

PS343: Study-Guide Outline for Final
Clark, Capitalism, Not Globalism
Franzese, Macroeconomic Policies of Developed Democracies

I. We emphasized several topics and arguments from Clark's book:

A. Globalization/International-Capital-Integration & Convergence Arguments & Evidence

1. *Standard Argument*: Trade & Capital Mobility sharpen capital's threat vs. domestic govts to flee "excessive & inefficient" tax & pub policies, forcing welfare/tax-state retrenchment & tax-burden shifts from more-mobile cap (esp. financial) toward less-mobile labor (esp. skilled-manual). In short, globalization curtails domestic govts' economic-policy-making autonomy/maneuverability.

2. Several Counters:

a) Empirical record regarding the claim somewhat mixed.

b) Gist of Most Theoretical Counter-Arguments: *Govts Retain Maneuvering Room*: b/c...

(1) Other ntl diffs (e.g., commerce, reg, & other policy; lab-mrkt instits; intermed-supply availability; final-mrkt proximity; etc.: Hines '99) also affect invest-location. Plus, other factors than cap. mob. affect govts' tax policies.

(2) *Garrett*: Certain Left-Lab combo's efficient, so not fled. I.e., certain combos left govt w/ soc-welf, ALMP, coord-barg, & related as or more effic. than neolib minimalism & cons. govt; so cap not flee such combos.

(3) *Boix*: Left-PubInv & Right-Min econ. close & suff'ly pol. effective. Pub hum- & phys-cap invest=alt to neolib minimalism that sufficiently efficient macroec'ly to attract/retain cap & pol'ly to support left electorally.

(4) "Varieties of Capitalism": Instit's & PubPol affect comparative advantage, and comparative advantage fosters specialization, i.e. divergence, not convergence

(a) Hall&Soskice '01: complex national networks of political-economic institutions confer comparative advantages:

(b) Mosher&Franzese '02 => fixed-capital mobility & trade integration spurs specialization (of public policy & PE-inst'l structure); Only liquid-capital mobility creates int'l tax-competition, & this has other implications than commonly thought => Strategic Interdependence & Race to a "Bottom" Not Necessarily ≥ 0

(5) *Swank*: Domestic pol & institutional constraints. Inst'l struct. polity & welf sys itself shape domestic pol-resp to integ. Not fundamentally challenge exclusive or superior macroec effic. neolib min'ism; Rather, stresses primacy of domestic political conditions in determining nature & mag of welf/tax-policy reactions to global economic integration.

(6) *Hays*: Domestic political-economic structure (capital endowment & majoritarian vs. consensus governing institutions) condition response to increased cap mobility.

(7) *Basinger-Hallerberg*: *Strategic Interdependence*: insofar as any these constrain 1 state, they ease capital-competition pressures on others.

3. *Clark's Counter*: Never any [macro] partisan diverge to converge, b/c:

- a) partisan convergence = “hallmark of [macro] economic policymaking in democratic capitalist societies and, consequently, predated the recent rise in capital mobility” (p. 2).
- b) “domestic political consequences of *globalization*—partisan convergence, constraints...to anticipate the response of *footloose* capital...are not the recent effects of changes in the international economy. Instead...enduring features of the process of economic policy choice in politics dominated by private investment and electoral politics” (p. 2)
- c) I.e., democratic competition in elections forces convergence & that’s been around for long time, well predating capital mobility, so convergence long-since obtained.

[SEE “*Convergence Stories*”: <http://www-personal.umich.edu/~franzese/ps343.Clark.ConvergenceStories.pdf>]

B. Book explores converge args in context of Nordhaus-Tufte Electoralist vs. Hibbs-Alesina Partisan [MACRO] Cycles, recognizing Context Dependence, esp. dependence on Capital Mobility, Exchange-Rate Regime, and Central Bank Independence of efficacy & maneuverability of aggregate policy

C. *ASIDE: Downsian Electoral Competition: Partisan Converge & Divergence*

1. Black’s Median-Voter Theorem (MVT) & Hotelling-Downs’ Partisan Convergence

- a) MVT: if 1-dimension, binary vote-choice, sincere simple-proximity voting, “single-peaked” preferences => Median-Voter *Rules*
- b) Hotelling-Downs: MVT => strong convergence electoral competition if 2 parties, 1 dimension, and full commitment & certainty.
- c) Multiple Dimension Extensions: McKelvey-Schofield “Chaos Theorems” & Arrow’s “Impossibility Thrm”. Strongly suggests institutional restrictions on proposal- & decision-making process essential to non-arbitrary democratic decision-making:

(1) Shepsle’s Structurally Induced Equilibrium

(2) Kadane (1972) showed that if eqbm exists in unstructured multi-D space (may not), then must be multi-D median, a.k.a. Dimension-by-Dimension Median (DDM).

2. Theoretically, partisan divergence can emerge as equilibria of several reasonable representations of electoral competition.

a) ***Electoral uncertainty*** (esp. re: med-vote pref) / ***abstention*** / (Lobby-IntrstGrp) ***Extra-Electoral Influences***:

(1) *Uncertainty*: allows pol-interested prtys to drift from expected medians at finite (rather than infinite) expected-vote cost, yielding divergence. If add a reason party’s might want to drift from center, then for given magnitude of such incentive, more divergence the greater is uncertainty regarding location of median voter (Wittman 77,83; Calvert 85; Roemer 92).

(2) *Abstention*: several models; *alienation* one that could produce divergence. Probabilistic turnout => median location uncertain; if alienation (being far from even the closest party to ideal point leads voters to abstain).

(3) *Extra-Electoral Influences*: if resources other than votes can sway elect, by “buying”, “informing”, or “persuading” votes e.g., & if these come not from median (which logical), can also produce divergence.

b) **Credibility**: Divergence can also arise if pre-electoral promises must be credible, i.e. post-electoral optimal for winners to implement.

(1) w/ 2 parties, no entry, & 1-stage games (e.g., no reelects allowed) winners no incentive to implement med prefs if theirs differ, so voters only believe victors will enact victors' own preferences => full diverge.

(2) In repeated ele's, prtys can build reps => some (not full) converge.

(3) => Any degree of divergence is sustainable.

c) **Entry/Multiple Parties**:

(1) Free entry=>no eqba; entry free, so *any # prtys enter anywhere*

(2) Roughly => systems w/ low-cost entry [?] could sustain multiple prtys w/ any degree of divergence.

(3) w/some entry-costs, many possible *citizen-candidate eqba* (Besley-Coate 97):

(a) One, that only the median enters, => Hotelling-Downs-Black, but

(b) Others => 2 cand's equidistant from median enter, w/ sustainable divergence widening as entry costs grow.

(4) Even w/ just 2 parties, potential of entry => entry-deterrence reason to diverge.

3. Degree of Divergence \therefore = an empirical matter

D. Explore Implications CapMob (and CB Indep & Exchange-Rate Regime) for Domestic Policy

1. Starting Points: Need approp pol-econ model: contested. *Electoralist* or *Partisan*? Use ways CBI & CapMob interact to shape policy control & efficacy to evaluate *electoralist vs. partisan [macro]* (context-conditional cycles) models

2. So, Clark considers how CapMob, CBI, & ExchReg affect macro policy maneuverability and efficacy, deriving implications for under what combinations of conditions we should see monetary cycles, fiscal cycles, both, or neither and then asking whether we see electoral cycles or partisan ones in these monetary/fiscal policies

3. He finds mostly stronger evidence for electoral than for partisan cycles following these patterns, so he concludes that globalization could not have generated the convergence we now see since he does not find any strong, consistent partisan macro-policy differences to begin (i.e., before, during, or after the rise of capital mobility).

II. *The Structural Context of Macroeconomic Policy Choice (Ch. 2)*

A. Basic Argument/Consideration:

1. *Common Assumption Electoralist & Partisan Models*: [Sufficient Macro] Policy Control & Efficacy [Influence Macro] Outcomes

2. Pol-Mkrs not act'ly full control & efficacy, partly b/c world not deterministic, but also ltd info & *strategic interax w/ other actors*

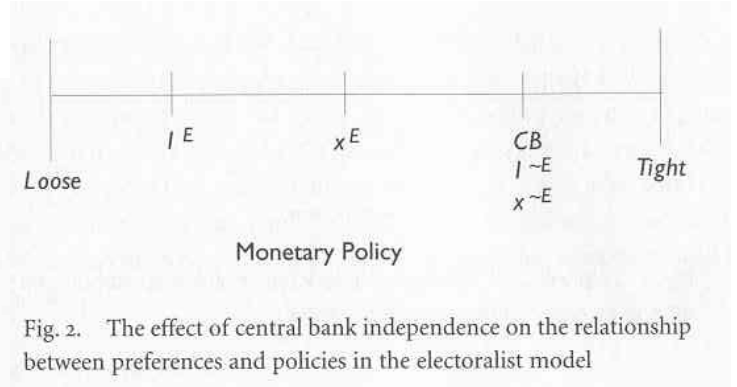
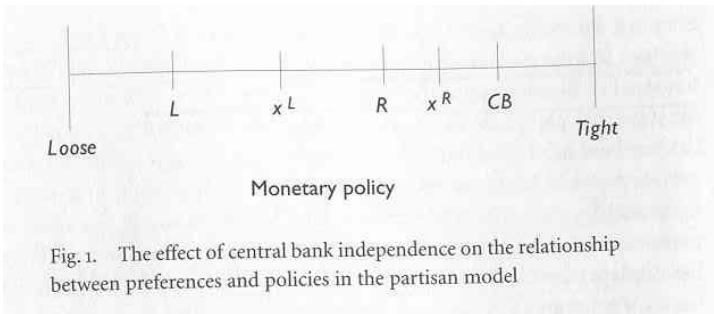
3. Consider 2 Such Limiting Factors Partic'ly: *CBI & Int'l CapMob*, effect of *CapMob* on autonomy/efficacy depends on *Exchange Regime*

4. Consider 1st simple *decision-theoretic* then *strategic, game-theoretic*:

B. Decision-Theoretic (non-strategic) Model:

a) *CBI & Control*: \uparrow CBI \Rightarrow \downarrow control by political authorities of monetary policy \Rightarrow \downarrow partisan & electoral cycles

b) Figures 1 & 2 illustrate:



c) If CBI=1, then $m=m_b^*$; o/w [as always], $CBI \in (0..1)$

(1) $\Rightarrow m$ =some compromise m_b^* and m^*

(2) $\Rightarrow \downarrow (m_l^*|CBI - m_r^*|CBI)$ and $\downarrow (m_e^*|CBI - m_{\sim e}^*|CBI)$

d) Refer also to Franzese *AJPS* '99 for broader implications of this proposition:

(1) CB never fully independent or fully dependent... [Why? How know this?]

(2) CBI \therefore measures how far CB could stray from current govt before govt would bear political-economic costs to alter CB law or seize mon pol itself. \therefore mon pol (& so infl) always partly CB & partly govt control \Rightarrow

(3) Actual infl (mon pol) = wtd avg of what it would be if conserve CB credibly, fully, & auton'ly control mon pol & what if instead curr govt had mon pol w/o any CB influence, w/ $^\circ$ CBI measure wt on former:

$$m = CBI \cdot m_b^*(\mathbf{X}_b) + (1 - CBI) \cdot m_g^*(\mathbf{X}_g)$$

(4) \Rightarrow anti-infl impact CBI not constant but rather varies depending on the broader Political-Economic environ in which CB operates. (& all the converses).

(5) E.g., anti-inf impact CBI greater when left govt than when right does & *vice versa*, less the more open the econ & *vice versa*, vary depending on other labor- and goods-market institutions & *vice versa*, etc.

2. *International Capital Mobility & Exchange-Rate Regimes*:

a) CB affects control, not efficacy [actually, can affect both, but ignore]; CapMob can affect efficacy, but how depends on exchange-rate regime.

b) Mundell-Fleming (Open-Economy Macroeconomics):

(1) *CapMob & Fixed E.R.* \Rightarrow *monetary policy ineffective [unavailable actually]*,

but fiscal hypereffective:

(a) $\uparrow m \Rightarrow \downarrow i \Rightarrow (\uparrow I, \text{ but also})$ depreciation, which must fight by $\downarrow m \uparrow i$ back ($\Rightarrow \downarrow I$ back); alternative, shorter route to answer: if Fix & CapMob, then i must be held at rate nec. to maintain peg.

(b) $\uparrow \text{def} \Rightarrow \uparrow \text{AD} \& \uparrow i \Rightarrow$ appreciation, which must fight by $\uparrow m \downarrow i$ (i.e., fiscal forces accommodating monetary also, so dbly effective)

(2) *CapMob & Flexible E.R. \Rightarrow fiscal [relatively] ineffective; mon hypereffective.*

(a) $\uparrow m \Rightarrow \downarrow i \Rightarrow \uparrow I$, & also depreciation, which $\Rightarrow \uparrow (X-M)$ also.

(b) $\uparrow \text{def} \Rightarrow \uparrow \text{AD}$, but also $\uparrow i \Rightarrow$ appreciation, which $\Rightarrow \downarrow (X-M)$ (i.e., two sources of “crowding out” so fisc [rel] ineffective).

c) Aside: Elaboration of Mundell-Fleming Framework

[See Franzese & Hays, PS651 *Open-Economy Macroeconomics Lecture Notes (IS-LM-BoP)*]

<http://www-personal.umich.edu/~franzese/OpenEconomyEcon.LectureNotes.pdf>

C. Game-Theoretic (Strategic) Model:

1. An independent & *strategic* CB would use monetary policy, **if** capital mobility & exchange regime allow it to do so, to lean against fiscal authorities' electoral or partisan cycles, **if** those fiscal authorities have the incentive & capacity to conduct them.

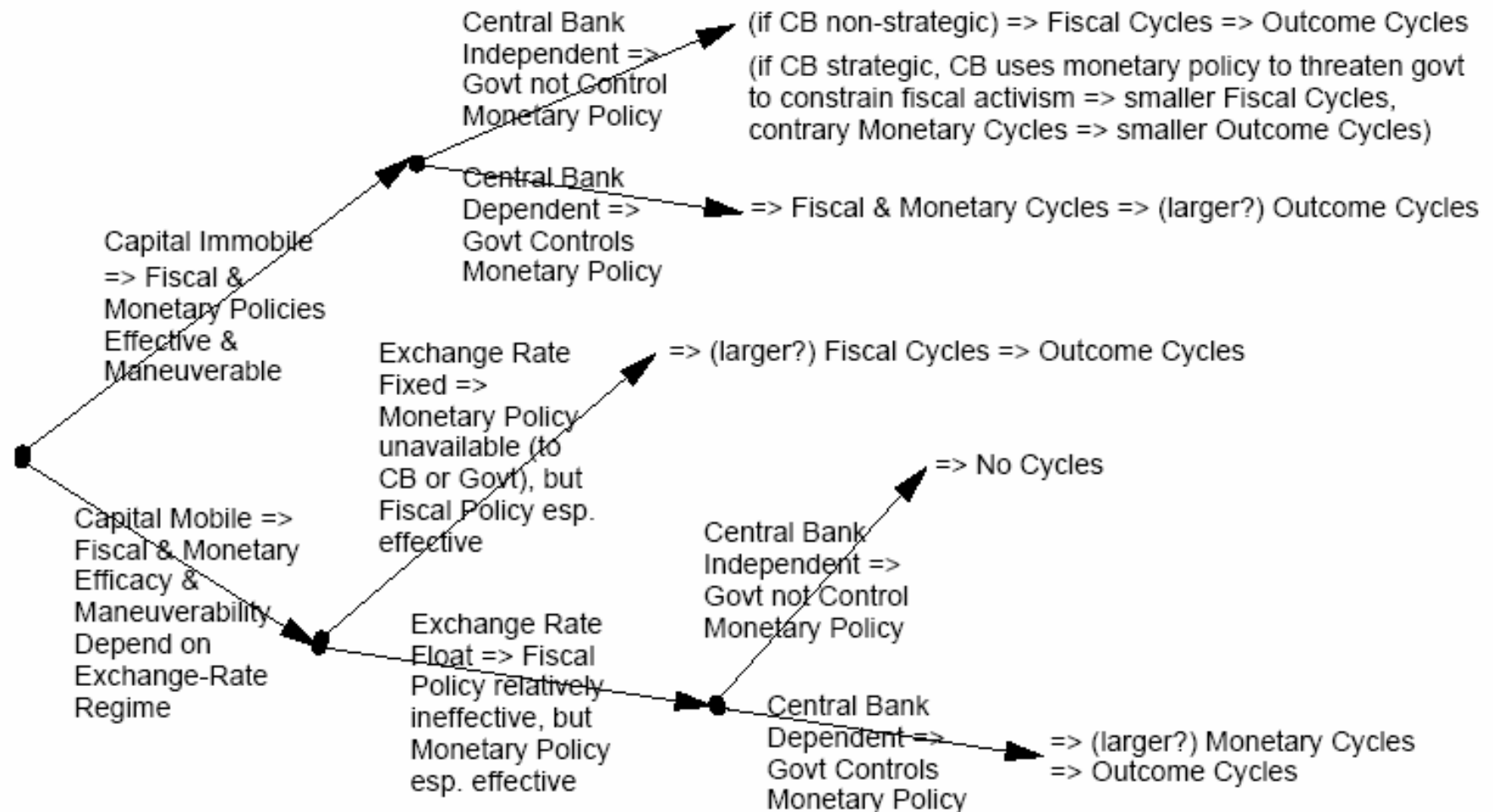
2. All of these conditions hold only when capital is immobile and CB is independent; under those conditions, we would see smaller fiscal cycles insofar as the CB's threat is effective, and monetary cycles in the opposite direction (monetary contraction when fiscal authorities want to expand).

3. \Rightarrow ***Policymaking Highly Context-Dependent***, misleading at best to explore [theoretically or] empirically w/o consider context.

D. Summary of Theoretical Expectations for Electoral &/or Partisan Cycles in Fiscal &/or Monetary Policies (i.e., macro-, aggregate-demand policies) under varying combos of ExchReg., CapMobm, & CBI:

PS343: Political Economy of Developed Democracies

The Implications of Capital Mobility, Exchange-Rate Regime, & Central Bank Independence for Electoral and Partisan Cycles in Fiscal and Monetary (i.e., Aggregate-Demand, i.e. Macro-) Policies from Clark, *Capitalism, Not Globalism*



III. Partisanship and Fiscal & Monetary Policy (Ch. 3)

A. Empirical Models: all of Clark's empirical models are some version of this

$$\begin{aligned} E(\text{Policy}) = & \beta_0 + \text{CONTROLS} + \beta_1 \text{CapMob} + \beta_2 \text{Fix} + \beta_3 \text{CBI} + \beta_4 \text{EP} \\ & + \beta_5 \text{CapMob} \times \text{EP} + \beta_6 \text{Fix} \times \text{EP} + \beta_7 \text{CBI} \times \text{EP} \\ & + \beta_8 \text{CapMob} \times \text{Fix} + \beta_9 \text{CapMob} \times \text{CBI} + \beta_{10} \text{Fix} \times \text{CBI} \\ & + \beta_{11} \text{CapMob} \times \text{Fix} \times \text{EP} + \beta_{12} \text{CapMob} \times \text{CBI} \times \text{EP} + \beta_{13} \text{Fix} \times \text{CBI} \times \text{EP} \\ & + \beta_{14} \text{CapMob} \times \text{Fix} \times \text{CBI} + \beta_{15} \text{CapMob} \times \text{Fix} \times \text{CBI} \times \text{EP} \end{aligned}$$

Where EP is either an electoral indicator or a govt-partisanship indicator, and Policy is a fiscal or a monetary policy.

B. Models: Interpretation

1. In these models, the effect of Partisanship (i.e., size of partisan cycles), or the effect of an election year (i.e., the size of partisan cycles) are given by the combination of CapMob, Exch-Reg, and CBI conditions according to:

$$\begin{aligned} \frac{\partial E(Policy)}{\partial EP} = & +\beta_4 + \beta_5 CapMob + \beta_6 Fix + \beta_7 CBI \\ & +\beta_{11} CapMob \times Fix + \beta_{12} CapMob \times CBI + \beta_{13} Fix \times CBI \\ & +\beta_{15} CapMob \times Fix \times CBI \end{aligned}$$

2. So, for example, monetary cycles (electoral or partisan) are supposed to be impossible under capital mobility and fixed exchange-rates, so we expect the effects of EP to be zero when CapMob and Fix are both 1. That is:

$$\left. \frac{\partial E(MonPol)}{\partial EP} \right|_{CapMob=Fix=1} = +\beta_4 + \beta_5 + \beta_6 + \beta_{11} + (\beta_7 + \beta_{12} + \beta_{13} + \beta_{15}) CBI = 0$$

$$\Rightarrow +\beta_4 + \beta_5 + \beta_6 + \beta_{11} = \beta_7 + \beta_{12} + \beta_{13} + \beta_{15} = 0$$

3. Another example: monetary cycles (electoral or partisan) are supposed to occur (i.e., be non-zero, namely positive) under capital mobility and flexible exchange-rates, i.e., when CapMob=1 and Fix=0, but only if CBI=0 and not if CBI=1. So:

$$\left. \frac{\partial E(MonPol)}{\partial EP} \right|_{CapMob=1; Fix=0; CBI=1} = +\beta_4 + \beta_5 + \beta_7 + \beta_{12} = 0$$

$$\left. \frac{\partial E(MonPol)}{\partial EP} \right|_{CapMob=1; Fix=0; CBI=0} = +\beta_4 + \beta_5 > 0$$

$$\Rightarrow +\beta_4 + \beta_5 = -(\beta_7 + \beta_{12})$$

4. And so on...

C. Findings & Conclusions: Already summarized above

IV. Franzese: Outline/Overview of Book (section I of notes, pp. 1-4, specifically the parts related to chs. 1-3, already provide a workable study guide). Be able to work with interactions of participation and inequality from chapter 2, and with “adjustment rates” and how interest rates, fractionalization, and polarization affect them. Finally, have some idea also of the theories to explain public debt on p. 36 of those notes that we covered today.

Sample questions coming...