Income Inequality, Fiscal Adjustments and Political (In)Stability[*]

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Abstract

We use data for a panel of developed and developing countries to assess the impact of income inequality and fiscal adjustments on political instability. We find that voters are likely to punish governments when inequality increases and, for OECD countries, this effect is stronger when income inequality is high. Accounting for fiscal developments, the empirical findings suggest that a rise in the debt-to-GDP ratio fuels political instability and that changes in the composition of fiscal policy also affect the likelihood of government crises. In addition, the results reveal that unsuccessful fiscal adjustments and increasingly contractionary fiscal adjustments are strongly detrimental for the political cohesion, in particular, when coupled with an uneven distribution of income. From a macroeconomic point of view, economic growth and low inflation seem to be crucial for political stability.

JEL: Income inequality, fiscal adjustments, political instability.
Keywords: H63, G01, G15.

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[*] The opinions expressed herein are those of the authors and do not necessarily reflect those of the European Central Bank, the Eurosystem, the OECD or its member countries. The usual disclaimer applies.

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1. Introduction

By fuelling political disaffection, income inequality is typically seen as being at the roots of political instability. Yet, the severity of the most recent financial turmoil that emerged in 2008 forced fiscal authorities in many G20 countries to implement comprehensive support packages based on expenditure hikes. These have, in turn, ended up leading to sharp increases in budget deficits.

As concerns about long-term (un)sustainability of public finances started mounting, governments across the world faced the need to implement budgetary consolidation measures and decided to shift wealth towards banks and debtors and away from taxpayers, fuelling public anger about the unfairness of such decisions.

While the recent literature has started to provide some guidelines about the linkages between fiscal policy and income inequality (Roe and Siegel, 2011; Agnello and Sousa, 2012), there is still an important gap regarding our understanding about the effects of the income gap and the implementation of fiscal adjustments on the likelihood of government crises.

Is an increase in income inequality likely to shorten a government's mandate? Do fiscal adjustment programs raise the probability of a government crisis? Is the impact of inequality on political instability amplified in the context of the adoption of fiscal consolidation programs?

From a theoretical point of view, the tentative answer to the above mentioned questions should be "yes". Fiscally constrained governments loose popularity and this is particularly true when restrictive fiscal measures and fiscal consolidation programmes are implemented in countries experiencing a high degree of income inequality. In contrast, the effects of inequality (on political stability) might be muted when fiscal adjustments are perceived as equalizing. In this context, investigating the impact of inequality and fiscal adjustments on political instability emerges as the main goal of our paper.

We show that inequality raises the prospects of political instability. More specifically, when the income gap rises, the likelihood of a government crisis increases. While the effect of inequality on political instability is generally linear, for OECD countries, we find that economies characterized by high inequality in income distribution are also more susceptible to face an unstable political environment.

When considering the dynamics of fiscal policy, we show that a deterioration of the fiscal stance as expressed by a rise of the debt-to-GDP ratio fuels political instability. Similarly, when government taxes are raised, voters are more likely to punish the government in power, suggesting that changes in the composition of fiscal policy may lead to the occurrence of government crises.

With regard to fiscal adjustment programs, the empirical findings reveal that un(successful) fiscal adjustments and increasingly contractionary fiscal adjustments severely undermine political cohesion and contribute to a more politically unstable environment.

When conditioning the effect of inequality on the occurrence of fiscal consolidation episodes, our results suggest that fiscal adjustments amplify the impact of inequality on political instability, in particular, when fiscal consolidation is not effective (at bringing the debt-to-GDP ratio to a sustainable path) or when it leads to an increasingly recessionary context.

Additionally, we show that some factors characterizing the legislature, such as whether the government has a majority of seats in the parliament and whether the government consists of a coalition or not, help explaining a reduction in political instability. Similarly, while the level of government fractionalization increases the number of government crises, the regime durability and the level of political competition provide the ground for a more stable legislature. Moreover, the political regime (as measured by the level of democracy) has a positive effect on the occurrence of government crises, signalling a potentially nonlinear relationship between political instability and the level of democracy. We also find that the larger the number of years in office of the chief executive is, the more likely it will be that voters evaluate favourably the performance of the government.

Finally, economic growth seems to be the key for a stable legislature, but inflation tends to deteriorate political cohesion.

The rest of the paper is organized as follows. Section 2 briefly looks at the related literature. Section 3 presents the econometric methodology. Section 4 describes the data and discusses the empirical results. Section 5 provides the sensitivity analysis. Finally, Section 6 concludes.

2. Literature Review

Several studies looked at the relationship between political instability and the economic performance of a country, as weak growth is likely to shorten policymakers' horizons leading to the implementation of sub-optimal macroeconomic policies in both democracies and dictatorships (Kramer, 1971; Fair, 1978). These studies find that, in general, high income growth rates during pre-election years are likely to increase the probability of the re-election of the incumbent government in democratic countries. As for dictatorships and military regimes, the likelihood of experiencing coups increases with the decline of GDP per capita. Londregan and Poole (1990) consider the number of coups experienced by 121 countries over the period 1950-1982 and find a pronounced inverse relationship between coups and income. In addition, coups are more likely to

occur among the poorest countries than among the wealthiest ones. Alesina et al. (1996) use data on 113 countries from 1950 to 1982 and show that a high propensy of government collapse is characterized by low GDP growth. Jong-a-Pin (2009) and Butkiewicz and Yanikkaya (2012) find evidence supporting the existence of a negative relationship between economic growth and the degree of socio-political instability. Klomp and de Haan (2009) also notice that economic volatility and political instability and policy uncertainty tend to be positively linked. More recently, Aisen and Veiga (2013) find that higher degrees of political instability are associated with lower growth rates of GDP per capita, as a reflex of the lower rates of productivity growth and physical and human capital accumulation. Other studies assessed the relationship between political instability and the dynamics of inflation. Paldam (1987) compares the path of consumer price with the incidence of political change for eight Latin American countries over the period 1946-1984. The author uncovers a significant connection between the frequency of military regimes and the level of inflation. Interestingly, while military regimes are relatively strong in fighting inflation, civilian regimes are less stringent about the level of inflation. In addition, just a few regimes survive to the spell of hyperinflation. Aisen and Veiga (2008a) use a dataset covering around 100 countries for the period 1960-1999 and show that greater political instability is associated with high inflation, especially, in developing, less democratic and socially-polarized countries, with low access to domestic and external debt financing and high turnover of central bank presidents. One important policy implication of their study is the need to develop strong institutions conducive to greater political stability. Similar conclusions are found by Aisen and Veiga (2008b) concerning the linkages between political instability and inflation volatility.

Another strand of the literature investigated how the institutional framework affects political instability. Taylor and Herman (1971) find a fairly strong relation between government stability and the fractionalization of the parliamentary party system: the more fragmented the party system is, the more unstable the cabinet is. Gates et al. (2006) show that regimes exhibiting a mix of democracy and autocracy characteristics tend to be short-lived. The least stable political system is the dictatorship with a large degree of political participation. Similarly, when the executive is highly constrained and the electorate is very small, the political configuration will be unstable. Using a probit model, Alesina et al. (2012) point to a positive effect of the length of the cabinet tenure on the probability of a government change.

With regard to the relationship between political instability and income inequality, Alesina and Perotti (1996) show that the two variables are positively related because of the social discontent associated with income inequality. Perotti (1996) and Odedokun and Round (2001) show that countries with high income inequality are more likely to be politically unstable.

Acemoglu and Robinson (2006) develop a theoretical model of democracy and income inequality where they argue that high income inequality in Latin America can be one of the main causes of weak democracy in the region. Blanco and Grier (2009) investigate the underlying causes of political instability in a panel of 18 Latin American countries from 1971 to 2000 and find that income inequality, in particular, have an important nonlinear effect on political instability: increases in income inequality raise instability up to a point, after which any further increases lower instability.

Despite the recent mounting interest of the effects of fiscal consolidation on growth prospects, a thorough analysis of the impact of fiscal retrenchment on political stability has been neglected. To the best of our knowledge, only few works assess how budget cuts affect the lack of political cohesion. Paldam (1987) points that fiscal austerity measures are typically associated with higher levels of social unrest. Similarly, Haggard et al. (1995) show that the IMF interventions in developing countries were accompanied with greater instability. On the electoral effects of large fiscal adjustments, Alesina et al. (2012) use data for a group of 19 OECD countries from 1975 to 2008 and find no evidence that governments that quickly reduce budget deficits are systematically voted out of office. In fact, many governments are able to decisively reduce deficit and avoiding an electoral defeat.

Our paper contributes to the existing literature in three major directions. First, it specifically looks at the relationship between fiscal adjustments and political instability (as proxied by government crises episodes). Second, given the strong linkage between income inequality and fiscal consolidation (Roe and Siegel, 2011; Agnello and Sousa, 2012), we assess the interaction between those two variables in determining the likelihood of government crises. Therefore, we evaluate the impact of inequality on political instability, in particular, when countries are under periods of fiscal adjustment. Finally, because of the crucial role played by the composition of the fiscal consolidation programs (Alesina and Ardagna, 1998), we identify several measures of fiscal adjustment with the aim of assessing their effect on political cohesion. These are avenues of research that the previous theoretical and empirical works have so far neglected, but denote important dimensions to be considered for a better understanding of the relationship between income inequality, fiscal adjustments and political (in)stability. With the current paper, we aim at fill such gaps.

3. Econometric Methodology

Our modelling strategy consists of three steps. First, we explore the empirical relationship between income inequality and political stability by estimating the following equation:

$$C_{it} = Y'_{it}\Gamma + X'_{it}\beta + \lambda Gini_{it} + \alpha_i + \varepsilon_{it} \tag{1}$$

where C_{it} denotes, for each country i included in the sample, our proxy of government instability; Γ and X are a set of political and macroeconomic controls that we assume to be correlated with the degree of government fragility respectively; Gini is the income inequality index.

Then, we broaden our analysis by focusing on the relation between fiscal policies and government stability. To do so, we enlarge the model specification (1) including a set of fiscal policy indicators (F_{it}). Specifically, we control for the importance of fiscal policy developments by alternatively considering the impact changes of: a) debt to GDP ratio; b) government revenues and spending; and c) cyclically-adjusted budget balance (CAB).

We also control for the impact of specific fiscal episodes on political instability. Similarly to Alesina and Ardagna (1998), we have used a statistical approach to identify a variety of fiscal adjustment events. Specifically, for each country included in our sample, we have considered episodes of: (i) fiscal adjustments; (ii) expansionary fiscal adjustments; (iii) increasingly expansionary fiscal adjustments; (iv) contractionary fiscal adjustments; (v) increasingly contractionary fiscal adjustments; (vi) successful fiscal adjustments; and (vii) unsuccessful fiscal adjustment. A detailed description of such events is presented in the data section. Formally, we run the following regression model:

$$C_{it} = Y'_{it}\Gamma + X'_{it}\beta + \lambda Gini_{it} + \phi F_{it} + \alpha_i + \varepsilon_{it} \tag{2}$$

where F_{it} is either a continuous variable measuring the change of a specific fiscal item as defined above ((a)-(c)) or a binary variable taking value one when a specific fiscal episodes ((i)-(vii)) occurs and zero otherwise. The remaining variables in (2) have the usual meaning.

Finally, we assess the importance of the interplay between income inequality and episodes of fiscal adjustments by running the following regression:

$$C_{it} = Y'_{it}\Gamma + X'_{it}\beta + \lambda_1 Gini_{it} + \lambda_2 Gini_{it} \cdot 1_F(F_{it}) + \alpha_i + \varepsilon_{it} \tag{3}$$

where $1_F(F_{it})$ is a fiscal indicator function taking value of one during periods of fiscal adjustments and zero otherwise. Its inclusion aims to check whether the effects of income inequality on government stability change during periods of fiscal adjustments. Under the assumption that fiscal consolidation plans are detrimental for income distribution (Agnello and Sousa, 2012), we would expect, for instance, that the impact of inequality on government stability are magnified during the years of their implementation.

Due to the endogenous nature of economic growth and inflation, models (1)-(3) are estimated using an instrumental variables (IV) approach. As is standard in the literature, GDP growth and inflation are instrumented using their own lags.

4. Data and Empirical Results

4.1. Data

We start by using a panel dataset consisting of 128 countries for which a variety of political indicators (**Y**) are retrieved from the Database of Political Institutions (DPI) of the World Bank, the Polity IV Database (Polity IV) and the Cross-National Time-Series Data Archive (CNTS).

The set of macroeconomic variables (**X**) are provided by the WEO of the IMF and includes: the GDP growth rate, the inflation rate and the real interest rate.

The net income Gini inequality index data comes from the Standardized World Income Inequality Database (SWIID).

Fiscal data are retrieved from the World Economic Outlook (WEO) of the International Monetary Fund (IMF). Government spending and revenues are cyclically adjusted to arrive at a proxy of the cyclically adjusted budget balance. Data on public debt are retrieved from the Historical Public Debt Database assembled by the Fiscal Affairs Department of the International Monetary Fund (Ali Abbas et al., 2011).

The presence of missing values for several variables and the limited time span of fiscal variables (mainly for developing countries) reduce the number of countries in the estimation to at most 58.

The dependent variable, c_{it}, used in our specification is Government crisis (CNTS). It counts the number of any rapidly developing situation that might lead to the fall of the current regime and remove a particular government from power with the exclusion of situations of revolt.

The set of institutional variables (**Y**) includes:

- *military* (DPI): It is a dummy variable that takes the value one if the Chief Executive is military officer and zero otherwise.
- *stabs* (DPI): It counts the percentage of veto players who drop from the government in a specific year and, as such, it provides information about the veto points in the decision making process and the constraints that governments face in the course of policy implementation.
- *system* (DPI). This variable characterizes the political system. A value of 0 is given in the case of a presidential system, a value of 1 is allocated in the case of an Assembly-elected presidential system, and a value of 2 is associated to a parliamentary system.

- *govfrac* (Polity IV). It refers to the degree of government fragmentation as measured by the probability that two deputies picked at random from among the government parties will be of different parties.

- *polity2* (Polity IV). This describes how democratic a country is. It subtracts the country's score in an "Autocracy" index from its score in a "Democracy" index and produces a polity scale ranging from -10 (strongly autocratic) to +10 (strongly democratic).

- *durable* (DPI). This variable counts the number of years that a cabinet has been in power, up to the current year. A cabinet that falls during its first year in power is counted as 1. Every time there is a government termination, the variable is reset to 1 the year after the termination.

- *polcomp* (Polity IV). It measures the level of political competition in the next election that is expected by the incumbent when making policy decisions over the administration cycle.

- *yrsoffc* (DPI). It counts the number of years the chief executive has been in office.

- *maj* (DPI). It is a dummy variable equal to 1 if the cabinet has majority support in parliament.

- *party_coal* (DPI). It is a dummy variable equal to 1 if a coalition cabinet (including ministers from two or more parties) is in power.

The fiscal adjustment episodes (F_{it}) considered in our study can be defined as follows:

- *Fiscal adjustment.* A period of fiscal adjustment is a year in which the cyclically adjusted primary balance improves by at least 1 per cent of GDP.

- *Expansionary (contractionary) fiscal adjustment.* It corresponds to a period of fiscal adjustment followed by a positive (negative) GDP growth for consecutive two years.

- *Increasingly expansionary (contractionary) fiscal adjustment.* It is a period of fiscal adjustment followed by an increasing (declining) GDP for consecutive two years.

- *Unsuccessful fiscal adjustment.* It is a period of fiscal adjustment (not) followed by the cumulative reduction of the debt to GDP ratio greater than 4.5 percentage points over the three years after the beginning of a fiscal adjustment.

4.2. Political Instability

We start by investigating the institutional and economic determinants of political instability and the impact of income inequality on the occurrence of government crises. Therefore, we estimate the baseline model and provide a summary of the findings in Table 1. In Column 1, we focus on the set of institutional variables; in Column 2, we add a set of economic determinants; in Column 3, we also consider the level of inequality; and, in Column 4, we condition the results on the strength of the income gap.

Looking at the set of institutional variables, we find that some factors providing details on the legislature, such as whether the government has a majority of seats in the parliament (*maj*) and whether the government consists of a coalition or not (*party_coal*), are important determinants of political instability. Both variables have a negative effect on the number of episodes of government crisis, in line with the conventional wisdom, being particularly relevant in the case of *party_coal* as shown by the large magnitude of the estimated coefficient. Similarly, the level of government fractionalization (*govfrac*) – which represents a Party variable in the legislature - helps explaining the occurrence of government crises and it has a positive and statistically significant impact on the dependent variable. As expected, the regime durability (*durable*) reduces the probability of government crisis and the level of political competition (*polcomp*) seems to provide the ground for a more stable legislature. In what concerns the political regime (*polity2*), the evidence suggests that it has a positive effect on the number of government crises, which indicates that the relationship between political instability and the level of democracy might be nonlinear. Indeed, Gates et al. (2006) show that regimes that are strongly autocratic and strongly democratic display a high degree of stability, as the maintenance of the institutional framework is in the interest of the political elites. In contrast, inconsistent regimes (as those with a mix of characteristics of autocracy and democracy) lack self-enforcing equilibrium and tend to be shorter. As for the chief executive variables (*yrsoffc, system* and *military*) and the stability and checks and balances determinants, our results show that only the number of years in office of the chief executive contributes significantly for a more stable political environment. Turning to the group of economic variables, the empirical findings interestingly reveal that while economic growth contributes to stable legislature, an increase in inflation tends to deteriorate it,corroborating the findings of Aisen and Veiga (2008a, 2008b). In light of the magnitude of the coefficient associated to real GDP growth, the baseline model suggests that the performance of the economy is, perhaps, the most important determinant of political stability. In addition, the negative coefficient of inflation shows that voters are averse to

positive price developments. As for the interest rate, it does not seem to play a significant role in explaining the number of government crises.

Moving to the analysis of the impact of inequality on political instability, our results clearly suggest that when the income gap rises, the likelihood of a government crisis increases (Column 3). This, in turn, highlights that countries which fail to address the problem of inequality in income distribution are more susceptible to face social polarization (Woo, 2003) and, hence, an unstable political environment. However, the effect does not seem to depend on how large the income gap is, as shown in Column 4.

[INSERT TABLE 1 HERE.]

4.3. Political Instability and Fiscal Developments

In this Section, we analyse the impact of fiscal developments on the level of political (in)stability, as proxied by the number of episodes of government crisis. The results are summarized in Table 2. In Column 1, we consider the change in the government debt to GDP ratio; in Columns 2 and 3, we assess the effects of variation in government revenue and government expenditure, respectively; and, in Column 4, we evaluate the impact of changes in the cyclically-adjusted budget balance. In this way, we control for changes in the composition of the fiscal adjustment.

Our empirical findings corroborate the idea that the dynamics of the fiscal policy exerts a significant effect on the occurrence of government crises. In particular, a deterioration of the fiscal stance as expressed by a rise of the debt-to-GDP ratio fuels an increase in political instability. Additionally, when taxes are raised, voters tend to punish the government in power. In contrast, an improvement in the soundness of fiscal policy, given by an increase of the cyclically-adjusted budget balance, tends to be beneficial for the stability of the government.

[INSERT TABLE 2 HERE.]

4.4. Political Instability and Fiscal Consolidation

We now assess the effects of fiscal consolidation episodes on political (in)stability. We consider different typologies of fiscal consolidation, namely: (i) fiscal adjustments, (ii) increasingly expansionary fiscal adjustments, (iii) expansionary fiscal adjustments, (iv) increasingly contractionary fiscal adjustments, (v) contractionary fiscal adjustments, (vi) successful fiscal adjustments, and (vii) unsuccessful fiscal adjustments.

It can be seen that, in general, episodes of fiscal consolidation are associated with more unstable political environments. In fact, the results suggest that fiscal adjustments lead to an

increase in the occurrence of government crises. The effects are particularly strong when the episodes of fiscal consolidation deteriorate the performance of the economy, as in the case of increasingly contractionary fiscal adjustments and un(successful) fiscal adjustments. Thus, the rise in unemployment and the lack of effectiveness of such programs are likely to contribute to more political instability.

[INSERT TABLE 3 HERE.]

4.5. Political Instability and Interaction Between Inequality and Fiscal Consolidation

We condition the effect of inequality on political instability by accounting for the occurrence of fiscal consolidation episodes, that is, we interact the net income Gini inequality index with the various fiscal policy variables and fiscal consolidation episodes and assess whether the impact on the likelihood of a government crisis is amplified.

The results are summarized in Table 4 and show that: 1) when the change in the cyclically-adjusted budget balance is negative (i.e. when there is a deterioration of the fiscal stance), inequality is more prone to lead to political instability; and 2) unsuccessful fiscal consolidation programs can amplify the impact that inequality can have on the stability of the government.

All in all, these findings interestingly suggest that in countries where income distribution is uneven, governments implementing fiscal consolidation programmes are penalized by voters. Yet, fiscal authorities are punished even more severely if the programme ends up being unsuccessful or is not effective in terms of achieving its goal.

[INSERT TABLE 4 HERE.]

5. Sensitivity Analysis

In this section, we provide the sensitivity analysis. We assess the robustness of the previous findings along different dimensions, namely: (i) by analysing the evidence for OECD and non-OECD countries; and (ii) by estimating an ordered probit model.

5.1. Evidence for OECD and non-OECD countries

We start by investigating the effects of income inequality on political instability in two sets of countries: (i) OECD countries and (ii) non-OECD countries. In light of the lack of a sufficiently large number of fiscal consolidation episodes in non-OECD countries, the results including fiscal developments are reported only for OECD countries. In Tables 5-8, we present

the main findings using data for OECD countries, while, in Table 9, we provide the evidence for non-OECD countries.

Tables 5-8 show that the results for OECD countries are similar to the ones found when using the full sample. More specifically, among the list of institutional variables, the fact that the government in power is made of a coalition (*party_coal*) and the regime durability (*durable*) contribute to higher political stability. Moreover, while the number of years in office of the chief executive reduces the occurrence of government crisis' episodes, the political regime (in the form of more democracy) seems to lead to an increase of political tensions.

Among the group of economic variables, we find that economic growth and inflation have opposite effects on political instability: while economic growth strongly reduces the occurrence of government crises, an increase in inflation tends to erode political cohesion.

In what concerns inequality, we clearly uncover a positive effect the number of episodes of government crisis. In addition, the impact tends to be larger when inequality is high, i.e. very unequal societies are more vulnerable to the risk of political instability.

When we add the fiscal policy variables to the set of regressors (Table 6), the empirical findings show that both an improvement in the cyclically-adjusted budget balance and a rise in government spending are associated with a larger number of government crises. This is, perhaps, signaling that when pressure groups repeatedly compete over a fluctuating level of resources, spending hikes are more likely to take place. As a result, the voracity model of procyclical fiscal policy, which argues that the common pool problem is more severe when power is diffused among a larger number of agents, would highlight that different interest groups lobby more intensively for a higher share of government revenue/spending, thereby, explaining the rise in political instability.

With regard to the effects of fiscal adjustments, we find that unsuccessful fiscal consolidation programmes and increasingly contractionary fiscal adjustments are particularly detrimental for the stability of the political regime (as shown in Table 7).

This piece of evidence is corroborated in Table 8, when we interact the level of inequality with the implementation of fiscal adjustment programs. It shows that conditioning the impact of inequality on the lack of success or on the increasingly negative output effects of the fiscal adjustment amplifies the number of government crisis episodes.

[INSERT TABLE 5 HERE.]

[INSERT TABLE 6 HERE.]

[INSERT TABLE 7 HERE.]

[INSERT TABLE 8 HERE.]

As for the evidence for non-OECD countries (reported in Table 9), our results show that level of political competition (*polcomp*) and the fact that the government in power is made of a coalition (*party_coal*) or has a majority of seats in the parliament (*maj*) reduce the occurrence of government crises, while more democracy (*polity2*) may exacerbate political stability. Economic growth is undoubtedly the most important factor contributing to the stability of the government, as can be seen by the large magnitude of the coefficient associated to this variable. In contrast, inflation and, to some extent, increasing funding costs (as expressed in a higher interest rate) boost the possibility of political tensions. Finally, we show that inequality has a significant impact on the number of government crises but only when it is low, a result that is in sharp contrast with the evidence found for OECD countries.

[INSERT TABLE 9 HERE.]

5.2. Evidence from an Ordered Probit Model

As a final robustness exercise, we estimate an ordered probit model, which assesses the institutional and economic determinants of the probability of political instability and evaluates the impact of inequality and fiscal adjustments on the likelihood of government crises.

Table 10 provides evidence of the relationship between political instability and inequality. The results are in line with our baseline model estimated by an IV approach. Indeed, it suggests that variables providing detailed information about the legislature, such as the existence of a majority of seats in the parliament by the incumbent government (*maj*) as well as whether it consists of a coalition or not (*party_coal*), strongly reduce the probability of occurrence of government crises. Similarly, the regime durability (*durable*) and the level of political competition (*polcomp*) both have a negative effect on the likelihood of political instability. In contrast, the level of government fractionalization (*govfrac*) and the political regime (*polity2*) increase the probability of occurrence of government crises, while the number of years in office of the chief executive (*yrsoffc*) warrants a more stable government.

In what concerns the group of economic determinants, our results show that economic growth increases the likelihood of a stable legislature, while inflation erodes it and contributes to an increase in the probability of government crises.

With regard to inequality, the empirical findings do not corroborate the existence of a significant impact on the likelihood of government crises, despite the fact that the coefficient estimate has the expected positive sign. In addition, we do not uncover a nonlinear effect of inequality on the probability of the occurrence of government crises.

[INSERT TABLE 10 HERE.]

In Table 11, we account for fiscal developments and consider, in addition, a set of fiscal policy variables in the group of regressors. It can be seen that not only has the change in the debt-to-GDP ratio a positive impact on the likelihood of political instability, but also the change in the composition of the fiscal stance (as measured by changes in government revenue and government spending) helps explaining the increase in the probability of government crises.

[INSERT TABLE 11 HERE.]

Finally, in Table 12, we evaluate the impact of fiscal adjustment programs on political instability. While fiscal adjustments tend to be detrimental for political stability, unsuccessful fiscal adjustments and increasingly contractionary fiscal adjustments strongly deteriorate political cohesion and raise the prospects of government crises.

[INSERT TABLE 12 HERE.]

5. Conclusion

In this paper, we use data for a panel of developed and developing countries to assess the impact of income inequality and fiscal adjustments on political instability.

We find that governments are punished by voters when inequality increases. Moreover, for OECD countries, we show that high inequality in income distribution leads to less stable legislatures.

Accounting for fiscal developments, the empirical findings suggest that a rise in the debt-to-GDP ratio fuels political instability and changes in the composition of fiscal policy also affect the likelihood of government crises.

The results also reveal that un(successful) fiscal adjustments and increasingly contractionary fiscal adjustments are strongly detrimental for the political cohesion. Moreover, the implementation of fiscal consolidation episodes is likely to amplify the impact of inequality on political instability, especially, when fiscal adjustments are not effective or induce a recessionary environment.

Finally, we find that the existence of a majority of seats or a coalition government, the regime durability, the level of political competition and the number of years in office of the chief executive reduce political instability, while the level of government fractionalization and the political regime has a positive effect on the occurrence of government crises. In addition and from a macroeconomic point of view, economic growth and low inflation seem to be key for political stability.

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Table 1: Political instability.

government crisis	[1]	[2]	[3]	[4]
military	0.0131	0.0027	0.1035*	0.0883
	[0.020]	[0.027]	[0.062]	[0.062]
stabs	0.0091	-0.0088	-0.0816	-0.0824
	[0.035]	[0.041]	[0.057]	[0.057]
system	0.0105	-0.0071	0.0214	-0.0108
	[0.012]	[0.015]	[0.025]	[0.025]
govfrac	0.0751**	0.0822*	0.0688	0.0656
	[0.037]	[0.044]	[0.063]	[0.063]
polity2	0.0183***	0.0156***	0.0335***	0.0330***
	[0.004]	[0.005]	[0.010]	[0.010]
durable	-0.0010***	-0.0006*	-0.0009**	-0.0012***
	[0.000]	[0.000]	[0.000]	[0.000]
polcomp	-0.0217***	-0.0219**	-0.0557***	-0.0594***
	[0.008]	[0.009]	[0.019]	[0.019]
yrsoffc	-0.0014	-0.0026**	-0.0031	-0.0046*
	[0.001]	[0.001]	[0.002]	[0.003]
maj	-0.2345***	-0.1939***	-0.1815*	-0.2015*
	[0.054]	[0.062]	[0.108]	[0.109]
party_coal	-0.0308***	-0.0124	-0.0430*	-0.0419*
	[0.008]	[0.012]	[0.024]	[0.024]
GDP growth rate		-1.3798***	-2.7839***	-2.6519***
		[0.359]	[0.767]	[0.767]
Inflation		0.0144***	0.0290***	0.0278***
		[0.004]	[0.008]	[0.008]
real interest rate		0.0001	0.0000	0.0000
		[0.000]	[0.000]	[0.000]
inequality			**0.0047****	-
			[0.002]	-
(inequality<average)				0.0000
				[0.000]
(inequality>average)				-0.0136
				[0.048]
constant	0.4721***	0.4492***	0.5410***	0.8187***
	[0.071]	[0.087]	[0.189]	[0.178]
Observations	2690	1752	991	991
R-squared	0.053	0.068	0.093	0.09
Hansen Statistic	-	3.242	4.991	5.038
p-value	-	0.518	0.288	0.283

Note: Robust standard errors in brackets. *** p<0.01, ** p<0.05, * p<0.1.

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Table 2: Political instability and fiscal developments.

government crisis	[1]	[2]	[3]	[4]
military	0.0945	0.0634	0.0666	0.0997
	[0.063]	[0.065]	[0.066]	[0.068]
stabs	-0.0807	-0.104	-0.0987	-0.0787
	[0.057]	[0.063]	[0.063]	[0.063]
system	0.0169	0.0317	0.0303	0.0305
	[0.025]	[0.027]	[0.027]	[0.028]
govfrac	0.081	0.0093	0.0122	0.0291
	[0.063]	[0.064]	[0.064]	[0.065]
polity2	0.0320***	0.0342***	0.0342***	0.0356***
	[0.010]	[0.011]	[0.011]	[0.011]
durable	-0.0008**	-0.0009**	-0.0009**	-0.0011**
	[0.000]	[0.000]	[0.000]	[0.000]
polcomp	-0.0515**	-0.0546**	-0.0550**	-0.0600***
	[0.020]	[0.022]	[0.022]	[0.022]
yrsoffc	-0.0029	-0.0041	-0.004	-0.0034
	[0.003]	[0.003]	[0.003]	[0.003]
maj	-0.1872*	-0.1827	-0.1839	-0.2126*
	[0.110]	[0.118]	[0.118]	[0.119]
party_coal	-0.04	-0.0581***	-0.0543**	-0.0417*
	[0.025]	[0.022]	[0.022]	[0.023]
GDP growth rate	-2.1726***	-2.9928***	-2.9739***	-3.1023***
	[0.667]	[0.778]	[0.784]	[0.806]
Inflation	0.0230***	0.0310***	0.0309***	0.0322***
	[0.007]	[0.008]	[0.008]	[0.008]
real interest rate	0.0000	0.0000	0.0000	0.0000
	[0.000]	[0.000]	[0.000]	[0.000]
inequality	0.0047**	0.0063***	0.0061**	0.0058**
	[0.002]	[0.002]	[0.002]	[0.002]
Δ(Debt-to-GDP ratio)	**0.0048***			
	[0.003]			
Δ(Gov. Revenues)		**0.0000****		
		[0.000]		
Δ(Gov. Spending)			0.0000	
			[0.000]	
Δ(CA Budget Balance)				**-0.0000****
				[0.000]
constant	0.4907**	0.5221***	0.5247***	0.5618***
	[0.192]	[0.195]	[0.195]	[0.197]
Observations	981	909	909	909
R-squared	0.101	0.116	0.113	0.105
Hansen Statistic	5.29	6.787	9.504	7.954
p-value	0.382	0.237	0.0906	0.159

Note: Robust standard errors in brackets. *** p<0.01, ** p<0.05, * p<0.1.

Table 3: Political instability and fiscal consolidation.

government crisis	[1]	[2]	[3]	[4]	[5]	[6]	[7]
military	0.0877	0.0862	0.0877	0.0866	0.0858	0.0865	0.0896
	[0.068]	[0.068]	[0.068]	[0.067]	[0.068]	[0.069]	[0.069]
stabs	-0.0919	-0.0829	-0.0919	-0.0966	-0.0862	-0.0868	-0.1025*
	[0.062]	[0.063]	[0.062]	[0.061]	[0.063]	[0.063]	[0.061]
system	0.0197	0.0244	0.0197	0.0208	0.0242	0.0238	0.0227
	[0.027]	[0.027]	[0.027]	[0.027]	[0.027]	[0.028]	[0.027]
Govfrac	0.0359	0.0323	0.0359	0.0343	0.0328	0.0333	0.0365
	[0.065]	[0.065]	[0.065]	[0.065]	[0.065]	[0.065]	[0.065]
polity2	0.0355***	0.0342***	0.0355***	0.0347***	0.0345***	0.0345***	0.0335***
	[0.011]	[0.011]	[0.011]	[0.011]	[0.011]	[0.011]	[0.011]
durable	-0.0010**	-0.0010**	-0.0010**	-0.0010**	-0.0010**	-0.0010**	-0.0010**
	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]
polcomp	-0.0551**	-0.0562**	-0.0551**	-0.0553**	-0.0561**	-0.0559**	-0.0520**
	[0.022]	[0.022]	[0.022]	[0.022]	[0.022]	[0.023]	[0.023]
yrsoffc	-0.0029	-0.0035	-0.0029	-0.0033	-0.0033	-0.0034	-0.0036
	[0.003]	[0.003]	[0.003]	[0.003]	[0.003]	[0.003]	[0.003]
maj	-0.1762	-0.2028*	-0.1762	-0.1884	-0.1933	-0.1931	-0.1781
	[0.119]	[0.121]	[0.119]	[0.119]	[0.118]	[0.120]	[0.118]
party_coal	-0.0440*	-0.0440*	-0.0440*	-0.0440*	-0.0435*	-0.0437*	-0.0420*
	[0.023]	[0.023]	[0.023]	[0.023]	[0.023]	[0.024]	[0.023]
GDP growth rate	-3.0361***	-2.9501***	-3.0361***	-3.0754***	-2.9446***	-2.9929***	-3.0213***
	[0.798]	[0.799]	[0.798]	[0.807]	[0.798]	[0.811]	[0.807]
Inflation	0.0312***	0.0306***	0.0312***	0.0317***	0.0306***	0.0310***	0.0311***
	[0.008]	[0.008]	[0.008]	[0.008]	[0.008]	[0.008]	[0.008]
real interest rate	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000
	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]
Inequality	0.0055**	0.0054**	0.0055**	0.0055**	0.0054**	0.0054**	0.0060**
	[0.002]	[0.002]	[0.002]	[0.002]	[0.002]	[0.002]	[0.002]

	(cont.)						
Fiscal Adjustments	**0.0793***						
	[0.047]						
Increasingly Expansionary Fiscal Adjustments		-0.1056					
		[0.082]					
Expansionary Fiscal Adjustments			**0.0793***				
			[0.047]				
Increasingly Contractionary Fiscal Adjustments				**0.1533***			
				[0.084]			
Contractionary Fiscal Adjustments					0.0000		
					[0.000]		
Successful Fiscal Adjustments						0.0089	
						[0.049]	
Unsuccessful Fiscal Adjustments							**0.1854****
							[0.090]
constant	0.5132**	0.5573***	0.5132**	0.5349***	0.5421***	0.5426***	0.4825**
	[0.199]	[0.199]	[0.199]	[0.195]	[0.196]	[0.196]	[0.199]
Observations	914	914	914	914	914	907	909
R-squared	0.102	0.101	0.102	0.104	0.1	0.099	0.105
Hansen Statistic	5.333	5.426	5.333	5.53	5.392	5.357	5.617
p-value	0.255	0.246	0.255	0.237	0.249	0.253	0.23

Note: Robust standard errors in brackets. *** p<0.01, ** p<0.05, * p<0.1.

Table 4: Political instability and interaction between inequality and fiscal consolidation.

government crisis	[1]	[2]	[3]	[4]	[5]	[6]	[7]
military	0.1042*	0.0859	0.0852	0.0881	0.0881	0.0868	0.0899
	[0.063]	[0.068]	[0.068]	[0.068]	[0.068]	[0.067]	[0.069]
stabs	-0.0824	-0.0857	-0.0903	-0.0908	-0.0908	-0.0956	-0.1004
	[0.057]	[0.063]	[0.063]	[0.062]	[0.062]	[0.062]	[0.061]
system	0.0196	0.0241	0.0225	0.0182	0.0182	0.0205	0.0222
	[0.025]	[0.027]	[0.027]	[0.027]	[0.027]	[0.027]	[0.027]
Govfrac	0.0726	0.0325	0.0307	0.0367	0.0367	0.0348	0.0378
	[0.064]	[0.065]	[0.065]	[0.065]	[0.065]	[0.065]	[0.065]
polity2	0.0328***	0.0344***	0.0339***	0.0358***	0.0358***	0.0349***	0.0331***
	[0.010]	[0.011]	[0.011]	[0.011]	[0.011]	[0.011]	[0.011]
durable	-0.0009**	-0.0010**	-0.0010**	-0.0010**	-0.0010**	-0.0010**	-0.0010**
	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]
polcomp	-0.0542***	-0.0559**	-0.0535**	-0.0557**	-0.0557**	-0.0558**	-0.0515**
	[0.020]	[0.022]	[0.022]	[0.022]	[0.022]	[0.022]	[0.023]
yrsoffc	-0.0032	-0.0034	-0.0033	-0.0031	-0.0031	-0.0033	-0.0037
	[0.003]	[0.003]	[0.003]	[0.003]	[0.003]	[0.003]	[0.003]
maj	-0.1866*	-0.1936	-0.1706	-0.1771	-0.1771	-0.1883	-0.1816
	[0.110]	[0.118]	[0.120]	[0.119]	[0.119]	[0.119]	[0.118]
party_coal	-0.0427*	-0.0437*	-0.0440*	-0.0436*	-0.0436*	-0.0438*	-0.0415*
	[0.024]	[0.023]	[0.023]	[0.023]	[0.023]	[0.023]	[0.024]
GDP growth rate	-2.7068***	-2.9254***	-3.0911***	-3.0415***	-3.0415***	-3.0842***	-3.0185***
	[0.814]	[0.828]	[0.811]	[0.797]	[0.797]	[0.810]	[0.808]
Inflation rate	0.0282***	0.0304***	0.0319***	0.0312***	0.0312***	0.0317***	0.0310***
	[0.008]	[0.008]	[0.008]	[0.008]	[0.008]	[0.008]	[0.008]
real interest rate	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000
	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]
Inequality	0.0045*	0.0056*	0.0048**	0.0051**	0.0051**	0.0053**	0.0057**
	[0.002]	[0.003]	[0.002]	[0.002]	[0.002]	[0.002]	[0.002]

	(cont.)						
Inequality*I[Δ(Debt-to-GDP ratio)>0]	0.0005						
	[0.001]						
Inequality*I[Δ(Gov. Revenues)>0]		-0.0002					
		[0.002]					
Inequality*I[Δ(CA Budget Balance)<0]			**0.0018***				
			[0.001]				
Inequality*I[Fiscal Adjustment=1]				0.0021			
				[0.001]			
Inequality*I[Expansionary Fiscal Adjustment=1]					0.0021		
					[0.001]		
Inequality*I[Increasingly Contractionary Fiscal Adjustment=1]						0.0037	
						[0.002]	
Inequality*I[Unsuccessful Fiscal Adjustment=1]							**0.0051***
							[0.003]
constant	0.5342***	0.5420***	0.5082**	0.5340***	0.5340***	0.5456***	0.4933**
	[0.187]	[0.196]	[0.198]	[0.196]	[0.196]	[0.195]	[0.199]
Observations	983	914	914	914	914	914	909
R-squared	0.093	0.1	0.104	0.103	0.103	0.103	0.105
Hansen Statistic	4.955	5.401	5.284	5.369	5.369	5.586	5.724
p-value	0.292	0.249	0.259	0.252	0.252	0.232	0.221

Note: Robust standard errors in brackets. *** p<0.01, ** p<0.05, * p<0.1.

Table 5: Political instability – Evidence for OECD countries.

government crisis	[1]	[2]	[3]	[4]
military	0.3421**	-0.4795*	-0.1682	-0.0982
	[0.166]	[0.267]	[0.154]	[0.174]
stabs	-0.0798	-0.0538	-0.1248	-0.1201
	[0.073]	[0.087]	[0.090]	[0.090]
system	-0.0155	-0.0381	0.0645	0.0584
	[0.029]	[0.045]	[0.061]	[0.048]
govfrac	-0.0096	0.0041	-0.0014	0.084
	[0.095]	[0.108]	[0.118]	[0.122]
polity2	0.0461**	0.0704***	0.0700***	0.0661***
	[0.019]	[0.020]	[0.023]	[0.023]
durable	-0.0016***	-0.0001	-0.0007	-0.0011*
	[0.000]	[0.000]	[0.001]	[0.001]
polcomp	-0.0448	-0.0895*	-0.104	-0.1077*
	[0.049]	[0.052]	[0.065]	[0.065]
yrsoffc	-0.0101**	-0.0069	-0.0064	-0.0064
	[0.005]	[0.007]	[0.008]	[0.008]
maj	0.1144	-0.1064	-0.1003	-0.0675
	[0.178]	[0.186]	[0.195]	[0.193]
party_coal	-0.0995*	-0.1086*	-0.1169*	-0.089
	[0.052]	[0.057]	[0.061]	[0.059]
GDP growth rate		-1.5771**	-2.1484**	-2.2110**
		[0.782]	[0.878]	[0.890]
Inflation rate		0.0250***	0.0271***	0.0268***
		[0.008]	[0.008]	[0.008]
real interest rate		-0.0023	-0.0004	-0.0004
		[0.002]	[0.003]	[0.003]
Inequality			**0.0087***	
			[0.005]	
(Inequality<average)				0.0000
				[0.000]
(Inequality>average)				**0.1920***
				[0.065]
constant	0.5525*	0.8031**	0.584	0.7610*
	[0.306]	[0.378]	[0.471]	[0.454]
Observations	716	520	470	470
R-squared	0.052	0.078	0.09	0.111
Hansen Statistic		2.683	3.248	2.567
p-value		0.612	0.517	0.633

Note: Robust standard errors in brackets. *** p<0.01, ** p<0.05, * p<0.1

Table 6: Political instability and fiscal developments – Evidence for OECD countries.

government crisis	[1]	[2]	[3]	[4]
military	-0.1919	-0.1914	-0.2256	-0.188
	[0.141]	[0.149]	[0.147]	[0.159]
stabs	-0.1233	-0.1233	-0.1202	-0.1194
	[0.091]	[0.094]	[0.092]	[0.092]
system	0.0567	0.0823	0.0779	0.0803
	[0.060]	[0.065]	[0.064]	[0.064]
govfrac	0.0038	-0.0077	-0.0001	-0.0058
	[0.119]	[0.118]	[0.117]	[0.118]
polity2	0.0699***	0.0645***	0.0608***	0.0635***
	[0.023]	[0.023]	[0.022]	[0.023]
durable	-0.0006	-0.0009*	-0.0006	-0.0009
	[0.001]	[0.001]	[0.001]	[0.001]
polcomp	-0.0976	-0.0902	-0.0748	-0.0871
	[0.065]	[0.064]	[0.062]	[0.064]
yrsoffc	-0.0053	-0.0051	-0.002	-0.005
	[0.008]	[0.008]	[0.008]	[0.008]
maj	-0.1017	-0.1015	-0.1449	-0.1126
	[0.197]	[0.203]	[0.203]	[0.205]
party_coal	-0.1202*	-0.1156*	-0.1306**	-0.1225**
	[0.061]	[0.061]	[0.057]	[0.061]
GDP growth rate	-1.5119*	-2.0350**	-2.0252**	-2.0785**
	[0.890]	[0.910]	[0.900]	[0.902]
Inflation rate	0.0214**	0.0261***	0.0261***	0.0258***
	[0.009]	[0.009]	[0.009]	[0.009]
real interest rate	-0.0009	0.0002	0.0010	0.0010
	[0.003]	[0.003]	[0.003]	[0.003]
Inequality	0.0091*	0.0097**	0.0099**	0.0096**
	[0.005]	[0.005]	[0.005]	[0.005]
Δ(Debt-to-GDP ratio)	0.0058			
	[0.004]			
Δ(Gov. Revenues)		0.0000		
		[0.000]		
Δ(Gov. Spending)			**0.0000***	
			[0.000]	
Δ(CA Budget Balance)				**0.0089***
				[0.005]
constant	0.4995	0.4327	0.3304	0.4364
	[0.488]	[0.470]	[0.463]	[0.469]
Observations	469	462	462	462
R-squared	0.093	0.094	0.106	0.097
Hansen Statistic	5.182	3.559	4.415	4.791
p-value	0.394	0.615	0.491	0.442

Note: Robust standard errors in brackets. *** $p<0.01$, ** $p<0.05$, * $p<0.1$.

Table 7: Political instability and fiscal consolidation – Evidence for OECD countries.

government crisis	[1]	[2]	[3]	[4]	[5]	[6]	[7]
military	-0.1725	-0.169	-0.1725	-0.1832	-0.1715	-0.1719	-0.1943
	[0.158]	[0.161]	[0.158]	[0.148]	[0.159]	[0.159]	[0.151]
stabs	-0.1353	-0.1248	-0.1353	-0.1498*	-0.125	-0.1253	-0.1630*
	[0.089]	[0.093]	[0.089]	[0.086]	[0.092]	[0.093]	[0.086]
system	0.0707	0.0767	0.0707	0.0679	0.077	0.0772	0.0699
	[0.065]	[0.064]	[0.065]	[0.064]	[0.064]	[0.064]	[0.064]
govfrac	0.0024	-0.0012	0.0024	-0.0038	-0.0005	-0.0006	0.0041
	[0.118]	[0.119]	[0.118]	[0.117]	[0.119]	[0.119]	[0.118]
polity2	0.0669***	0.0658***	0.0669***	0.0662***	0.0658***	0.0657***	0.0631***
	[0.023]	[0.023]	[0.023]	[0.023]	[0.023]	[0.022]	[0.024]
durable	-0.0009*	-0.0008	-0.0009*	-0.0009*	-0.0008	-0.0008	-0.0009*
	[0.001]	[0.001]	[0.001]	[0.001]	[0.001]	[0.001]	[0.001]
polcomp	-0.0862	-0.0949	-0.0862	-0.0889	-0.0945	-0.0946	-0.081
	[0.067]	[0.064]	[0.067]	[0.066]	[0.064]	[0.065]	[0.068]
yrsoffc	-0.004	-0.0061	-0.004	-0.0057	-0.006	-0.006	-0.0039
	[0.008]	[0.008]	[0.008]	[0.008]	[0.008]	[0.008]	[0.008]
maj	-0.0251	-0.0803	-0.0251	-0.0342	-0.0777	-0.0784	0.0159
	[0.213]	[0.207]	[0.213]	[0.207]	[0.206]	[0.208]	[0.211]
party_coal	-0.1233**	-0.1158*	-0.1233**	-0.1212**	-0.1161*	-0.1158*	-0.1144*
	[0.061]	[0.061]	[0.061]	[0.060]	[0.061]	[0.062]	[0.060]
GDP growth rate	-2.1892**	-2.0130**	-2.1892**	-2.2240**	-2.0182**	-2.0136**	-2.1957**
	[0.898]	[0.898]	[0.898]	[0.895]	[0.897]	[0.905]	[0.891]
Inflation rate	0.0265***	0.0256***	0.0265***	0.0261***	0.0256***	0.0256***	0.0254***
	[0.009]	[0.009]	[0.009]	[0.009]	[0.009]	[0.009]	[0.009]
real interest rate	0.0004	0.0001	0.0004	0.0011	0.0001	0.0001	0.0016
	[0.003]	[0.003]	[0.003]	[0.003]	[0.003]	[0.003]	[0.003]
Inequality	0.0101**	0.0094**	0.0101**	0.0093**	0.0096**	0.0095**	0.0103**
	[0.005]	[0.005]	[0.005]	[0.005]	[0.005]	[0.005]	[0.005]

	(cont.)						
Fiscal adjustment	**0.1214***						
	[0.073]						
Increasing Expansionary Fiscal Adjustment		-0.0253					
		[0.049]					
Expansionary Fiscal Adjustment			**0.1214***				
			[0.073]				
Increasingly Contractionary Fiscal Adjustment				**0.2513****			
				[0.122]			
Contractionary Fiscal Adjustment					0.0000		
					[0.000]		
Succesful Fiscal Adjustment						-0.0056	
						[0.070]	
Unsuccessful Fiscal Adjustment							**0.3035****
							[0.133]
constant	0.3447	0.4716	0.3447	0.4217	0.4627	0.4648	0.282
	[0.504]	[0.481]	[0.504]	[0.480]	[0.473]	[0.480]	[0.496]
Observations	464	464	464	464	464	464	464
R-squared	0.098	0.091	0.098	0.104	0.091	0.091	0.109
Hansen Statistic	2.938	2.892	2.938	2.977	2.89	2.885	2.847
p-value	0.568	0.576	0.568	0.562	0.576	0.577	0.584

Note: Robust standard errors in brackets. *** p<0.01, ** p<0.05, * p<0.1.

Table 8: Political instability and interaction between inequality and fiscal consolidation – Evidence for OECD countries.

government crisis	[1]	[2]	[3]	[4]	[5]	[6]
military	-0.1789	-0.2216	-0.1498	-0.1498	-0.1638	-0.1744
	[0.158]	[0.182]	[0.161]	[0.161]	[0.150]	[0.152]
stabs	-0.1236	-0.1256	-0.1324	-0.1324	-0.1506*	-0.1655**
	[0.092]	[0.092]	[0.089]	[0.089]	[0.085]	[0.084]
system	0.0746	0.0671	0.0659	0.0659	0.0648	0.0635
	[0.064]	[0.063]	[0.065]	[0.065]	[0.064]	[0.064]
govfrac	0.0111	-0.0037	0.004	0.004	-0.0004	0.0073
	[0.117]	[0.119]	[0.117]	[0.117]	[0.117]	[0.119]
polity2	0.0655***	0.0659***	0.0676***	0.0676***	0.0665***	0.0614**
	[0.023]	[0.023]	[0.024]	[0.024]	[0.024]	[0.024]
durable	-0.0008	-0.0008	-0.0009	-0.0009	-0.0010*	-0.0009
	[0.001]	[0.001]	[0.001]	[0.001]	[0.001]	[0.001]
polcomp	-0.0941	-0.0885	-0.0872	-0.0872	-0.088	-0.079
	[0.064]	[0.067]	[0.068]	[0.068]	[0.067]	[0.069]
yrsoffc	-0.0056	-0.0046	-0.0041	-0.0041	-0.0056	-0.0042
	[0.008]	[0.008]	[0.008]	[0.008]	[0.008]	[0.008]
maj	-0.0809	-0.0732	-0.0412	-0.0412	-0.0458	-0.0118
	[0.206]	[0.207]	[0.212]	[0.212]	[0.207]	[0.210]
party_coal	-0.1130*	-0.1246**	-0.1234**	-0.1234**	-0.1223**	-0.1145*
	[0.060]	[0.063]	[0.061]	[0.061]	[0.060]	[0.060]
GDP growth rate	-1.9889**	-2.2779**	-2.1721**	-2.1721**	-2.2474**	-2.2359**
	[0.898]	[0.930]	[0.892]	[0.892]	[0.893]	[0.891]
Inflation rate	0.0254***	0.0279***	0.0263***	0.0263***	0.0265***	0.0259***
	[0.009]	[0.009]	[0.009]	[0.009]	[0.009]	[0.009]
real interest rate	0.0002	0.0007	0.0002	0.0002	0.0008	0.0014
	[0.003]	[0.003]	[0.003]	[0.003]	[0.003]	[0.003]
Inequality	0.0140**	0.0086*	0.0093**	0.0093**	0.0089*	0.0095**
	[0.007]	[0.005]	[0.005]	[0.005]	[0.005]	[0.005]

	(cont.)					
Inequality*I[Δ(Gov. Spending)>0]	-0.0048					
	[0.005]					
Inequality*I[Δ(CA Budget Balance)<0]		0.0023				
		[0.002]				
Inequality*I[Fiscal Adjustment=1]			0.004			
			[0.003]			
Inequality*I[Expansionary Fiscal Adjustment=1]				0.004		
				[0.003]		
Inequality*I[Increasingly Contractionary Fiscal Adjustment=1]					**0.0080****	
					[0.004]	
Inequality*I[Unsuccessful Fiscal Adjustment=1]						**0.0107****
						[0.005]
constant	0.461	0.4295	0.3889	0.3889	0.4396	0.3288
	[0.474]	[0.486]	[0.499]	[0.499]	[0.483]	[0.498]
Observations	464	464	464	464	464	464
R-squared	0.094	0.096	0.099	0.099	0.105	0.111
Hansen Statistic	2.904	2.91	2.876	2.876	3.007	2.732
p-value	0.574	0.573	0.579	0.579	0.557	0.604

Note: Robust standard errors in brackets. *** $p<0.01$, ** $p<0.05$, * $p<0.1$.

Table 9: Political instability – Evidence for non-OECD countries.

government crisis	[1]	[2]	[3]	[4]
military	-0.009	0.0032	0.0759	0.0731
	[0.019]	[0.028]	[0.073]	[0.068]
stabs	0.0264	0.0027	-0.0727	-0.073
	[0.039]	[0.048]	[0.083]	[0.083]
system	0.007	-0.0087	-0.006	-0.0062
	[0.014]	[0.016]	[0.037]	[0.037]
govfrac	0.045	0.0483	0.0713	0.0706
	[0.043]	[0.053]	[0.094]	[0.092]
polity2	0.0159***	0.0121**	0.0245**	0.0242**
	[0.004]	[0.005]	[0.012]	[0.012]
durable	0.0001	-0.0003	-0.0012	-0.0012
	[0.001]	[0.001]	[0.001]	[0.001]
polcomp	-0.0211***	-0.0162*	-0.0405	-0.0400*
	[0.008]	[0.009]	[0.025]	[0.024]
yrsoffc	-0.0015	-0.0024*	-0.0033	-0.0034
	[0.001]	[0.001]	[0.003]	[0.003]
maj	-0.2791***	-0.2205***	-0.2101	-0.2146*
	[0.058]	[0.068]	[0.133]	[0.129]
party_coal	-0.0224***	-0.0056	-0.0298	-0.0309
	[0.009]	[0.012]	[0.031]	[0.029]
GDP growth rate		-1.3813***	-3.0371***	-3.0378***
		[0.400]	[1.073]	[1.071]
Inflation rate		0.0141***	0.0311***	0.0311***
		[0.004]	[0.011]	[0.011]
real interest rate		0.0001**	0.0000	0.0000
		[0.000]	[0.000]	[0.000]
Inequality				0.0000
				[0.000]
(Inequality<average)				0.7117***
				[0.185]
(Inequality>average)			0.0006	
			[0.005]	
constant	0.4765***	0.4310***	0.6802**	0.0000
	[0.073]	[0.090]	[0.305]	[0.000]
Observations	1974	1232	521	521
R-squared	0.058	0.085	0.118	0.118
Hansen Statistic		3.925	4.998	4.988
p-value		0.416	0.287	0.289

Note: Robust standard errors in brackets. *** p<0.01, ** p<0.05, * p<0.1.

Table 10: Political instability – Ordered probit model.

government crisis	[1]	[2]	[3]	[4]
military	0.0961	0.039	0.2489	0.2159
	[0.117]	[0.154]	[0.196]	[0.196]
stabs	-0.0279	-0.1138	-0.3570*	-0.3730**
	[0.117]	[0.138]	[0.183]	[0.184]
system	0.0461	0.0039	0.0588	-0.0424
	[0.039]	[0.048]	[0.072]	[0.074]
govfrac	0.2652**	0.3312**	0.1942	0.2093
	[0.121]	[0.148]	[0.192]	[0.192]
polity2	0.0857***	0.0729***	0.1026***	0.1026***
	[0.021]	[0.024]	[0.035]	[0.035]
durable	-0.0048***	-0.0037***	-0.0047***	-0.0057***
	[0.001]	[0.001]	[0.002]	[0.002]
polcomp	-0.0907**	-0.0800*	-0.1237*	-0.1459**
	[0.036]	[0.041]	[0.064]	[0.064]
yrsoffc	-0.014	-0.0229**	-0.0195	-0.0256*
	[0.009]	[0.010]	[0.013]	[0.013]
maj	-0.7961***	-0.6213***	-0.2869	-0.3699
	[0.199]	[0.231]	[0.319]	[0.321]
party_coal	-0.1055**	-0.0336	-0.1858**	-0.1769**
	[0.047]	[0.062]	[0.081]	[0.080]
GDP growth rate		-4.7104***	-7.0495***	-6.6619***
		[0.926]	[1.411]	[1.406]
Inflation rate		0.0491***	0.0725***	0.0687***
		[0.009]	[0.014]	[0.014]
real interest rate		0.0000	0.0000	0.0000
		[0.000]	[0.000]	[0.000]
Inequality			0.011	
			[0.007]	
(Inequality>average)				-0.1309
				[0.151]
threshold 1	0.0782	0.2456	0.2116	-0.6381
	[0.260]	[0.306]	[0.594]	[0.512]
threshold 2	0.9558***	1.1501***	1.0962*	0.2468
	[0.261]	[0.309]	[0.601]	[0.518]
threshold 3	1.6334***	1.9940***	2.0061***	1.1515**
	[0.277]	[0.337]	[0.608]	[0.530]
threshold 4	1.9386***	2.3781***	2.3653***	1.5045***
	[0.304]	[0.369]	[0.620]	[0.552]
Observations	2690	1922	1079	1,079

Note: Robust standard errors in brackets. *** $p<0.01$, ** $p<0.05$, * $p<0.1$.
Inequality<average dropped because of collinearity.

Table 11: Political instability and fiscal developments – Ordered probit model.

government crisis	[1]	[2]	[3]	[4]
military	0.2377	0.1817	0.1833	0.2265
	[0.196]	[0.209]	[0.211]	[0.221]
stabs	-0.3484*	-0.4625**	-0.4548**	-0.3870**
	[0.184]	[0.197]	[0.196]	[0.196]
system	0.0517	0.0757	0.0716	0.0648
	[0.072]	[0.079]	[0.079]	[0.078]
govfrac	0.2229	-0.0203	-0.0153	0.0455
	[0.193]	[0.202]	[0.201]	[0.200]
polity2	0.1040***	0.0954**	0.0952**	0.0941**
	[0.036]	[0.040]	[0.040]	[0.038]
durable	-0.0046***	-0.0042**	-0.0042**	-0.0047***
	[0.002]	[0.002]	[0.002]	[0.002]
polcomp	-0.1261*	-0.0965	-0.0978	-0.1049
	[0.066]	[0.075]	[0.075]	[0.073]
yrsoffc	-0.0182	-0.0273*	-0.0277*	-0.0248*
	[0.013]	[0.014]	[0.014]	[0.015]
maj	-0.2774	-0.2142	-0.2104	-0.2533
	[0.321]	[0.337]	[0.336]	[0.335]
party_coal	-0.1704**	-0.2821***	-0.2716***	-0.2222**
	[0.083]	[0.089]	[0.088]	[0.087]
GDP growth rate	-5.8544***	-7.2174***	-7.1757***	-7.3688***
	[1.416]	[1.444]	[1.446]	[1.493]
Inflation rate	0.0607***	0.0743***	0.0739***	0.0756***
	[0.014]	[0.014]	[0.014]	[0.015]
real interest rate	0.0000	0.0000	0.0000	0.0000
	[0.000]	[0.000]	[0.000]	[0.000]
Inequality	0.0103	0.0149*	0.0146*	0.0125*
	[0.007]	[0.008]	[0.008]	[0.008]
Δ(Debt-to-GDP ratio)	**0.0083****			
	[0.004]			
Δ(Gov. Revenues)		**0.0000****		
		[0.000]		
Δ(Gov. Spending)			**0.0000****	
			[0.000]	
Δ(CA Budget Balance)				0.0000
				[0.000]
threshold 1	0.2675	0.2858	0.2808	0.213
	[0.601]	[0.668]	[0.666]	[0.656]
threshold 2	1.1563*	1.1975*	1.1909*	1.1101*
	[0.608]	[0.673]	[0.670]	[0.661]
threshold 3	2.0814***	2.1166***	2.1051***	2.0108***
	[0.614]	[0.685]	[0.682]	[0.672]
threshold 4	2.4695***	2.4806***	2.4677***	2.3768***
	[0.625]	[0.690]	[0.687]	[0.676]

Observations	1067	989	989	989

Note: Robust standard errors in brackets. *** $p<0.01$, ** $p<0.05$, * $p<0.1$.

Table 12: Political instability and fiscal consolidation – Ordered probit model.

government crisis	[1]	[2]	[3]	[4]	[5]	[6]
military	0.2024	0.2355	0.2024	0.2048	0.215	0.1807
	[0.214]	[0.213]	[0.214]	[0.212]	[0.213]	[0.218]
stabs	-0.4039**	-0.3817*	-0.4039**	-0.4252**	-0.3832**	-0.4212**
	[0.193]	[0.195]	[0.193]	[0.192]	[0.195]	[0.191]
system	0.0468	0.0684	0.0468	0.0514	0.0659	0.0553
	[0.077]	[0.078]	[0.077]	[0.076]	[0.077]	[0.078]
govfrac	0.0608	0.0424	0.0608	0.0407	0.0445	0.077
	[0.199]	[0.200]	[0.199]	[0.199]	[0.200]	[0.198]
polity2	0.0945**	0.0936**	0.0945**	0.0926**	0.0966**	0.0960**
	[0.038]	[0.038]	[0.038]	[0.038]	[0.039]	[0.039]
durable	-0.0048***	-0.0047***	-0.0048***	-0.0049***	-0.0048***	-0.0049***
	[0.002]	[0.002]	[0.002]	[0.002]	[0.002]	[0.002]
polcomp	-0.098	-0.106	-0.098	-0.0992	-0.11	-0.1038
	[0.072]	[0.072]	[0.072]	[0.072]	[0.073]	[0.073]
yrsoffc	-0.0239	-0.0254*	-0.0239	-0.0256*	-0.0237	-0.0237
	[0.015]	[0.015]	[0.015]	[0.015]	[0.015]	[0.015]
maj	-0.2257	-0.2584	-0.2257	-0.2352	-0.235	-0.2348
	[0.332]	[0.335]	[0.332]	[0.336]	[0.335]	[0.330]
party_coal	-0.2258**	-0.2220***	-0.2258**	-0.2272***	-0.2187**	-0.2096**
	[0.088]	[0.086]	[0.088]	[0.087]	[0.088]	[0.088]
GDP growth rate	-7.6577***	-7.3820***	-7.6577***	-7.6487***	-7.3344***	-7.4952***
	[1.489]	[1.486]	[1.489]	[1.496]	[1.486]	[1.503]
Inflation rate	0.0778***	0.0757***	0.0778***	0.0779***	0.0752***	0.0762***
	[0.014]	[0.014]	[0.014]	[0.015]	[0.014]	[0.015]
real interest rate	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000
	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]	[0.000]
Inequality	0.0121	0.0127*	0.0121	0.0122	0.0122	0.0131*
	[0.007]	[0.007]	[0.005]	[0.007]	[0.007]	[0.008]

	(cont.)					
Fiscal adjustment	**0.2300***					
	[0.135]					
Increasing Expansionary Fiscal Adjustment		-0.2785				
		[0.317]				
Expansionary Fiscal Adjustment			**0.2300***			
			[0.135]			
Increasingly Contractionary Fiscal Adjustment				**0.4029***		
				[0.207]		
Succesful Fiscal Adjustment					0.0113	
					[0.164]	
Unsuccessful Fiscal Adjustment						**0.4465****
						[0.186]
constant	0.267	0.2	0.267	0.2135	0.2007	0.3023
	[0.654]	[0.656]	[0.654]	[0.652]	[0.653]	[0.660]
	1.1665*	1.0981*	1.1665*	1.1129*	1.0978*	1.2048*
	[0.660]	[0.661]	[0.660]	[0.658]	[0.658]	[0.666]
	2.0661***	2.0008***	2.0661***	2.0112***	1.9976***	2.1056***
	[0.672]	[0.671]	[0.672]	[0.668]	[0.668]	[0.677]
	2.4297***	2.3674***	2.4297***	2.3771***	2.3628***	2.4682***
	[0.677]	[0.677]	[0.677]	[0.674]	[0.674]	[0.681]
Observations	989	989	989	989	989	989

Note: Robust standard errors in brackets. *** $p<0.01$, ** $p<0.05$, * $p<0.1$.