Incumbent Contesting
1994	Nelson Mandela	African National Congress	42.2%	No
1999	Thabo Mbeki	African National Congress	56.8%	No
2004	Thabo Mbeki	African National Congress	57.3%	Yes
2009	Jacob Zuma	African National Congress	49.2%	No
2014	Jacob Zuma	African National Congress	39.9%	Yes

2.6.4 South Africa’s policy changes and macroeconomic outlook over the period 1994 to 2014

South Africa has seen a lot of development in its economy since the apartheid era ended and the international sanctions in place were abolished. The government had the mammoth task of rebuilding the nation to ensure that all its citizens had access to equal social and economic benefits by addressing the injustices of the colonial era. In the lead up to elections in 1994, the ANC promised to implement the Reconstruction and Development Programme (RDP) and it lived up to that promise after the 1994 election victory. The RDP was an integrated socio-economic policy framework based on the six principles of: an integrated and sustainable programme, a people-driven process, peace and security for all, nation building, link reconstruction and development and democratisation of South Africa. The principles of the programme were targeted at addressing and redressing the inherited gross inequalities of apartheid (Heymans, 1995).

Up until 1994, the South African economy was being driven mainly by minerals (resources) (11% of GDP) with manufacturing, transport and telecommunication sectors beginning to pick up and show promise thereafter. After noticeable success of the RDP policy, the South African government introduced the Growth, Employment And Redistribution (GEAR) strategy in 1996. GEAR was designed to stimulate faster economic growth, which required the provision of resources to meet social investment needs (SA History Online, 2014). It was successful in achieving the aforementioned goals because the government met its fiscal targets for the fiscal deficit, inflation and government consumption by the end of 2000. Tightening monetary policy and restructuring all government levels helped maintain government consumption at a reasonable figure (Edwards & Lawrence, 2008).

However, despite its success, GEAR did not address the issues of poverty and increasing unemployment in South Africa. As a result, the government introduced the Accelerated and Shared Growth Initiative for South Africa (ASGISA) in 2005 as a replacement for GEAR. ASGISA aimed to build on the goals of GEAR and RDP as well as to reduce poverty by 2010 and cutting unemployment by half from 28% in 2004 to 14% in 2014 (Marais, 2001). President Thabo Mbeki, who proposed and implemented this initiative, did not get to see it have meaningful impact after he lost ANC presidency in 2008 and Zuma got elected president in 2009. President Zuma scrapped ASGISA and replaced it with the New Growth Plan (NGP), which he announced in 2010 at the State of the Nation Address (SONA). The NGP was complemented by the National Development Plan (NDP) 2030, which the SA government launched in 2013 as a long-term plan to achieve socio-economic development (SA History Online, 2014). It is worth noting how changes in leadership leads to the scrapping and replacement of development plans which in turns hit the lower-class members of society as they are the major beneficiaries of the changes effected by those plans.

South Africa's average annualised growth rate in real GDP over the period 1994 to 2014 stood at about 3.5% with the highest levels observed in the period 2005 to 2007 and the lowest during and after the global financial crisis (2008 – 2009). The share of mining in GDP dropped from 11% (1994) to about 5% of GDP (2014) while the financial and business services sector share increased from 17% to about 24% in the same period (Bhorat, Hirsch, Kanbur, & Ncube, 2013). South Africa's strong and reputable financial system led to increased FDI but concern is on the manufacturing sector that has not seen a significant increase in its share of GDP over 20 years and this is a possible explanation for why the unemployment levels in South Africa are still up (Edwards & Lawrence, 2008).

Unlike Russia, South Africa managed to diversify its drivers of GDP growth from the primary source, mining. The success could be attributed to the policy approach the SA government took. The government implements fiscal policy on a 3-year horizon and is usually countercyclical to a weakening economic growth environment. One fiscal measure that has been viewed negatively by economic players is the rising fiscal deficit which the government has been relying on to spur economic growth. This is viewed as a sign that the government is lacking efficiency in utilising current government revenue, 89% of which is attributed to tax revenue collected via personal, corporate and value added tax (Aziakpono & Wilson, 2015).

Monetary policy has also been subject to developments. From 1986 through to 1998, the South African Reserve Bank (SARB) used a pre-announced M3 monetary target. After 1998, the SARB shifted to using daily tenders of liquidity through repurchase transactions. It took to announcing monetary growth guidelines and target ranges every three years. In February 2000, it adopted a new framework based on inflation targeting which was modified in 2009 to headline-inflation targeting (Aziakpono & Wilson, 2015). The government's influence on monetary policy is through setting and adjusting inflation targets but the SARB has operational independence in monetary policy. After 1979, South Africa switched to a flexible exchange rate system from a fixed regime with the Rand pegged to the Dollar or Pound. The dual currency ended in 1995 and exchange rate management by the SARB halted after inflation targeting was put in place in 2000 (Bhorat, Hirsch, Kanbur, & Ncube, 2013).

South Africa's credit rating history is one that has shown a cyclical movement over the duration from 1994 to 2014. Across all the 3 CRAs it began at BB level (below investment grade) from 1994 to 2000, treaded on the BBB- level (investment grade) between 2001 and 2003, went above that from 2004 through to 2012 maintaining a high of BBB+ between 2006 and 2012 before beginning a way down to BBB- by mid-2014. A unique characteristic of the SA economy is the resilience it showed during the 2008 global financial crisis – the credit rating levels were unchanged and while GDP growth was hampered, the government managed to still to reduce its gross loan debt as a percentage of GDP (Stanlib, 2015). The main drivers for the series of downgrades that SA experienced from 2012 to 2014 were industrial action across a variety of sectors (mining and public works), rising unemployment levels and declining growth forecasts due to the financial crisis in Europe which is SA's largest trading partner. (Bauer, 2012)

Chapter 3 – Theoretical Framework

3.1 Introduction

This chapter lays out a chronological order of how the Political Business Cycle (PBC) theory and literature has evolved, from inception right through to its current state. It takes from the works of a range of academics who have built in various assumptions to the traditional model in order to make the theory more relevant and testable. The framework acknowledges that the focus was on developed economies in earlier works on PBC theory and thus modifications to the original theory needed to be applicable to both developed and developing democracies. As a result, this chapter presents the traditional PBC theory as the main theory that was initially used to explain political business cycles and thereafter it presents the various other theories that are as a result of the modifications that led to the split of the traditional PBC theory into opportunistic PBC and partisan PBC theories. To achieve this objective, the rest of the chapter is organised as follows; section 3.2 provides an overview of the traditional PBC theory. Thereafter the sections 3.3 and 3.4 present the Opportunistic PBC and Partisan PBC theories respectively with each dissected further and discussed from both a traditional and rational perspectives respectively.

3.2 Traditional PBC Theory

Literature on PBCs dates back to the ground-breaking papers by Nordhaus (1975), Lindbeck (1976) and Tufte (1978) who conducted research exclusively on industrialized democracies. They developed the traditional PBC theory, which characterizes politicians as identical and opportunistic individuals, whose main and perhaps only preference is to stay in power for as long as they possibly can (Nordhaus, 1975). Their theory proceeded to characterise voters as myopic, naïve people that are highly prone to voting for incumbents based on how effective they were in delivering social services and keeping unemployment low in the lead up to elections (Chiripanhura & Nino-Zarazua, 2015).

The theory first developed by Nordhaus (1975) took its framework from the Phillips Curve, where a downward sloping curve shows a trade-off between unemployment and output versus the rate of inflation. The trade-off is greater in the short-run than in the long run i.e. a change in unemployment will led to less inflation in the short run than it would in the long run. Using similar reasoning, Nordhaus (1975) also noted that incumbents' terms in office are characterised by predictable policy patterns, beginning with conservative austerity in early

years and ending with large spending in the lead up to elections. Nordhaus (1975) and McRae (1977) found that economic policy choices were motivated by support from voters who had largely homogenous preferences (low unemployment and low inflation) and high discount rates i.e. had short memories, lacked foresight and looked only at the incumbents' most recent performance.

Econometric tests for PBC in Inflation and/or unemployment yielded mixed results. Allen et al. (1986), McGavin (1987), Haynes & Stone (1988, 1989, and 1990), Keil (1988) and Findlay (1990) found evidence in favour of Nordhaus' Theory while McCallum (1978), Golden & Poterba (1980), Beck (1982), Alesina (1988, 1989) and Davidson et al. (1990) did not agree with Nordhaus' findings and the conclusions that were drawn from his study

Contrary to Nordhaus (1975), Tufte (1978) took a different approach and studied variables that the government has direct control of instead of inflation and unemployment. He found that the USA government tried to impress the public before elections by raising (social welfare) transfers or by lowering taxes. This form of tampering with fiscal balances was considered the most robust empirical characteristic of the electoral cycle.

Academics who looked at the early PBC works raised some concerns and this led to the traditional PBC theory being split into the Opportunistic PBC and Partisan PBC theories. Each of these theories is discussed separately below in light of how it fits to the traditional theory and how it differs once the element of rationality is taken into account.

3.3 Opportunistic PBC Theory

The opportunistic PBC theory can be best understood by discussing it in terms of the traditional and rational perspectives. The subsequent sub sections provide a discussion on the opportunistic PBC theory in light of these two categories mentioned above. The first subsection provides a descriptive view in light of the traditional view as well as discussing empirical evidence gathered in past studies based on this perspective. The second subsection explains the opportunistic PBC theory in light of the rational perspective as well as discussing evidence gathered in past studies based on this view. The discussion of these sub theories is presented below as follows:

3.3.1 Traditional Opportunistic PBC Theory

The traditional opportunistic PBC Theory is a progression from the original theory built by Nordhaus (1975). It combines the adaptive expectations of voters with politicians who manipulate the country's economic business cycle so that they have higher chances of re-election. This manipulation is done through the use of expansionary monetary and fiscal policies before elections.

Empirically, Cuikerman and Meltzer (1986) conducted a study on how much influence incumbents had on central banks and the role that politicians' credibility and ambiguousness played in the occurrence of PBCs. They found that despite central banks being revered as independent bodies, they were subject to influence from the government and this affected the decisions that they made. The opportunism arose from the fact that the public was completely unaware and uninformed about the political and economic factors that steered the government to exerting influence on the banks. The manner in which this influence was exerted was very unpredictable and only applied when it best suited the political leaders.

Cuikerman and Meltzer (1986) also found a strong link between the credibility of policymakers and the informational disadvantage that the public faced. Policymakers that instituted a large informational gap between them and their constituents lacked credibility and their actions had a detrimental effect on the sovereigns' economies (Cuikerman and Meltzer, 1986). A means of measuring the credibility of policymakers was assessed by observing the level of ambiguity in their policymaking. Unstable objectives of policy makers were evidenced by an imperfect control of money growth that led to an increase in ambiguity and left the public in the dark. The Cuikerman and Meltzer (1986) study also found that policy makers had a tendency to steer clear from efficient monetary control procedures as a given level of ambiguity allowed them the leeway to create monetary surprises that were timely and advantageous to them i.e. in the lead up to elections. The resultant effect of high levels of ambiguity by policy makers was high levels of noise in monetary control and large variances in the inflation levels of the sovereigns. This, to other economic players and the international investment community, are signs of political instability (Cuikerman and Meltzer, 1986). Inflation levels would decrease considerably before elections and spike right after due to the contractionary effects of unstable policies implemented in the short run (Cuikerman and Meltzer, 1986).

Rogoff and Sibert (1988) conducted a study in an effort to find electoral cycles based on national elections in the United States (USA) and Germany. They found positive evidence for cycles in taxes, government spending and monetary growth in the aforementioned countries. Their study focused on the competency levels of the two governments. Competent governments, are governments that were able to deliver a higher level of public goods for a given level of tax revenue. In their study, Rogoff and Sibert (1988) observed that information on the governments' levels of competency was visible more quickly to the government whereas the public observed it with a lag. They also observed that the temporary information asymmetries between the government and the public were the main drivers of the electoral cycles (Rogoff and Sibert, 1988). They observed that information asymmetries existed mostly in current than in past information and that it was information relating to government performance indicators that the public had little or no access to (Rogoff and Sibert, 1988). They also found that incumbents fared the worst when their private information was either extremely favourable or unfavourable as the public was in a position to make a better decision based on what they got access to (Rogoff and Sibert, 1988). As a result, Rogoff and Sibert (1988) concluded by adding that opposition parties were disadvantaged in that they had no means of signalling their policy competence to the public and this left the public with only the incumbent signals to rely on.

Two years later, Rogoff (1990) conducted another study focusing on the composition effect of electoral cycles in output and inflation as influenced by fiscal policy. He termed these types of cycles the "Political Budget Cycles" (Rogoff, 1990). His findings were very much consistent with those of the Rogoff and Sibert (1988) study in that he found that governments tended to direct funds (consumption expenditure) to projects with high immediate visibility (a sign of their competence) as elections drew closer in order to sway the public (Rogoff, 1990). Therefore, in an attempt to balance out the current account, Rogoff (1990) found that government investment had to be lowered because the full influence of such action took long to be apparent.

Persson and Tabellini (1990), on the other hand, found that voters re-elected incumbent policymakers based on their competency and voted them out if they were lacking. Their findings stressed that the competency of the government is not directly observable but that it has a simultaneous effect on the level of employment which is observable (Persson & Tabellini, 1990). They also observed that the policymaker would inflate the economy and raise employment before elections in a bid to mimic a high level of competence (Persson and

Tabellini, 1990). However, they also observed that the consequences of the pre-election inflationary action only became recognizable after the elections (Persson and Tabellini, 1990).

An examination of the above findings shows that they all follow the adverse selection model that focuses on the informational advantage that incumbents and the government have over voters concerning their true competence (Dubois, 2016). In a bid to develop a framework in which political and economic cycles intersect, Ales et al, (2014) found that both cycles are driven by the interactions of “non-benevolent policymakers who do not commit to policies and that have private information about the tightness of government budgets and rents” (Ales et al, 2014, p.224). However, the limitation in the studies above is that they do not analyse or try to understand voter behaviour or the link between voter behaviour and the incumbents’ decisions. The theory that follows below delves into that.

3.3.2 Rational Opportunistic PBC Theory

Apart from the traditional opportunistic PBC theory, some studies replaced the assumptions of the traditional opportunistic PBC theory by assuming that voters are rational, and hence, they form rational expectations and that they model their voting behaviour around their expectations (that is, they also vote in a rational manner). This line of thought led to another dimension of the opportunistic PBC theory, which was then coined the rational opportunistic PBC theory.

This theory builds by opposes the voter irrationality assumption and replaces it with the assumptions that voters tend to have rational expectations and that their voting is rationally retrospective. It too, relies on the asymmetric information between voters and policy makers who manipulate the economy to appear more competent prior to elections (Block, 2002).

Lohmann (1998) was the first to conduct a study that incorporated these assumptions and based them on a model of political cycles in inflation and output growth. Lohmann (1998) found voters to be poorly informed about the quality or competence of political candidates and when they tried to scrutinise the incumbent’s economic performance (to know their competency levels), it resulted in policy and selection effects with ambiguous consequences for welfare. As a result, Lohmann (1998) interpreted the quality of a candidate/incumbent to being the fit between their known policy positions and the unknown characteristics of the political and economic environment.

Based on a study conducted on Argentina and Brazil, Stein and Streb (1998) sought to identify a link between the timing of price stabilization and elections. They found that the Primavera Plan by the Argentinian government and the Cruzado Plan by the Brazilian government were

marked by lowering inflation (a signal of competency) in the short run through foreign debt accumulation (Stein and Streb, 1998). This method of increasing their chances of re-election result in “stop-go cycles in inflation”, similar to political cycles. The governments’ use of foreign debt accumulation to stabilize prices was facilitated by using exchange rates as a nominal anchor for prices. This strategy leads to a boom in the short run that later gives way to a recession. It also means that the government shifts the inflation tax burden to the future, when all the debt has to be repaid. As a result, Stein and Streb (1998) opined that voters only observe the effect of foreign debt with a lag after the elections have taken place and the incumbent has been re-elected. Stein and Streb (1998) concluded their study with a recommendation for institutional reform that would increase government transparency on accounts such as budget deficits, reserves, monetary aggregates, balance of payments accounts and debt – in order to make the information available to the public.

Roemer (2000) had a similar view on candidate competency when he found that candidates ended up standing for the objective accuracy of their ideologies and overlooked the workings of the economy. He opined that since voters have no information to evaluate the quality of the challenger, they are forced to choose by comparing their estimate of the incumbent’s quality to the expected quality of a random challenger from a pool of challengers (Roemer, 2000). The result of this is that the incumbent will be re-elected if economic outcomes are favourable and the challenger wins if they are not. Lohmann (1998) study also deduced that competent incumbents had a stronger incentive to avoid losing elections and were more likely to inflate the monetary supply for electoral purposes, hence, causing negative welfare consequences.

The above findings all follow the moral hazard problem faced by voters that comes about when incumbents modulate their efforts to appear than they really are through policy instruments that are unobservable to the public (Dubois, 2016). Baleiras (1997) conducted a micro level study focusing on the drivers of asymmetry on key policy outcomes – preferences polarisation. In trying to understand PBC determinants from the politician’s point of view, he found that the incumbent’s own post-electoral welfare concern is a cause of PBC. In other words, politicians chose policies that will maximise their own welfare after elections especially as most of them have no alternative career path to follow once they have relinquished their power. Baleiras & Costa (2004) expanded on the finding above through a study on Portuguese municipal electoral data from 1986 to 1993. Motivation for Portugal as the country of study was due to the high fiscal decentralisation it had been experiencing in the past two decades and uncertainty about political decision making that was higher on a local government level. Analysis of the data

revealed that public expenditures shot up in the lead up to local government elections and that was because incumbents wanted to satisfy their own utility and maximise their re-election chances (Baleiras & Costa, 2004).

Several studies have looked at how voters either rewarded or penalised incumbents for opportunistic behaviour. Rewarding of opportunistic behaviour was observed in Russia's regional elections by (Akhmedov & Zhuravskaya, 2004), Portuguese municipal elections by (Aidt, Veiga, & Veiga, 2011), Brazil's local government elections by (Sakurai & Menezes-Filho, 2008) and Litschig & Morrison (2012), Argentina's provincial elections by Jones et al (2012) and in 68 general elections by Mourao & Veiga (2010). Penalization of said behaviour was observed in elections in the USA by Peltzman (1992), Latin American and Caribbean countries by Kraemer (1997), Argentina by Meloni (2001), Israel by Brender (2003) and a mix of countries by Brender and Drazen (2008).

Apart from empirical evidence provided by some studies with the focus on the opportunistic PBC theory and its sub theories, other studies provided empirical evidence on the political business cycles using the Partisan PBC theories and its sub categories. The review of the Partisan PBC theory and its sub categories is discussed in the next section.

3.4 Partisan PBC Theory

Similar to the opportunistic PBC theory, the Partisan PBC theory is also split into the traditional and rational PBC theory perspectives. A discussion based on each split is conducted separately in the subsequent sub sections as follows:

3.4.1 Traditional Partisan PBC Theory

Hibbs (1977) developed the Traditional Partisan theory in 1977 by conducting a study that looked at aggregated data on unemployment and inflation outcomes from 12 West European and North American nations. His research built on the Nordhaus (1975) model and the trade-off between unemployment and inflation but insisted that politicians were not only entirely opportunistic but that they were also reliant on the partisan preferences of their electorate (Hibbs, 1977). He maintained the notion that voting behaviour was still retrospective and voters were naïve and myopic. Hibbs (1977) found that lower income and occupational status groups favoured a relatively low unemployment and high inflation macroeconomic landscape while those of upper income and occupational status groups were drawn to a high unemployment and low inflation configuration.

With countries' data to work with, Hibbs (1977) identified that a low unemployment-high inflation and output growth configuration was prevalent in nations regularly governed by Leftist leaders and that a high unemployment-low inflation pattern prevailed in political systems dominated by centre and rightist parties. The variances observed in inflation and unemployment levels over time were found to be a function of the party in power (Hibbs, 1977). To substantiate the aforementioned finding, Hibbs (1977) conducted further time series analysis on unemployment data from the US and Great Britain and found that unemployment rate had been driven downwards by Democratic and Labour administrations and upwards by Republican and Conservative governments. In light of this finding, Hibbs (1977) concluded that governments tend to pursue macroeconomic policies that are in accordance with the economic interests and subjective preferences of their class-defined core political constituencies. This model affirms that the level of inflation and unemployment in any given country will be a function of the preference of the party in power. Voters' expectations are still adaptive and as a result, incumbents can put policies in place that sway them in their favour.

Apart from the traditional partisan PBC theory, other studies focus on the rational partisan PBC theory. The next sub section discusses how actions of incumbents differ when voters with differing ideologies are assumed to have rational expectations of their incumbents' policy choices.

3.4.2 Rational Partisan PBC Theory

Alesina (1987) rationalised the Hibbs (1997) model by considering voters to have rational expectations and rational voting behaviour. He also added that voters are perfectly informed given their interaction with only two parties (Alesina, 1987). Alesina (1987)'s model was based on the interaction of two different parties, with different objectives and policy objectives pertaining to inflation and unemployment. Furthermore, the Alesina (1987) model assumes that incumbents have different incentives to deviate from their commitments, which also leads to economic cycles connected to the political affiliation. The model also incorporated wage setters who are private agents that are rational and forward looking. The model assumes that wage setters have to act first by setting the nominal wage and policy makers are assumed to respond thereafter. The Policy makers are argued to use this as an opening to implement and maintain low inflation policies in the earlier years of their office terms and then generate unexpected inflation that would reduce unemployment when they are closer to elections (Alesina, 1987).

Alesina (1987) studied the USA system, using the post-world war II data. He wanted to find which assumption was more relevant between parties caring about the effects of their policies and parties having different objectives and incentives. This “partisan view of macroeconomic policy suggesting that parties act differently when in office was receiving increasing support for the US and other industrialised economies” (Alesina, 1987, p. 652). In his findings, Alesina (1987) asserted that the cycles observed were just economic cycles that were not similar to political business cycles. He observed that when a party was elected into office, it had two choices: that is, to enforce a policy plan that would maximise the short run benefits for its constituency or to follow a cooperative policy path that makes both constituencies better off in the end (Alesina, 1987). For the latter to happen, Alesina (1987) opined that a bargaining process needed to take place first between the two parties involved, which would then lead to a potential adoption of a cooperative common policy rule that makes both constituencies better off in the end. Repeated interaction between the two parties and with the public was argued to help to improve the uniformity and reduce the costly and sizeable fluctuations in inflation and output that would occur due to drastic policy switches when there is a change in administration (Alesina, 1987).

As a follow up on the Alesina (1987) study, Alesina and Roubini (1992) conducted a study with particular focus on how GNP growth, unemployment and inflation were affected by the timing of elections and change of governments in 18 OECD economies for a duration of three decades. They tested the implications of both the opportunistic and partisan models of PBC and their data set yielded results that leaned towards the latter model (Alesina and Roubini, 1992). One of their key findings was that their data rejected the hypothesis formulated by Nordhaus (1975). However, they did observe that inflation tended to spike immediately after elections, with the likely cause for this being pre-electoral expansionary monetary and fiscal policies (Alesina and Roubini, 1992). They also found temporary partisan differences in output and unemployment and long run partisan differences in the level of inflation as suggested by Alesina’s (1987) “rational partisan theory” (Alesina and Roubini, 1992).

Bove et al. (2016) studied two types of spending that they believed were causes of PBCs in a country where the electorate had differing partisan preferences. Their findings showed that when the left-wing was in power, the government was more concerned with state intervention, income redistribution and expansionary fiscal policies and as such they increased social “butter” expenditure. This fostered an environment conducive for economic voting - voting influenced by redistributive policies (unemployment and old age benefits) relative to non-

economic voting influenced by higher defence spending (to quell conflict or improve national security. Their study showed that right-wing administrations favoured military “guns” expenditure and the trade-off between the two expenditures was larger when countries are experiencing a conflict (Bove, Efthyvoulou, & Navas, 2016).

After expounding on the variations of PBC theory, the remainder of this chapter examines the BRICS members individually with the aim of identifying and substantiating the relevant PBC theory that applies to each of them. The examination of the types of PBC theories that applies to individual members of the BRICS nations is discussed in the subsequent section.

3.5 PBC theories that apply to the BRICS

Brazil has a highly segmented political party system, which should make their elections competitive. However, there are four main parties and two of them have produced all the Presidents over the period from 1994 to 2014. The dominant parties are the Brazilian Social Democracy Party (PSDB) and The Workers' Party (PT). Both these parties are viewed as being centre-left as are other strong political parties in Brazil (Hobold, 2015). There are no strong right-wing parties and as such, partisan effects would not affect Brazil. The most relevant PBC theory for Brazil would be the Rational Opportunistic theory.

Russia has a multiparty political system but because parties forge alliances to rally behind the two strongest parties, the system exhibits characteristics of bipolarity. The ruling political party is United Russia and it describes itself as being centrist and conservative. It has won four of the five elections that Russia held between 1994 and 2014 (BBC, 2012). The main opposition party is the Communist Party of the Russian Federation (CPRF), which is the largest and most popular left-wing party in Russia (Kagarlitsky, 1998). The most relevant PBC theory for Russia would be the Rational Partisan theory because of the clear two-party contention for presidency with both having close but differing ideologies e.g. centrist versus leftist.

India has a multiparty political system with six recognized national parties, namely the Congress, the Bharatiya Janata Party, the Communist Party of India (CPI), the CPI (M), the Bahujan Samaj Party and the Nationalist Congress Party. On top of these, it has 52 state parties and 1112 registered unrecognized parties (Balaji, 2010). Members of the Vidhan, Lok and Rajya Sabhas as discussed in Chapter 2 elect the President. The most relevant PBC theory for India would be the Rational Opportunistic theory because the electoral system allows multiple parties to determine who gets in to government and this competition breeds room for manipulative policies and actions for the sake of better re-election chances.

China, on the other hand, has a multiparty political system with nine recognized political parties. The main party is the Communist Party of China (CPC) and it has produced the president from 1994 to 2014. The other eight parties are democratic but not opposition parties and they support the leadership of the CPC (About China, 2004). The case of China is very peculiar when it comes to determining the most relevant PBC theory because it has a single-party political system. It is likely that the Rational Opportunistic theory fits best because the current party is unchallenged and its monopoly of the government paves way for opportunism and policies that favour those that support the government and fund it during elections which are not intensely contested either way.

South Africa has a multiparty political system that has seen the number of opposition parties increasing since independence in 1994. The ruling party is the African National Congress (ANC) that has produced the presidents from 1994 to 2014. Opposition parties have gradually been building supporter numbers with the top two being the Democratic Alliance (DA) and the Economic Freedom Fighters (EFF). There is no clear defined left or right-wing party in South Africa, as the ideologies that define either of them are not engrained in the political system. The most relevant PBC theory for South Africa would also be the Rational Opportunistic theory because the ruling party is coming under pressure from a growing opposition and they are going to have to perform in order to prove to voters that they are still the top party of choice. Economic conditions and the political climate are not favourable and this is likely to push the incumbents to manipulating policy and accounts to retain supporters.

It's vital to note that CRAs were active in the 5-member countries that this study is looking at from 1994 to 2014. They released ratings at no predetermined times of the year, taking into consideration a wide array of factors, some of which are political. Given that CRAs posted ratings both before and after election periods, in the former case, they are likely to have eroded some of the informational advantage that policy makers possess over their voters. A voter base that paid attention to rating actions that their sovereign received would be in a position to make an informed decision come elections but in BRICS, the rate of literacy amongst voters is substantially low and thus voters couldn't make use of the information conveyed in the ratings.

The next chapter shall look at the literature view, categorizing it based on studies that investigated for PBC in individual countries and in a group of countries. The view of literature highlights the nature of the economies that were covered in both cases (individual and group cases) based on whether they were developed and/or developing.

Chapter 4 - Literature Review

4.1 Introduction

The literature on political business cycles has been growing over the last forty years since the original theory was developed and publicized. As observed in chapter 3, further extensions arose from the initial theory and academics have been doing a lot of work using data from various economies to validate the assumptions affiliated with the theories.

The literature review below is split into two – academic work on developed economies and those based on developing economies. The reason for using that as the divide is because early research was conducted using data from developed economies because it was readily available and well documented unlike that of developing economies which was inconsistent and mostly unavailable. However, as democratization took root in developing economies, they began to play a bigger role in the global economy. Institutions such as the WB and the IMF began to track and keep records of their political and macroeconomic data and this paved way for PBC research to be conducted on them.

The split above is further categorized into literature from single industrialized and single developing economies, groups of purely industrialized or developing economies and lastly, evidence from a mix of both industrialized and developing economies. The reason for this further split is so that we can see what causes PBCs in individual countries and then compare that to cases where evidence of PBCs is tested for a group of countries with similar economic statuses or that are in a particular region affiliated with a set type of currency or commodity.

The final part of the literature review below looks at academic works that have investigated the link between PBCs and credit ratings.

4.2 Evidence from single industrialized developed economies

McCallum (1978) ran a least-squares regression on quarterly USA data for the period 1948 through to 1974 to test the hypothesis developed by Thomas Sargent and Neil Wallace (1975) who used works of Robert Lucas (1976) to come up with the Lucas-Sargent Proposition (LSP). The LSP suggests that incumbent governments are not capable of creating economic booms in the lead up to elections because output and unemployment are likely to remain unaffected due to private consumers and firms anticipating attempts by authorities to manipulate monetary and

fiscal policies (McCallum, 1978). His findings, although not strong, showed that the USA administration could not affect unemployment rates and so had no means by which to induce pre-electoral booms to sway voters – disproving the PBC theories put forward by Nordhaus in 1975 and MacRae in 1977 (McCallum, 1978).

Beck (1987) looked for evidence of political monetary cycles (PMCs) in the USA and whether the Federal Reserve created the cycles or accommodated them. He found that although the Federal Reserve did not cause such cycles given the large costs they would incur if caught, they passively accommodated PMCs that were fiscally induced by the powers of the president on other economic policies (Beck, 1987). Since fiscal policymaking in the USA is done jointly by the President and Congress, it is a lengthy cumbersome process, which takes more than a year until implementation. Monetary policymaking, on the other hand, is much simpler, flexible and is done by the Federal Reserve, which is an independent and nonpartisan agency that cannot be controlled by the executive arm of the government. In his study, Beck (1987) found positive evidence of cycles in money supply (increasing sharply during an election year) that were not caused by the Federal Reserve. The findings in his study showed that the Federal Reserve does not take any actions to offset them but they instead respond to fiscal policy that affects variables such as inflation.

Alesina (1987) found that in a two-party system e.g. the USA, it would be beneficial for the parties to agree to more similar policies and in so doing create less disruption after a change in administration and avoid PBCs. Rogoff, and Sibert (1988) and Rogoff (1990), both argued that although developed economies have efficient markets and rational behavior, they are still likely to experience political cycles due to: asymmetric information between voters and policymakers (Rogoff and Sibert, 1988), rational ignorance among voters, uncertainty over the outcome of an election and long-run uncertainty (Rogoff, 1990).

Keech and Pak (1989) observed robust electoral cycles in a cluster of veterans' benefit programs between 1961 and 1978 but they could not attribute them to an increasing public-sector growth. They used a linear regression with generalized least squares (GLS) estimates on USA quarterly data for the 17-year period. Incumbents preferred the aforementioned programs as a target for political gains over other programs such as the unemployment benefits program that was similar in size and also unindexed. The government began to index veterans' benefits in 1978, right after Tufte's *Political Control of the Economy* book and this saw transfer

payments cycles reduce substantially and there was no evidence of them thereafter (Keech and Pak, 1989).

Grier (1989) used quarterly USA data from 1961 to 1982 to identify the political links present between fiscal and monetary policies. He found the presence of a four-year electoral cycle in M1 money growth, which proved the existence of political monetary cycles during that period. Furthermore, his regressive analysis on the residual electoral cycles yielded results consistent with PBC movements in inflation (minimal in the quarter before elections) and output (maximal in the quarter of the election). In his study, Grier (1989) concluded that the Federal Reserve is likely to actively pursue a PMC to the advantage of incumbent president given the substantial influence that presidential elections have on interest rates, deficits and the GNP.

Haynes and Stone (1989) made two notable empirical contributions to the electoral model of business cycles. First, they were the first to present the unrestricted estimates of presidential electoral patterns in the US economic outcomes i.e. real GNP, unemployment and inflation and policy effects on money growth and the cyclically adjusted budget surplus. In assuming this approach, Haynes and Stone (1989) contrasted the approach in previous studies whose tests were subjected to ad hoc restrictions that weakened the power of the tests. Secondly, Haynes and Stone (1989) went on to provide an integrated test of the electoral model by examining whether the estimated electoral patterns in macro policy yield predicted patterns for the real GNP, unemployment and inflation that are consistent with estimates of actual electoral patterns in macroeconomic outcomes and voting behavior. The results of their study which used quarterly data for the period from 1951 Q1 to 1986 Q2, showed that the four-year electoral cycles in macro-economic outcomes and policies were strongly significant in the USA

In a similar vein, Haynes and Stone (1990) used the same data set as in their 1989 study and found that the abovementioned electoral cycles were significant for Republican incumbents, supporting the notion that partisan cycles are significant. Their findings from specification tests showed that during Democratic administrations, there were higher real GNP and inflation levels while unemployment levels were low (Haynes and Stone, 1990). As a result of this finding, they concluded the majority party found itself to be more flexible to pursue partisan objectives.

In 1994, Haynes and Stones conducted another study based on time-series literature with emphasis on statistical properties of measures of real economic activity and structural business cycle literature to determine how political factors play a role in real economic activity. With

an information set that had the political party of the incumbent president and the quarter of the electoral term from 1951 to 1990, their study found that party affiliation of the president and the timing of the electoral period statistically informed over a third of the variation in measures of real economic activity for the USA (Haynes and Stones, 1994).

Klein (1996) tested the timing of economic events relative to political events to examine if there are any temporal links in the US business cycle for the period from 1855 to 1991. He used duration analysis to test whether the 31 observed business cycles had turning points that were affected by the occurrence and outcome of an election. His study found a significant increase in the likelihood of the end of a contraction in the 2-year period before an election when there was a Democratic president and a higher likelihood of the end of an expansion occurring in any given month following Republican presidential victories (Klein, 1996). Consistent with PBC theory and evidence by many researchers, Klein (1996) also found that expansions are more likely to end soon after elections.

In contrast, Faust and Irons (1999) conducted a study whose findings opposed PBC theory and concluded that economic activity strongly predicts election outcomes and not the other way around. They used a standard vector auto regressive framework on quarterly USA data from 1948 to 1995 to test how electoral cycles influenced the unemployment rate, interest rate, inflation, GNP growth and M2 growth and found no evidence of political effects on the USA macro economy through monetary policy. They found weak evidence from fiscal policy for the first half of republican administration that experienced recessions as predicted by partisan PBC theory.

In Spain, Balageur-Coll et al. (2015) sought to find how significant public spending amongst was in determining re-election in Spain's local governments over the period from 2003 to 2007. He focused on municipal elections despite that the power in local governments is lower (due to decentralization) and that there is a high degree of autonomy in terms of budget planning. He applied a Bayesian approach¹ relative to the frequentist approach used in most studies. His study found that municipal spending increased over term in office to boost the re-election

¹ A feature of the Bayesian method is that a given variable is neither significant nor non-significant but instead its result provides a full posterior probability distribution on how a given covariate might affect the probability of being re-elected. This method also adds extra robustness to the findings.

prospects; and that pre-election increases in current expenditure were found to be more rewarding relative to capital expenditure, because capital expenditure took time to complete.

4.3 Evidence of PBC from groups of industrialized developed economies

In his 1978 book, Tufte observed electoral-economic cycles in national elections held in the USA and other capitalist industrialized democracies post World War II from 1946 to 1976. In Tufte observed that real disposable income per capita rose during the election years and fell after the election years while unemployment fell before elections and rose afterwards (Tufte, 1978). Furthermore, he found that presidents increased transfer payments to social security and veteran programs right before elections and facilitated a delay in tax increments until after elections. In his conclusion, he urged the press and opposition parties looking to compete in elections to expose the narrow-minded and detrimental economic policies of the incumbents (Tufte, 1978).

Paldam (1979), examined 17 OECD countries with 49 stable governments from 1948 to 1975 to test if electoral cycles exist in 8 main national accounts: GDP, GFI (Gross Factor Income), Private Consumption, Government Consumption, Fixed Investments, Taxes, Exports and Imports. He defined a 'stable' government as one where the government has a parliamentary majority and remains in power through the normal election period. Using data based on various national accounts series, he computed component series for each of the accounts to get the current growth rate, real growth rate and growth in implicit price deflators. He found statistically weak evidence for a policy-generated cycle, which led him to claim that the cycles were caused by foreign trade prices. This was considered evidence in support of the theory predictions that governments have little control over events (Paldam, 1979).

Lewis-Beck and Paldam (2000) and Paldam (2004) developed the responsibility hypothesis that states that the electorate considers the government to be responsible for the country's economic performance and that different levels of governments show different effects, with the electorate "punishing" local governments for poor management of budgets allocated to them relative to the counterparts in the national governments.

Bachman (1992) examined the effect that political risk as characterized by elections, has on the forward exchange bias. His goal was to find an explanation for the observed time-varying risk premium in foreign exchange markets with political events being his main driver. He analyzed data from 13 elections in Canada, France, the United Kingdom and the USA between 1973 and

1985. The countries he included in his sample have partisan political systems with voters having to vote for one of two parties. In his study, he highlighted the informational value of elections to investors especially on the adoption of different economic policies which are likely to alter the value of a country's assets. Estimations by regression coefficients from his study showed that after half of the elections, the average forward bias changed significantly (Bachman, 1992).

Ellis and Thoma (1995) conducted a study to investigate the predictions of two open economy models in which partisan effects are present. The first model assumed a small country- one-good model of exchange rate determination while the second assumed that two countries specialize in the production of one good (Ellis and Thoma, 1995). The first model was used to predict the time paths of exchange rates and to explain why systematic differences may exist between future spot rates and risk adjusted forward exchange rates. The second was used to predict the behaviour of terms of trade, the current account and exchange rates (Ellis and Thoma, 1995). Their empirical analysis used panel regression of time series cross sectional data based on quarterly data of 14 OECD countries from 1960 to 1987 and from 1960 to 1992. Empirical results from their study supported the theoretical predictions that systemic partisan effects were present in current accounts, real exchange rates and terms of trade (Ellis and Thoma, 1995).

Gartner (1999) looked at the different empirical implications that naïve (backward looking) and rational retrospective (forward-looking) voters have on the inflation rate during election periods. He used an auto regressive model on the change in inflation using quarterly panel data from the G-7 countries (Canada, France, Germany, Japan, Italy, UK and the US) for the period 1961 to 1992. He found significant statistical evidence of election patterns due to persistence of demand shocks and that monetary policy was used as a tool to appeal to retrospective voters (Gartner, 1999). Furthermore, his study found that a higher level of independence of central banks from the government and a drop-in persistency in output after demand shocks led to a reduction in the inflationary bias (Gartner, 1999).

Carlsen (1999) used quarterly data on 50 elections in six OECD countries (USA, U.K., Canada, Australia, Sweden and Norway) from 1955 to 1994 to investigate the relation between post-electoral inflation movement and the incumbent's re-election chances. He did panel data regressions combined with estimations of election win probabilities for incumbents and factoring for variable and fixed electoral terms in the sample countries. His results show

positive evidence for above average post-election inflation if the election race is close but not if the incumbent's election prospects are very good or poor (Carlsen, 1999).

Persson and Tabellini (2003) investigated political budget cycles in developed economies in 60 democracies from 1960 to 1998. Their study was the first to zone in on the impact of both the political regime (parliamentary versus presidential) and the electoral rule (proportional versus majority) on PBCs. Their hypothesis was that majoritarian elections have "stronger individual accountability" in comparison to proportional elections where the electoral rules incentivize politicians to advocate for broad policy programs. Majoritarian elections were observed to have politicians who directed spending towards smaller geographic locations that had swing voters. Their findings illustrated stronger cycles in countries that had majoritarian presidential regimes due to the concentration of policymaking power in the hands of a few figures (Persson & Tabellini, 2003).

Mink and de Haan (2006) tested for political budget cycles in 12 countries in the Euro area that had adopted the Euro currency from 1999 to 2004. They inputted net lending, cyclically adjusted net lending and primary budget balance into a multivariate model with an election variable suggested by Franzese (2000) as opposed to a dummy electoral variable used in most PBC studies. Their findings showed strong evidence of policy makers in the Euro area pursuing expansionary policies before elections despite the 1997 implementation of the Stability and Growth Pact (SGP) in the EU. The SGP aims were to "prevent fiscal policies from heading in potentially problematic directions, while others are there to correct excessive budget deficits or excessive public debt burdens" (European Commission, 2015). Mink and de Haan (2006) found that budget deficits increased in election years but not in the year prior to elections. The results also showed a small significant partisan effect on net lending with more expansionary measures enacted under left-wing policy-makers.

Tujula and Wolswijk (2007) did a study to test election year effects on budget balance changes in 22 OECD and EU countries for the period 1970 to 2002. Using panel regression analysis on the 713 observations, they found that budget balances deteriorated by about 0.3% of GDP in election years and that there was a deliberate use of fiscal expansion to get electoral support (Tujula and Wolswijk, 2007). The coefficient obtained suggested there was a lack of parliamentary backing for government actions in the event of unfavorable macroeconomic or budgetary developments and that fiscal tampering reflected a strategic attempt by an outgoing

government to limit the room for operation for a new government with a new political or economic ideology (Tujula and Wolswijk, 2007).

Klasnja (2008) conducted an empirical survey on whether electoral cycles in total expenditures and revenues differ systematically among transition countries with different political systems i.e. majoritarian presidential systems (Eastern Europe and Central Asia) versus proportional-parliamentary systems (Central and South Eastern Europe and the Baltics). He used annual data for 25 post-communist transition countries that held 135 elections from 1990 to 2006. He found that taxes were cut and targeted outlays were increased before elections only in countries with majoritarian presidential governments while revenues were consolidated after elections only in countries with proportional-parliamentary systems (Klasnja, 2008). The results showed that ineffective constitutional checks and balances intended to separate power, prevailed in presidential regimes than in parliamentary ones leading to more wastefulness, limited accountability and negative externalities in fiscal composition around elections.

Klose (2012) examined PBCs in monetary policy in a sample of 16 OECD countries - Australia, Austria, Belgium, Canada, Denmark, France, Germany, Italy, Japan, Netherlands, Norway, Spain, Sweden, Switzerland, United Kingdom and USA. He applied a two-dimensional asymmetric Taylor reaction function and a panel Generalized Method of Moments (GMM) on monthly data from 1975 to 2010 on inflation, interest rates and output (GDP). The Taylor function shows how the central bank “reacts to deviations of the inflation rate from its target and to deviations of the output from its potential, i.e. the so-called output gap” (Klose, 2012, p. 269) before and after an election. Klose (2012), after finding PBCs as evidenced by inflation and output movements, concluded that the central banks in the OECD countries lack independence, despite the conventional view that they are.

Chang et al. (2013) conducted a study to investigate the political and economic factors that affect business cycles in 14 OECD countries from 1980 to 2010. The countries studied were Australia, Austria, Canada, Denmark, France, Germany, Japan, Italy, Netherland, Norway, New Zealand, Portugal, United Kingdom, and USA. They used panel data and incorporated the traditional and rational partisan theories of PBC into an open economy framework to allow for synchronization of business cycles. Their main finding was that economic policies and the political environment significantly influence business cycles in the countries and correlations across the countries alike (Chang et al, 2013). Specific to the political factors, they found mixed evidence of PBC in the member countries when applying the traditional partisan theory by

Hibbs (1977) but the rational partisan theory by Alesina (1987) showed a robust link between partisan ideologies and output co-movements (Chang et al, 2013). In addition, they found that the similarity in the type of parties (left or right wing) holding office in countries is an important source of shocks across countries (Chang et al, 2013).

In a study that included countries from developed and developing countries, Klomp and De Haan (2013) examined political budget cycles in 70 democratic countries from 1970 to 2007. They used a pooled mean group (PMG) estimator on a cross-country time series dataset instead of the frequently applied GMM estimator for dynamic panel models to control for panel heterogeneity. The variables used for their model were GDP per Capita, real GDP growth, Inflation rate, Unemployment rate, an election dummy variable, a globalization level variable, age dependency ratio and a partisan variable to control for left or right-wing governments. Their results showed that there was significant evidence of electoral effects on fiscal policy in the short run for some but not all the countries. As further analysis, Klomp and De Haan (2013) went on to evaluate the countries that had PBC occurrences and found that the level of occurrence was conditional to the level of development and democracy, government transparency, the country's political system, membership of a monetary union and the degree of political polarisation (Klomp and De Haan, 2013).

Adam (2014) studied 86 elections in 14 European Union countries from 1985 to 2010 to identify what effect elections had on economic sentiment. He found that there was statistically and economically significant improvement in sentiment the month when elections occurred but that it was short-lived, i.e. lasting less than 2 months – a sign of public irrationality. The indicators that Adam (2014) used to track the state of the economy were unemployment and the inflation rate. The changes in the unemployment rate were found to be significant but changes in the inflation rate were not. There are other reasons that explain the irrational behaviour of economic agents such as the “weekend effect” and the “January effect”, both of which are beyond the scope of this study.

4.4 Evidence of PBC from single developing economies

Empirical studies on developing countries focused mainly on the Opportunistic and Rational Opportunistic theories of PBC and they limited their analysis to a narrow range of fiscal policy indicators.

In Israel, Ben-Porath (1975) studied the government and observed the implementation of a new tax system with a bid to curb high inflation levels that followed the 1973 elections and war. Ben-Porath part of a five-man committee that was delegated by the government to come up with the new tax system. The results of the 1975 study found positive PBC evidence in taxes as the variable that the government chose to influence (Ben-Porath, 1975). Brender (2003) looked at the Israeli economy and found a positive relation between fiscal policy and PBC, consistent with Ben-Porath's (1975) findings in Israel.

In Turkey, Krueger and Turan (1993) analysed a set of fiscal aggregates from 1950 and 1980 and found positive evidence of PBC effects which were driven by pre-electoral expenditure policies aimed at swaying voters into re-electing the ruling party. The findings showed that the investment programs were extended to unsustainable levels before elections and then scaled down substantially thereafter to the detriment of the general public. The effects of this turnaround in investment hurt individuals in the lower income brackets who ironically made up a sizeable portion of the entire voting population.

In Africa, Fouda (1997) conducted a study on Cameroon from 1960 to 1992 based on a political monetary cycle framework. A noteworthy point is that Cameroon's monetary policy is determined by the Reserve Bank of Cameroon but Cameroon is part of a monetary union, the BEAC CFA Zone that has an independent central bank. Fouda (1997) used the dating reference cycles method which involves discovering regularities on a given time series, after which he applied the Dickey-Fuller econometric test to analyse the presidential and parliamentary electoral data. He found positive evidence of election cycles in monetary growth that lasted for about seven to eight months. Furthermore, the Fouda (1997) study showed that the central bank lacked credibility, as it had no sanctions in place for members that manipulated monetary aggregates and this threatened the proper functioning of the monetary union (Fouda, 1997).

Ergun (2000) studied the Turkish government from 1985 to 1999 to determine if they influenced inflation levels prior to elections through policy change. He used a monthly data test for fiscal and monetary policy indicators alongside important economic policy instruments and indicators that were extensive for budget items. Through the use of an autoregressive model that applied an Ordinary Least Squares (OLS) methodology alongside a Hausman Specification test, he found statistically significant evidence that confirmed that the Turkish government used

expansionary fiscal policies prior to elections by increasing government expenditures and dropping tax revenues (Ergun, 2000). Furthermore, he found statistically significant evidence for the adoption of pre-election expansionary monetary policies through an increase in money supply and declining interest rates which in turn caused inflation to increase post elections (Ergun, 2000).

In Mexico, Gonzales (2002) conducted an econometric analysis to examine if Mexico's time-varying degree of democracy affected the manner in which economic policy was chosen as elections approached. She studied Mexico's fiscal policy choices between 1957 and 1997 and found that the government creatively used public spending in infrastructure and current transfers as a way of earning votes prior to federal elections (Gonzales, 2002). Mexico, like other Latin American countries, has been subject to swings in their political systems that made them more or less democratic regardless of elections taking place as scheduled (Gonzales, 2002). Her study aimed to determine whether the effect was stronger as democratization made elections so competitive that politicians were incentivised to increase visible government expenditure or democratization that increased the transparency of the economy to the point that voters had a better understanding of incumbents' competence. Gonzales (2002) concluded that the Mexican government turned to pre-election spending to counter the growing threat of the ruling party losing power because of democratization.

In India, Khemani (2004) examined the election effects in 14 Indian States and found evidence of policy manipulation that was geared towards benefiting special interest groups in return for campaign support (financial and mobilization through local influence) as opposed to the mainstream populist spending sprees that targeted large voter masses from 1960 to 1992. The state legislative elections reviewed in this study are crucial, as the elected leaders are responsible for electing the president. Khemani (2004) found no significant evidence of broad based fiscal expansions in pre-electoral periods as overall spending on public services and on state fiscal deficits remained unchanged. However, the evidence pointed at pre-electoral targeting of special groups rendered critical for electoral victory through tax breaks for small groups of producers and spending on public investment projects such as road construction in exchange for campaign support. These forms of manipulation were used because voters in India had begun to scrutinize large spending increases and tax rate cuts and were less likely to be influenced by it since experience had shown that they had short-term benefits that were easily reversed after elections (Khemani, 2004).

In Turkey, Karagol and Turhan (2008) tested for evidence of partisan and electoral effects in external debt and defence expenditure from 1960 to 2002. They found positive evidence of partisan over electoral effect shocks in the defence expenditure, which meant that political ideology of the government influenced fiscal policy choice and consequently the defence expenditure. However, post-election increments in defence expenditure could be interpreted to be an inheritance from previous governments that had used it to draw voters according to Ergun (2000).

In Brazil, Hiroi (2009) conducted a study to test the policy consequences of electoral cycles and exchange rate regime choices from 1985 to 2006. In that period, Brazil had six different currencies and nine major stabilization plans for its currency and economy. Hiroi (2009) used Brazil's disaggregated monthly data for a time-series regression analysis on fiscal and monetary policy variables namely: inflation rate, interest rate, GDP growth, exchange rate, money supply and budget balance. He found significant electorally induced fiscal cycles under fixed and crawling peg exchange rate regimes as evidenced by deteriorating budget balances during election years and electorally induced monetary cycles under floating exchange rates as evidenced by a 2.83% increase in money supply in election years (Hiroi, 2009). However, Hiroi further observed that electorally induced monetary cycles under floating exchange rates only occurred due to the nation's central bank lacking independence, as was the case with Brazil over the said period.

4.5 Evidence of PBC from groups of developing economies

In Latin America, Ames (1987) used central government data from 17 Latin American countries between 1947 and 1982 to determine if in the lead up to elections, the government used budgetary allocations to garner support. High levels of institutional instability dominated Latin America and incumbents took advantage of this by using public funds to strengthen their political base and increase their re-election chances. Incumbents were seen to 'reward' supporters as elections drew closer while newly elects increased spending to the public after elections (Ames, 1987). The study looked at various patterns of expenditure in military, health, welfare and education among countries. On average, Ames observed that government expenditure increased by 6.3% in the pre-election year and decreased by 7.6% in the year after

elections.

Building on work done by Ames in 1987, Remmer (1993) studied eight Latin America countries from 1980 to 1991, selecting countries that had weak institutions, high poverty levels and economic instability in order to test for PBCs. He made use of an interrupted time-series analysis and found no evidence for pre-electoral influence in government deficits, money supply changes, inflation and exchange depreciation. However, Remmer (1993) found mixed evidence of PBC effects in economic outcomes for the post-electoral period mainly due to varying policy-making infrastructures present in the countries considered for her study. These findings opposed prior research stating that leaders in Latin America pursued policies with short-term material payoffs that maximised electoral support but destroyed long-term economic performance (Remmer, 1993). Furthermore, Remmer (1993, p.393) observed that competitive elections improved rather than undermined “the capacity of political leaders to address outstanding problems of macroeconomic management”. This observation was critical because Latin American economies had to adapt to “a new internationally defined and policed economic orthodoxy” (Remmer, 1993, p.395) narrowing the policy choices their leaders could make at a time when many nations in the region were dealing with debt crises.

In Chile, Edwards (1994) conducted a study between 1952 and 1973 to understand the political economy of inflation and stabilization in developing countries. Using a series of recent models, Edwards found that inflation tax depends positively on the level of political stability in a country. His findings were consistent with the notion that certain policy actions pursued by government are strategically done to benefit from inflationary financing (Edwards, 1994). In addition to this finding, he further examined the role of the six congressional elections held plus 4 presidential elections, of which the former had been overlooked by prior studies and he found that these elections had also contributed positively to PBC during the said period. As a result, Edwards (1994, p.262) concluded that, “political variables have affected in a systematic way the economic developments in developing countries”.

Schuknecht (1996) used annual data on 35 developing countries from 1972 to 1992 to examine the impact that elections had on economic policymaking. The results showed that the implementation of expansionary fiscal policies during the pre-election cycle increased fiscal deficits by more than 0.6 percent of GDP (Schuknecht, 1996). Furthermore, fiscal consolidation took place after elections because of the contractionary effects of the policies

that were implemented during the pre-election period. In addition to the above, Schuknecht (1996) found that the cycles in fiscal policies were more significant in economies that were less trade-oriented and where IMF-supported programs aided fiscal stabilization.

As a follow up on his 1996 study, Schuknecht (1999) examined the fiscal policies around elections in 25 developing countries from 1978 to 1992. His focus was on whether a flexible or fixed exchange rate regime was susceptible to expansionary fiscal policies in the lead up to elections. He conducted regression analysis using annual panel data of countrywide general, legislative or presidential elections. Results showed that for a limited sample of non-African developing countries with fixed exchange rates and sufficient reserves, governments resorted to expansionary fiscal policies that positively affected public expenditure (both current and capital) to improve their chance of re-election. In a book released in 2000, Schuknecht and Tanzi found that election-oriented policy affected the expenditure side more than tax cuts because increased public spending had direct and immediate impacts while the tax cuts were inefficient since the tax bases were small in developing countries (Tanzi & Schuknecht, 2000).

Drazen (2000) conducted a critical review on the lessons learnt from existing PBC research conducted for over 25 years, through a review of both the opportunistic and partisan PBC models. He found that models based on electoral manipulation via monetary policy were questionable both theoretically and empirically while those based on fiscal policy manipulation conformed better to data and constituted a solid foundation for a compelling theoretical model (Drazen, 2000). He wanted to find a causal relationship between the fiscal and monetary cycles and to determine whether existent monetary cycles could be explained by fiscal cycles. In his study, Drazen (2000) proposed a new model based on the Rogoff (1990) rational opportunistic model of a political budget cycle combined with monetary policy controlled by a separate monetary authority. He called his model the “active-fiscal, passive-monetary” (AFPM) model of opportunistic PBCs. One of the model’s main arguments was that the role of an independent central bank in a fiscal induced PBC was not to exacerbate the cycle but to offset the fiscal effects that would drive up interest rates (Drazen, 2000).

Block (2002) conducted a cross-country study that covered 44 Sub-Saharan African countries that held presidential elections from 1980 to 1995. The reason for focusing on presidential elections only was that they pose a more direct threat to power relative to legislative elections. Using panel data, he employed a GMM estimator alongside OLS and fixed effects method as

the methods for analysing the results. Block (2002) sought to identify electoral interventions in five monetary and four fiscal policy variables. In his study, he observed a pattern of electorally timed interventions in monetary policy instruments through monetary expansion and lower interest rates in election years followed by increased inflation and seigniorage after the elections. With respect to fiscal policy manipulation, Block (2002) found that fiscal deficits, government consumption, public spending (current over capital expenditures) and net claims on the government increased during election years with post-election declines only clear in fiscal deficits and public expenditures.

Block et al. (2003) used macroeconomic data from African economies from 1980 to 1995 to test the hypotheses that PBCs are evident in competitive multiparty elections and that larger cycles should only be visible in founding elections². Most African economies only became democratised during the sample period and as such lacked independent monetary institutions and had weak legislatures. Block et al (2003) found that of the 65 elections studied, 22 were founding elections. Their study, which analysed five macroeconomic variables relevant to the African countries found strong evidence of electorally timed interventions in fiscal, monetary and exchange rate policy for competitive elections (Block et al, 2003). They also observed large monetary interventions and greater cycles of fiscal policy interventions for the case of founding elections (Block et al, 2003).

4.6 Evidence of PBC from a mix of both developed and developing economies

Shi and Svensson (2002) examined fiscal policy in a sample of 91 countries for the period 1975 to 1995 and found evidence of PBC in government consumption, tax revenues and the fiscal deficit increasing by 1% of GDP in election years. They also found that the cycles were of greater magnitude in developing than in developed countries. Expanding on their 2002 study, Shi and Svensson (2003, 2006) discussed models that proposed that political budget cycles arose because of a moral hazard problem of the competence approach. The argument proffered in their study was that all politicians face the same incentives regardless of their competence and that specific incentives depend on the politico-institutional environment a politician finds himself or herself in (Shi and Svensson, 2003, 2006). Through the use of large panel data, they

² Founding elections are elections in which “the office of head of government was openly contested following a period during which multiparty politics had been denied” (Bratton and van de Walle, 1997)

found that the more private benefits politicians gain when in power, the stronger their incentives to influence the voters' perceptions prior to elections and thus the larger the size of political budget cycles (Shi and Svensson, 2003).

Brender and Drazen (2005) sought to find the existence of political budget cycles in a sample of developed and developing economies, to prove that pre-election manipulation is useful to get voter support, and that voters punish rather than reward fiscal manipulation. They used an OLS regression with country fixed effects on a data set of 68 countries over the period from 1960 to 2001, focusing on central government balance, total expenditure and total revenue and grants. They found that political budget cycles characterised by increased expenditure in election years in "new democracies" significantly caused a political deficit cycle in a large cross-section of countries, which disappeared when they were removed from the sample (Brender and Drazen, 2005). These "new democracies" were mostly developing countries that were susceptible to fiscal manipulation because voters were inexperienced with elections and/or lacked information to evaluate fiscal changes.

Following their 2005 study, Brender and Drazen (2008), conducted another study using data from 350 election campaigns in 74 democracies from 1960 to 2003 to examine the direct effect of fiscal performance and economic growth on voter behaviour and re-election chances on a national level. Their analysis found that an increase in the government's budget deficit in an election year did not increase an incumbent's chance of re-election in all the countries they studied. Instead, incumbents were punished at the polls for increasing government spending in an election year in developed and established economies (Brender and Drazen, 2008). They also observed that budget deficits in the earlier years of an incumbent's term led to significantly lower chances of re-election, hence, proving that voters were indeed fiscally conservative and looked at performance of the entire office term rather than just the electoral year figures (Brender and Drazen, 2008). In contrast to the findings based on developed countries, their findings on developing countries were consistent with their 2005 study. Brender and Drazen (2008) found that, in less developed countries and new democracies, high growth rates of real GDP per capita over an incumbent's term signalled strong economic performance to voters and led to a significant increase in the incumbent's chances of being re-elected.

Vergne (2009) used data from 42 developing countries from 1975 to 2001 with special focus on the overall budget dynamics and how public spending fluctuated due to electoral

composition influence. His findings showed that in an election-year, public spending was directed towards more visible current expenditures such as wages and subsidies and got redirected from capital expenditure and that the impact of these changes in allocation lasted despite countries gaining experience in electoral politics (Vergne, 2009). His study supported the theory of politicians preferring broad-based spending at election times although he did highlight that as countries got experienced and were able to identify the spending deficits, voters would punish politicians and kick them out of office.

Chauvett and Collier (2009) deviated from the norm of using economic variables to test for PBC and instead looked at the structural and cyclical impact of elections on economic policies and governance in 82 developing countries over the period from 1978 to 2004. The core measure they used was the Country Policy and Institution Assessment (CPIA) annual ratings developed by World Bank covering 20 different aspects of economic policy and institutions in 130 countries since 1977. A regression analysis found elections to have both cyclical and structural effects; cyclical effects suggest that the mid-term is the fitting moment for policy change and periods leading up to elections are unfavourable for policy improvement (Chauvett and Collier, 2009). Structural effects suggest that a higher frequency of elections improves policy and governance net of any cyclical effects unless the electoral process is conducted poorly (Chauvett and Collier, 2009). As a result of their findings, Chauvett and Collier concluded that honest elections increase accountability and discipline governments to improve economic policy and governance and that international organisations should push developing countries to achieve this.

Brender & Drazen (2013) conducted another study on 71 democracies over the period from 1972 to 2009, with the objective of identifying changes in government spending before and after elections relative to changes in leadership. The three main findings in their study were that: elections had no material short run effects on expenditure as it takes time to effect changes; over the medium term, large composition changes were observed in developing economies and lastly, in election years, the expenditure composition changes tended to be greater in established than in new democracies. The last finding above was supported by the evidence that showed that the longer the leadership's tenure in office, the greater the change in expenditure composition come election time (Brender & Drazen, 2013).

A recent trend that is developing in PBC research is one in which the presence and magnitude of electoral fiscal cycles are thought to be conditional on certain institutional, political and economic contexts. One of this context was the past support variable for incumbent governments which assumed that a persistence of support, possible inertia at the polls and better results in a past election all contributed to having more support in the next election. (Aidt et al., 2011; Brender and Drazen, 2005; Franzese and Jusko, 2006; Rose, 2006; Schneider, 2010; Shi and Svensson, 2006; Vergne, 2009). This trend also highlights the signalling effect of PBC where incumbents' competence was signalled by changing composition of budget in electoral years through the provision of more visible and electorally effective expenditures (Drazen and Eslava, 2010).

4.7 Evidence on the possible link between PBC and sovereign credit rating action

This section seeks to review literature that investigates the link between PBC and credit rating action. Similar to this study, researchers have used macroeconomic variables to test for PBC evidence then proceeded to utilise the same variables in a model that computes a credit rating outcome that is then compared to actual rating(s) by one or all of the three main CRAs. This study follows a similar methodology in the sense that it uses macroeconomic variables in a model and considers the ratings provided by the three main CRAs.

CRAs are private companies that provide sovereign credit ratings, which reflect a country's perceived willingness and ability to repay its sovereign debt in full and on time (Chen et al., 2013) given its political, social and economic state. These ratings determine the rated countries' access to international capital markets, predict the likelihood of sovereign defaults and reduce monitoring costs for lenders and investors. Sovereign credit ratings can indirectly boost the demand of a sovereign's bond offering through the signalling of improved transparency, country risk levels and investor protection. They can also provide a mechanism to weaken financially repressive sovereign regimes as low ratings consequently yield low capital inflows which then pressures the regime to be responsible with its current funds and resources.

CRAs publish letter-grade sovereign ratings on a 6- or 16- point ordinal scale understandable by capital market participants (Block et al., 2003). CRAs also provide reviews - also called Watch lists and outlook reports. A review can be for an upgrade or a downgrade. It is an opinion by a CRA highlighting its concerns or developments in the current rating of a sovereign over the next three months. Reviews indicate the active analysis CRAs are conducting to determine

whether the current ratings should change (Lexicon, 2017). Outlook reports are prepared by a rating agency analyst and distributed via a press release available on CRA's websites. They indicate the analyst's forecast of the future rating of a sovereign. The forecast can either improve, decline or remain unchanged. A large proportion of changes in the outlook precede a change in rating. The ratings are pertinent for pricing and hedging risky fixed-income securities of corporate, municipal and sovereign issuers especially if the rating is below the investment grade level³.

Emerging markets have over the last decade attracted significant interest in the global market space and consequently drawn international players in the financial sector to invest in them. In earlier years of the 20th Century, CRAs only released ratings on developed and industrialised economies. These countries had to pay for the ratings, creating an income stream for CRAs but also raising a conflict of interest⁴ dilemma. It was possible to produce ratings for specific countries as data from those economies was available and reliable to use. However, after a few market crises, CRAs had to be regulated first through the Credit Rating Agency Reform Act ("the 2006 Act"), and then through the 2010 Dodd–Frank Act according to Hanusch and Vaaler (2013). The two academics also found that CRAs were in a position to play a positive role in emerging democracies as private guardians of public fiscal discipline. This conclusion was arrived at after conducting econometric analyses on 18 emerging democracies that held 32 presidential elections from 1989 to 2004. After the subprime mortgage crisis of 2008, which CRAs took part of the blame for⁵, CRAs needed to be more thorough in their assessments especially of emerging markets that were having investors flocking into them in search for growth and diversification. The demand for sovereign ratings also increased due to the inevitable globalization of markets.

International lenders often look to sovereigns to provide implicit and explicit payment guarantees to private borrowers. The sovereigns' financial institutions in both local and foreign currencies play a crucial role in this regard, but also, private debt issuers' credit rating is

³ An indicator of the quality of your fixed income and debt offerings. This level is a rating of 'BBB' or higher by S&P, Moody's or Fitch.

⁴ The Conflict of Interest could arise from agencies being incentivized to give more positive ratings to sovereigns, increasing their FDI and thus increasing the demand for ratings. This will make the role of ratings attractive for unrated countries which then approach the agencies for ratings.

⁵ CRAs took part of the blame as they assigned high ratings to the institutions and structured financial products such as mortgage-backed securities (MBSs) and collateralized debt obligations (CDOs) that were at the heart of the crisis. There was limited information on these products and high ratings were the cause of heightened investor interest in them (Bahena, 2010).

bounded from above by their respective country's sovereign ratings. Sovereign credit ratings are considered to be a reference measure of country risk (Pretorius & Botha, 2017). The number of developing countries rated by CRAs jumped from 12 in 1987 to 51 in 1997 and was around 70 in the early 2000s – the number has not grown much further due to most developing countries' data being unavailable. This clearly shows that the need for risk information on developing countries increased rapidly and thus credit ratings stepped in to address the issue of information asymmetry and transparency that are associated with emerging markets. This is exacerbated by the fact that many institutional investors investing in developing countries are required to hold securities with ratings above a certain threshold (Cantor & Packer, 1996)

There is a vast array of factors that can be used to determine the sovereign default risk (the risk that a government will not fully pay back public debt) of a country and in turn its credit rating level. These factors can be either quantitative or qualitative but not limited to “macroeconomic, government performance and other explanatory variables” (Afonso, Gomes, & Rother, 2007). One such factor is the level of decentralization (fiscal and/or political.) A study by Eichler and Hofmann (2013) found that higher levels of fiscal decentralization significantly increase sovereign default risk in emerging countries especially through high levels of intergovernmental transfers. These transfers worsen the common pool problem⁶ by providing incentives to implement unsustainable fiscal policies at the subnational level (municipal and provincial departments) and then having the federal governments bail them out leading to unsustainable debt levels.

Other determinants of sovereign risk identified and documented in various academic studies are: **high public debt levels** by Edwards, 1984, 1986; Dailami et al., 2008; Manasse and Roubini, 2009; **political business cycles** by Block and Vaaler, 2004; **the design of the political system** by van Rijckeghem and Weder, 2009; Saiegh, 2009; Kohlscheen, 2010, **fiscal deficits** by Schuknecht et al., 2009, (von Hagen, Schuknecht, & Wolswijk, 2011), **volatile economic fundamentals** and **financial markets** by Hilscher and Nosbusch, 2010; and **quality of institutions** by Faria et al., 2011.

Elections in majority of developing countries tended to affect the cost and availability of credit in the 1980s and 1990s. Goldsmith (1994) expected democratization efforts to promote greater

⁶ The classic common pool problem in economics is about how the impact of just one fisherman extracting more fish on the amount of fish in the lake is small, but if there are lots of fishermen doing the same we have a problem. (Wren-Lewis, 2014)

political freedom and stability but instead he found no correlation with enhanced attractiveness for lending and investment purposes. Behaviour predicted by PBC theory matters to agencies that are assessing the creditworthiness of developing countries in and around election periods. In this context, Block and Vaaler (2004) found that elections are associated with greater frequency of sovereign credit downgrades. This leads to agencies viewing elections in developing countries negatively, which consequently led to a substantial premium being exerted on those seeking capital (Block and Vaaler, 2004).

Erdem and Varli (2014) also examined the factors that CRAs consider when determining the ratings for emerging markets given the strong signalling effect that ratings have. They used a linear ordered response analyses on quarterly panel data of eight emerging countries - Brazil, China, India, Indonesia, Mexico, Russia, South Africa and Turkey from 2002 to 2011 and found that the most relevant factors were budget balance/GDP, GDP per capita, governance indicators⁷ and reserves/GDP with a 93% success rate albeit observing a lag in the ratings. As a result of the observed lag in the ratings in Turkey for example, Erdem and Varli (2014) questioned whether the CRAs were reacting fast to bad news and slowly to good news.

Ozturk (2014) studied six governance indicators that affect institutional quality in an attempt to identify which were responsible for (bias) low sovereign ratings that had the potential to disrupt proper functioning financial systems. Using an ordered response model, he found that government effectiveness and regulatory quality caused a variation in institutional quality among the 106 countries studied and this contributed to the lower credit ratings they received between 1999 and 2010. Maltritz and Molchanov (2014) using Bayesian Model Averaging found that GDP growth and external debt to GDP ratio were the most important determinants of credit ratings for 31 emerging and 19 developed economies and that these factors played a vital role in influencing their default risk. Bissoondoyal-Bheenick (2005) conducted a study using an ordered response model on 25 developed and 70 developing countries over the period 1961 to 1999 and found that of all economic variables considered, on average, GNP per capita and inflation seemed to be the most relevant quantitative inputs into sovereign rating decisions (Bissoondoyal-Bheenick, 2005). He added that the weight assigned to different economic and financial indicators by CRAs depended on if the country is a highly-rated country and has a

⁷ Governance Indicators are: Control of corruption, government effectiveness, political stability and absence of violence/terrorism, regulatory quality, rule of law and voice and accountability

long institutional stability history or is a low rated country that is still undergoing rapid structural change (Bissoondoyal-Bheenick, 2005). In addition to the two variables above, the current account balance and level of foreign reserves played an important role in determining the sovereign ratings of low rated countries.

Cantor and Packer (1996) using a cross-section analysis and an OLS regression technique on 49 developed and developing countries found that the six important factors used by Moody's and S&P are: per capita income, GDP growth, inflation, external debt, level of economic development, and default history. These findings are consistent with the findings by Eliasson (2002) which show that the same set of variables are significant in ratings determination though she only used S&P credit ratings in a static and dynamic context for emerging markets. Similarly, Rowland (2004) used the same variables as Cantor and Packer (1996) but focused only on developed economies. His findings showed that the important factors for Moody's and S&P are: GDP per capita, the economic growth rate, the inflation rate, external-debt ratios, debt-service ratios, the level of international reserves, and the openness of the economy. Both studies found GDP per capita and debt ratio to be significant.

Gultekin-Karakas et al (2011) used a random effect ordered probit model for a mix of 93 developing and developed countries between 1999 and 2010 and found inconsistencies in ratings issuance; for example, they found that low-income countries received lower ratings with a similar distinction when it came to OECD versus non-OECD countries. Afonso (2003) used cross-section data from 81 developing and developed markets. He employed a linear, logistical and exponential transformation of S&P and Moody's rating levels and found that: (1) GDP per capita, (2) external debt-to-exports ratio, (3) level of economic development, (4) default history, (5) real growth rate, and (6) inflation rate as important factors. Evidence in this study shows that external debt and external reserves are more relevant for low-rated and developing countries while inflation was profound for high rated countries (Afonso, 2003).

There are also other studies that investigated the link between political variables and sovereign risk. For example, Citron and Nickelsburg (1987), Brewer and Rivoli (1990) and Balkan (1992) all found political stability to be statistically significant in explaining the probability of sovereign default. Van Rijckeghem and Weder (2004) using a non-parametric technique found politics to be relevant in explaining sovereign defaults on external and domestic debt obligations focusing on the effects that a sovereign's debt level can have on the quality of its institutions.

Kohlscheen (2006) finds that higher political turnover per se increases the likelihood of sovereign default in 72 democracies excluding Latin America and OECD countries between 1976 and 2000. Cuadra and Sapriza (2008) looked at how the political process of a country, as characterized by political instability and polarization, can impact sovereign interest rate spreads. They found that countries subject to larger political uncertainty and stronger domestic disagreement face a higher default risk premium in international credit markets.

Based on the above literature review, this study has illustrated the development of PBC research in countries of different economic and political standings. It has proceeded to provide evidence of the link present between PBCs and credit rating action in various economies. The next chapter shall now elaborate on the data used and the methodology applied to it.

Chapter 5 – Data and Methodology

5.1 Introduction

This chapter presents a detailed description of the data and the methodology that is followed by this study. Before discussing the appropriate method(s) to be used in this current study, it will explain the data types that are used, covering their sources and the time frame for which the study is focusing on in section 5.2. Thereafter, section 5.3 and 5.4 get into an explanation of the models and estimation techniques adopted for this study, citing previous literature that have also applied the same methodologies. The explanation will cover the hypotheses that the study aims to test, the applicable equations and the variables that make up the equations i.e. dependent versus independent. Lastly, section 5.5 will discuss the estimation strategy.

5.2 Data

This study makes use of three types of data: Macroeconomic data, Election Data and Credit Rating Data with each data type and source explained in the sub sections below.

5.2.1 Macroeconomic Data

Prior research by Cantor and Packer (1996a, b), Larrain et al. (1997) and McNamara and Vaaler (2000) used various macro-economic variables to determine whether they explain the variation in agency sovereign ratings for both industrialized and developing countries in the 1980s and 1990s. Similarly, Block and Vaaler (2004) and Vaaler, Schrage and Block (2006) also used macroeconomic data based on a sample of 19 developing countries which included Brazil, Russia and South Africa for the period from 1987 to 2000. Consistent with the studies above, this study also uses macro-economic variables to examine if they explain the presence of PBC and consequently the variation in CRAs' sovereign ratings of the BRICS countries. The annual data for each of the macroeconomic variables was collected from the World Bank's database for World Development Indicators (WDI) for the period from 1994 to 2014 for BRICS. The macro-economic variables considered for the purpose of this study are briefly explained below:

- **Broad Money Growth (BMG)**, which represents the annual growth of the sum of currency outside banks, demand deposits other than those of the central government, foreign currency deposits of resident sectors other than the central government as well as other securities such as certificates of deposit and commercial paper.

- Current Account Balance (**CAB**), which is the sum of balance of trade (exports minus imports of goods and services), net factor (primary) income e.g. interest and dividends and net transfer payments (secondary income) e.g. foreign aid.
 - External balance on goods and services (**EXTBAL**), which represents the difference between the exports of goods and services and imports of goods and services relative to GDP.
 - External Debt (**EXTDEBT**), which refers to the sum of short-term, long-term public sector, public and publicly guaranteed and private non-guaranteed debt relative to GDP.
 - Fiscal Balance (**FISCBAL**), which refers to the annual overall budget balance (government tax revenue less government final consumption expenditure) relative to GDP for the current year
 - GDP growth (**GDPG**), which represents the annual real GDP growth rate.
 - GDP per capita growth (**GDPCG**) represents the growth of the annual real GDP relative to the number of people in the country.
 - General government final consumption expenditure (**GFCE**), which refers to the government's final expenditure relative to GDP.
 - Government tax revenue (**GREV**) refers to compulsory transfers to the central government for public purposes. Excludes certain compulsory transfers such as fines, penalties, and most social security contributions. Treats refunds and corrections of erroneously collected tax revenue as negative revenue.
 - Inflation (**INF**), which represents the average annual consumer price inflation.
 - Unemployment (**UNEMP**) refers to the national estimate of the share of the labor force that is without work but which is available for and seeking employment.
- Real Interest Rate (**RIR**), refers to the lending interest rate adjusted for inflation as measured by the GDP deflator.

5.2.2 Electoral Data

In addition to macro-economic variables, this study also uses electoral data. The Electoral data for BRICS was sourced from the **World Bank's Database of Political Institutions (DPI)** for the period from 1994 to 2014. The focus for this study is solely on presidential elections because “they present a more direct threat to power and are more relevant in a political context” (Bratton and van de Walle, 1997). All the countries sampled have fixed-term presidencies from 1994 to 2014, which addresses the concern around the potential bias that could occur to our

estimates if elections were endogenous i.e. if politicians / governments could call elections when the economic conditions were favorable (Block, Ferree, & Singh, 2003). The only country in our study to have founding elections worth noting is South Africa which held its first ever democratic elections on 27th April 1994. The data set includes **22** multiparty presidential elections held as follows: **6** in Brazil, **5** in Russia, **4** in India, **2** in China and **5** in South Africa.

The information from the database that is relevant for this study is: **Election year, incumbent government party/candidate, winning party/candidate** and where applicable, whether the aforementioned parties were either **left or right wing**.

The Election year is captured as a dummy variable (**ELECYR**) and it takes a value of “1” when there were elections during a particular year else “0” when there were no elections for a given year. Other studies coded the election data differently to the above. For example, McCallum (1978) took a different approach with the electoral variable by increasing it by 1 every quarter from the time an incumbent got into office until about their 3rd year in office, then decreasing it by 1 so that it is back at 1 or 0 in the quarter when elections are held and the incumbent either gets re-elected or loses. He then conducted tests to find correlations between the electoral variables and residuals from autoregressive-moving average (ARMA) models run on the macroeconomic variables. However, this study does not replicate this as it makes use of annual data.

The party orientation variable as per the DPI takes the following values: 1 = Right, 3 = Left, 2 = Center, 0 = No information and NA = No executive.

The **right** for this study represents parties that are defined as conservative, republican or fascist, or right wing. The **left** represents parties that are defined as communist, socialist, democrat, or left-wing while the center represents parties that are defined as centrist or parties whose position can best be described as centrist (e.g. party advocates strengthening private enterprise in a social-liberal context). Parties can also be described as centrist if competing factions “average out” to a centrist position (e.g. a party of “right-wing Muslims and Beijing-oriented Marxists”).

5.2.3 Credit Rating Data

This is the data relating to long term sovereign credit ratings. The credit ratings data used for this study was sourced from Trading Economics and verified against the ratings posted on the sites of the CRAs. Particular focus was on the annual credit ratings that are published by Standard and Poor Global Ratings (S&P), Moody's Investors Service (Moody's) and Fitch Ratings Inc. (Fitch). This study uses ratings from these three CRAs as they have dominance in the industry, specifically the sovereign rating segment. They also have the broadest country coverage that is complemented by a large pool of analysts globally. Furthermore, when combined, they have the largest market share of ratings for individual bond issuances.

Consistent with prior studies that looked at the determinants of credit ratings, this study adopts a linear transformation over a non-linear transformation to quantify the rating categories. According to Pretorius and Botha (2017), a linear transformation's main assumption is that the distance between rating categories is the same. Consistent with Cantor and Packer (1996), the credit ratings are transformed into an ordinal linear scale of 17 points as shown below:

16 = AAA, 15 = AA+, 14 = AA, 13 = AA-, 12 = A+, 11 = A, 10 = A-, 9 = BBB+, 8 = BBB, 7 = BBB-, 6 = BB+, 5 = BB, 4 = BB-, 3 = B+, 2 = B, 1 = B- and 0 = C.

The final sample comprises of **315 ratings** published by 3 agencies for 5 countries that hold **22 presidential elections**. This study acknowledges that rating changes happen at different and multiple times in a year for the focus countries, hence, to avoid inconsistency, this study uses each country's rating at the end of the 4th quarter (31 December) for the purpose of the analysis. The tables below provide a description of the ratings by the three main rating agents as well as the scale that shall be used for the purpose of this study.

Table 6: Summary of credit rating levels as set by the 3 main CRAs in the World

Moody's		S&P		Fitch		Description	
Long-term	Short-term	Long-term	Short-term	Long-term	Short-term		
Aaa	P-1	AAA	A-1+	AAA	F1+	Prime	Investment-grade
Aa1		AA+		AA+		High grade	
Aa2		AA		AA		Upper medium grade	
Aa3		AA-		AA-			
A1	A+	A+	A-1	A+	F1	Upper medium grade	
A2		A		A			
A3	P-2	A-	A-2	A-	F2	Lower medium grade	
Baa1		BBB+		BBB+			
Baa2	P-3	BBB	A-3	BBB	F3	Lower medium grade	
Baa3		BBB-		BBB-			
Ba1	Not prime	BB+	B	BB+	B	Speculative	Non-investment grade
Ba2		BB		BB			
Ba3		BB-		BB-		Highly speculative	
B1		B+		B+			
B2		B		B			
B3		B-		B-			
Caa1	C	CCC+	C	CCC	C	Substantial risks	
Caa2		CCC		Extremely speculative			
Caa3		CCC-		Default imminent with little prospect for recovery			
Ca		CC					
	C						
C	D	/	/	DDD	/	In default	
/				DD			
				D			

Source: http://www.billiontrader.com/tim/106_2.png

Table 7: Sovereign risk ratings on long term foreign denominated debt from the 3 main CRA presented in a 17-point scale

	Fitch	Moody's	S&P
16	AAA	Aaa	AAA
15	AA+	Aa1	AA+
14	AA	Aa2	AA
13	AA-	Aa3	AA-
12	A+	A1	A+
11	A	A2	A
10	A-	A3	A-
9	BBB+	Baa1	BBB+
8	BBB	Baa2	BBB
7	BBB-	Baa3	BBB-
6	BB+	Ba1	BB+
5	BB	Ba2	BB
4	BB-	Ba3	BB-
3	B+	B1	B+
2	B	B2	B
1	B-	B3	B-
0	CCC	Caa1	CCC+

5.3 Hypothesis development

Following from the discussion of the theoretical frameworks and models of PBCs in chapter 3 above, the opportunistic model would be the most appropriate model for the analysis of results. A deterrent from using the partisan model is because it is rooted in the idea of left-right ideological differences in parties with varying preferences for inflation and unemployment (Kaplan, 2006). Party distinctions are not clearly identifiable in emerging and frontier countries and this is the main reason why this study excludes party orientation in the regression model.

Given that this study is organized into two parts, the first part shall examine whether PBCs around election years affect real economic outcomes in BRICs economies while the second

part examines whether election years and the evidence of PBC play a role in influencing sovereign rating action that BRICS received for the period under consideration.

Testing for Hypothesis 1

Firstly, based on evidence from prior literature, the study assumes that election years are associated with higher political risk explained by a strong presence of political business cycles (PBCs). The evidence of PBCs is identified by observing the changes in specific macroeconomic outcomes in the periods leading up to and after elections. Based on the argument above, hypothesis 1 tests the following:

H₀: Election years do not affect real economic outcomes and are not the cause of PBCs in BRICS

H₁: Election years are the likely cause for a strong presence of PBCs in BRICS

To address the above arguments this study examines each macroeconomic intervention with a specification that takes the form of:

$$y_{i,t} = \sum_{j=1}^k \gamma_j y_{i,t-j} + \beta_1 \text{ELE}_{i,t} + \beta_2 \text{ELEPOST}_{i,t} + \alpha_i + u_{i,t} \quad (1)$$

where α_i captures unobserved time-invariant country-specific effects

$$\text{ELE}_{i,t} = \begin{cases} 1 & \text{if } t \text{ is an election year} \\ 0 & \text{otherwise,} \end{cases}$$

and

$$\text{ELEPOST}_{i,t} = \begin{cases} 1 & \text{if } t \text{ is a post – election year} \\ 0 & \text{otherwise.} \end{cases}$$

Therefore, for this study, the dependent variable ($y_{i,t}$) will be one of the eleven macroeconomic variables described above. The independent variables are: the lag of the dependent variable ($y_{i,t-1}$), election year dummy variable ($\text{ELE}_{i,t}$), the post-election year dummy variable ($\text{ELEPOST}_{i,t}$) and the error term ($u_{i,t}$). The information relating to the independent variables is coded as shown above.

The objective is that each of the macro economic variables will be tested against the independent variables for evidence of a PBCs in BRICS. This test is conducted on macro-economic variables that are relevant in fiscal policy formation (fiscal balance, current account balance, external balance on goods and services, government expenditures and revenues) and monetary policy setting (inflation, real interest rates, and broad money growth).

Consistent with suggestions in previous studies, the lagged values of the dependent variable (LDVs) are used for this part of the study. Lagged values of the dependent variable are important in the ARMA context as future dependent variables are influenced by their historical values (Kaplan, 2008). Furthermore, as suggested by Kaplan (2008), LDVs aid in accounting for any partial and autocorrelation in the data, hence, capturing any inertial effects in the macroeconomic variables and accounting for any unobserved factors that may explain differences in the macroeconomic variable over time. The LDV is an annual variable, and though a ‘blunt indicator’, it is still appropriate for this analysis as it reflects the same frequency, with which the agencies review their country ratings (Block & Vaaler, 2004). In addition to the LDVs, the Schwarz Information Criterion (SIC) was used to determine the appropriate number of lags (k) on the dependent variation.

However, one of the problems that arises in prior studies is that there could be potential endogeneity. The problem of endogeneity comes about as a result of the election dummy variable having a biased coefficient estimate due to the timing of elections not being fixed and also because political leaders have the power to call elections at a time of their choice. Furthermore, endogeneity could be as a result of another set of unobserved variables affecting both the timing of elections and the macroeconomic variable outcomes. Specific to this study, the problem of endogeneity is eliminated by the fact that for BRICS, how and when to call an election is determined in the constitution unless in the instance when an incumbent steps down before the end of their term in which case the constitution stipulates that the successor can either continue with that term or seek a new mandate from voters. Block and Vaaler (2004) further advocated the use of the GMM estimator as it allows control for potential bias arising from endogeneity.

Given the presence of a lagged dependent variable (LDV) alongside the panel data used in the study, the estimation method that best suits this study is the GMM as proposed by Block and Vaaler (2004) and Arellano and Bond (1991). The GMM estimator is an instrumental variables approach and it deals with the concern of possible endogeneity associated with elections though

all the countries sampled have fixed electoral terms. It selects the estimates that minimize the quadratic form of moment conditions and gets as close as possible to solving the over-identified system in the case where we have more sample moment conditions than we have parameters (Block, 2002). The OLS cannot be used as it fails to control for country-specific unobserved effects over the sample period. The Fixed Effects (FE) model (within groups) would have been preferred as per Hausman tests conducted over the Random Effects (RE) model. However, the FE model is still not a good fit for this study as its estimates could be potentially biased by LDVs which have turned out to be significant as results below will show (Klein & Sakurai, 2015). Upon evaluating both the robust and non-robust GMM estimation models, this study will make use of the latter model which is non-robust to heteroskedasticity as used in the previous works by Arellano and Bond (1991).

Testing for Hypothesis 2

The second part of this study aims to find a possible link between the macroeconomic variables that are tested for PBC evidence in BRICS and the credit rating action that BRICS receive around election years. This led to the development of hypothesis 2 which is set out as follows:

H₀: Election years do not play a role in influencing sovereign rating action for BRICS?

H₂: Election years are associated with a higher likelihood of (negative) sovereign rating action for BRICS?

CRA's take into account political risk amongst other risk indicators, when determining ratings for sovereigns. Election years, especially in developing and frontier markets, tend to be viewed negatively as heightened political uncertainty around the outcome leads to a higher possibility of a downgrade or a negative outlook. Therefore, guided by the prior works by Block and Vaaler (2004), the equation that is appropriate for this study is presented below as follows:

$$RATING_{it} = \beta_0 + \beta_1 RATING_{it-1} + \sum_{j=1}^8 \psi_j MACRO_{it} + \eta_i ELEC_{it} + v_{it} \quad (2)$$

In order to explain these annual rating levels, this current study uses the variables: i is for the country and t for the year. The rating is as per the ordinal scale described above (0 – 16) as assigned by either of the three CRA's to each of the member countries of BRICS over the duration between 1994 and 2014. The rating agency is not used as one of the control variables because tests are conducted based on each individual rating agency's ratings for all the countries separately (refer to Table 21).

The right-hand side of the equation contains the independent variables which are the: LDV (Rating_{it-1}), a vector of macro variables, dummy variables to account for the unobserved and characteristic effects related to the election year and the error term.

The macroeconomic variables selected for use in this part of the analysis were based on two criteria: variables found significant in providing evidence of PBC and determining credit ratings in prior empirical literature and variables we believe CRAs consider when they assign ratings. The variables that shall be used to test for hypothesis 2 are: GDP per capita (expected to be positively related to the credit rating), Broad Money Growth (expected to be positively related to the credit rating), Current Account Balance (a deficit is expected to be negatively related to credit rating while a surplus is expected to be positively related to the credit rating), Government Revenue (expected to be positively related to the credit rating), Inflation (expected to be negatively related to the credit rating), Fiscal Balance (positively related to credit rating if it is positive and negatively related to credit rating if it is negative), External Balance (positively related to credit rating if it is positive and negatively related to credit rating if it is negative) and External Debt (expected to be negatively related to the credit rating assigned). It is important that the variables picked can be influenced by both fiscal or monetary policy action which is central to opportunistic PBC theory.

Estimation Strategy

The dependent variable is a rating level between 0 and 16 and is thus ordinal. This makes the case for using an ordered probit regression model although it is not possible to control for unobserved country heterogeneity since no model can provide such explanations. (Eliasson, 2002) . Using this model over a linear regression is preferred because the latter implicitly assumes that the difference between one ordinal point (1) and another (2) is the same between the one ordinal point (2) and the next (3) and that assumption cannot hold for this study.

The above sections have laid out the foundation for our analysis by expounding on the data types, the hypotheses the study aims to prove and the empirical methods that shall be used. The chapter to follow lays out the results, clearly explaining the outputs obtained and interpreting their meanings and how they add value to the objectives of this study.

Chapter 6 – Results

6.1 Introduction

This chapter is structured as such, section 6.2 explains the descriptive statistics for the data collected and used on the 11 macroeconomic variables from 1994 to 2014 for BRICS. Section 6.3 will discuss the results from running model 1 in Chapter 5 above to investigate hypothesis 1 (evidence of PBC in BRICS as tested for through macroeconomic changes around election years) and then section 6.4 will discuss results from running model 2 to test the link between PBC and credit rating action as identified by changes in macroeconomic variables.

6.2 Descriptive statistics

Table 8: Descriptive statistics for the macroeconomic variables for Brazil, Russia, India, China and South Africa (1994 – 2014)

Variable	Mean	Standard Deviation	n
Broad money growth (annual %)	32.59569	107.9572	105
Current account balance (% of GDP)	0.75508	4.326219	105
External balance on goods and services (% of GDP)	2.103405	4.917482	105
External Debt (% of GDP)	34.93836	18.74811	105
Fiscal Balance (% of GDP)	-0.31696	5.660512	105
GDP growth (annual %)	5.0733	4.208616	105
GDP per capita growth (annual %)	3.981498	4.276007	105
General government final consumption expenditure (% of GDP)	16.33807	3.33183	105
Government tax revenue (% of GDP)	16.02111	5.982389	105
Inflation, consumer prices (annual %)	33.35629	204.4677	105
Real interest rate (%)	11.66031	19.1128	101
Unemployment, total (% of total labour force) (national estimate)	9.49619	7.623422	105

Table 8 above presents summary data on the macroeconomic variables used for BRICS. The statistics above explain why one cannot classify the bloc as either a developing or developed 'economy' though it does display features that are usually associated with frontier economies.

The broad money growth for BRICS averages to 33% for 105 observations though this metric is likely to have been skewed by Brazil's broad money growth which was at 1102% in 1994 before dropping to 44% in 1995 (World Bank, 2017) as per figure 1 in the appendix. The current balance (% of GDP) has an average of 0.76% for 105 observations, the high positive balances in Russia and China are evened down to 0.76% by low balances in Brazil, India and South Africa as shown in Figure 2. The external balance on goods and services as % of GDP has an average of 2.1% for 105 observations, Russia and China drive the positive metrics with all-time highs of 20% and 9.5% respectively while the other 3 countries maintained low figures, with India having the lowest balance in 2012 (-6.5%) as shown in Figure 3. External debt as a % of GDP averages at 35% for 105 observations with all the countries illustrating an increasing trend since 1994 although China's pace has been higher than its counterparts as shown in Figure 4. GDP growth and GDP per capita growth averaged 5% and 4% respectively with 105 observations each. China's growth supported the group with a high of (+14.2%) in 2007 while Russia had the lowest growth in 1994 of (-12.57%) as shown in Figure 5.

Government Consumption expenditure as a % of GDP averaged to 16.4% for 105 observations. Russia has had consistently high expenditures over the years, closely followed by Brazil and South Africa while China and India's governments have kept their expenditure at below 17% and 13% respectively over the 20-year time frame as shown in Figure 7. The tax revenue as a % of GDP averaged out to 16% for 105 observations with South Africa maintaining consistently high tax revenues of above 20% while India and China kept their levels around 10% as shown in Figure 8. Inflation averaged out to 33% for 105 observations though this mean is biased due to Brazil's 1994 inflation high of 2076% that dropped drastically in 1995, vastly different from the 2014 levels for BRICS that ranged between 2% (China) and 8% (Russia) as shown in Figure 9. The real interest rate averaged out to 12% for 101 observations, boosted up by the +20% interest rates that Brazil had over the 20 years and evened up by Russia that had 10 years (1998 to 2008) of negative interest rates with a record low of (-19%) in 1999 as shown in Figure 10. Unemployment averaged to 9.5% for 105 observations, with SA having levels over 20% from year 2000 onwards, followed closely by Brazil and Russia that have had levels above 5% but below 15%. India and China have maintained consistently low levels of unemployment as shown in Figure 11.

6.3 Political Business Cycle Results

The results below are based on the regression of each macroeconomic control variable on the LDV and the election and post-election dummy variables based on OLS, Fixed Effects (within groups) and GMM estimates. The heteroskedastic-consistent (white) standard errors are shown in parenthesis and the coefficients on LDVs are omitted in the tables of results below. GMM results reported in the tables are two-step estimators with instruments based on the assumption that elections are pre-determined rather than strictly exogenous (Arellano and Bond, 1991).

Broad Money Growth

Results in Table 9 show that broad money growth is statistically significant in the post-election year at the 1% level in the GMM model. The GMM estimate indicates that broad money growth is positively related to elections. Broad money growth is likely to increase substantially by a 6.24-percentage point in the post-election year. This finding defies traditional PBC theory, which predicts that BMG should fall, or fall negatively after elections. The observation here suggests that in BRICS, governments upon election / re-election will foster and push for expansionary monetary policies that cause an increase in money growth.

One reason for this could be due to the influx in FDI on the back of the positive light in which the international community views successful elections. BRICS show monetary policy independence and so investors do not expect any tampering with those policies, and so will increase investments should elections end with no qualms. It is with this similar thinking that (Drazen, 2000) sought to look for political budget cycles induced by fiscal policy manipulation around election times. Another reason for that increase in money supply may be due to the existing high interest rates that compel investors to increase their foreign deposits in BRICS. A period of high interest rates is associated with low inflation levels which also defies PBC theory that post-election periods are associated with high inflation (Cuikerman & Meltzer, 1986).

Table 9

<i>A. Broad Money Growth (BMG)</i>				
Independent Variables	OLS	Fixed effects	GMM	GMM-robust
ELECYR	0.863	-3.367*	-1.039	-1.039
	(3.497)	(1.407)	(2.235)	(1.736)
ELECYRPOST	7.522	4.597	6.245***	6.245
	(5.372)	(5.463)	(2.148)	(5.640)
Observations	95	95	95	95
R-squared	0.297	0.187		
Wald test	0.198	0.198	0.00663	0.0815
Number of Countries		5	5	5
Sargan (p-value)			0	0

*** p<0.01, ** p<0.05, * p<0.1

Current Account Balance

Results in Table 10 show that the current account balance is statistically significant in the election year at the 5% level in GMM and the 10% level in OLS. The GMM estimates show that there is a positive relationship between elections and the current account balance. The current account balance is observed to increase by a 1.01-percentage point in the election year. This coincides with PBC theory as an improvement in the current account balance is an indicator of competence in managing the government's resources. As incumbents target low inflation levels in the lead up to elections as PBC literature illustrated (Grier, 1989), it will create a favorable exchange rate fostering consumer spending and increased imports which are favorable for BRICS which are mostly exporting countries except for China that is both a large importer and exporter.

Table 10

<i>B. Current Account Balance</i>				
Independent Variables	OLS	Fixed effects	GMM	GMM-robust
ELECYR	0.982*	0.905	1.010**	1.010
	(0.576)	(0.667)	(0.473)	(0.652)
ELECYRPOST	0.928	0.546	0.714	0.714
	(0.714)	(0.574)	(0.458)	(0.586)
Observations	95	95	95	95
R-squared	0.837	0.527		
Wald test	0.946	0.360	0.603	0.343
Number of Countries		5	5	5
Sargan (p-value)			0.00482	0.00482

*** p<0.01, ** p<0.05, * p<0.1

External Balance on Goods and Services

Results in table 11 show that there is no significant relationship between the external balance on goods and services and elections for all three estimators. This finding could be due to incumbents not having a direct hand in controlling the flow of goods and services. As discussed in (Bove, Efthyvoulou, & Navas, 2016), incumbents will target current expenditure that is visible and has immediate results and benefits (social welfare programs, unemployment and old age benefits) to the electorate.

Table 11

<i>C. External Balance on goods and services</i>				
Independent Variables	OLS	Fixed effects	GMM	GMM-robust
ELECYR	0.495 (0.446)	0.420 (0.410)	0.520 (0.421)	0.520 (0.397)
ELECYRPOST	0.345 (0.674)	0.0639 (0.462)	0.185 (0.405)	0.185 (0.489)
Observations	95	95	95	95
R-squared	0.891	0.566		
Wald test	0.837	0.206	0.509	0.150
Number of Countries		5	5	5
Sargan (p-value)			0.000363	0.000363

*** p<0.01, ** p<0.05, * p<0.1

External Debt

Results in Table 12 show that external debt is statistically significant in the election year at the 5% level in OLS but not in Fixed Effects and GMM. The OLS estimate shows a negative relationship between elections and external debt. Election periods are associated with a decline in external debt by about 5.2 percentage points in the election year. This finding is in line with PBC theory, because incumbents refrain from taking on external debt to supplement tax and other revenues necessary for current expenditure and campaigning. This also signals competency to voters as it shows that the government is managing their current resources well and need not take on more external debt. It is likely that reducing external debt seems more lucrative to incumbents at a time when low inflation policies are in place, to reduce the interest charges on the debt before and during the election period. Future interest charged on the debt will be the burden of those who take office after elections.

Table 12

<i>D. External Debt</i>				
Independent Variables	OLS	Fixed effects	GMM	GMM-robust
ELECYR	-5.192**	-4.469	-3.908	-3.908
	(2.493)	(4.278)	(2.665)	(3.542)
ELECYRPOST	-0.643	0.123	0.650	0.650
	(2.401)	(2.076)	(2.613)	(2.136)
Observations	90	90	90	90
R-squared	0.823	0.613		
Wald test	0.184	0.466	0.150	0.363
Number of Countries		5	5	5
Sargan (p-value)			0.216	0.216

*** p<0.01, ** p<0.05, * p<0.1

Fiscal Balance

Results in table 13 show that there is no relationship between the fiscal balance and elections for all three estimators. This finding goes against empirical findings from studies done on developing economies by Ames (1987), Block (2002), Gonzalez (2002), Schuknecht (1996) and Shi & Svensson, (2000) who found PBCs as evidenced by pre-election expansion and post-election contraction in fiscal deficits. The case of BRICS may be different owing to the fact this group of countries have distinct levels of government revenues, revenue sources and expenditure. Furthermore, the member states are independently marred by issues such as corruption and fund misappropriation by governments, though it probably occurs over the terms of the ruling governments and not specifically around election time.

Table 13

<i>E. Fiscal Balance</i>				
Independent Variables	OLS	Fixed effects	GMM	GMM-robust
ELECYR	0.0657	0.170	-0.0889	-0.0889
	(0.521)	(0.366)	(0.584)	(0.310)
ELECYRPOST	-0.571	-0.377	-0.654	-0.654**
	(0.463)	(0.290)	(0.561)	(0.331)
Observations	95	95	95	95
R-squared	0.903	0.710		
Wald test	0.233	0.298	0.420	0.181
Number of Countries		5	5	5
Sargan (p-value)			0.642	0.642

*** p<0.01, ** p<0.05, * p<0.1

GDP Growth

Results in table 14 show that there is no relationship between the GDP growth and elections for all three estimators. This finding is expected as the electoral effect is usually short term - lasting anywhere from 1 to 3 months excluding campaigning time. Election dates and years are public information and so the event is not likely to have any direct impact on the GDP growth of a sovereign.

Table 14

<i>F. GDP Growth</i>				
Independent Variables	OLS	Fixed effects	GMM	GMM-robust
ELECYR	-0.408 (0.623)	-0.271 (0.798)	-0.488 (0.860)	-0.488 (0.529)
ELECYRPOST	0.313 (0.663)	-0.191 (1.064)	-0.390 (0.832)	-0.390 (0.965)
Observations	95	95	95	95
R-squared	0.646	0.138		
Wald test	0.261	0.923	0.924	0.915
Number of Countries		5	5	5
Sargan (p-value)			0.590	0.590

*** p<0.01, ** p<0.05, * p<0.1

GDP Per Capita Growth

Results in table 15 show that there is no relationship between the GDP Per Capita Growth and elections for all three estimators. This finding is similar to that of GDP growth above because of the short - lived electoral effect that doesn't get to impact the population growth. Economic activity remains unchanged around election periods.

Table 15

<i>G. GDP per capita growth</i>				
Independent Variables	OLS	Fixed effects	GMM	GMM-robust
ELECYR	-0.365 (0.643)	-0.236 (0.779)	-0.409 (0.867)	-0.409 (0.558)
ELECYRPOST	0.362 (0.689)	-0.140 (1.062)	-0.318 (0.839)	-0.318 (0.994)
Observations	95	95	95	95
R-squared	0.655	0.160		
Wald test	0.294	0.908	0.930	0.921
Number of Countries		5	5	5
Sargan (p-value)			0.568	0.568

*** p<0.01, ** p<0.05, * p<0.1

Governmental Final Consumption Expenditure

Results in Table 16 show that there is no relationship between the Government Final Consumption Expenditure and elections for all three estimators. This finding defies PBC theory and literature which found that in the lead up to elections, government consumption is expected to increase in a bid to incentivize voters to re-elect the ruling government / party for another term (Balaguer-Coll, Brun-Martos, Forte, & Tortosa-Ausina, 2015). An examination of the electoral outcomes in BRICS shows that the same parties have retained power for long periods of time and this consequently increased their re-election chances regardless of whether they manipulated consumption levels. Brender (2003) observed this phenomenon in Israel and termed it the “past support variable” for incumbent governments.

Table 16

<i>H. Government Final Consumption Expenditure</i>				
Independent Variables	OLS	Fixed effects	GMM	GMM-robust
ELECYR	-0.00968	-0.0853	-0.0212	-0.0212
	(0.171)	(0.166)	(0.222)	(0.102)
ELECYRPOST	-0.333	-0.215	-0.229	-0.229
	(0.268)	(0.354)	(0.215)	(0.315)
Observations	95	95	95	95
R-squared	0.942	0.401		
Wald test	0.237	0.565	0.437	0.439
Number of Countries		5	5	5
Sargan (p-value)			0.144	0.144

*** p<0.01, ** p<0.05, * p<0.1

Government Tax Revenue

Results in Table 17 show that the government tax revenue is statistically significant in the post-election year at the 10% level in OLS but not in Fixed Effects or GMM. The OLS estimate shows that there is a negative relationship between elections and government tax revenue. Government tax revenue is expected to drop by 0.9% in the post-election year. The post-election drop in government tax revenue is validated by prior PBC research by Tufte (1978) that found that unemployment rose in the post-election period due to short tenure of temporary jobs created in the pre-election period by governments’ in a bid to appease voters. A rise in unemployment and a spike in inflation in the post-election period as predicted by rational PBC theory, leads to reduction in the tax base, driven primarily by a fall in consumer demand and spending (Mourmouras & Tijerina, 1994). Alavirad (2004) found that in Iran’s inflationary period, the government expenditure grew faster than revenue, and in a bid to narrow the deficit, the government increased inflation over the period from 1981 to 1997.

Table 17

<i>I. Government Tax Revenue</i>				
Independent Variables	OLS	Fixed effects	GMM	GMM-robust
ELECYR	0.0668	0.109	-0.0919	-0.0919
	(0.455)	(0.271)	(0.555)	(0.264)
ELECYRPOST	-0.896*	-0.624	-0.860	-0.860
	(0.524)	(0.568)	(0.533)	(0.575)
Observations	95	95	95	95
R-squared	0.936	0.704		
Wald test	0.118	0.344	0.250	0.252
Number of Countries		5	5	5
Sargan (p-value)			0.862	0.862

*** p<0.01, ** p<0.05, * p<0.1

Inflation

Results in Table 18 show that the inflation is statistically significant in the post-election year at the 1% level in the GMM model. The GMM estimate shows that there is a positive relationship between the elections and inflation. Inflation is expected to spike by about 13 percentage points in the post-election year as also observed in prior literature. Rational opportunistic theorists like Ergun (2000) explain that this increase in post-election inflation is a counter effect of politicians implementing expansionary monetary policies (low interest rates and rising money supply) in the pre-election period to appear competent (Block, 2002). The increase in inflation after elections could be the reversal of decreased tax rates before elections causing the governments to raise taxes and consequently making consumers to demand higher wages so that their disposable income can afford the now pricier goods and services.

Table 18

<i>J. Inflation</i>				
Independent Variables	OLS	Fixed effects	GMM	GMM-robust
ELECYR	4.428	-0.959	2.068	2.068
	(3.510)	(0.897)	(3.704)	(1.945)
ELECYRPOST	14.20	10.71	13.10***	13.10
	(9.841)	(10.95)	(3.560)	(10.47)
Observations	95	95	95	95
R-squared	0.371	0.218		
Wald test	0.245	0.314	0.0130	0.197
Number of Countries		5	5	5
Sargan (p-value)			0	0

*** p<0.01, ** p<0.05, * p<0.1

Real Interest Rate

Results in Table 19 show that there is no relationship between the real interest rate and elections for all three estimators. This study concurs with this results as the real interest rate is a monetary policy tool that is set by the central bank or a monetary policy committee. Either of the two aforementioned parties should be independent of government influence and so elections are not supposed to have any bearing on their decisions and policy choices. However, as governments target fiscal policies that will keep inflation at low levels in the lead up to elections (Klose, 2012), low interest rate levels are desired so that people can access cheaper credit and the governments' programs can have the greatest value-add. An expected result would have been rising interest rates in the post-election period as the contractionary effects of the pre-election policies kick in, and the central banks have to curb borrowing levels and high inflation levels.

Table 19

<i>K. Real Interest Rate</i>				
Independent Variables	OLS	Fixed effects	GMM	GMM-robust
ELECYR	3.045 (2.072)	3.158 (1.646)	2.853 (2.305)	2.853* (1.470)
ELECYRPOST	-2.620 (2.367)	-1.578 (2.682)	-0.831 (2.295)	-0.831 (2.282)
Observations	91	91	91	91
R-squared	0.865	0.573		
Wald test	0.0523	0.308	0.192	0.273
Number of Countries		5	5	5
Sargan (p-value)			0.637	0.637

*** p<0.01, ** p<0.05, * p<0.1

Unemployment

Results show that there is no relationship between unemployment and elections for all three estimators. This result defies a large amount of empirical work on PBC, dating back from earlier works by Nordhaus (1975) to recent work by Kaplan (2008) who found that the unemployment rate drops in the lead up to elections and increases after the elections are over. The lack of electoral effects on unemployment levels could be due to incumbents opting to use social welfare programs to draw voters over temporary job creation measures.

Table 20

<i>L. Unemployment Rate</i>				
Independent Variables	OLS	Fixed effects	GMM	GMM-robust
ELECYR	-0.382	-0.180	-0.321	-0.321*

	(0.247)	(0.210)	(0.243)	(0.177)
ELECYRPOST	0.0684	0.159	0.0865	0.0865
	(0.218)	(0.158)	(0.233)	(0.140)
Observations	95	95	95	95
R-squared	0.988	0.668		
Wald test	0.0674	0.140	0.162	0.0272
Number of Countries		5	5	5
Sargan (p-value)			0.151	0.151

*** p<0.01, ** p<0.05, * p<0.1

Overall, the findings from this study coincide with what thirty years of research has observed – that there is limited empirical support for traditional PBC theory as evidenced by no statistical significance in real GDP and unemployment fluctuations around elections (Alesina & Roubini, 1992; Drazen, 2000).

Furthermore, the results from this current study are consistent with the findings of Kaplan (2006) who found that policy alteration in developing countries did not have any “systematic” effect on macroeconomic indicators – specifically, real GDP growth, inflation and unemployment. Kaplan (2006) also found that the governments lacked the necessary capacity and this limited their ability to influence macroeconomic outcomes. High levels of corruption, lack of skilled public service employees and an insufficient rule of law (Easterly, 2001) further aggravated the governments’ incapacity to affect macroeconomic variables.

The next section provides further analysis based on examining the relationship between macroeconomic variables and LDVs to compare to the credit ratings the BRICS countries received during the period under study. The credit ratings used are those provided by the three main global rating agencies, that is, the S&P, Moody’s and Fitch. The aim is to identify if the same variables that influence the presence (or lack) of PBC are significant in determining the long-term credit rating level for the sovereign. The discussion of these results follows in the subsequent sections.

6.4 Sovereign Ratings Model Results

The entire data set shows that the average sovereign rating figures for BRICS are 7.2095 (Fitch), 7.3430 (Moody’s) and 6.8 (S&P). This mean value is insightful because it means that all the countries in our sample have a rating around BBB- on average, which is the lowest investment grade rating, and before the first speculative rating, BB+. The average figures could pose the risk of misrepresentation because a country such as China has averaged a rating of

10.762 across the three CRAs while the worst performing counterpart, Brazil has averaged 4.703, a junk status.

The SIC recommended an auto regressive of order one for all the macroeconomic variables except for External Debt, for which an auto regressive of order two was recommended – the result of the auto regressive was that partial autocorrelation vanishes and autocorrelation diminishes to zero over time (Karakas, 2013).

Table 21 presents the non-robust GMM estimation results based on proposals by Arellano and Bond (1991) from the three CRAs that this study is focusing on. It presents a summary of results based on how the ratings provided by each of three major rating agencies were influenced by the macro economic variables and elections years.

Table 21: Summary of results on how ratings are affected by macroeconomic variables in election years

Variables	S&P	Moody's	Fitch
RATING _{it-1} (lagged rating)	0.789*** (0.0680)	0.697*** (0.0753)	0.874*** (0.0579)
GDPC	3.29e-05 (4.15e-05)	5.28e-05 (4.07e-05)	-6.97e-05* (4.03e-05)
BMG	0.00786 (0.0111)	-0.00682 (0.0101)	-0.0253** (0.0105)
CAB	0.246*** (0.0787)	0.181** (0.0727)	-0.0159 (0.0733)
GREV	-0.118 (0.0966)	-0.0460 (0.0868)	-0.0455 (0.0870)
INF	-0.00342 (0.00642)	0.00612 (0.00585)	0.0168*** (0.00590)
FISCBAL	0.124 (0.0824)	0.0414 (0.0756)	0.0657 (0.0767)
EXTBAL	-0.198** (0.0823)	-0.145* (0.0754)	0.0260 (0.0767)
EXTDEBT	-0.0222*** (0.00686)	-0.0271*** (0.00643)	-0.0291*** (0.00596)
ELECYR	-0.168 (0.148)	-0.0326 (0.135)	-0.135 (0.138)
Observations	93	93	93
Number of Countries	5	5	5
AR2_test	0.921	0.892	0.316

Robust standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

Based on the results in Table 21, it is evident that the election year dummy variable has a negative relationship with the credit ratings given, although it is not statistically significant at any level. This forms the basis for refuting hypothesis 2. According to the data available and figure 12 in the appendix, election years in BRICS were viewed mainly in an optimistic light by all three CRAs. There were thirteen sovereign rating upgrades during election years - 3 in Brazil (all took place in 2006) ,7 in Russia (2 in 1996, 2 in 2000, 2 in 2004 and 1 in 2008), 1 in China (2003), 1 in India (2007) and 1 in South Africa (2009). Comparatively, there were seven downgrades in the election years – 3 in Brazil (1998, 2002 and 2014), 2 in Russia (2004 and 2008) and 2 in South Africa (2014).

The reason why CRAs have a positive sentiment about elections in BRICS and seem to trust the countries' electoral systems and procedures, is because their political systems have over time proved to be reliable and free of manipulation. Additionally, any political turmoil around or as a result of elections has had minimal effect on the economic standing and activity of the countries. However, given that we are dealing with long-term sovereign ratings, CRAs are likely to only change their ratings in the case that a short-term event affects the long-term prospects of the economy. Elections didn't seem to have a negative effect in the short term.

For the purpose of analyzing the results for this study, the main focus shall specifically be on the output based on Moody's rating over S&P and Fitch. The reason Moody's makes for a good choice is that it has been the most active CRA in our sample countries as it accounts for 45% of election year rating changes in comparison to 30% by S&P and 25% by Fitch. The choice to analyze results based on the output obtained using the Moody's rating is consistent with the pick made by Block and Vaaler (2004). However, results based on other rating agencies will be referred to and compared when necessary in order to enrich the findings of this study.

A glance at the findings in Table 21 shows that the results of Moody's and S&P are very similar in terms of variables that are statistically significant and those that are not. The results based on the Moody rating agency do not allow us to reject the null hypothesis. They show that the electoral year does not affect the ratings that BRICS received. Therefore, there is not enough evidence to prove that elections in BRICS are associated with a (negative) change in sovereign ratings. The notable outcomes of our analysis are how the current account balance and the external debt levels significantly influence sovereign rating changes in election years. The two factors shall be discussed below.

Current Account Balance

Results have shown that the current account balance of BRICS has a positive relationship to the credit rating level. It is statistically significant at the 5% level in GMM and 1% level in Ordered Probit model with the LDV and election year DV incorporated. The results predict that Moody's credit rating level is likely to be upgraded with an 18.1 percent probability and that of S&P by 24.6 percent due to the positive change in the current account balance level at the time. This finding coincides with the findings by Bissoondoyal-Bheenick (2005), who also found that an improvement in the current account balance is viewed positively by CRAs and thus increases the likelihood of the sovereign receiving a positive outlook or rating upgrade.

External Debt

Results indicate that the external debt levels of BRICS have a negative relationship to the credit rating levels of the countries in election years. This macroeconomic variable is found to be statistically significant at the 1% level across all the three main CRAs. Furthermore, the results show that during election years in BRICS, for high levels of external debt around election years, it is expected that the credit rating levels will be negatively affected by a 2.71 percent probability for Moody's, 2.22 percent for S&P and 2.91 percent for Fitch. This finding is consistent with the studies conducted by Cantor and Packer (1996) using a sample on 49 countries (mix of developed and developing economies), Afonso (2003) based on a sample of 81 countries (mix of developed and developing economies) and Rowland (2004) based on a sample of developed economies only. A most recent study by Maltritz & Molchanov (2014) based on a mix of economies examined the impact of 28 independent variables on credit risk and found that external debt to GDP (a variable that is directly impacted by credit rating action) was significant in determining country credit risk.

This macroeconomic variable is important because it highlights the size of obligations that the member states have to their lenders. With the pressure to 'capture' more voters through capital and social expenditure, governments find themselves turning to external debt sources to supplement the limited revenue they get from taxes and grants. The interest payable on this debt varies largely based on the current credit rating level of the country as this is the main indicator that lenders look at when deciding the interest rate to charge the sovereigns.

Elections, if not completed successfully, heighten the risk associated with meeting debt obligations and as such CRAs downgrade countries with a reputation of election dispute and post-election violence.

The results and findings above have brought to light two crucial observations that apply to BRICS based on macroeconomic data collected from the period of 1994 to 2014. BRICS data suggests that there is mixed to little evidence in support of PBCs in BRICS and consequently, that only two macroeconomic variables (current account balance and external debt) were of significance to CRAs as they assigned credit ratings to BRICS. Owing to these findings, the next chapter provides concluding remarks on this study as well as suggestions for future research.

Chapter 7 – Conclusion and suggestions for future research

Empirical research on the presence of PBCs has grown extensively since the seminal papers by Nordhaus in 1975. The research was initially conducted on developed economies as their economic and political data was readily available and well documented. The evidence obtained in various studies based on developing economies showed limited evidence of traditional and partisan PBCs. The reasons provided for this weak evidence of PBC was that developed economies have controlled political systems and institutions that have been established for a long period, hence, making it impossible for incumbents to manipulate policy variables in their favour. This lack of evidence motivated academics to begin studies on developing countries especially those that were prominent for contentious elections and lengthy power struggles. Initial studies on developing countries formed the basis for opportunistic and rational opportunistic PBC theory which was found to be present in many developing economies in Latin America, Africa and the Middle East.

This paper contributes to the existing literature through the two main objectives it aims to achieve. The first is that, this study investigated the presence of political business cycles in BRICS countries from 1994 to 2014. This evidence was sought for by analysing a historical dataset of macroeconomic control variables over a 20-year period with focus on the election and post-election changes. The second objective examined the relationship between elections and credit rating action by the three main CRAs – Moody's, S&P ratings and Fitch Ratings on BRICS. The period chosen for this study is justified because all members of BRICS countries were Republics that could hold elections for the said years – in line with international standards. Furthermore, the period chosen represents a period when none of the participating countries were facing any sanctions, their economies were open to trade regionally and internationally and they were eligible to receive FDI and grants from international lending bodies.

This study is unique because it focuses on four countries that had only been a trading bloc for about four years, before South Africa joined and then for eleven years in total at the time of writing. The countries that make up BRICS have very distinct forms of governments and have been independent election holding sovereigns for varying periods. All but South Africa were independent before 1994 and their economies had been through multiple booms and recessions in line with the global economy. In addition, the BRICS countries can be a tricky to categorise as either developed or developing countries given the size of their economies against the population and income levels of majority of their citizens. Furthermore, member states all bring

valuable attributes to the bloc and this has caught the attention of the International community. It is believed that by 2050 or even earlier than that, BRICS is likely to be an economic super power capable of challenging the G20 – China is currently the second largest economy behind the US and its currency is now being used by the IMF as a reserve currency alongside the Dollar and the Euro.

In line with the objectives of this study, the analysis conducted provides some findings worth welcoming for policy makers in BRICS countries. The findings suggest that BRICS as a bloc is not faced with a challenge that is associated with majority of developing economies – that is, political business cycles. Findings from this study are statistically insignificant for PBCs in BRICS. The findings show that there is weak evidence to support the claim that politicians in BRICS manipulate fiscal and monetary policies in order to appear competent and sway voters in their favour in the lead up to elections. This lack of PBC evidence may be testament to the fact that financial institutions within BRICS are strong, regulated accordingly in line with international standards and free of government interference. The results also suggest that unlike in most developing countries, elections in BRICS are not associated with heightened risk but are viewed as a period of peaceful power exchange with the new governments being expected to be better for the economies.

A point worth noting also is that, in BRICS, the ruling parties were able to maintain their control of the government for substantial amounts of time. This continuous tenure in office is likely to provide the governments enough time to deliver on medium and long term promises to voters and as such eliminate the possibility or need for manipulative behaviour come election time. It leaves the opposition parties at a disadvantage unless the ruling party really performs poorly on its commitments (without valid enough reasons) or is tangled up in multiple scandals that they cannot absolve themselves from before the elections period.

To further complement previous research and the first set of findings for this study, the second analysis performed for this study found that there is no correlation between elections and credit rating actions that BRICS received between 1994 and 2014. Prior research found evidence that suggested that elections in developing countries than in developed economies, were viewed negatively by CRAs leading them to downgrade sovereigns around the said periods. CRAs had observed elections to be periods of heightened political risk which trickled down and manifested itself in macroeconomic variables, hence, causing the economy to perform poorly around the same time. As a result of this, the incoming government would find itself trying to

restore economic activity while having to deal with higher debt obligations than those their predecessors faced due to higher interest rates being charged because the nations had been downgraded during the election period.

Overall, the results obtained in this study provide several potential extensions which can enable a better understanding of the economic capabilities and challenges that BRICS as a trading bloc is likely to face. A starting point could be to study a longer time frame beyond the 20-year period that this study focused on to identify any cross-country correlations in political and economic behaviour. It is likely that some members of the Next 11 (N11) will express interest in joining the BRICS bloc and so research could be conducted on that group of countries in order to identify those that may be a suitable fit to join BRICS and not increase its overall risk as a trading bloc. As far as political risk is concerned, an extension to this study can test for the presence of PBC on a local government level, either focusing on municipalities or provincial government offices. A future study could also investigate the effects that other information such as opinion polls that becomes available towards elections has on the evidence of PBCs in BRICS. It would be interesting to test whether there is any correlation between the presidential term limits in BRICS and how this contributes to PBCs presence in the bloc. Another possible line of research would involve testing whether there is any spill over effects of political and/or economic risk among BRICS and if credit rating action in a member state has cross country effects on the rest in the bloc. Moreover, research on BRICS credit ratings could also be conducted using monthly or quarterly data so that any trends that may be evident over the course of a year can be observed. These issues are beyond the scope of this study and are material for further research on the interrelation of politics and economics in BRICS.

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Appendix

Figure 1: Broad money growth (annual %) (World Bank, 2017)

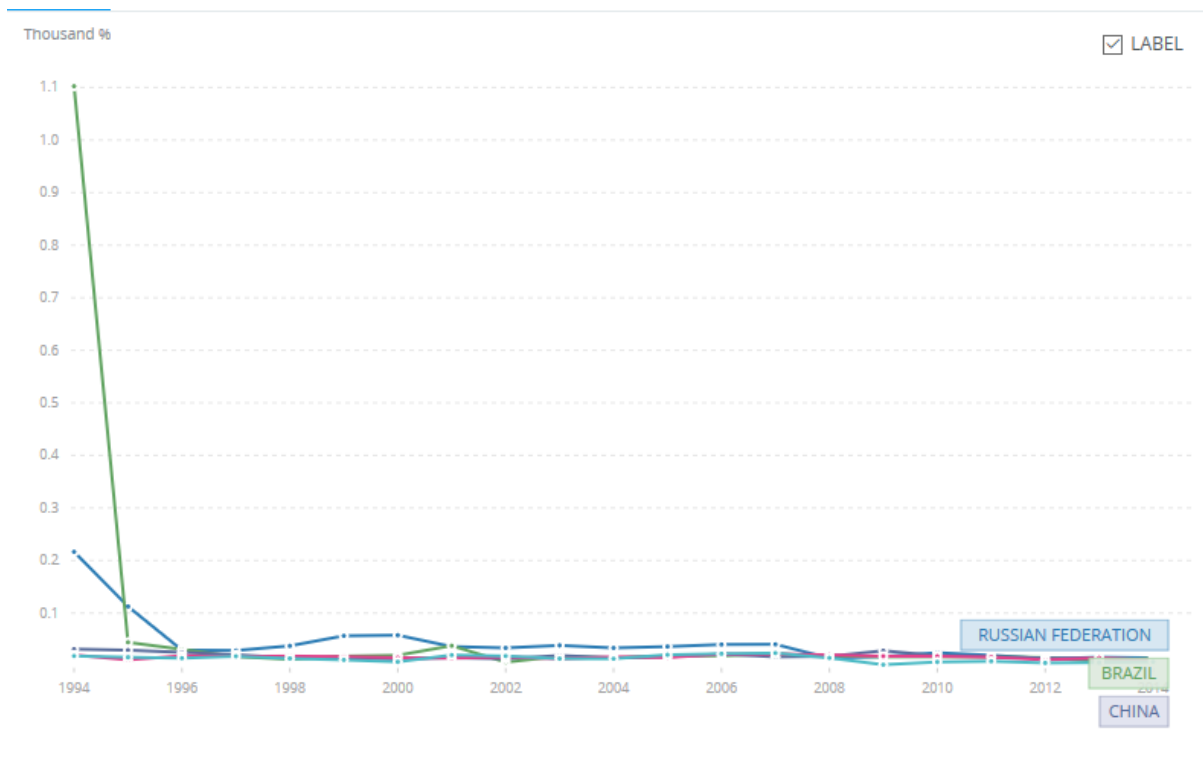


Figure 2: Current account balance (% of GDP) (World Bank, 2017)

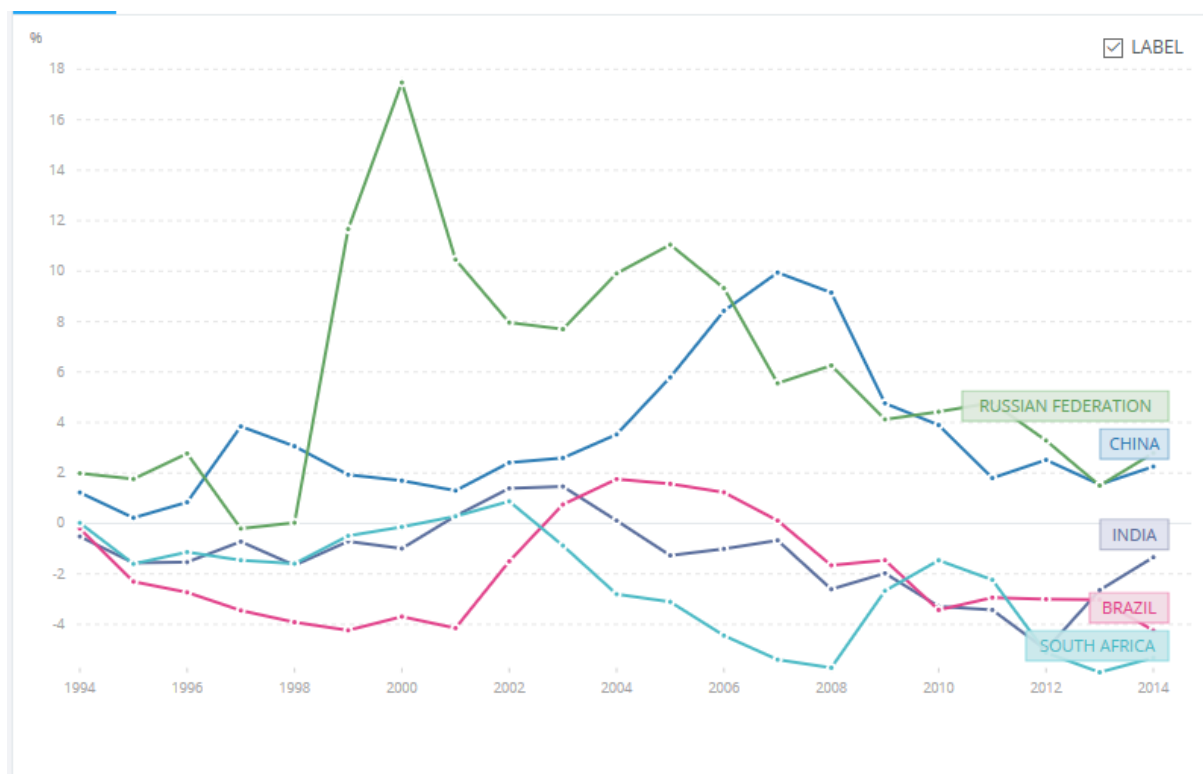


Figure 3: External balance on goods and services (% of GDP) (World Bank, 2017)

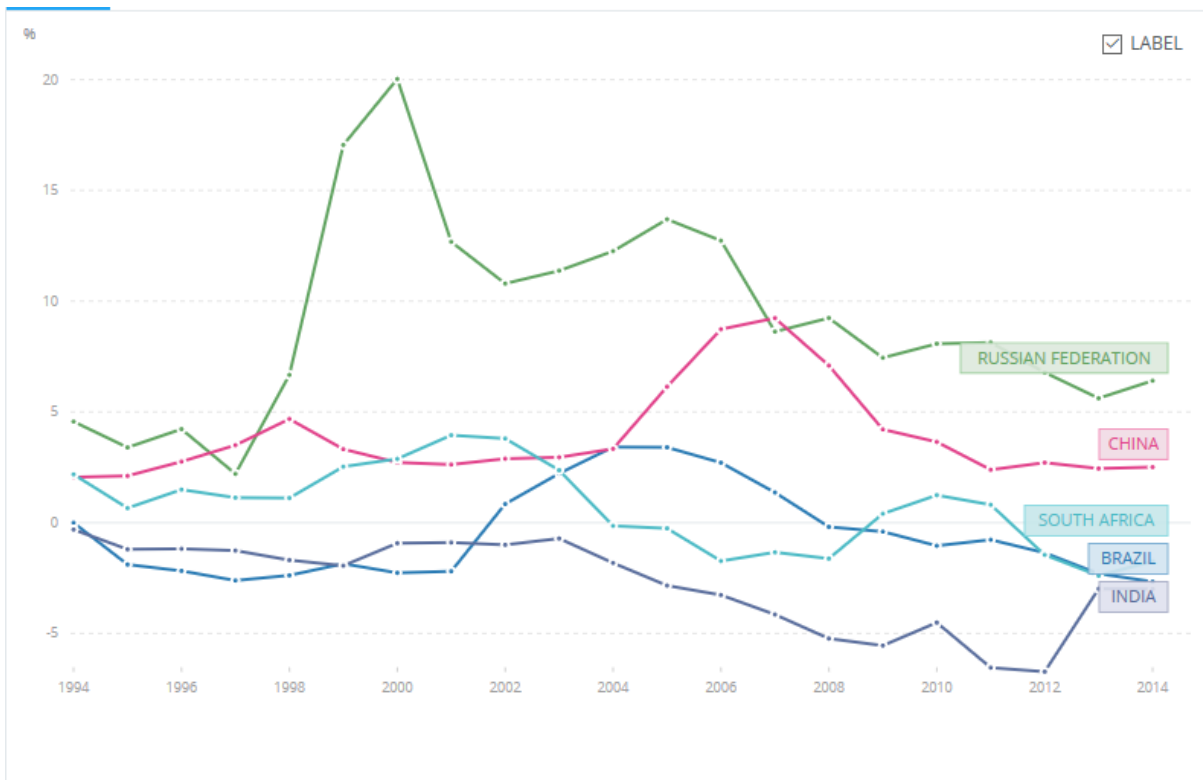


Figure 4: External Debt (Total) (World Bank, 2017)

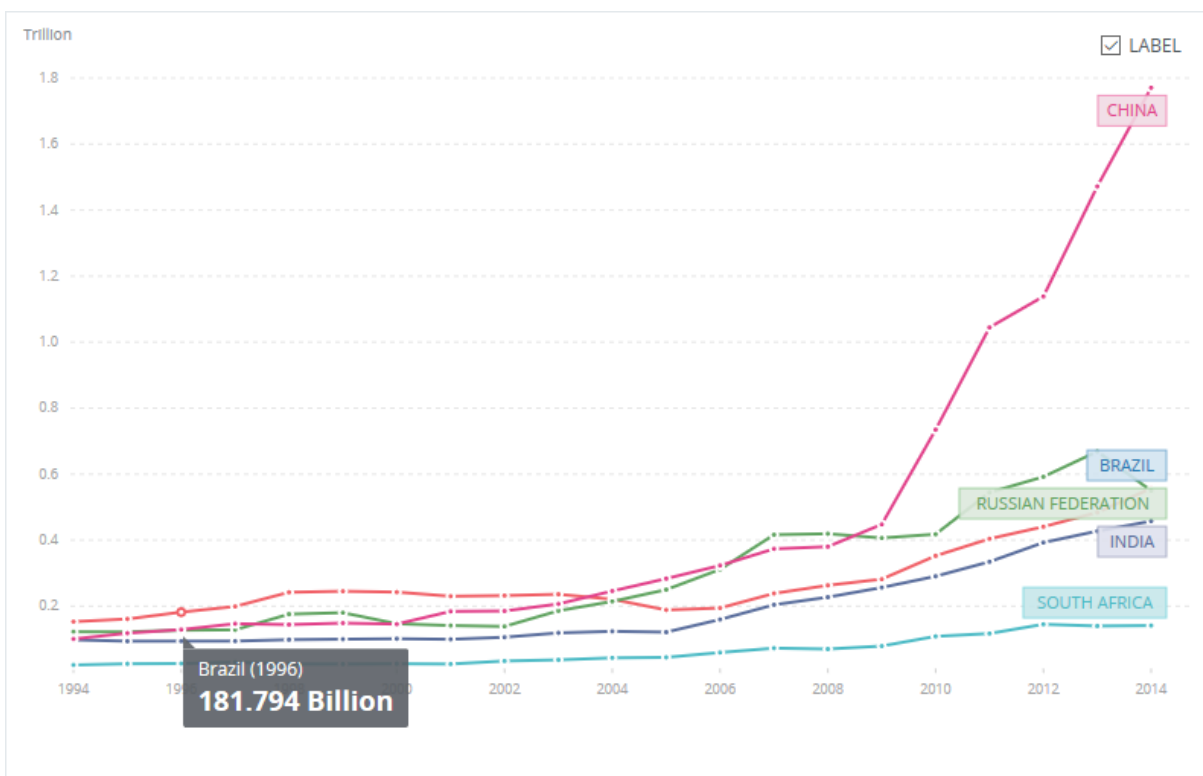


Figure 5: GDP growth (annual %) (World Bank, 2017)

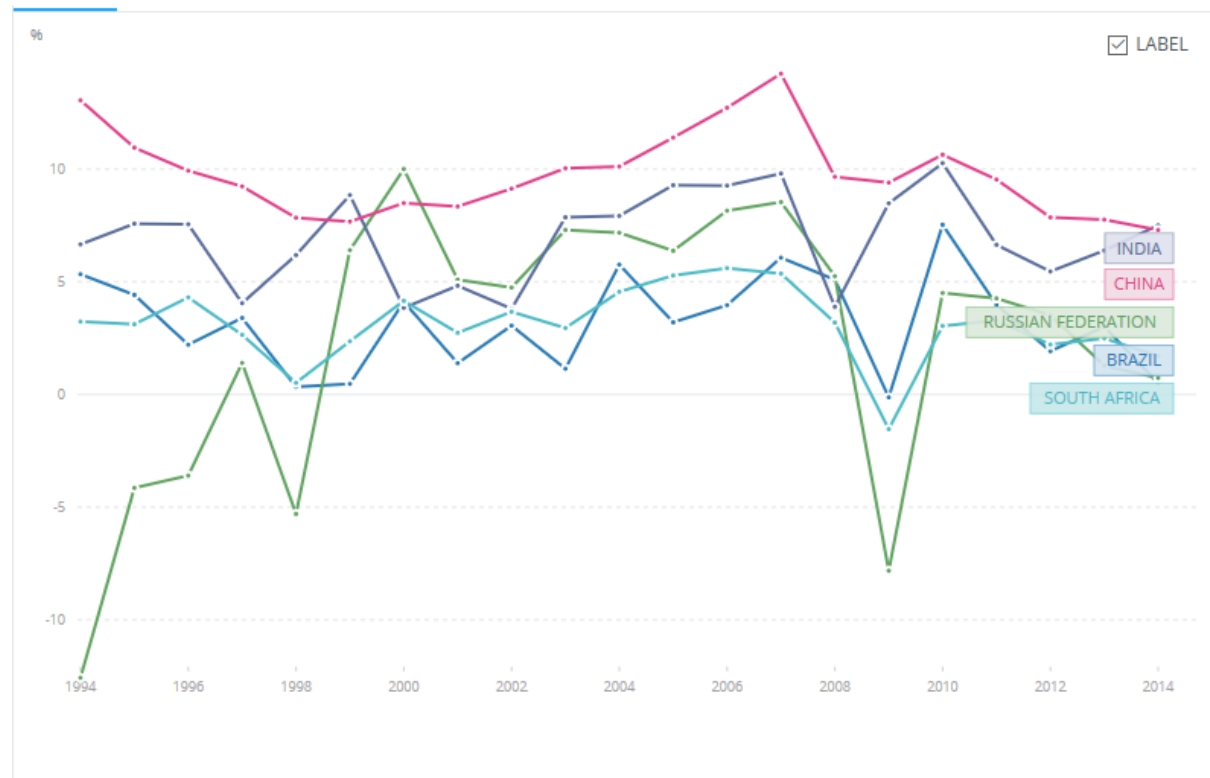


Figure 6: GDP per capita growth (annual %) (World Bank, 2017)

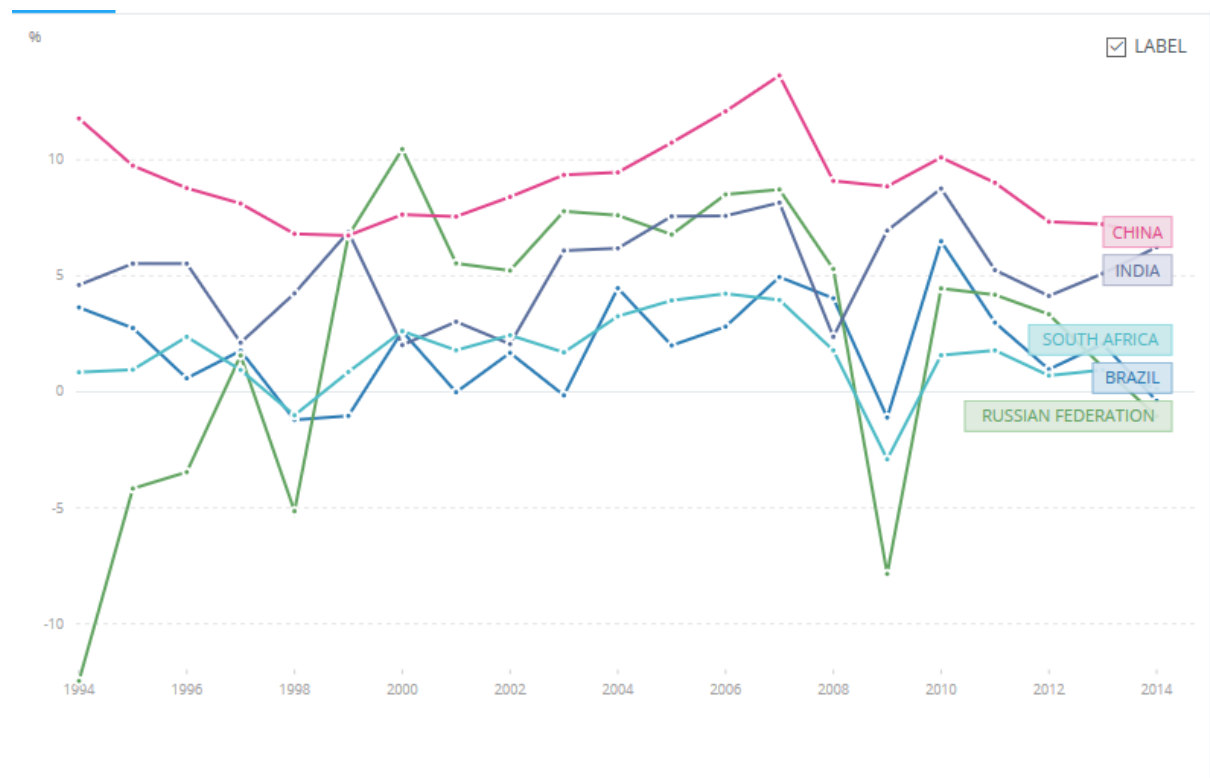


Figure 7: General government final consumption expenditure (% of GDP) (World Bank, 2017)

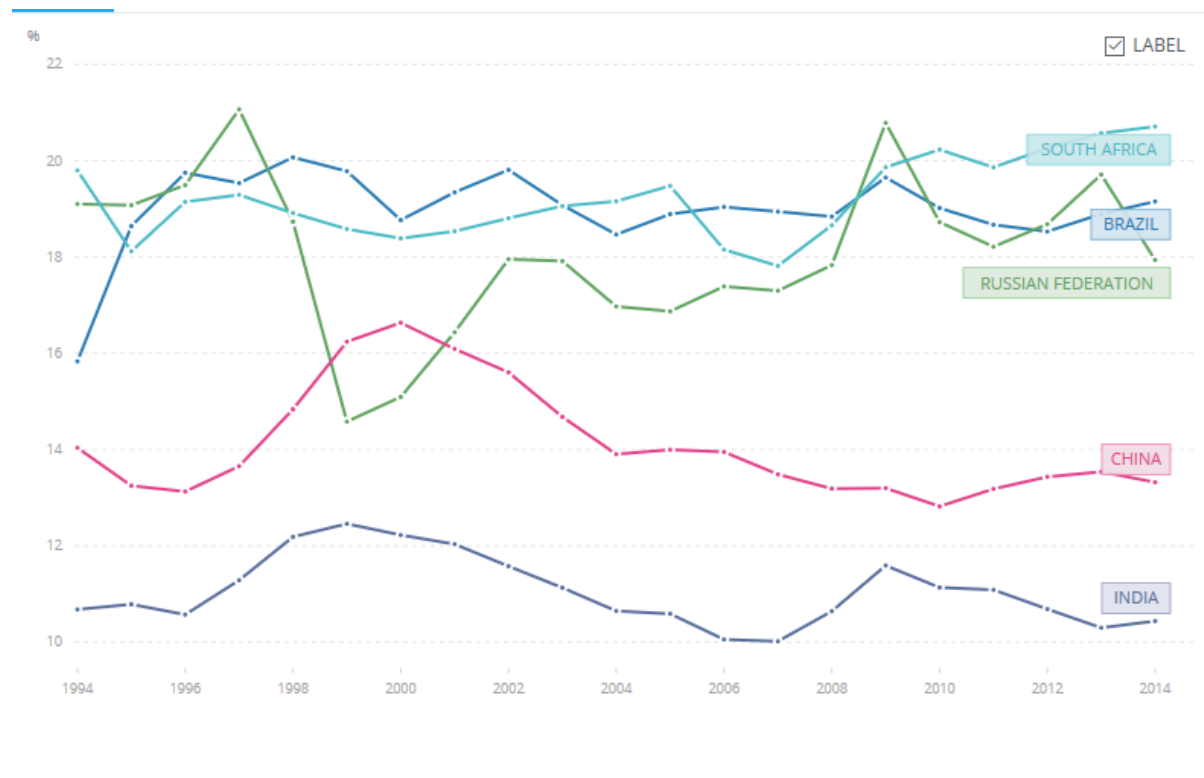


Figure 8: Government tax revenue (% of GDP) (World Bank, 2017)

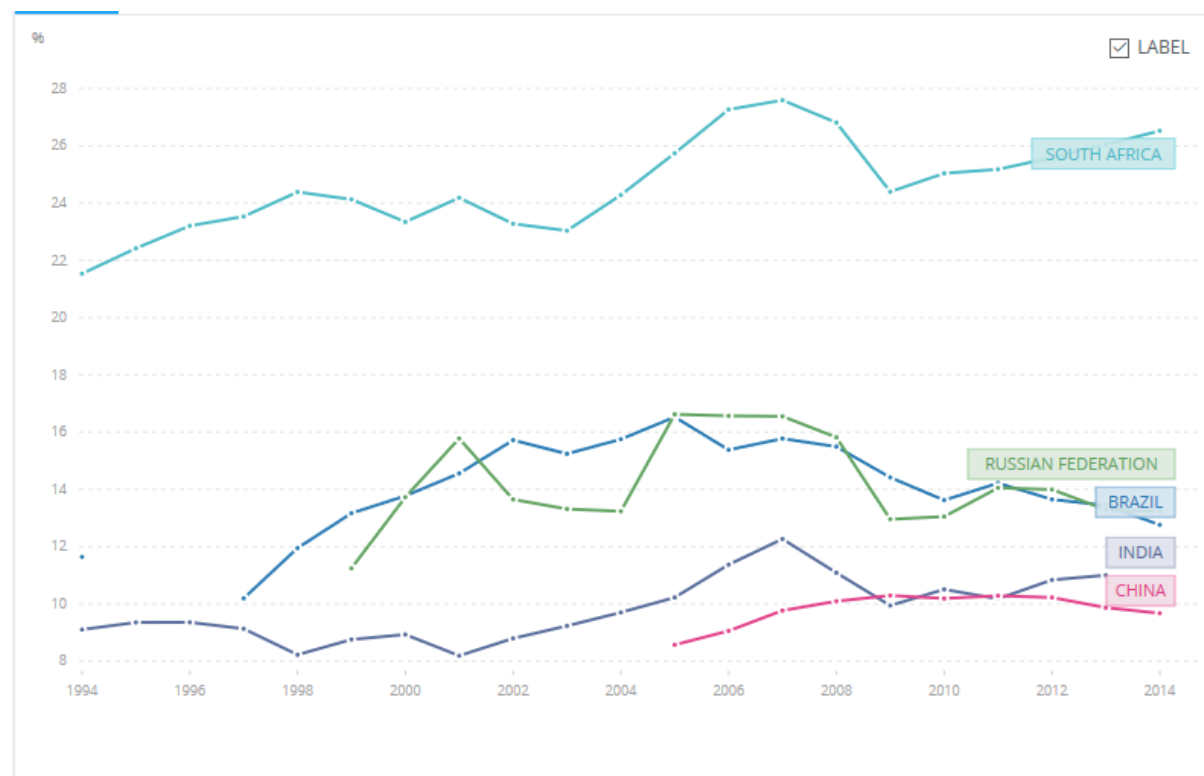


Figure 9: Inflation, consumer prices (annual %) (World Bank, 2017)

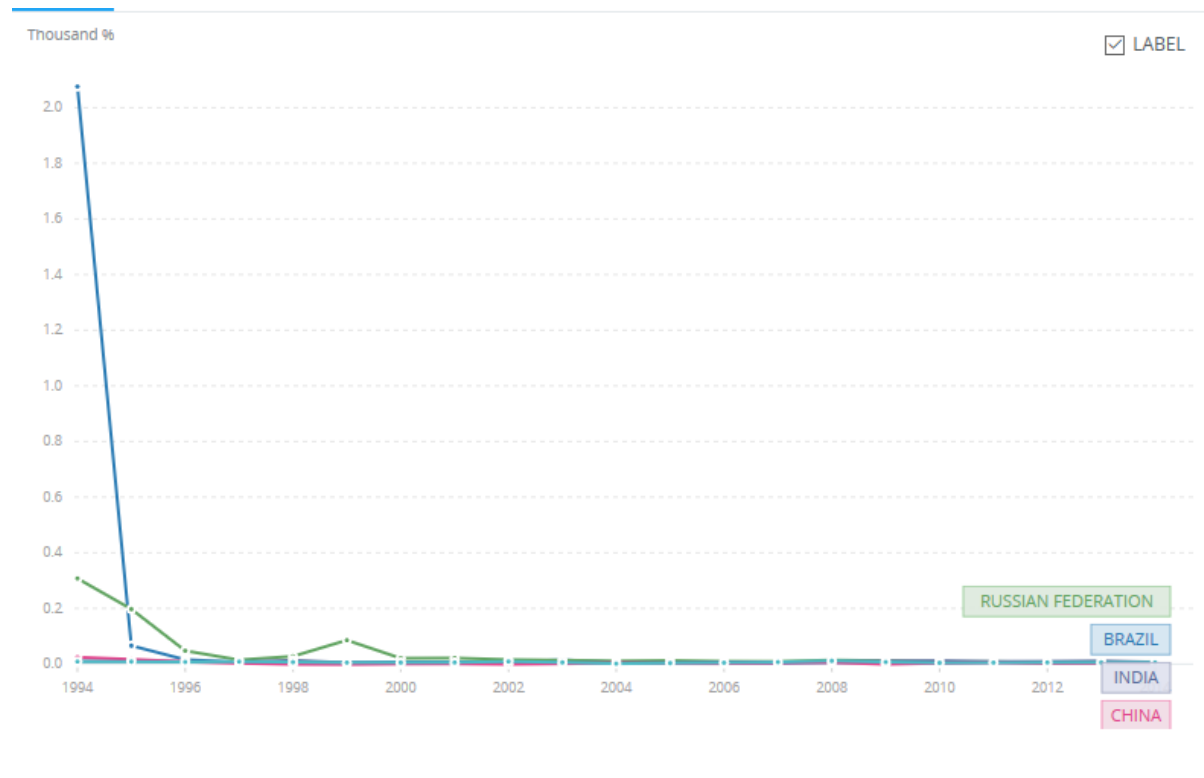


Figure 10: Real interest rate (%) (World Bank, 2017)

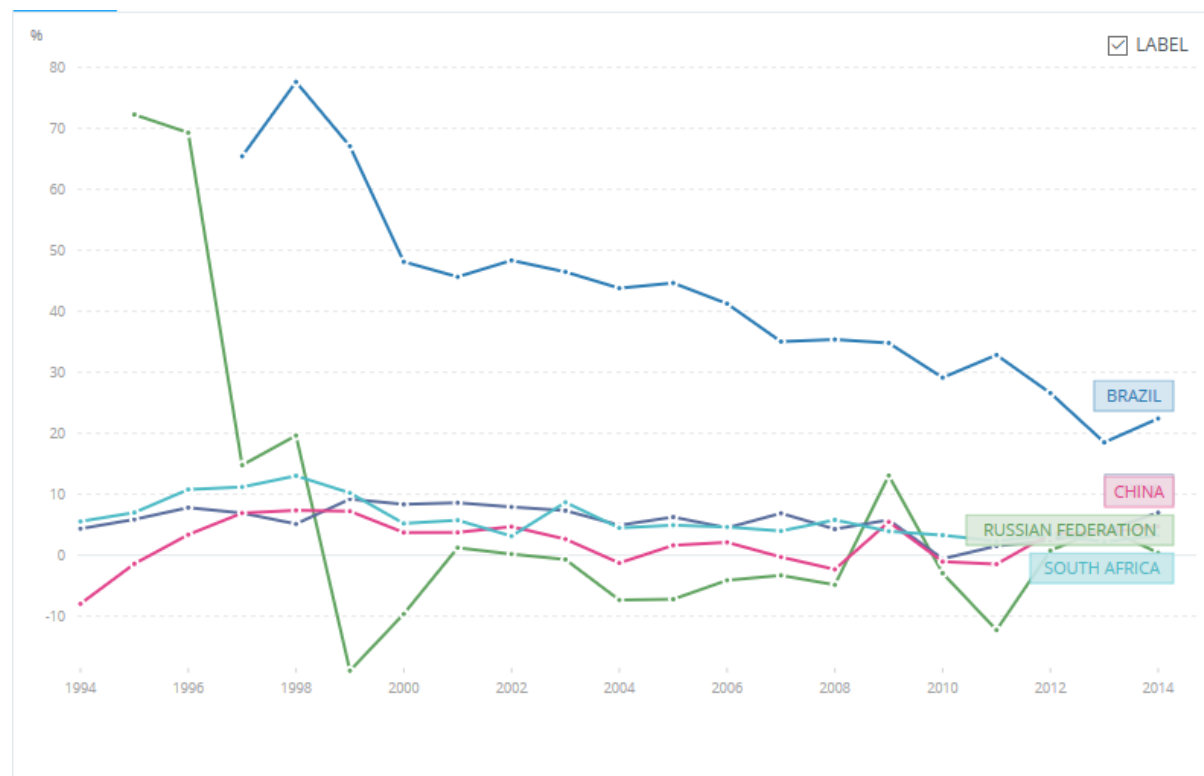


Figure 11: Unemployment, total (% of total labour force) (national estimate) (World Bank, 2017)

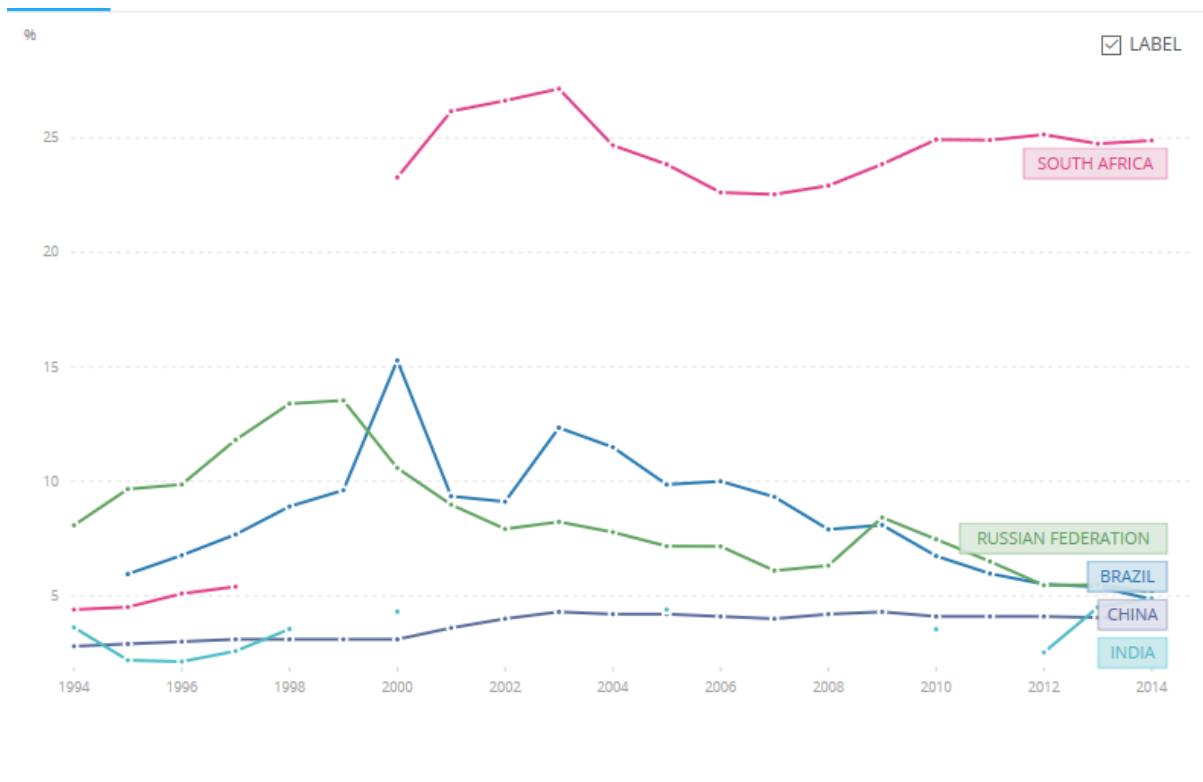


Figure 12: Credit ratings for BRICS and the changes from 1994 to 2014.

Year	Brazil			Russia			India			China			South Africa		
	Fitch	Moody's	S&P	Fitch	Moody's	S&P	Fitch	Moody's	S&P	Fitch	Moody's	S&P	Fitch	Moody's	S&P
1994	B+	B1	B	BB	Ba3	BB-	BBB-	Baa3	BB+	A	A3	BBB	BB	Baa3	BB
1995	B+	B1	B+	BB	Ba3	BB-	BBB-	Baa3	BB+	A	A3	BBB	BB	Baa3	BB+
1996	B+	B1	B+	BB+	Ba2	BB-	BBB-	Baa3	BB+	A	A3	BBB	BB	Baa3	BB+
1997	B+	B1	BB-	BB+	Ba2	BB-	BBB-	Baa3	BB+	A-	A3	BBB+	BB	Baa3	BB+
1998	B+	B2	BB-	BB-	B3	CCC-	BBB-	Ba2	BB	A-	A3	BBB+	BB	Baa3	BB+
1999	B	B2	B+	BB-	B3	CCC+	BBB-	Ba2	BB	A-	A3	BBB	BB	Baa3	BB+
2000	B	B1	B+	B	B2	B-	BB+	Ba2	BB	A-	A3	BBB	BBB-	Baa3	BBB-
2001	B	B1	BB-	B+	Ba3	B+	BB	Ba2	BB	A-	A3	BBB	BBB-	Baa2	BBB-
2002	B	B2	BB-	BB-	Ba2	BB	BB	Ba2	BB	A-	A3	BBB	BBB-	Baa2	BBB-
2003	B+	B2	B+	BB+	Baa3	BB	BB	Ba1	BB	A-	A2	BBB	BBB	Baa2	BBB
2004	BB-	B1	BB-	BBB-	Baa3	BB+	BB+	Baa3	BB	A-	A2	BBB+	BBB	Baa2	BBB
2005	BB-	Ba3	BB-	BBB	Baa2	BBB-	BB+	Baa3	BB+	A	A2	A-	BBB+	Baa1	BBB+
2006	BB	Ba2	BB	BBB+	Baa2	BBB+	BBB-	Baa3	BB+	A	A2	A	BBB+	Baa1	BBB+
2007	BB+	Ba1	BB+	BBB+	Baa2	BBB+	BBB-	Baa3	BBB-	A+	A1	A	BBB+	Baa1	BBB+
2008	BBB-	Ba1	BBB-	BBB+	Baa1	BBB	BBB-	Baa3	BBB-	A+	A1	A+	BBB+	Baa1	BBB+
2009	BBB-	Baa3	BBB-	BBB	Baa1	BBB	BBB-	Baa3	BBB-	A+	A1	A+	BBB+	A3	BBB+
2010	BBB-	Baa3	BBB-	BBB	Baa1	BBB	BBB-	Baa3	BBB-	A+	Aa3	AA-	BBB+	A3	BBB+
2011	BBB	Baa2	BBB	BBB	Baa1	BBB-	BBB-	Baa3	BBB-	A+	Aa3	AA-	BBB+	A3	BBB+
2012	BBB	Baa2	BBB	BBB	Baa1	BBB-	BBB-	Baa3	BBB-	A+	Aa3	AA-	BBB+	Baa1	BBB
2013	BBB	Baa2	BBB	BBB	Baa1	BBB-	BBB-	Baa3	BBB-	A+	Aa3	AA-	BBB	Baa1	BBB
2014	BBB	Baa2	BBB-	BBB	Baa2	BBB-	BBB-	Baa3	BBB-	A+	Aa3	AA-	BBB	Baa2	BBB-