

ps343: Lecture Notes on

Capitalism, Not Globalism:
Capital Mobility,
Central Bank Independence, and
the Political Control of the Economy

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I. Approach (from Acknowledgments):

A. Falsificationism:

Science is important not because it leads to the correct answer, but because it provides us with the best chance of discarding wrong answers.

B. Utility of Comparing

The discipline of political science seems to be divided between scholars with an intuition that events are the unique product of circumstances that will never be replicated, and those who view the social world as inherently systematic and therefore amenable to comparison and generalization. [Both incorrect in this stark form; if forced choose, Clark places self in latter camp.]

C. Modeling Political Economy

1. Start by positing/establishing goals for actors;
2. Assume reasoned decision-making;
3. Work backward from there to likely actions given those goals, (perceptions of) possible actions, & (percept's of) relations actions to goals

D. In this context, \Rightarrow Context-dependent Political (Electoral & Partisan) Cycles

II. Introduction (Ch. 1)

A. (Recent) Policymaker Behavior in Democracy:

1. As ‘lefts’ [& rights] became democratic competitors, behavior dictated by that electoral compet. for seats & governmental comp. for control

a) Przeworski (1985): “As soon as they decided to compete for votes, [in late 19th C], socialist parties [conservative parties] sought to gain electoral support of people other than workers [aristocrats & bourgeoisie]... As socialists become parties like other parties, workers turn into voters like other voters”

2. Examples of Recent “Left” Govts acting like “Ctr-Rts”:

a) Tony Blair (5/2/97 – 6/27/07):

(1) His “Christian Socialism” & the Party’s “New Labour”

(2) On **May 6**, transferred day-to-day control monetary policy from Whitehall to “Grand Old Lady of Fleet Street” (Bank of England)

b) Gerhard Schroeder (9/7/98 – 11/22/05):

(1) 6 Months into term replaced his leftist Finance Minister

(2) Soon began series of reforms (retrenchments) welfare state & labor & employ. reg's

c) [Could also reference early ‘80s Mitterand govt in France: Enters in slump w/ strong attempt fiscal expansion; soon backtracks & sim. to Schroeder later]

3. Each replaced very long-stand rt govts (16yrs Kohl; 19 Thatcher &ff), only to act as likely to hardwire policy outcomes similar to conserv. prefs.

B. 1 Key Q: Such Action by Lefts \Rightarrow Evidence of Convergence?

1. Clark's Account:

- a) Popular press (& some academics): growing convergence around *market-friendly* policies b/c of *globalization*: esp. rapid, strong integration int'l financial markets
- b) Empirical studies: mixed evidence for macro-policy convergence... [a quick review coming shortly]
- c) ...but this odd b/c, std arg: as ↑ease&speed, & ↓cost move financial assets (invest) most-favorable environs, econ costs to policymakers of deviating from most-favored practices (e.g., lowest cap-tax) ↑. Should \Rightarrow growing constraint domestic autonomy.

2. Explore *key Q* via propositions int'l-pol-econ-context [trade & cap open, CBI] & conditional electoral & partisan cycles, & test/gauge rel strength elec & part vs. each other,

3. Globalization (Int'l Capital-Market/Financial/Monetary Integration & Convergence) Arguments & Evidence:

a) Standard Argument:

(1) Briefest summary statement:

- (a) Trade & Capital-Mobility sharpen capital's threat v. domestic gov'ts to flee “*excessive & inefficient*” taxation & public policies \Rightarrow Policy Competition,
- (b) Forcing welfare/tax-state retrenchment, and...
- (c) ...tax-burden shifts from more-mobile tax bases, capital (esp. financial capital), to less-mobile bases, labor (esp. skilled-manual).

(2) (Slight) Elaboration: Policy Competition

- (a) ↑inter-jurisdictional competition undermines tax-policy autonomy of individual tax authorities (think, e.g., of US states' situation vis-à-vis each other competing to lure employers), inducing tax-rate convergence, esp. taxes levied on more-mobile assets.
- (b) Such inter-jurisdictional competition intensifies as capital becomes increasingly liquid & mobile across borders ⇒ virtually unmitigated race to some *bottom* (ill-defined: see below)
 - (i) Ex. Reviews: Zodrow & Mieszkowski '86, Wilson '86, Wildasin '89; Oates '01, Wilson '99.
 - (c) Striking post-'80↑int'l CapMob & steady postwar↑trade forces welfare/tax-state retrenchment & shift of tax burden from rel. mobile tax-bases (cap, esp. financial) to relatively immobile bases, (labor, manual more than very-highly skilled, maybe esp. skilled-manual).
 - (d) I.e., Globalization's Competition for Capital ⇒ “Race to the Bottom”

b) Numerous Counter-, Limiting, or Modifying Arguments:

- (1) First off, empirically, evidence for wide & strong policy convergence mixed:
 - (a) *Some find support*: e.g., Hines '99, Rodrik '97, Dehejia & Genschel '99, Genschel '01...
 - (b) *Others no support*: e.g., Quinn '97, Swank '98, '02, Swank & Steinmo '02, Garrett & Mitchell '01

First, consider some data on the extent and time path of international trade integration (summarize: impressive, steady growth postwar to present), and especially international financial/monetary/capital-market integration, i.e., capital mobility (summarize: steady since early-'80s; meteoric since mid-'90s):

Brune & Garrett (2005):

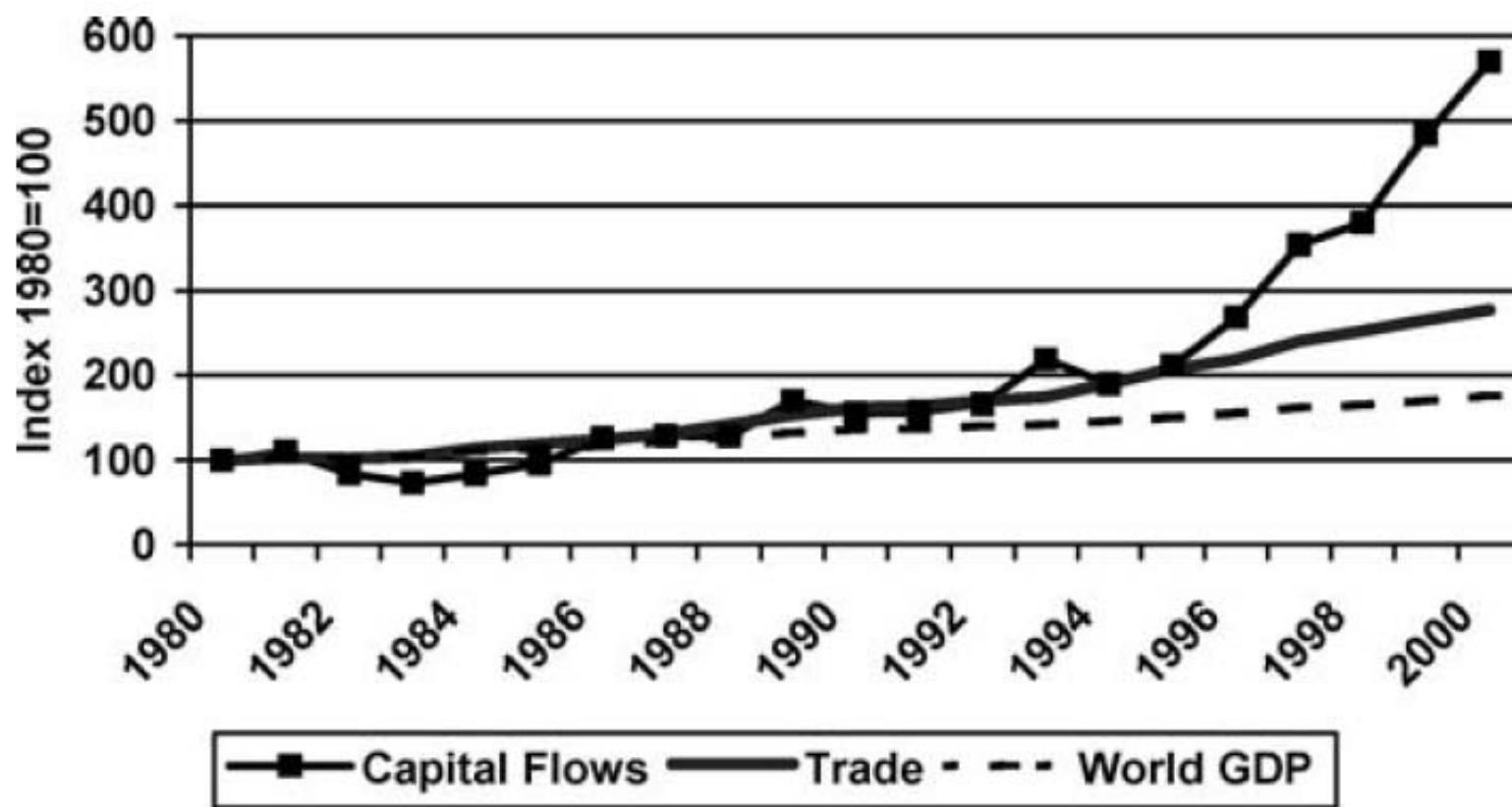


Figure 1 Global trade and private capital flows, 1980–2000. Capital flows are measured as the sum of absolute values of direct, portfolio, and other investment inflows, and outflows as a share of GDP. Trade is exports and imports as a share of GDP. Data from World Bank World Development Indicators CD-ROM 2004.

Clark's figure:

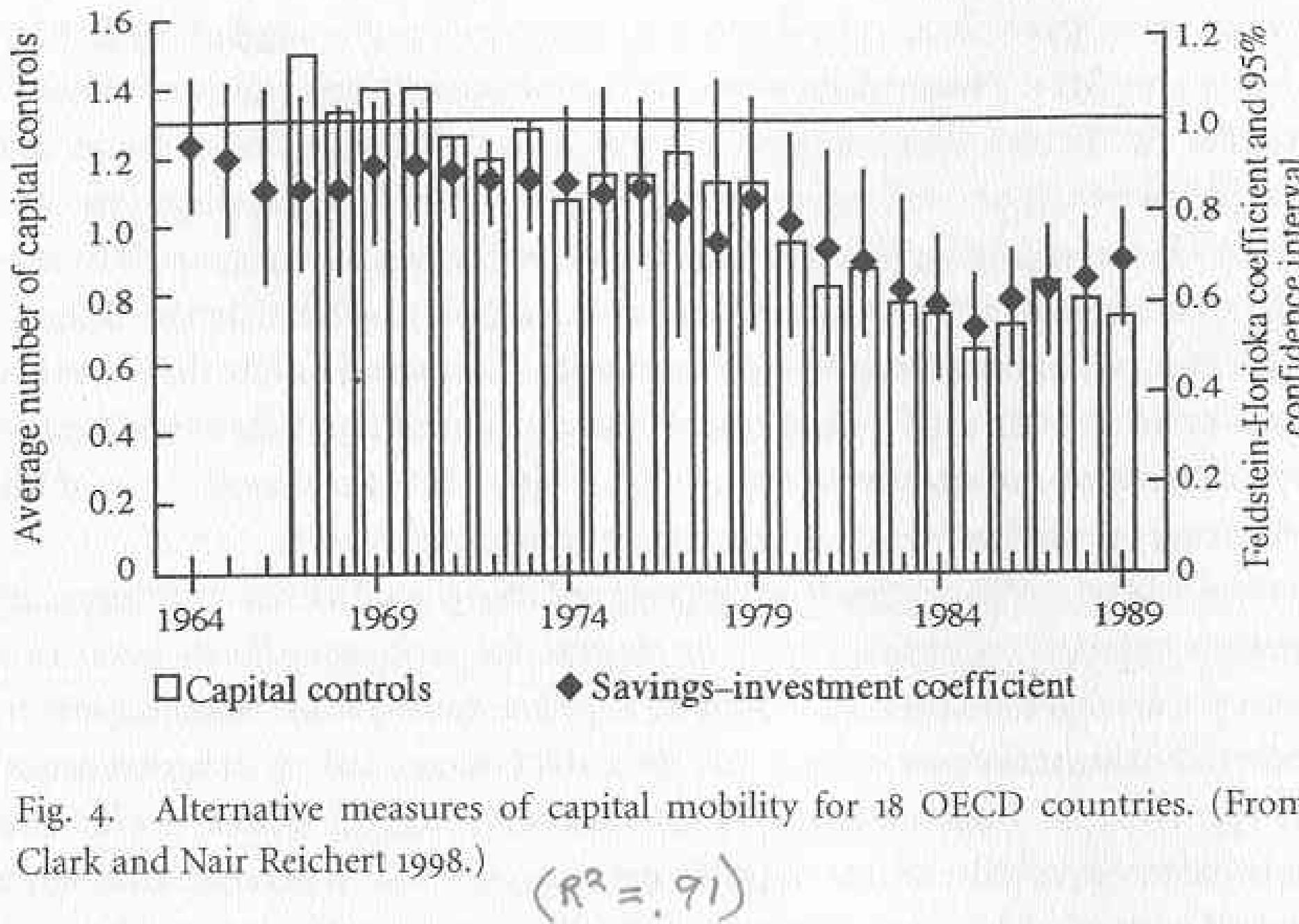


Fig. 4. Alternative measures of capital mobility for 18 OECD countries. (From Clark and Nair Reichert 1998.)

Now some of that mixed evidence on policy convergence:

Swank & Steinmo (2002):
 (1981-1995 data from developed democracies)

Quite Mixed / Seems Make Little Sense:

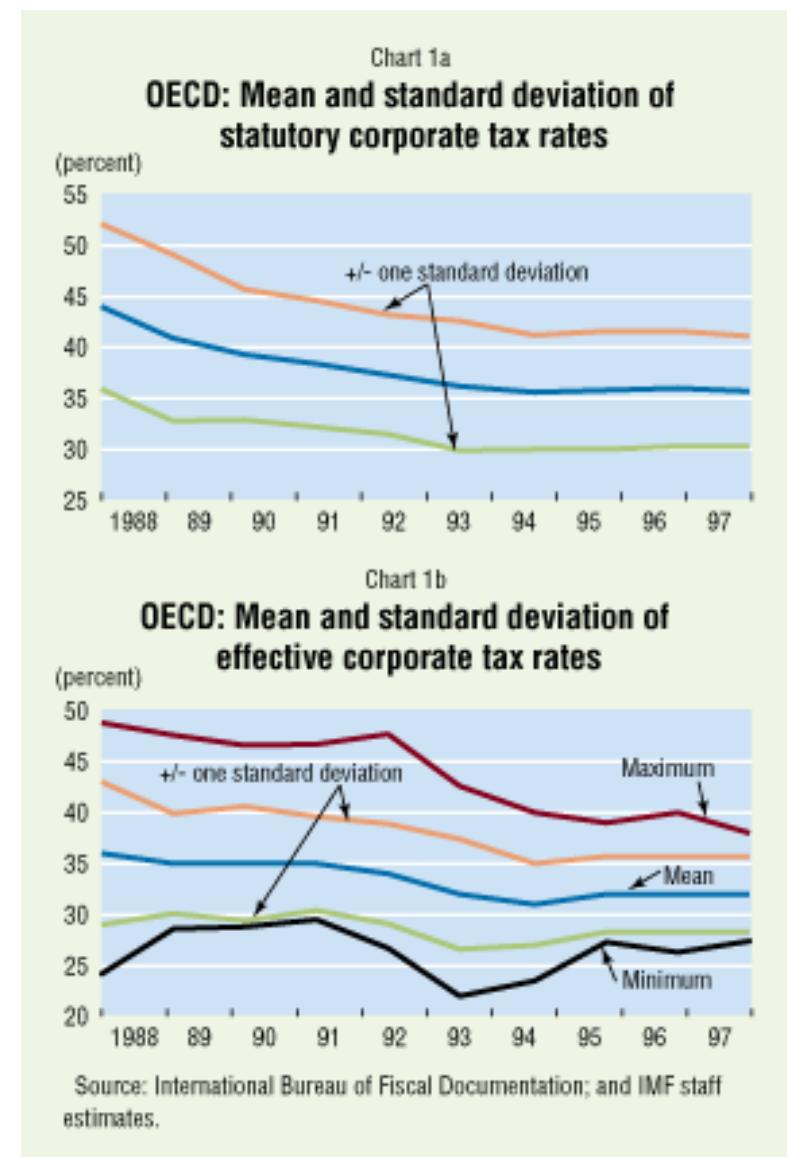
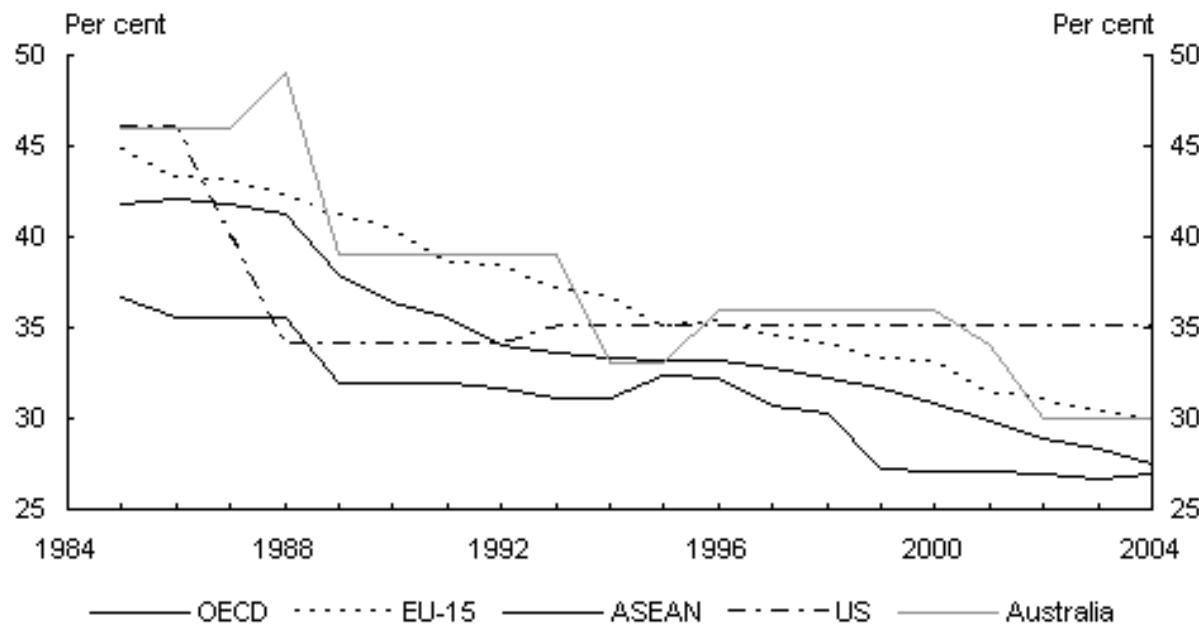
- 1) Cap (& less so trade) open has negative effect on statutory but not effective capital tax rate? Latter should matter not former.
- 2) Cap (& maybe less so trade) open has negative effect on labor but not capital tax-rate? Latter / former more / less mobile
- 3) Trade maybe even raises consumption tax-rate?

	Statutory Corporate Rate	Effective Tax Rate on Capital	Effective Tax Rate on Labor	Effective Rate on Consumption
Internationalization				
Liberalization of Capital Controls	-.0164** (.0038)	.1431 (.4900)	-.4854** (.2067)	-.1880 (.1584)
Trade	-.0002** (.0001)	-.0023 (.0083)	-.0019 (.0039)	.0038* (.0027)
Domestic Economic Change				
Structural Unemployment	-.0001 (.0011)	-.3450** (.1570)	-.2241** (.1187)	-.0283 (.0782)
Budgetary Pressures				
Public Sector Debt _t	.0001 (.0001)	.0227** (.0112)	.0068* (.0048)	-.0028 (.0031)
Needs—Elderly Population	.0010 (.0015)	-.0958 (.1495)	.0364 (.0751)	.0726* (.0556)
Tax Rate _{t-1}	.8747** (.0408)	.9316** (.0301)	.9945** (.0128)	.9802** (.0134)
General Model				
Growth _{t-1}	.0004 (.0016)	.2320* (.1685)	-.0007 (.0612)	.0230 (.0325)
Percent Change Real Profits _{t-1}	-.0008 (.0007)	.1588** (.0739)	—	—
Domestic Investment _{t-1}	.0003 (.0005)	.0793* (.0555)	—	—
Inflation _{t-1}	—	—	.0253 (.0278)	-.0097 (.0164)
Unemployment _{t-1}	—	—	.1616** (.0706)	.0254 (.0449)
Left Government _{t-1}	-.0001 (.0001)	.0134* (.0078)	.0017 (.0030)	-.0021 (.0019)
Christian Democratic Govt _{t-1}	.0003* (.0001)	-.0026 (.0096)	.0102** (.0038)	-.0010 (.0031)
constant	.0902	1.7557	.3642	-.0471
Observations	182	195	195	195
standard error of the estimate	.0282	3.3500	1.3137	.8253
mean of the dependent variable	.4268	39.8040	37.9090	17.0980
R ²	.8652	.9075	.9849	.9910

On other hand, some evidence corp tax generally declining (left) & converging (right) *over time*:

Kelly & Graziani (2004): Statutory tax rates on corporations [@ left]:

OECD (2000) statutory & effective corporate taxes [@ right]:

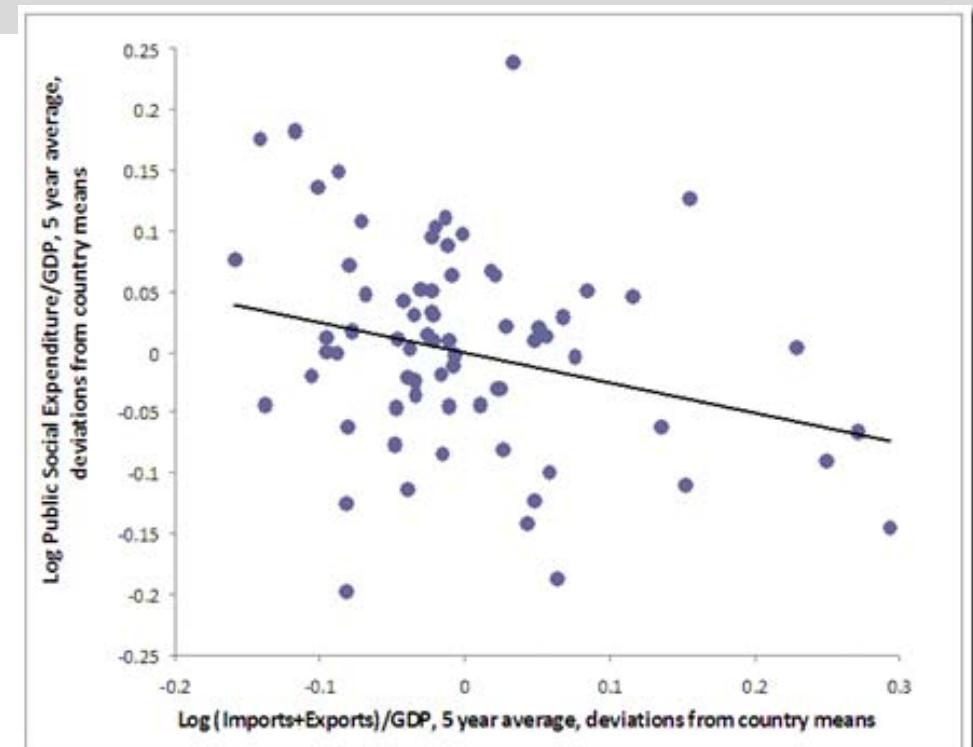
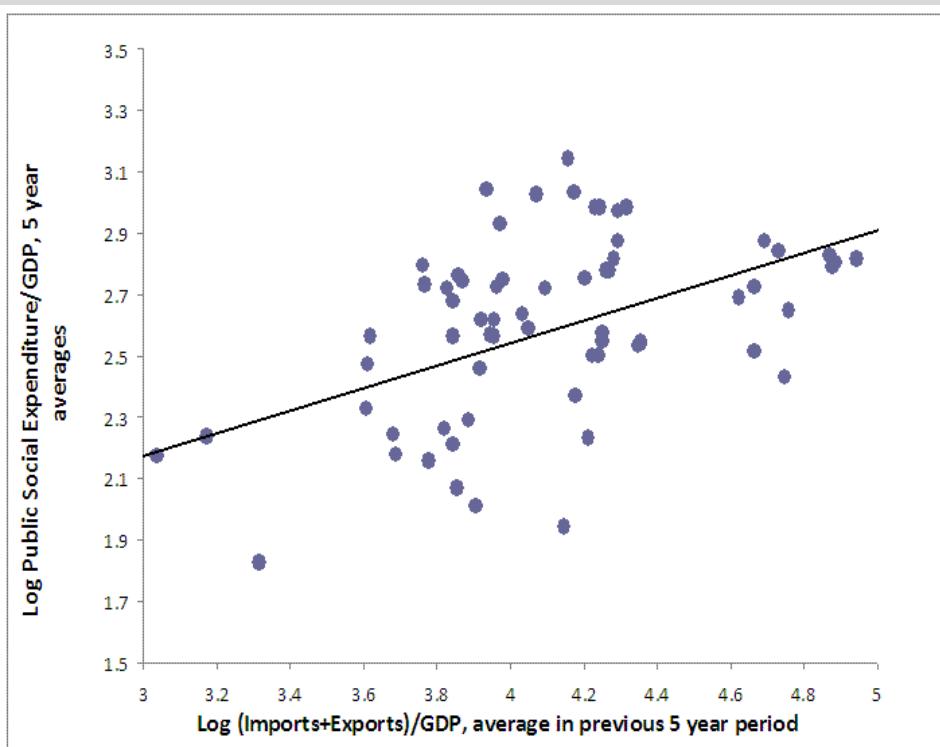


Bertola & La Prete (2008):

Compare relationship in levels 1960-90 averages [at left] – (we'll see this closer w/ Hays, Rodrik, Ruggie): used to be / had accumulated over time that higher int'l econ exposure associated w/ larger social safety-net & more-active Keynesian management: this b/c populations exposed to international risks demand public policies provide some insurance, compensation, assurance (safety nets & such)

– to changes/trends since [at right] (roughly; deviations from country mean & trend & other); here, some modestly clear signs of the Globalization \Rightarrow Welfare-State Retrenchment:

[\Rightarrow Rodrik's *globalization dilemma* is that globalization simultaneously increases 1) public demands for safety nets & the like and 2) constrains ability of gov'ts to fund them.]



One summary of the empirical literature:

(Stephan Heichel, Jessica Pape, & Thomas Sommerer, JEPP 2007—lots of *yes*'s, but more than a few *no*'s, & many *limited*'s also.)

[Point here just that evidence in lit for any simple globalization \Rightarrow convergence (to bottom) rather mixed]

Table 2 Empirical findings in convergence literature

<i>Policy fields</i>	<i>Source</i>	<i>Regions</i>	<i>Period</i>	<i>Convergence</i>
Social policy	Andersen <i>et al.</i> (2000)	13 EU countries	1970–1998	limited convergence
	Armington (1999)	18 OECD countries	1974–1978; 1990–1994	no
	Brooks (2004)	59 countries	1980–1999	limited convergence
	Dolowitz (1997)	UK, USA	1980s	yes
	Ferrara <i>et al.</i> (2001)	EU-15	1995–1999	no
	Gibson and Means (2000)	Australia, UK	1966–1998	yes
	Gornick and Meyers (2001)	14 European countries and USA	1980–1995	limited convergence
	Greve (1996)	12 EU countries	1980–1993	yes
	Montanari (2001)	18 OECD countries	1930–1990	limited convergence
	O'Connor (1988)	17 OECD countries	1960–1980	limited convergence
	Orenstein (2003)	152 countries	1981–2000	yes
	Overbye (1994)	22 European and Anglo-American countries	1970–1991	yes
	Pierson (2003)	Australia, UK	1990–1996	limited convergence
	Saint-Arnaud and Bernard (2003)	20 OECD countries	1985–1995	no
	Tavits (2003)	Estonia, Latvia	1990s	no
Fiscal policy (spending and taxing)	Bernauer and Achini (2000)	21 OECD countries and non-OECD	1970–1994	no
	Bouget (2003)	21 OECD countries	1980–1998	limited convergence
	De Bandt and Mongelli (2000)	17 OECD countries	1970–1998	limited convergence
	Gemmell and Kneller (2002)	16 OECD countries	1970–1995	limited convergence
	Kautto and Kvist (2002)	EU-15, Norway	1980–2000	limited convergence
	Olewiler (1999)	20 OECD countries	1975–1996	yes

	Sanz and Velazquez (2003)	26 OECD countries	1970–1997	yes
	Slemrod (2004)	96 countries	1975–1995	yes
	Swank (2002)	16 OECD countries	1981–1998	yes
	Tomka (2003)	11 EU countries, Norway, Switzerland	1918–1990	yes
	Wolf (2002)	EU-15	1980–1997	yes
	Wunder (1999)	14 OECD countries	1985–1997	yes
Environmental policy	Aguilar Fernández (1994)	Germany, Spain	1980s and 1990s	no
	Botcheva and Martin (2001)	21 OECD countries	1986–1994	yes
	Harrison (2002)	Canada, Sweden, USA	1982–1999	no
	Hoberg (1991)	Canada, USA	1980s	yes
	Howlett (2000)	Canada, USA	1960–2000	limited convergence
	Howlett (1994)	Canada, USA	1980–2000	no
	Kern <i>et al.</i> (2000)	OECD, CEE, Africa	1970–2000	limited convergence
	Liefferink and Jordan (2002)	10 European countries	1980s and 1990s	limited convergence
	Oberthür and Tänzler (2002)	EU-15	1992–2001	yes
	Ostergren and Hollenhorst (1999)	Russia–USA	1930–1996	yes
Trade policy	Seeliger (2001)	Canada, Germany, USA	1970–1996	limited convergence
	Tews <i>et al.</i> (2003)	48 OECD and CEE countries	1948–2000	yes
	Brune and Garrett (2000)	148 developing countries	1988–1997	limited convergence
	Martin and Schneider (2004)	90 developing countries	1978–1999	limited convergence
	Meseguer (2003)	51 developing countries	1964–1990	yes
	Nicoletti and Scarpetta (2003)	22 OECD countries	1980–2000	no
	Simmons and Elkins (2004)	182 IMF member states	1967–1996	yes

<i>Policy fields</i>	<i>Source</i>	<i>Regions</i>	<i>Period</i>	<i>Convergence</i>
Banking regulation	Busch (2002, 2003)	Germany, Switzerland, UK, USA	1974–1999	no
	Castro and McNamara (2003)	70 countries	1970–2000	yes
	Coleman (1994)	Canada, France, Germany, UK, USA	1973–1983	limited convergence
	Lütz (2004)	Germany, UK, USA	1960s–2002	limited convergence
Telecommunication, electricity and media	Bartle (2002)	France, Germany, UK	1980s and 1990s	yes
	Harcourt (2002)	France, Germany, UK, Italy, Spain	mid-1980s and 1990s	yes
	Levy (1997)	France, Germany	1990s	no
	Padgett (2003)	EU-15	1980s and 1990s	yes
Health policy	Gibson and Means (2000)	Australia, UK	1950s–1990s	yes
	Greener (2002)	UK–USA	1980–1990	yes
	Harrison <i>et al.</i> (2002)	UK–USA	1990s	yes
	O'Neill (2000)	UK–USA	1980s	yes
Monetary policy (EMU)	Angeloni and Dedola (1999)	6 EU countries	1980–1997	yes
	Brada and Kutan (2002)	5 EU, 9 EU candidate countries	1993–2000	limited convergence
	Bredin and Fountas (1998)	7 EU countries	1979–1992	no

Migration policy	Holzer and Schneider (2002) Lavenex (2002) Meyers (2002)	19 OECD countries 10 CEE countries 9 OECD countries	1983–1995 1990s–2002 1870–2000	limited convergence limited convergence yes
Organizational practices and infrastructure	Bissessar (2002)	4 states of the Caribbean Commonwealth	1980s and 1990s	limited convergence
	Guler <i>et al.</i> (2002)	85 countries	1993–1998	no
	Kerwer and Teutsch (2001)	France, Germany, Italy	1980s and 1990s	no
Competition policy	Eyre and Lodge (2000) Waarden and Drahos (2002)	UK, Germany Austria, Germany, Netherlands	1990s 1950–2000	no yes
Justice and data protection policy	Bennett (1988)	Germany, Sweden, UK, USA	1968–1984	limited convergence
	Jones and Newburn (2002)	UK, USA	1990s	yes
Agricultural policy	Coleman and Grant (1998)	Australia, Canada, Ireland, UK, USA	1970–1995	limited convergence
	Coleman (2001)	Australia, Canada, USA	1983–2000	yes
Education policy	Bleiklie (2001)	England, Norway, Sweden	1980s and 1990s	limited convergence
	Hackl (2001)	EU-15	1970–2001	yes
Foreign policy	Hill (1997)	EU-15	1969–1997	limited convergence

(2) General Gist of Most Counters to simple Glob \Rightarrow Converge story: *Maneuvering Room b/c*

(a) Other national differences (e.g., commercial, regulatory, & other policy; lab-mrkt instits; availability key resources or other advantages (e.g., Chinese, Indian labor supply; Middle Eastern oil, etc.); proximity large consumer base (U.S., EU); etc.) also affect invest-locate.

(b) Plus, other factors than capital mobility affect governments' tax policies.

(c) Some specific "maneuvering room" arguments in political economy:

(3) 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.

(4) Boix: Left-PubInv & Right-MinIntervention econ'ly close & suff'lly pol. effective

Pub human- & physical-cap investment=alternative to neolib minimalism that sufficiently efficient macroec'ly to attract/retain capital & politically to support left electorally.

(5) Swank: Domestic political & institutional constraints

Institutional structure of the polity & of welfare system itself shape domestic policy-responses to integration. Argument not fundamentally challenge exclusive or superior macroecon efficiency of neoliberal minimalism; Rather, stresses primacy domestic political conditions in determine nature & mag of welf/tax-policy reactions to int'l econ integ.

(6) "Varieties of Capitalism (VoC)" Theories: Institutions & Public Policies \Rightarrow comparative advantage \Rightarrow divergence (not convergence).

(a) Hall&Soskice '01: complex national networks of PE inst's confer comparative advan'ts

(b) Mosher&Franzese '02: VoC \Rightarrow Comparative Advantage

(i) Fixed-cap mob. & trade integ. spurs specialization (of PubPol & PE-inst'l struct. also);

(ii) Only liquid-cap mobility spurs int'l tax-competition, & it has other implications than commonly thought \Rightarrow Strategic Interdep. & Race to a "Bottom" that is variable & not necessarily ≥ 0 .

Aside: Comparative Advantage and International Trade

I. Simple (Ricardian) *Comparative Advantage*:

A. Ricardo's Examples (slightly amended): [hrs to produce in tables; 100 hrs total endow]

1. Absolute Advantage:

	Wine	Cloth
Portugal	10	25
England	15	20

a) Specialization & Export/Import:

(1) Not surprising here that, since Portugal better at producing wine and England at producing cloth, trade will induce England to specialize in cloth & export surplus to Portugal to buy (import) wine, & Portugal the reverse

b) Gains from Trade: little surprise either that both better off than without trade.

(1) For instance, w/o trade Eng could produce & consume 4 units wine & 2 cloth; With trade, it could produce 5 cloth, consume 2, & sell 3 surplus cloth in Portugal (export) where could buy (import) 7.5 wine w/ those 3 cloth.

(2) Port w/o trade could, e.g., produce & consume 2 cloth & 5 wine; With trade, it could produce 10 wine, consume 5 and export 5 surplus to Eng where could by 3.75 cloth.

(3) Notice that gains come from being able to separate the production & consumption bundles, producing at one relative-price ratio, p , (the domestic p) and consuming at another (the foreign or, more gen'lly, global p).

2. Comparative Advantage: Now Portugal has absolute advantage in both goods

	Wine	Wheat
Portugal	10	15
England	15	20

a) **Principle of Comparative Advantage:** specialize in, produce more, & export by relative efficiency; and all parties gain.

(1) Portugal: cost of wine in terms of wheat is .66 units; England: wine costs .75 units wheat. Wine is more efficiently produced relative to wheat in Portugal (wine-relative-to-wheat in Port compared to wine-rel-wheat in Eng). Portugal has a comparative advantage in wine production.

(2) Flip Side: England: cost of wheat in terms of wine is 1.33 units; Portugal cost of wheat in terms of wine is 1.5 units. England is relatively more efficient in wheat production; i.e., Eng has comp advantage in wheat.

(3) Portugal specializes in wine production, producing 10 units, and exports its surplus. England specializes in wheat production, producing 5 units, and exporting its surplus.

b) Gains from Trade: even though Port abs. advant. in both goods, both countries gain from trade.

(1) For instance, w/o trade Eng could produce & consume 4 units wine & 2 wheat; With trade, it could produce 5 wheat, consume 2, & export 3 surplus wheat to Portugal where could buy 4.5 units wine.

(2) Portugal w/o trade could, e.g., produce & consume 4 wine & 4 wheat; With trade, it could produce 10 wine, consume 4 and export 6 surplus to Eng where could buy 4.5 wheat.

(3) Notice that gains seem perhaps weaker here; this because gains from trade increasing in the diversity of the economies that trade & these hypothetical Eng & Port wine & wheat more similar than previous example.

B. Standard Baseline 2x2x1 Model:

1. 2 countries (**A** & **B**)
2. 2 goods (**X** & **Y**)
3. 1 factor of production (Labor, **L**)

C. Ctry **A** absolute advantage over **B** in production **X** if can produce **X** more efficiently (w/ less **L**).

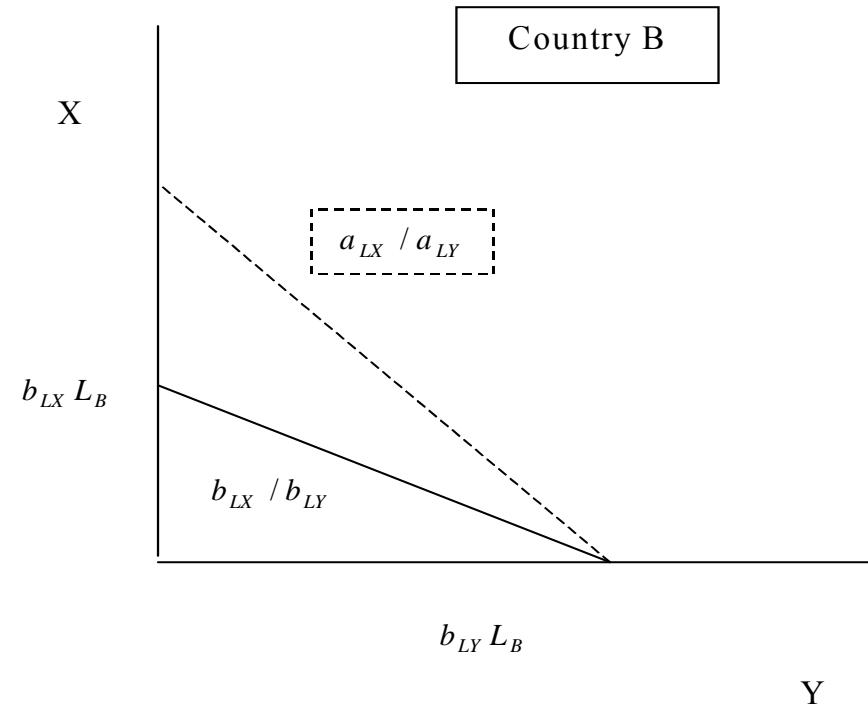
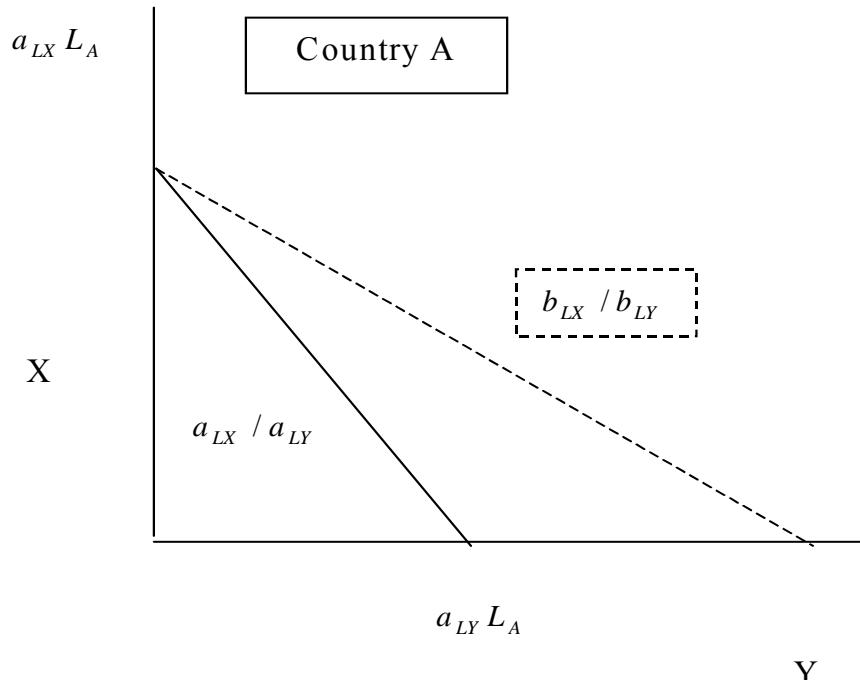
1. Production function: equation that maps input, **L**, into output, **X** or **Y**.
2. Examples: $X = a_X L$ and $X = b_X L$
3. **A** has absolute advantage in production of **X**, if $a_{LX} > b_{LX}$
4. Gains from Absolute Advantage in Trade: If $a_{LX} > b_{LX}$ & $a_{LY} < b_{LY}$, i.e., if **A** has absolute advantage in **X** and **B** has absolute advantage in **Y**, then rather intuitive that each would benefit from specializing in production of good it produces more efficiently and trading for the other.

D. **A** comparative advantage in production **X**, relative to **B**, if **A**'s opportunity cost of producing **X** in terms of good **Y** is less than **B**'s, or in terms of production functions, if $(a_{LX} / a_{LY}) > (b_{LX} / b_{LY})$.

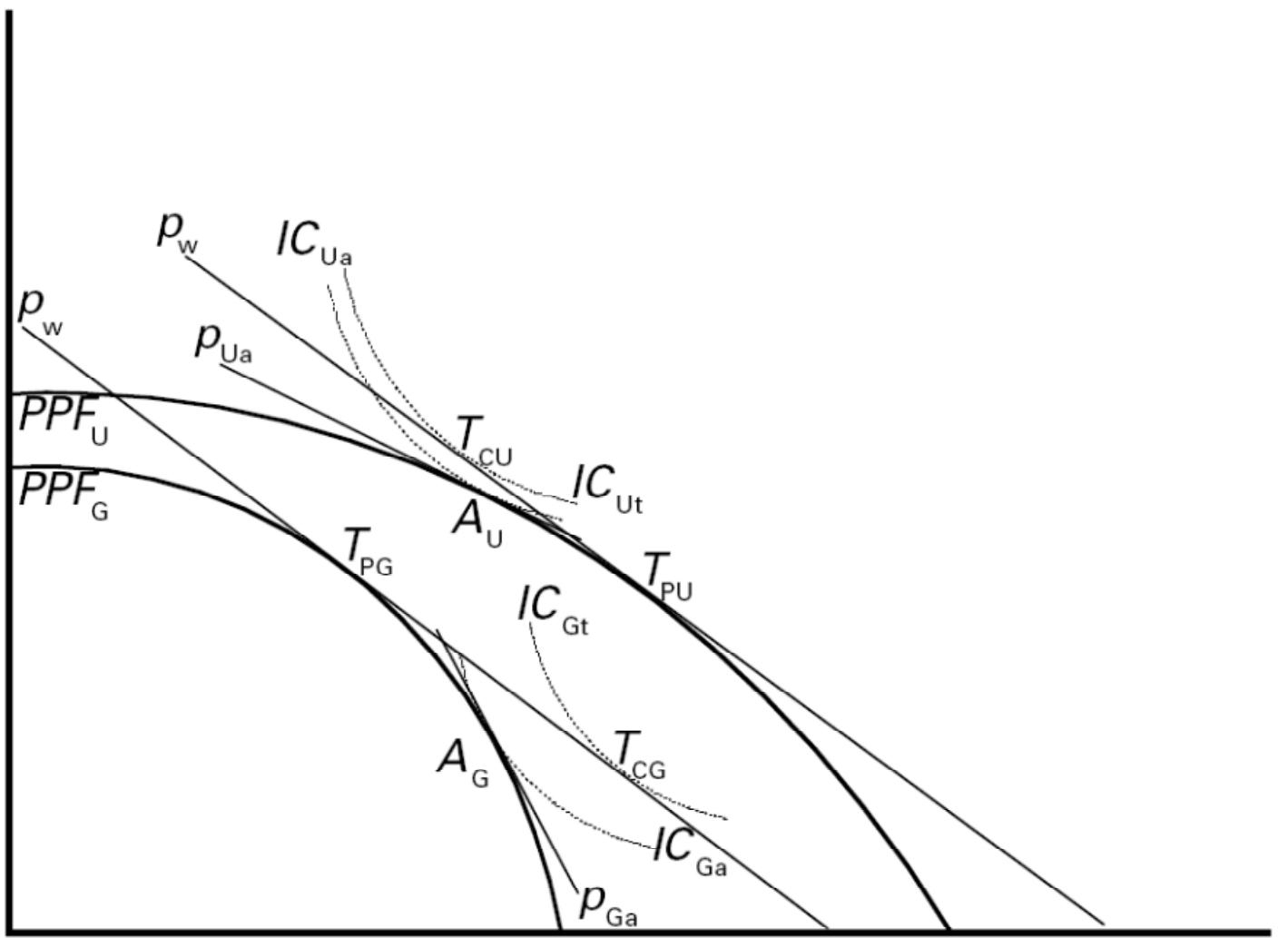
1. Each ctry specializes in & exports its comp.adv., not it's abs.adv.'s &, doing so, both ctrys better off, regardless of abs.adv.
2. B/c comparative advantage is relative, every ctry has comp.adv. in something: here, **A** comp.adv. in **X** \leftrightarrow **B** comp.adv. in **Y**
 - a) In fact, gains from trade come from ability to produce at domestic price-ratios and translate that production into consumption at foreign/global price-ratios.
 - b) And gains from trade (to both parties) thereby increase in diversity of economies trading.

E. **Production Possibility Frontiers (PPF's)**: maximum **X** ctry can produce for each level of **Y** produced & v.v. I.e., the limits of output capacity given tech (coefficients) and resources (**L**).

1. Production functions & $L = L_x + L_y \Rightarrow X = a_{LX} L_A - (a_{LX} / a_{LY}) Y$ and $X = b_{LX} L_B - (b_{LX} / b_{LY}) Y$
2. Graphically (dark lines are PPF's):
3. **Country A has comparative advantage in X \Rightarrow steeper PPF than B** (note: PPF goes higher on X).
4. **A** specializes in **X**, trades **X** for **Y**, (at p somewhere b/w 2 autarky p (i.e., b/w a_{LX} / a_{LY} & b_{LX} / b_{LY} , i.e., b/w the slopes of the 2 PPFs)).
5. Dotted line: **A's consumption possibility frontier w/ trade**, now seen higher than if have consume & produce same
6. A pol-econ example germane to globalization & **divergence** from Franzese & Mosher (2002) next slide.



Output/consumption of machine tools



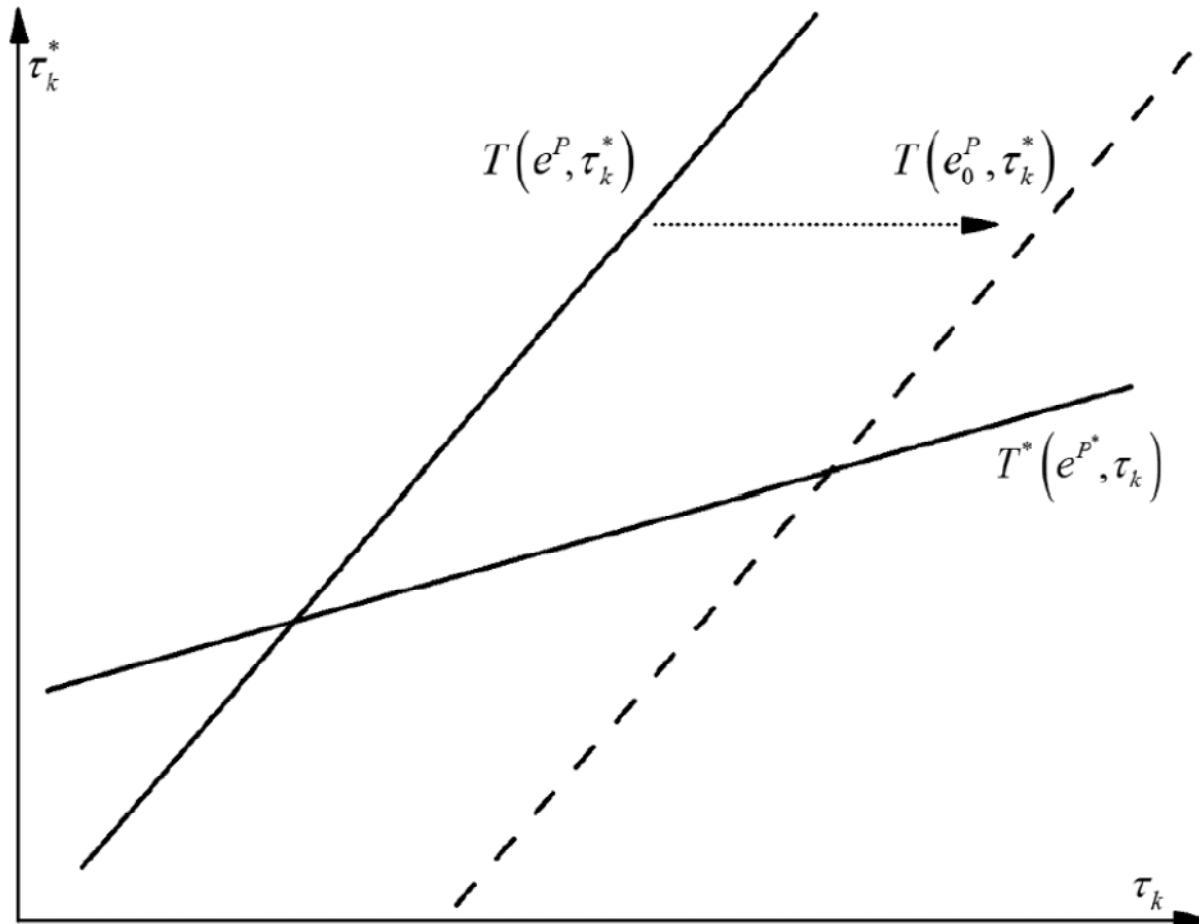
Output/consumption of banking services

7. PPF_G & PPF_U are hypothetical PPFs for Germany & US under their respective pol-econ institutions.
8. A_G and A_U are their respective productions & consumptions under autarky [no trade].
9. T_{PG} & T_{PU} are their productions under trade; T_{CG} & T_{CU} are their consumptions. Trade allows these differ.
10. IC's are (aggregate) consumers' *indifference curves*. Subscripts *a* and *t* refer to *under autarky* and *under free-trade*.
11. The p lines are relative prices: Ga, Ua, W subscripts indicating German or US autarkic, & World trade.

Returning to other arguments countering, limiting, or modifying strong Globalization-&-Convergence args:

7. Hays: Domestic political-economic structure (in partic.: cap-lab endowment & majority/consensus democracy) condition response to increased capital mobility.
8. Basinger & Hallerberg, Franzese & Hays, Hays:
 - a) *Strategic Interdependence*: insofar as any these considerations (arg's 2-7 above) constrain 1 state in its response to increased competition for capital, this eases capital-competition for others.
 - b) In sum: Extent & effect of capital-tax competition depends on what competitors doing
 - c) [See & discuss figure next slide].
9. Rodrik & others: also could expect ↑globalization to ↑demand public protection from vicissitudes global economy; so demand ↑ while ability to supply ↓
 - a) [Will see 7-9 up close in Hays' book @ end semester.]

Capital Tax Policy's Reaction Functions



Each country's optimal capital tax-rate, T (or T^*), depends on its competitor(s)'s tax-rate(s), τ^* (or τ), and other stuff, like domestic political-economic conditions, e^P .

As competitor(s)'s rate increases/decreases, slack to raise own increases/decreases, so these “reaction-functions” slope upward. [most likely upward; could also slope downward, but less plausible]

If something in one country's political-economic conditions, e^P , push it to increase its tax-rate, T , competitors tax-rates, τ^* , will rise as well (given that additional slack, all else equal)

Summary of Keys from Globalization & Policy Convergence:

- Most important aspect of economic globalization is massive increase in capital mobility across borders, which produces:
 - [Standard Argument:] More intense competition among policymaking jurisdictions (U.S. states, countries, etc.) for that footloose capital (investment). I.e., sharpens capital's threat v. domestic gov'ts to flee "excessive & inefficient" taxation & public policies ⇒ **Policy Competition**:
 - Forcing welfare/tax-state retrenchment, and
 - Tax-burden shifts from more-mobile tax bases, e.g., capital (esp. financial capital), to less-mobile bases, labor (esp. skilled-manual).
- Idea of **Race to the Bottom**, heard so often in discussions of globalization concerns, is where competitors keep undercutting each other until they hit some floor or *bottom*.
 - Like US states bidding against each other to lure a potential employer with lower & lower taxes, & then in that case often crossing 0 taxes & continuing into subsidies.
 - The *races to bottoms* could also be on other aspects than taxes: smallest social safety net, or lowest environmental protections, or weakest labor or safety standards, etc.
 - Case of US states competing to lure major employer with tax incentives illustrates how *bottom* rather ill-defined in these races. "How low can you go" can be quite negative or not very low at all. If some absolute-0, or lowest bottom to which one tax could be cut, e.g., exists, it'd be set by amount could raise from other taxes & borrowing.
 - Also vague re: notion of *bottom* here: different competitors will have different net advantages that will give them more or less leeway than other competitors not to race as far or as hard (if net advantaged in other regards, like China or India in enormous local supplies labor, or oil- or other resource-rich countries, or advantages of enormous final-markets (consumers) like U.S. or EU) or to have to race harder or farther (maybe like Michigan competing with British Columbia for Hollywood films?). The *bottom* is variable as well as ill-defined.
 - Then, finally, competitive pressure in these races for each policy on each jurisdiction is actually given by what the competitors are doing. So, slack in some countries from their advantages eases the pressure on their competitors: each country's best policies depend on what the others are doing. **This is globalization & interdependence.**

10. Clark's Counter: Never was much/any partisan diverge [on macro-econ policy anyway] to converge. Clark's arguments:

- a) No evidence rising partisan converge [*macro-policy*] b/c partisan convergence = “hallmark of [macro] economic policymaking in democratic capitalist societies &, 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.
- c) Instead, ...enduring features of the process of economic policy choice in polities dominated by private investment and electoral politics” (p. 2).
- d) N.b., *Privileged Position of Capital + Downsian Electoral Competition* \Rightarrow partisan convergence on the preferred policies of capital. [Elaboration to follow.]

11. Clark will explore these convergence args in broader context:

- a) Nordhaus-Tufte *Electoralist* v. Hibbs-Alesina *Partisan* [macro] Cycles
- b) Recognizing *Context Dependence* esp. dependence of cycles on *Capital Mobility (& Exchange-Rate Regime)* & *Central Bank Independence*

C. Downsian Electoral Competition: Partisan Convergence & Divergence

1. Black's Median-Voter Theorem (MVT) & Hotelling-Downs' Partisan Convergence [ELABORATED AT BLACKBOARD]

a) MVT:

- (1) 1-dimensional competition,
- (2) binary vote-choice,
- (3) sincere simple-proximity voting,
- (4) “single-peaked” preferences
- (5) \Rightarrow Median-Voter Rules

b) Hotelling-Downs: MVT \Rightarrow strong convergence from electoral competition

c) Slight Elaboration:

(1) One Dimension:

- (a) Black (58) Median Voter Theorem (MVT): If voters single-peaked pref's defined on single dim (e.g., left-right), then median-voter's ideal point is only pt majority-preferred to all others
- (b) Hotelling(28)-Downs(57) Party Competition Centripetal Tendency: Applied to **2-party** elects, MVT \Rightarrow strong incentives converge toward MV

(2) Multiple Dimension Extensions:

(a) McKelvey's & Schofield's "*Chaos Theorems*":

(i) w/ $>1D$, if choices not structured in restrictive ways: virtually certain that policy proposals will cycle around policy space, w/ no proposal majority-defeating all others

(ii) \Rightarrow either perpetual flux or arbitrary (Arrow's Impossibility Theorem).

(b) Strongly suggests inst'l restrictions on proposal- & decision-making process essential to non-arbitrary democratic decision-making:

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

(ii) Shepsle's *Structurally Induced Equilibrium* [elaborate...]

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

a) Already mentioned ***multiple dimensions***; no clear prediction arises there.

b) ***Electoral uncertainty*** (esp. re: median-voter's 'location') / ***abstention / Extra-Electoral Influences*** (Lobby or Interest Grp):

(1) *Uncertainty*: allows policy-interested parties to drift from expected medians at finite (rather than infinite) expected-vote cost, yielding divergence

(a) Issue is uncertainty about effective 'location' median voter's ideal point.

(b) Could be uncertain who is median, where is median's pref, or median re: where parties.

(2) More polarization as uncertainty \uparrow (Wittman 77,83; Calvert 85; Roemer 92).

(3) *Abstention*: several models; *alienation* is one, e.g., that produces divergence.

(4) *Extra-Electoral Influences*:

(a) if resources other than votes can sway elect, by *buying*, *informing*, or *persuading* voters

(b) & if these come not from median (which logical), this can also produce divergence.

c) **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 median preferences if their own preferences differ, so voters only believe victors will enact victors' own preferences \Rightarrow full divergence.

(2) In repeated elections, parties can build reputations \Rightarrow some ability promise something other than party's ideal point (as known by vote) \Rightarrow some (not full) converge.

(3) \Rightarrow Any degree of divergence is sustainable.

d) **Entry/Multiple Parties**:

(1) Free entry \Rightarrow no equilibria; entry free, so *any number of parties enter anywhere*

(2) Suggests systems w/ low-cost entry [?] could sustain mult prtys w/ any degree diverge.

(3) w/ some entry-cost, multiple *citizen-candidate equilibria* (Besley-Coate 97):

(a) One, that only the median enters, \Rightarrow Hotelling-Downs-Black, but

(b) Others \Rightarrow 2 candidates equidistant from median enter, w/ the degree of divergence sustainable widening as entry costs grow.

(4) Even w/ just 2 parties, potential of entry \Rightarrow **entry-deterrance** reason to diverge.

3. Degree of Divergence, therefore, is an empirical matter

- a) Tufte, Hibbs, Alesina, Me, & Huge Theoretical & Empirical Lit: (1) Clear, Obvious, Manifest, & Important Partisan Differences in (2) Preferences, Policies, & Outcomes, w/ degree of (1) generally ↓ in (2), i.e., as go pref's→pol's→out's.
- b) Clark: Not so much, esp. in **macro**economic policy & outcomes.

D. Clark: Explore Implications of Ctrl Bnk Indep & CapMob for Domestic [macro-]Econ Policy:

1. Starting Points:

- a) Need appropriate pol-econ model: contested. *Electoralist* or *Partisan*?
- b) Use ways CBI & CapMob, +exchange-rate regime, interact to shape policy control/efficacy to evaluate alternative *electoralist* & *partisan* **[macro]** models

2. Alternative Models:

- a) *Partisan [Macro] Model*=Hibbsian Model=“political parties w/ diff ideology orientations enact systematically diff pols & produce sys'ly diff macroecon outs”.
- b) *Electoralist [Macro] Model* (≈Downsian) = Nordhaus Model (≈Tufte): “electoral constraints force [all] politicians...to behave much same way...policies & outcomes to please median voter (Downs);...w/ some assumptions about way voters form expectations...yields predictions that tie...[policy]...to electoral calendar...growth & employ in period leading to elections, even if ...leads to future infl. (Nordhaus)”.

3. *Partisan & Electoralist [Macro] Models' Shared Assumption*: pol-mkrs control policies that can affect/control inflation, employment, output (macroec).

4. *CBI & CapMob challenge, or @ least modify, that Central Claim/Assumpt \Rightarrow*

a) Theory: nuanced propositions when, where, & what sort of macro cycles.

b) (*Clark's*) Empirical Conclusions:

(1) Little evidence of partisan macro policy or outcome cycles under any conditions.

(2) Electoral macro cycles not ubiquitous either, but growth & UE (& deficit & M^s) cycles when CBI & CapMob conditions leave policymaker some control over these & leave them effective.

(3) **International Capital Mobility & Globalization [Clark's emphases]:**

(a) **Little macro partisan convergence from globalization b/c little divergence even before global trade & capital-market integration.**

(b) **Altered circumstances under which macroeconomic electioneering occurs.**

(c) **Altered what macroeconomic policies used for this electioneering.**

c) Normative Considerations:

(1) CapMob & CBI generally discourage (macro) *electioneering* [& “*partisaneering*”], so universally and unambiguously *good*? Well...

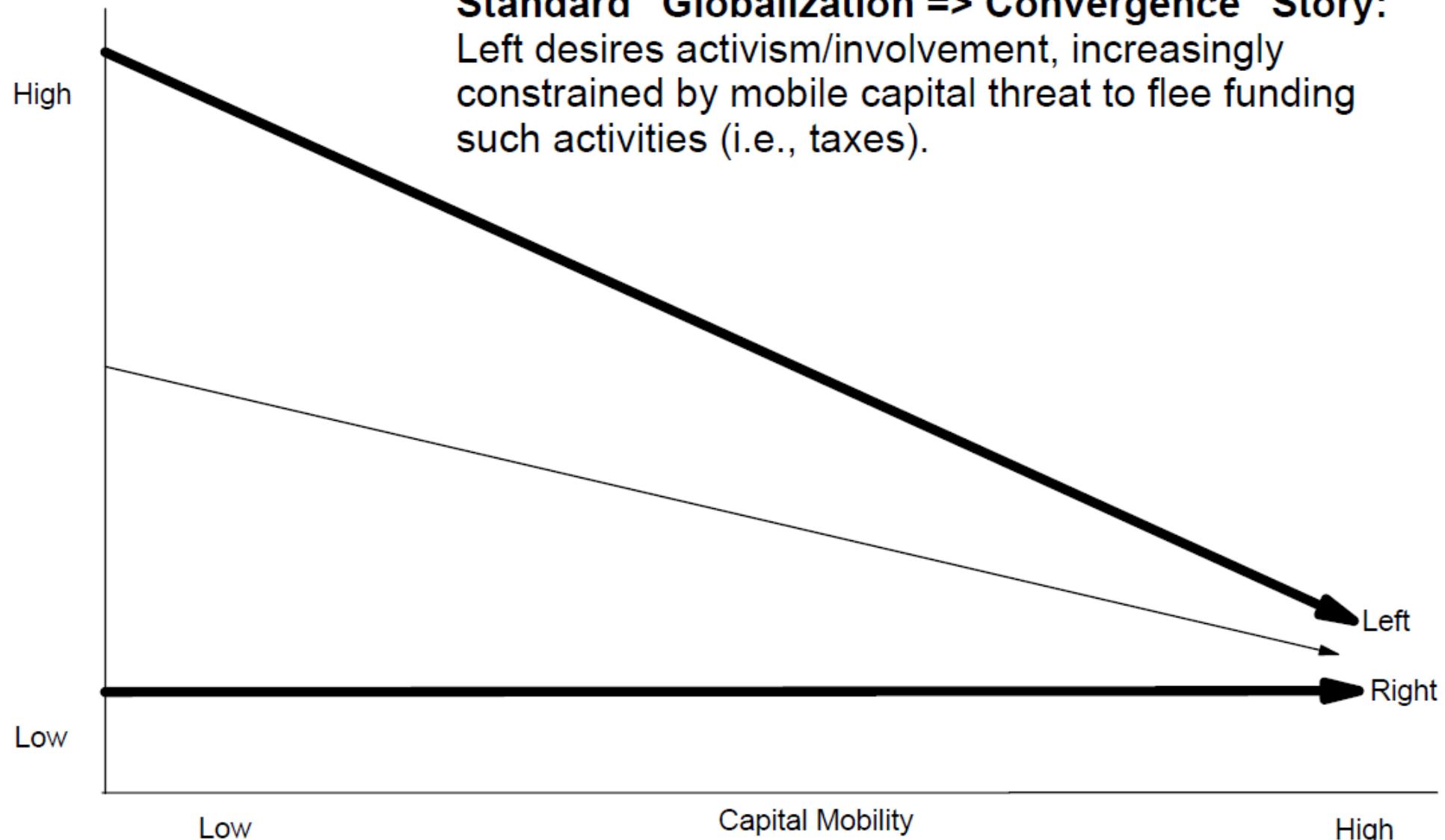
(2) Also induced rightward shift in mean policy & outcomes;

(3) If dem institutions working, then policy use desired, so not clear good to debar it.

(4) [**tradeoff**: rightward mean-shift of policy & foregone democratically responsive policymaking against less cynical (electoral or partisan) manipulation.]

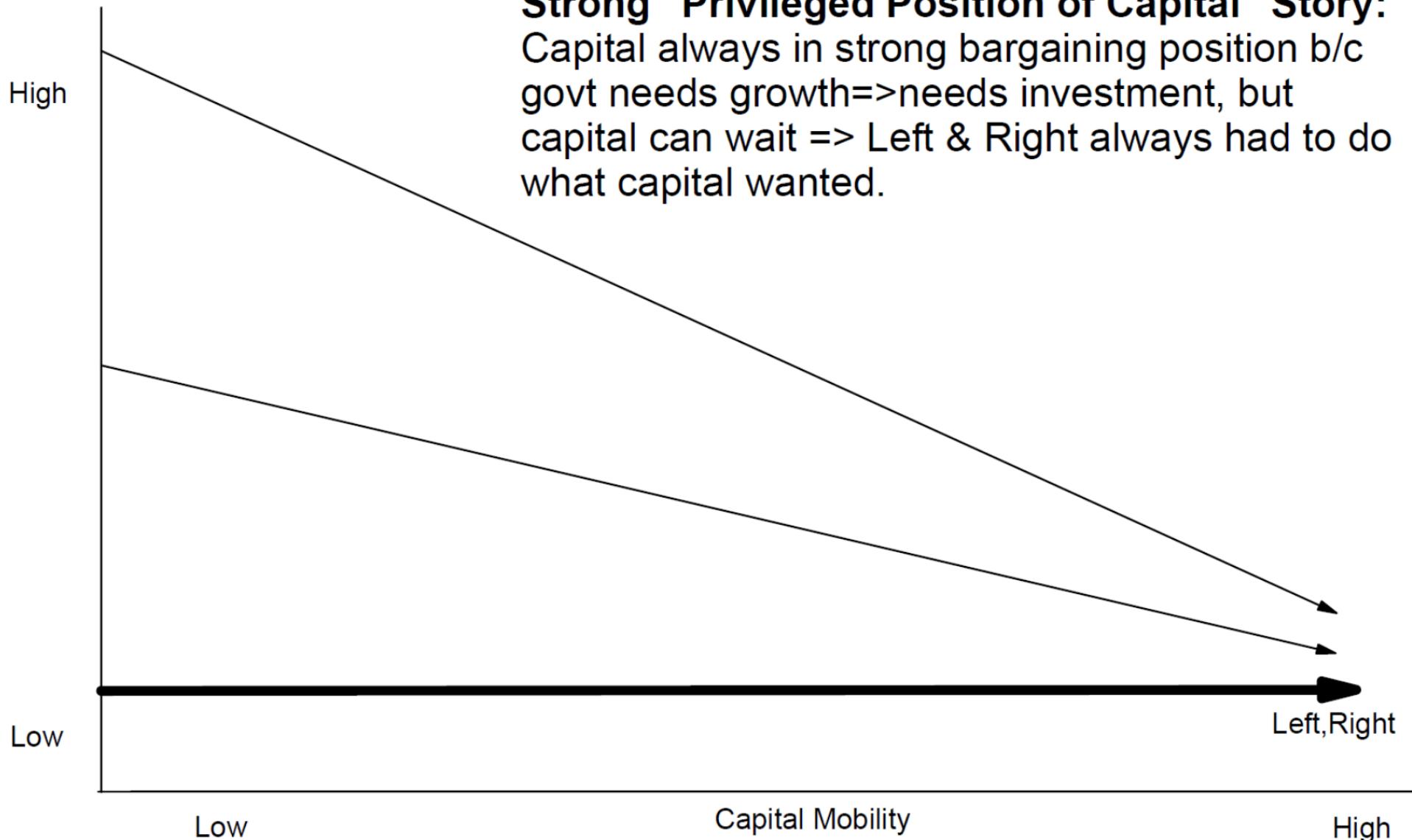
E. Pictures of Alternative Theories of (Partisan Policy-)Convergence

Degree of Policy Activism /
Govt Involvement in Economy



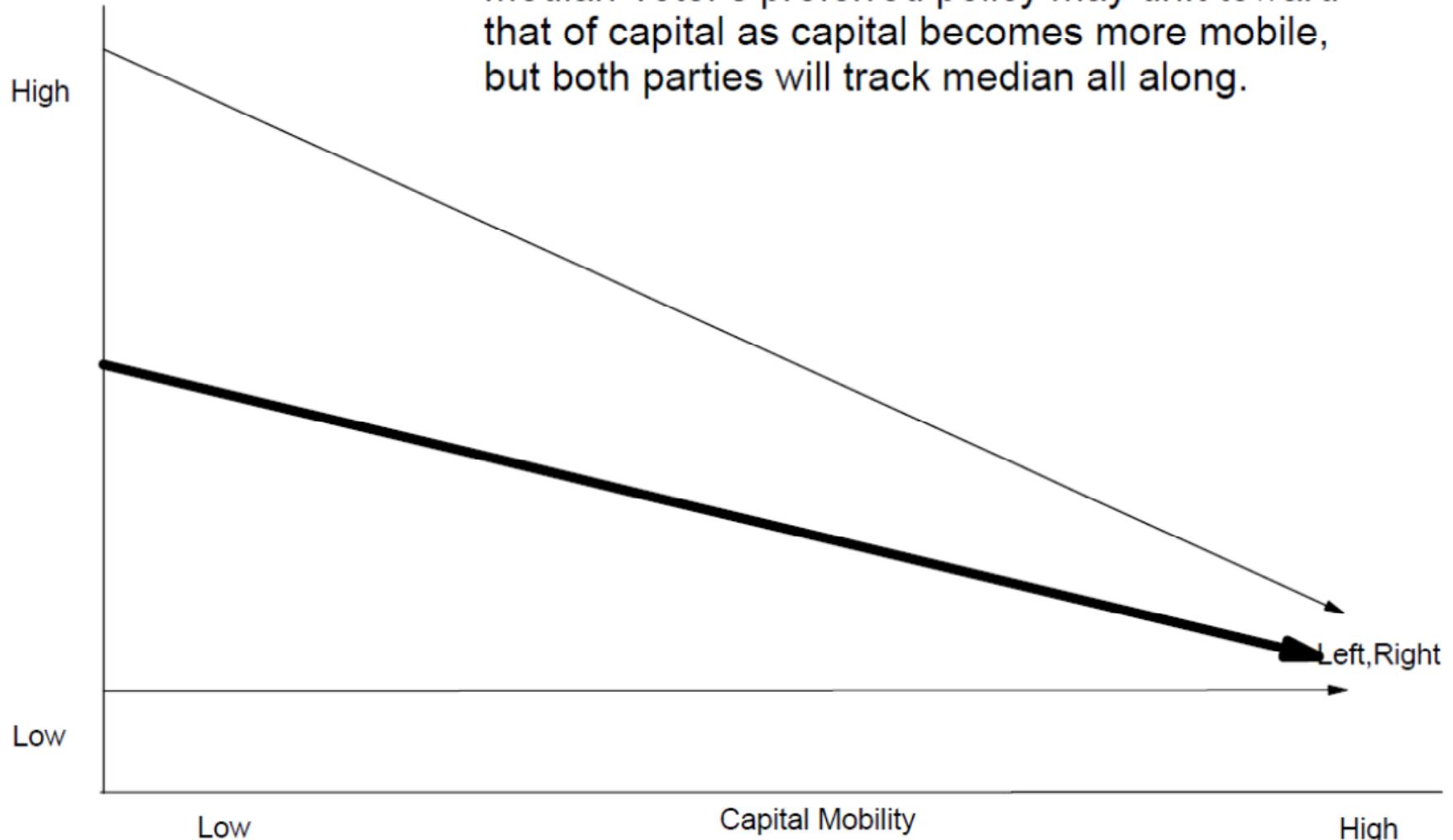
(Top line is left party/constituency preference; bottom is right party/constituency pref.
Middle line is median-voter's pref. **Bold** & labeled is policy under that partisan govt.)

Degree of Policy Activism /
Govt Involvement in Economy



(Top line is left party/constituency preference; bottom is right party/constituency pref.
Middle line is median-voter's pref. **Bold** & labeled is policy under that partisan govt.)

Degree of Policy Activism /
Govt Involvement in Economy



Downsian Convergence Story: Electoral competition (b/w 2 parties, on 1 dimension, w/ no uncertainty & full credibility) => convergence on median-voter's preferred policy.

Median-voter's preferred policy may drift toward that of capital as capital becomes more mobile, but both parties will track median all along.

(Top line is left party/constituency preference; bottom is right party/constituency pref.
Middle line is median-voter's pref. **Bold** & labeled is policy under that partisan govt.)

F. Workhorse Macro Political-Economic Models:

1. Adaptive *v.* Rational Expectations; Electoralist *v.* Partisan Motivations; Endogenous Elections; Context-Conditional Models [Table 1]

a) Point of this section for us = mostly that can still expect electoral & partisan cycles, perhaps in outcomes & certainly in policies, under rational expectations.

2. Adaptive-Expectations Electoral Cycles [Tufte]

- a) *Pol-mkrs*: care only about reelect; control pols that affect macro to aid reelect.
- b) *Voters*: [naively] retrospective [nec.] & pocket-book [not nec.].
- c) *Predictions*: real macro elect cycles (good pre-, poor post-); less precise re: infl.
- d) *Theory & Evidence*: Challenged.

3. Rational-Expectations Electoral Cycles [Rogoff, Sibert]

- a) *Econ*: Electoral manip not surprise [\Rightarrow , in new-K/-class, 0 real macro effect];
- b) *Voters* not [naively] retrospectively ignore future effects of current policies;
- c) [also, since pro- not retro-spective, not reward past but for expected future]
- d) *Predicts*: lesser real effects; [smaller, less regular macro elect cycles].
- e) Stronger *evidence* policy than outcome cycles [tons reasons for this].

4. Adaptive-Expectations Partisan Cycles [Hibbs]

- a) *Pol-mkrs*: partisan-differentiated weights on nominal vs. real economy;
- b) *Voters*: [naively] recognize these partisan diff's & their relevance to themselves;
- c) *Predictions*: real & nominal macro partisan cycles.
- d) *Theory & Evidence*: Challenged.

5. Rational-Expectations Partisan Cycles [Alesina]

- a) As above, except that only unpredicted policy-change affects real economy;
- b) *The Electoral Surprise* [EXPLAIN] \Rightarrow
- c) *permanent* partisan inflation [& policy] diff's, *temporary* partisan real-econ diff's.

6. Endogenous Election-Timing & Political Surfing

- a) *Adaptive*: straightforward political surfing [or w/ complications];
- b) *Rational*: more difficult to surf to beneficial effect b/c voters can infer signal that incumbent expects worse (or at least less-good) is to come
- c) Some evidence of simple surfing (in India, Japan, maybe UK);
- d) Clark, like most, will essentially ignore endogenous election-timing [which is to assume either no surfing or exogenous surfing or, if endog., *orthogonal surfing*].

7. Context-Conditional Electoral [& Partisan] Cycles:

- a) Relative Inattention in all 1-4 (& 5) to Institutional [& other] Contexts
- b) May help explain previous weakness & inconsistency of empirical results;
- c) Attention will uncover further, interesting & important political economy.
- d) Here: relax assumpt constant policy control & efficacy, specifically consider two (prior) institutional commitments that moderate control &/or efficacy:
 - (1) CBI: Clark: “may be others than elected officials in the monetary-policy driver seat” [i.e., Two Hands on the Wheel: see also Franzese *AJPS* ‘99]
 - (2) Capital Mobility (& Exchange-Rate Regime): Clark “steering column may be locked” [i.e., Multiple Hands on the Wheel: see also Franzese *PA* ‘03].

TABLE 1. Alternative Models of the Domestic Political Economy

	Traditional Electoralist Model ^a	Rational Electoralist Model ^b	Partisan Model and Rational Variant ^c	Context-Dependent Partisan Model
Assumptions				
Structure of macroeconomy	Output and employment are driven by changes in inflation	Output and employment are driven by changes in unanticipated inflation	Output and employment are driven by changes in unanticipated inflation	Output and employment are driven by changes in inflation
Inflation controlled by	Elected politicians	Elected politicians	Elected politicians	Elected politicians only under certain institutional arrangements
Politicians are	Electoralist	Electoralist	Partisan: Left-wing incumbents attribute higher cost to unemployment relative to inflation than right-wing parties	Partisan
Voters are	Homogenous, retrospective, and "pocketbook"	Homogenous, forward-looking, and "pocketbook"	Heterogenous, forward-looking, and "pocketbook"	Heterogenous, retrospective, and "pocketbook"
Implications				
	Increase in growth and employment prior to elections. Increase in inflation either before or after elections	Monetary and fiscal variables may exhibit short-lived and irregular cycles, but growth and unemployment are all but unrelated to elections	Output growth and inflation should be permanently (temporarily, for rational variant) higher and unemployment lower under left governments	Output growth and inflation should be permanently high and unemployment lower under left governments, unless (a) central bank is highly independent; or (b) country pursues a fixed exchange rate amid highly mobile capital

^aFor example, see Nordhaus 1975.^bFor example, see Rogoff and Sibert 1988; and Persson and Tabellini 1990.^cFor example, see Hibbs 1977; Alesina 1987; and Alesina and Rosenthal 1995.

III. Structural Context of Macroeconomic Policy Choice (Ch. 2)

A. Basic Argument/Consideration:

1. *Common Assumptions Electoralist & Partisan Models:*

- a) Policymakers Sufficient Macroeconomic Policy Control &
- b) Policies Sufficient Efficacy to Influence Macroeconomic Outcomes

(1) [Whether actually considering effect on outcomes or just policies, if not at least expected to be efficacious by policymakers, then hard to motivate use of policies.]

2. However:

- a) Policymakers not actually full control...partly b/c world not deterministic and limited information, but also because *strategic interaction w/ other actors*.
- b) Policy not always efficacious, depends on domestic & international (political-) economic conditions.

3. Consider 2 Such Limiting Factors in Particular:

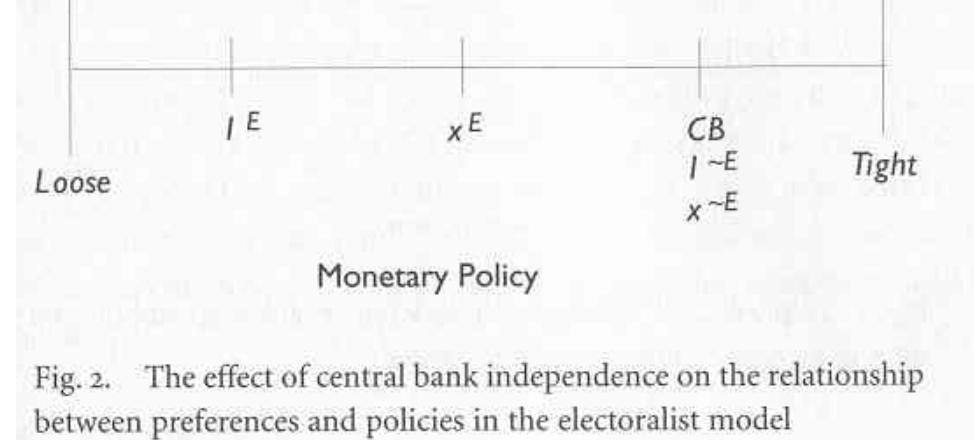
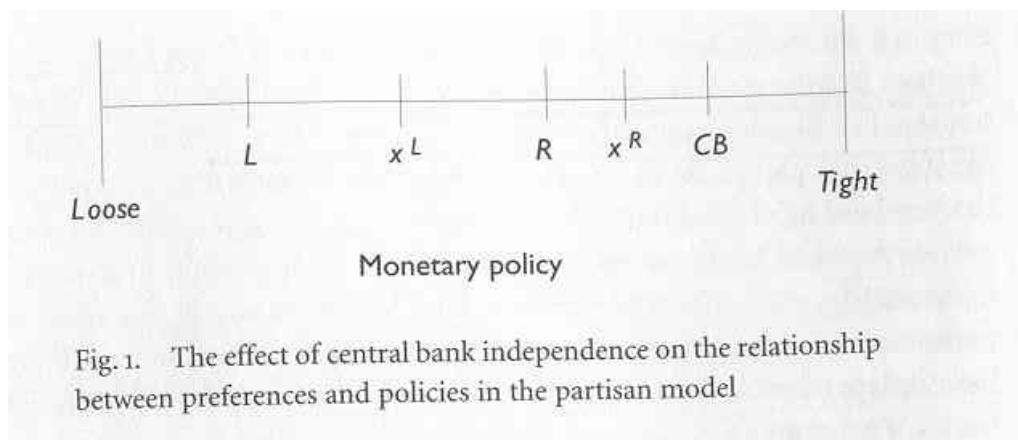
- a) **Central Bank Independence (CBI)** [define],
- b) **International Capital Mobility (CapMob)**, with effect of CapMob on policy autonomy/efficacy depending on **Exchange Regime, fixed (peg) or float (flex)**.

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

B. Decision-Theoretic Model:

1. *CBI & Control*: As CBI \uparrow , likely friction b/w incumbent's incentives & policy \uparrow ; Plausible that \uparrow CBI $\Rightarrow \downarrow$ partisan & electoral cycles
2. Clark's Figures 1 & 2 illustrate

- a) [Fig 1 places x^L unhelpfully; if L-CB compromise same 50-50 as R-CB, x^L closer to R , & see that $x^L - x^R$, cycles under $CBI=0.5$, smaller than L-R, cycles under $CBI=0$]:



3. If $CBI=1$, then $m=m_b^*$; & no partisan or electoral cycles in monetary policy; otherwise [as is always the case], $CBI \in (0..1)$

a) $\Rightarrow m = \text{some compromise } m_b^* \text{ and } m_g^*$

b) $\Rightarrow \downarrow (m_l^* | CBI - m_r^* | CBI)$, partisan monetary cycle under some CBI, relative to $(m_l^* - m_r^*)$, part mon cycle under no CBI; & analogously $\downarrow (m_e^* | CBI - m_{\sim e}^* | CBI) \dots$ for electoral monetary cycles. [Franzese *AJPS* '99 elaborates broader implications of this proposition]

4. Aside: Elaboration of PE Theory of CBI and monetary policy / inflation

a) PolSci & Econ gen'ly agree CBI $\Rightarrow \downarrow$ infl; both also similarly def CBI as degree of autonomy of (conservative) CB from political authority in making monetary pol.

(1) From PolSci view:

- (a) CB=bureaucratic institution, populated by financial experts generally hawkish on inflation, whether socialized to that view or coming from a population w/ those interests.
- (b) Govt instead, & especially in democracy, more responsive to various societal pressures that may emerge for inflation.
- (c) Only most conservative Govts as anti-inflationary as CB, so delegation of monetary-policy authority to CB, i.e., CBI, \downarrow inflation.

(2) From the (neoclassical) economist's view:

- (a) Monetary policy involves a *time-inconsistency problem* \Rightarrow inflationary bias if policy controlled by a discretionary, i.e., responsive, authority.
- (b) Credible delegation of monetary authority to an independent & conservative (i.e., a non-responsive) CB offers commitment device to evade time-incons. & so infl. bias \Rightarrow CBI \downarrow infl

b) *Aside: Elaboration of neoclassical model monetary policy by rule vs. discretion:*

(1) Start with a “rational expectations” model of a perfect-competition economy:

- (a) Equation (1), the economy: $Y = Y_n + \alpha(\pi - \pi^e)$.
- (b) I.e., output (Y) generally equal to natural output (Y_n), but short-run prices may be sticky so, if monetary authority created INF>expected INF (i.e., if $\pi - \pi^e > 0$), then Y temporarily exceeds natural rate. I.e. short-run (or expectations-augmented) Phillips curve (with slope α).

(2) Now suppose the policymaker has value function given by:

(a) Equation (2), policymaker's objective: $V = -(1/2)A(Y - Y^T)^2 - (1/2)\pi^2$

(i) I.e., policymaker does not like deviations of output from some (presumably high) target rate Y^T , & also dislikes inflation (deviations from target, set to 0 for simplicity).

(3) So, policymakers w/ preferences described by (2) facing economy described by (1) & controlling INF rate directly (*a simplification*), will act as if solving following maximization:

(a) $\text{Max}_\pi -(1/2)A(Y_n + \alpha(\pi - \pi^e) - Y^T)^2 - (1/2)\pi^2$ where, notice, (1) has been substituted into (2)

(b) $\Rightarrow -A\alpha(Y_n + \alpha(\pi - \pi^e) - Y^T) - \pi = 0$...maximize by taking derivative of expression to be maximized w/ respect to control variable (π) & setting result equal to zero...

(c) $\Rightarrow \pi = -A\alpha^2\pi - A\alpha(Y_n - \alpha\pi^e - Y^T)$...rearranging...

(d) $\Rightarrow \pi(1 + A\alpha^2) = -A\alpha(Y_n - \alpha\pi^e - Y^T)$...rearranging again...

(e) $\Rightarrow \pi(1 + A\alpha^2) = A\alpha^2\pi^e - A\alpha(Y_n - Y^T)$...and again...

(4) So, policymakers w/ preferences (2), facing economy (1), choose INF given by (3e),

(a) but here's the *rational expectations* part: Price setters know policymakers behave this way, so their π^e expectations also given by (3e). I.e, in eqbm, something Abe-Lincoln-like: "you can't fool all the people all the time". On avg, π^e will equal π . So, rewriting (3) with $\pi^e = \pi$ gives you:

c) *Rational-Expectations Equilibrium*: $\pi = A\alpha(Y_n - Y^T)$; and, substituting $\pi^e = \pi$ back into economy, (1), we also get that in eqbm: $Y = Y_n + \alpha(\pi - \pi^e) = Y_n$. I.e., monetary policy has no real effects in eqbm. (Note: if so, then to avoid real costs of monetary contraction: simply announce contraction soon enough & be believed so $\pi^e = \pi$ reflected in wage & price contracts will include expected contraction...]

- d) CB Autonomy from political authority in monetary policy-making, matter of \circ
- (1) Never complete b/c CB authority invariably derives from (usually) legal statute, i.e., law, or (occasionally) constitutional provision.
 - (2) Either subject to change by political authorities if CB policies ever sufficiently distasteful to them to justify expending political capital necessary to change CB status.
 - (3) Furthermore, CB authorities' appointed & perhaps replaced by govt...
- e) Nor can Govt costlessly ensure CB conducts policy precisely as current will:
- (1) CB expertise &/or an information advantage over govt in monetary policy,
 - (2) Plus, time & other resources for govt even to monitor CB, much less conduct monetary policy itself. (3) So, CB always at least some modicum leeway.

f) CBI must, therefore, measure how far CB could stray from current govt's will 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

(1) Actual monetary policy (inflation) = wtd average what would be if conservative CB credibly, fully, & autonomously controlled monetary policy & what would be if instead curr govt made mon pol w/o any CB influence, w/ \circ CBI measuring wt on former:

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

(2) \Rightarrow anti-infl effect of CBI not constant; it varies depending on political-economic environment in which CB operates. (Also implies all converses: [show derivatives].)

(3) E.g., anti-inf effect CBI greater when left govt than when right & v.v., less the more open the econ & v.v., vary depending other labor- & goods-market institutions & v.v., etc.

This is the generalization referenced earlier of the “CBI reduces electoral- & partisan-cycles” proposition.

C. International Capital Mobility & Exchange-Rate Regimes:

1. Clark: CB affects control, not efficacy [act'ly, can affect both, but nev. mind]; CapMob can affect efficacy (depending on exchange regime) [act'ly, can affect control & efficacy depending on cap-mob & e.r. regime, but nev. mind].

2. Mundell-Fleming Model Open-Economy Macroeconomics: Summary

a) *CapMob & Fixed E.R.* \Rightarrow monetary pol ineffective [unavailable, act'ly]; fiscal extra-effective.

(1) $\uparrow m \Rightarrow \downarrow i \Rightarrow$ (would $\uparrow I$, but also) exchange depreciation, which must fight by $\downarrow m$ back so $\uparrow i$ back (so not affect I); alternative quick explanation: if Fix E.R. & CapMob, then must use m to fix i at rate necessary to maintain peg.

(2) $\uparrow \text{deficit } (G-T) \Rightarrow \uparrow AD \& \uparrow i \Rightarrow$ exchange appreciation, which must fight by $\downarrow m$ to $\downarrow i$ (i.e., fiscal expansion forces reinforcing monetary move also, so efficacy reinforced)

b) *CapMob & Flexible E.R.* \Rightarrow fiscal [relatively] ineffective; monetary extra-effective.

(1) $\uparrow m \Rightarrow \downarrow i \Rightarrow \uparrow I$, & also exchange depreciation, which allowed/accommodated so $\Rightarrow \uparrow (X-M)$ also (exchange depreciation makes exports cheaper & imports more expensive).

(2) $\uparrow \text{deficit } (G-T) \Rightarrow \uparrow AD$, but also $\uparrow i \Rightarrow$ appreciation, $\Rightarrow \downarrow (X-M)$ (i.e., 2 sources crowding out now, crowding out invest as before b/c $\uparrow i$ & now $\downarrow (X-M)$ b/c apprec., so fiscal [relatively] ineffective).

3. \Rightarrow *Context-Conditional Electoral or Partisan Cycles*: we should see cycles via monetary policy, or via fiscal policy, or not at all depending on combinations of CBI, CapMob, and Exch.Rate Regime

IV. Open-Economy Macroeconomics (IS-LM-BoP Model)

A. Simultaneous eqbm in goods, money, & international markets:

1. Money (*Liquidity*) Market (LM): demand for, supply of money:

a) M^s (set by mon pol-mkr)= M^d (private actors demand for \$, which depends on i, Q)

2. Goods (*Investment & Saving*) market (IS): balance demand for investment funds & supply, Savings (which is 1-Pub&PrivNetConsumpt)

a) Balance Savings (Supply of Funds), which depends i, Q (roughly, income= Q minus priv C & pub (G-T)) with Investment (Demand for Funds), I, which depends i, Q .

(1)(Comes from balance of National Income, Y, with National Expenditures, Q.)

3. Int'l Trade & Capital Markets: *Balance of Payments* (BoP): net exports, trade surpluses (deficits), earn (require) foreign exchange, which flows out (in) as capital outflow (inflow).

a) Net Exports, $X-M$, net earnings from rest of world (RoW) or net spending in RoW ; for latter, need foreign currency (capital) inflow; former balanced by capital outflow.

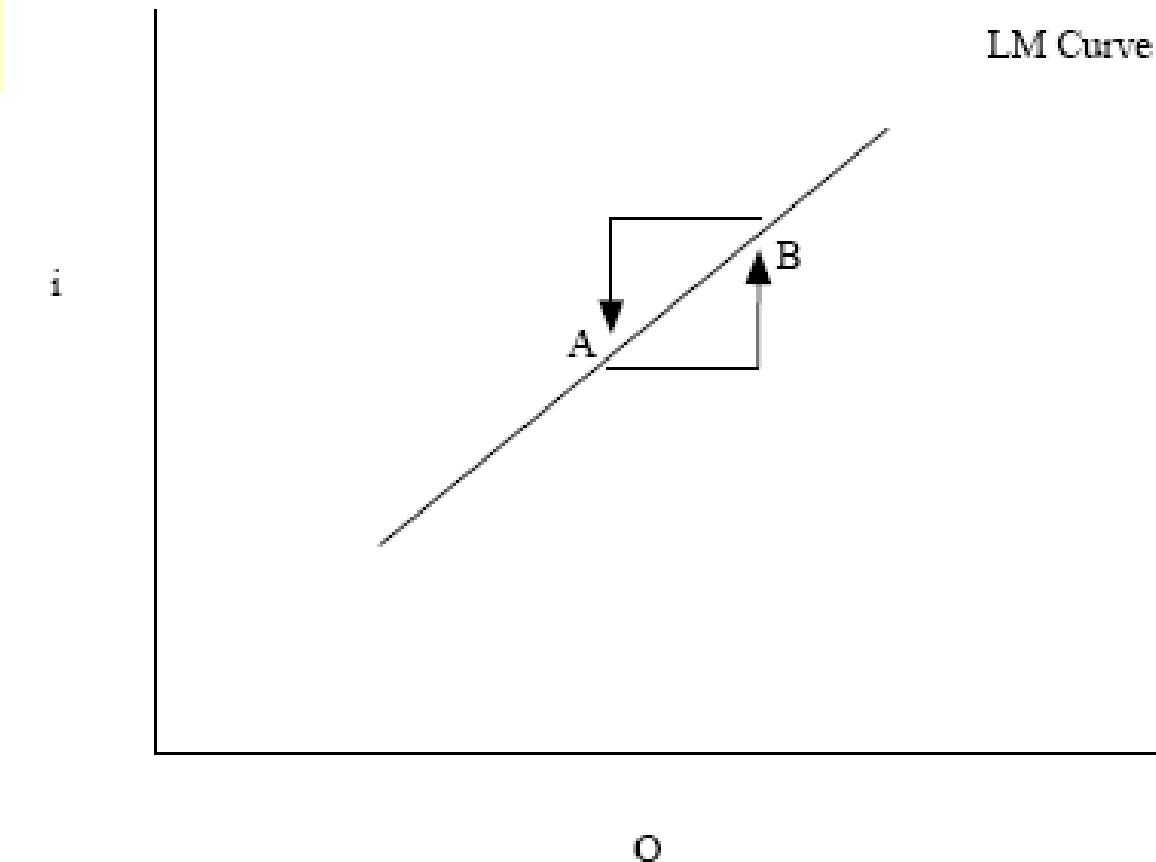
B. Equilibrium:

1. Interest rates (i) & national income (Q) that simultaneously clear goods & money markets (IS & LM), & that balance external accounts (BoP).

C. The LM (liquidity mrkt) Curve (eqbm in money mrkt)

1. For any given money supply (M^s), some interest rate, i , needed for folks to demand exactly that quantity of money given their income, Q . So, for some fixed M^s , can draw line as pairs of i & Q that equate M^d to that M^s .
2. **Slopes upward:** if more income, Q , demand more goods & services, \Rightarrow want more money, but for a given M^s , that additional demand for money only \Rightarrow price of money (i) must rise:
3. From pt A in fig, $\uparrow Q \Rightarrow \uparrow$ demand money, stock of money fixed, so i rises, to pt B, say, to keep $M^d = M^s$. Or from B, $\downarrow Q \Rightarrow \downarrow$ demand money, stock fixed, so i falls, to pt A, say, to keep $M^d = M^s$ [Just illustrating; not mean to suggest any tendency to cycle like this.]

4. MONETARY POLICY: $\uparrow M^s \Rightarrow \downarrow i$ at any given Q , $\uparrow Q$ for any given i to keep LM balance (to bring M^d to that new M^s); the reverse for $\downarrow M^s$, so: **expand/contract monetary policy ($\uparrow \downarrow M^s$) = outward/inward shift of LM curve.**

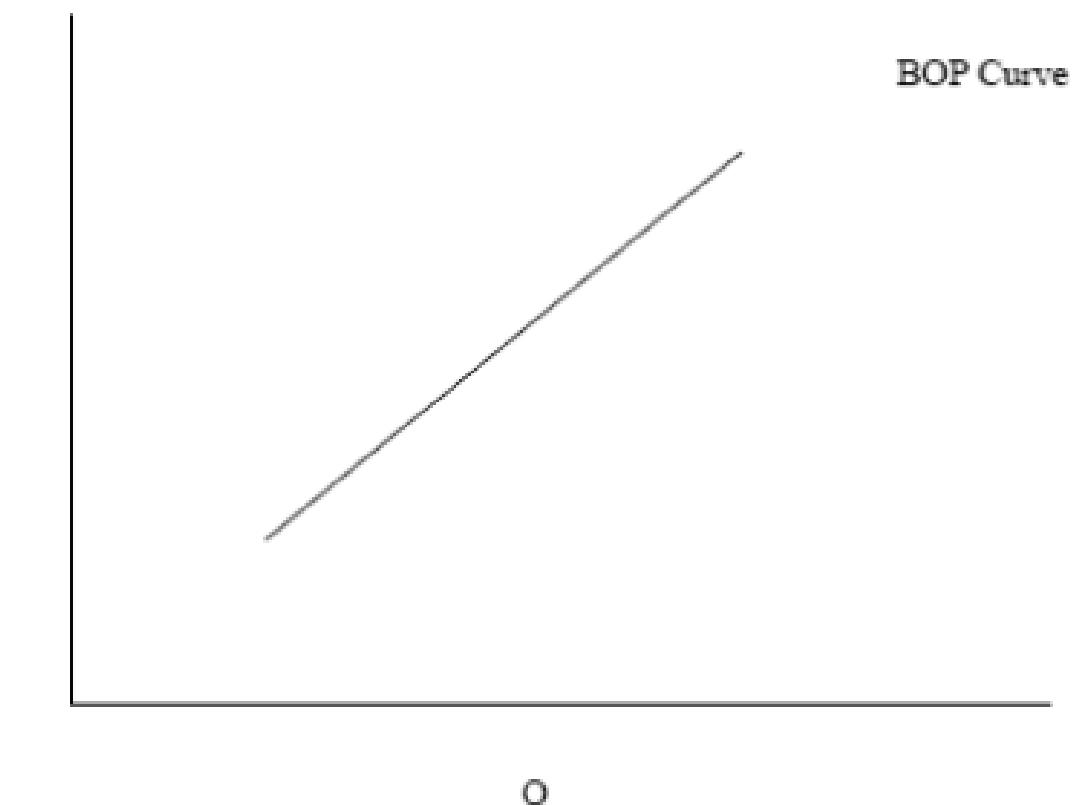


C. Balance-of-Payments (BoP) Curve (eqbm in external accounts)

1. **Balance-of-Payments (BoP):** Current Account (Trade Balance: $X - M$) + Capital Account (Net Outflow: Cap Outfl. – Cap Infl.) = 0. I.e., $X+M=NetCapFlow$. [another accounting identity]
2. Trade surplus matched by capital outflow (earnings from surplus flows out as investment abroad, a.k.a., outward *foreign-direct-investment*, FDI, + outward *portfolio-investment*); trade deficit matched by capital inflow (excess domestic consumption funded by foreign capital inflow).
3. For any i , some Q brings Trade Balance & Capital Account to parity, & v.v.
 - a) Import demand, $M=f(Q)$; X depend on Q^* (foreign) not on Q (domestic).
 - b) Capital Account = Capital (investment) out-/in-flow responds to i ; $\uparrow\downarrow i$ brings in, sends out.

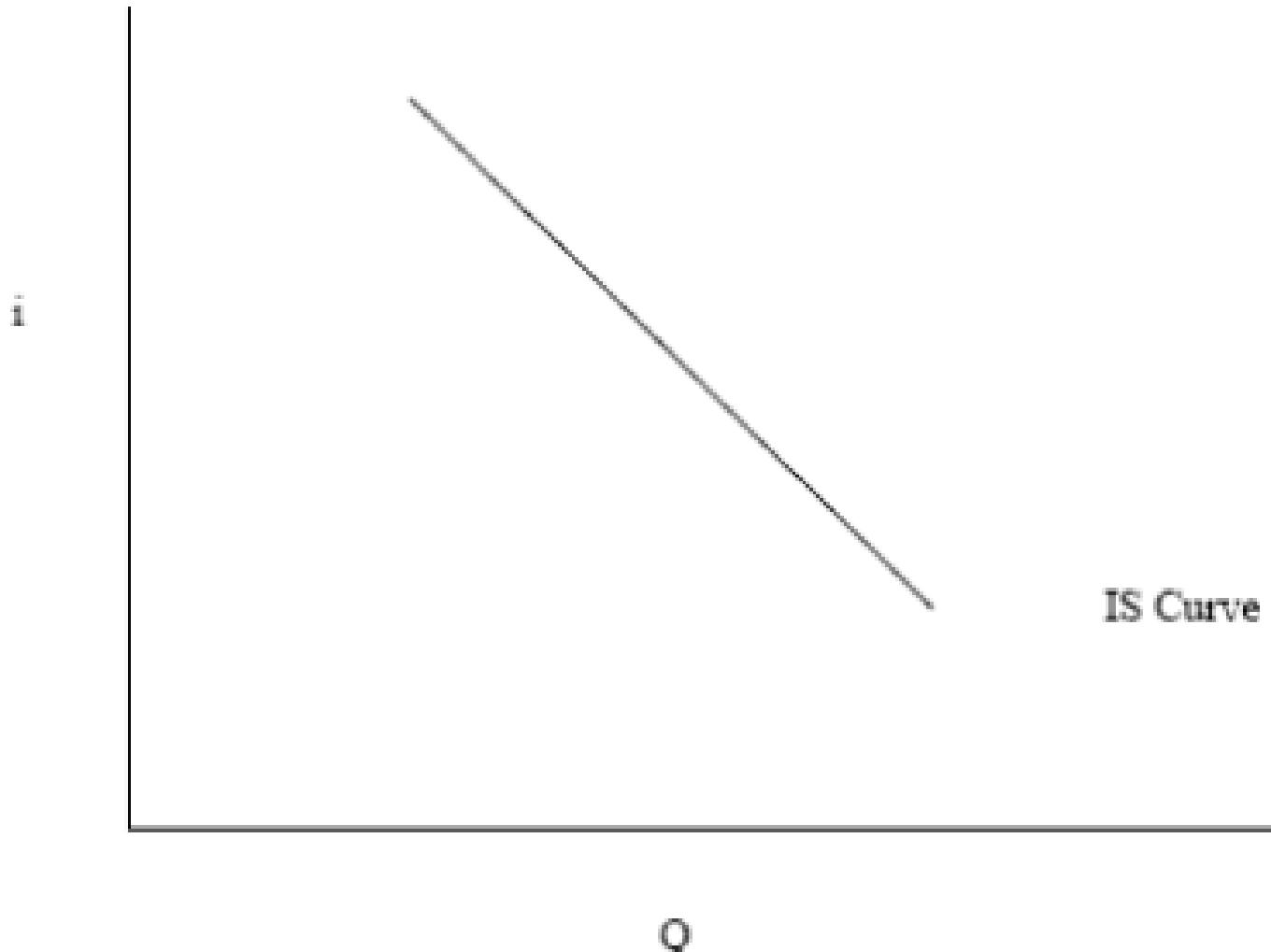
4. Slope: If $\uparrow Q$, imports rise, exports not \Rightarrow trade deficit \Rightarrow need cap inflow to balance that (to fund it); to get it, need higher i ; and v.v. for $\downarrow Q \Rightarrow$ trade surplus, which needs outflow, which get by $\downarrow i$.

5. Importantly, **BoP line flatter (more elastic, i.e., more interest-rate sensitive) the more mobile is cap.** Cap flows greater in response to $i \uparrow\downarrow$, the more mobile capital. Perfect capital mobility \Leftrightarrow horizontal BoP curve.

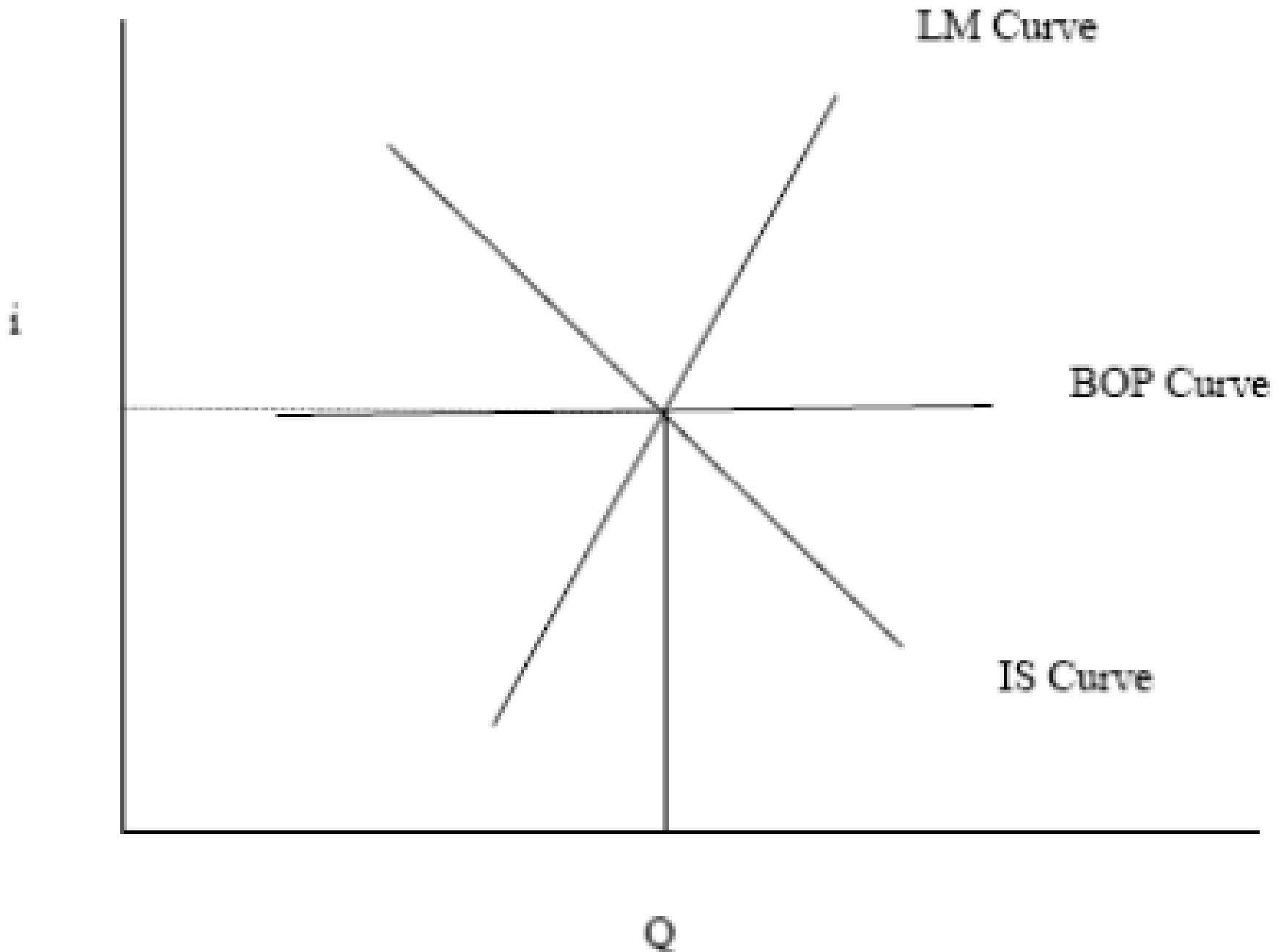


D. IS (investment-savings) Curve (equilibrium in goods markets)

1. National Income \equiv National Expenditures: $Y=Q=C+I+(G-T)+(X-M)$
2. IS-curve slopes downward: For given C , $(G-T)$, & $(X-M)$, any $\downarrow i \Rightarrow \uparrow I \Rightarrow \uparrow Q$.
3. **FISCAL POLICY:** $\uparrow(G-T) \Rightarrow \uparrow Q$ at any given i ; i.e., outward shift of IS curve; $\downarrow(G-T) \Rightarrow \downarrow Q$ at any given i ; i.e., inward shift of IS curve.



E.General Equilibrium in IS-LM-BoP Model: All 3 Curves Intersect

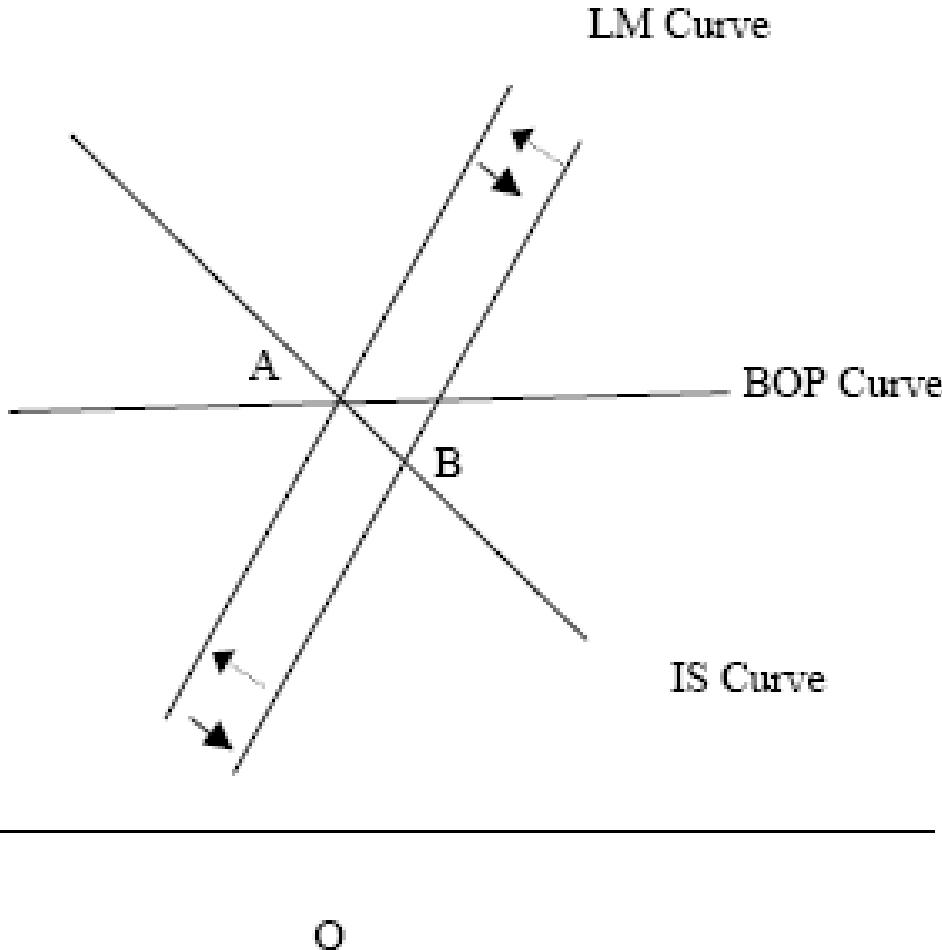


E. Using the IS-LM-BoP Model for Policy Analysis

1. Capital Mobile:

a) Monetary Policy under a Fixed Exchange-Rate Regime with highly Mobile Capital

(1) From pt A: $\uparrow M^s \Rightarrow LM$ shifts out, but this $\Rightarrow \downarrow i$ along IS curve to pt B, but this \Rightarrow capital outflow (investors leaving the lower i for better options elsewhere) \Rightarrow depreciation (b/c selling domestic currency for foreign to buy those better options), which violates Fixity. So pol-maker has to $\downarrow M^s$ back (keep i pegged to i^*).



(2) Monetary contraction, $\downarrow M^s \Rightarrow \dots$ [same chain, opposite direction] $\dots \Rightarrow$ appreciation, which violates Fixity.

(3) \Rightarrow *Monetary Policy forsaken (wholly unavailable) under perfect Capital Mobility & Exchange-Rate Peg:*

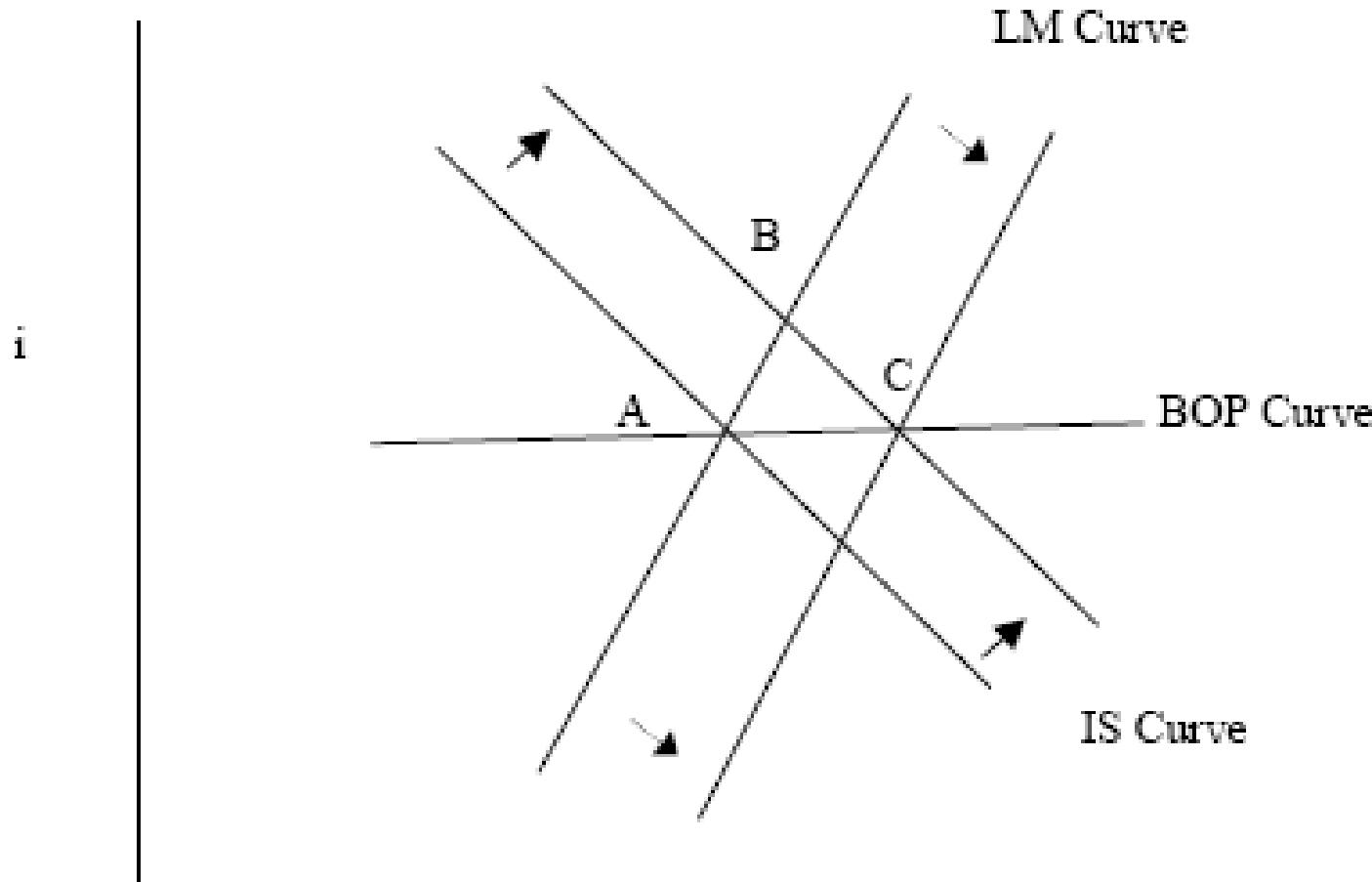
(a) *Intuition: to keep exchange-rate peg to some currency, must make capital content stay in each currency, not want to shift from assets in one currency to assets in other, which means must make return on two currencies equal, which means must match domestic interest rate to peg-currency rate (net of any risk-premium or other differentials).*

b) Fiscal Policy under a Fixed Exchange-Rate Regime

(1) $\uparrow(G-T)$ \Rightarrow IS shifts out (from pt A to pt B), but this $\Rightarrow \uparrow i$ along LM curve, but this \Rightarrow capital inflow \Rightarrow appreciation, which violates Fixity, so monetary policy must accommodate, i.e., M^s must expand to bring $\downarrow i$ back (from pt B to pt C), which amplifies stimulus.

(2) $\downarrow(G-T)$ \Rightarrow ...[same chain, opp. dir. ... $\Rightarrow M^s$ must shrink to $\uparrow i$ back, amplifies contraction... [could follow from C to unlabeled pt opposite B as IS shift in, to A as LM curve shifts in also]

(3) UPSHOT: ***Fiscal Policy extra-effective under Cap Mob & Peg*** (because it forces monetary policy to come along with it (& so amplify the fiscal) in order to maintain peg).

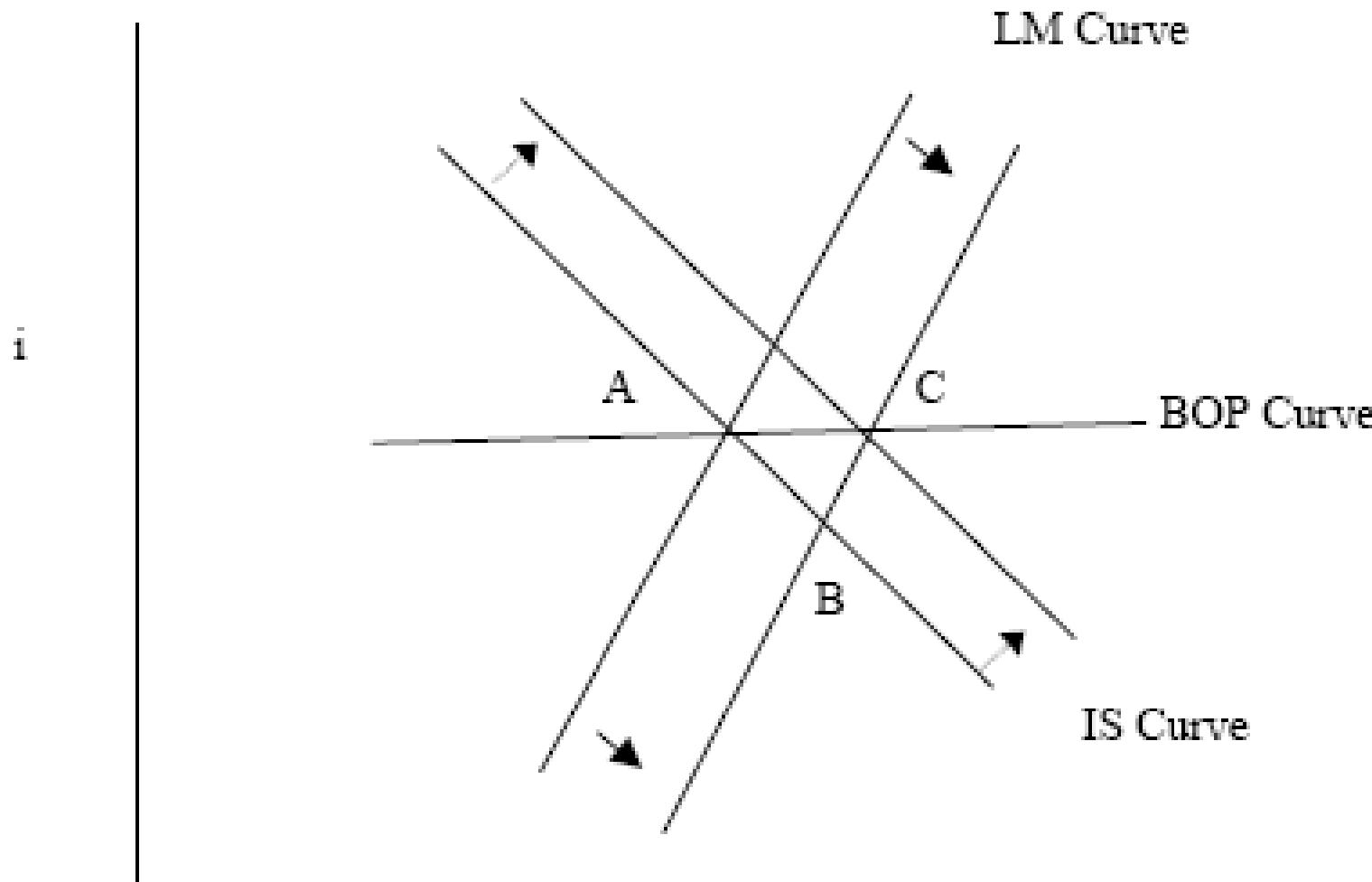


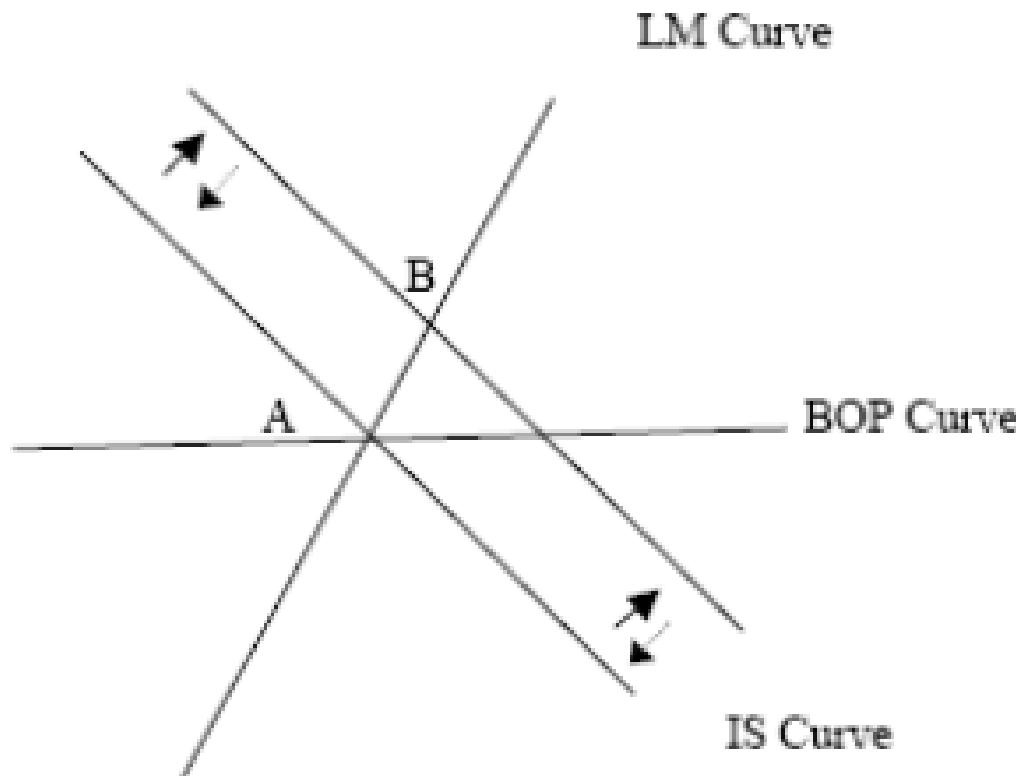
c) Monetary Policy under a Floating Exchange-Rate Regime

(1) $\uparrow M^s \Rightarrow LM$ shifts out, but this $\Rightarrow \downarrow i$ along IS curve (from pt. A to pt B), but this \Rightarrow capital outflow \Rightarrow depreciation, which allowed under float, so $\uparrow(X-M)$ \Rightarrow IS shifts out (from pt. B to pt C).

(2) $\downarrow M^s \Rightarrow \dots$ [same chain, opposite direction] $\dots \Rightarrow$ appreciation, which... $\downarrow(X-M)$ \Rightarrow IS shifts in. [could follow from C to unlabeled intersection of IS and LM (opposite vertex of diamond from B) as LM curve shifts in, & then to A as IS curve shifts in also]

(3) UPSHOT: *Monetary Policy extra-effective under Cap Mob & Float Exchange-Rate.*





d) Fiscal Policy under Floating Exchange-Rate Regime:

(1) $\uparrow(G-T) \Rightarrow$ IS shifts out $\Rightarrow \uparrow i$
 along LM curve (from pt A to pt B)
 \Rightarrow cap inflow \Rightarrow appreciation (as
 currency bought to capture that
 higher i), which appreciation \Rightarrow
 $\downarrow(X-M)$, which \Rightarrow some shift back
 of IS, might be more or less or same
 as original shift... [...depends on
 slopes of curves & exchange-rate
 elasticity of net exports, etc.].

(2) UPSHOT: Fiscal Policy relatively ineffective under Capital Mobility & Floating Exchange-Rates

2. Capital Immobile: Model reduces to IS-LM (without BoP) (i.e., our simple AD-AS (Agg Demand-Agg Supply) models from before) \Rightarrow

- a) Can Peg or Float w/o forsaking monetary autonomy, or amplifying or dampening monetary-policy or fiscal-policy efficacy.
 - b) Both fiscal policy & monetary policy retain normal maneuverability & efficacy as before.

II. Purchasing-Power Parity (PPP) & Interest Parity (IP)

C. Alternative way to see how *Cap Mob* may constrain monetary autonomy

D. **PPP: $P=EP^*$ or, in logs (\ln), $p=e+p^*$**

1. Given free trade, price of basket in one currency must equal price of same basket in another currency multiplied by the exchange rate.

2. Logic of *no-arbitrage*: could make ∞ \$ if this not true & trade is free (& costless).

3. Empirical: PPP holds very well on average over long periods (e.g., annual data or longer); not very well in short run (e.g., monthly or shorter).

E. **IP: $i = i^* + E(\hat{e})$ (... where $\hat{e} = \% \text{ change e.r.}$ & $E(\cdot)$ is “expected”)**

1. Logic similar, but applies *no-arbitrage condition* in different mrkts (money mrkts)

2. If not $i = i^* + E(\hat{e})$, all investors would want the better(-expected)-return currency only, so \hat{e} , i.e., expected depreciation must equalize the returns.

3. Empirical: holds very well up to extremely short-run [although one might note that prediction is VERY flexible given difficulty estimating that expectation term on the right...]

4. So: any difference in nominal int-rates (i.e., in monetary policy) will be met fully by nominal exchange-rate depreciation (under flexible e.r.) or real exchange-rate deprec. (under fixed e.r.). If capital *perfectly* mobile, these capital flows *infinite*, which perfectly unsustainable, so perfect mobility means monetary authorities (of small country) must match domestic to foreign policy

D. Clark's Context-Conditional Electoral & Partisan Cycles Predictions:
(CBI & CabMob+E.R.Regime being the “context”) [My summary version]
[See also **same info in flow charts** at end (I think much easier follow)]:

1. *Upshots from IS-LM-BoP, plus CBI:*

- a) If Cap Immob, then both Mon & Fisc available & effective
- b) If Cap Mob & E.R.Flex, monetary extra-effective but fiscal ineffective (to some degree)
- c) If Cap Mob & E.R.Fix, monetary unavailable but fiscal extra-effective
- d) If CB Independent, monetary policy unavailable to domestic *political* actors.

2. *Political-economic implications for policymakers: [See flow charts below... (pp. 57-58)]*

- a) *If CapImmob OR E.R. Flex*, pol-mkrs can use mon pol for electoralist or partisan purposes \Rightarrow macro cycles by monetary mechanism; these monetary-driven cycles would be dampened by *CapMob \& Fix E.R.*
- b) *If CapImmob OR E.R. Fix*, pol-mkrs can use fisc pol for electoralist or partisan purposes \Rightarrow macro cycles by fiscal mechanism; these fiscal-driven cycles dampened by *CapMob \& Flex E.R.*
- c) However, furthermore: If *CBI*, macro cycles by mon mech constraind/damp'd; fiscal-driven cycles still possible (although CB might also work some against these).
- d) \Rightarrow Cycles achievable under any combo except *CBI+CapMob+Flex* [interesting: may be that these developed democracies have been moving in this direction?].

E. Game-Theoretic (Strategic) Model:

1. *Basic Structure*: Govt Controls Fisc Pol; CB Controls Mon Pol, but (conservative) CB Prefs Differ from Govt's Only If [insofar as] Indep.

2. *Model*:

a) *Goals of Policymakers*: $L_i = (y - y_i^*)^2 + \alpha^i(\pi - \pi_i^*)^2$ [DEFINE TERMS]

(1) Real Target: $y_g^* = k_g y^n$: for *electoralist* model: $k > 1$ if election year; for *partisan* model: $k > 1$ if left government; $k = 1$ if non-elect, right, or if $CBI = 1$.

(2) Simplify: $\alpha_i = \pi_i^* = 0 \Rightarrow$ policymakers differ in real target only

b) *Economy*: $y = y^n + \mu(\pi - \pi^e) + \phi g$ [Define terms; note: ϕ =fisc & μ =mon efficacy]

(1) Expectations-augmented Phillips Curve + simple Keynesian fiscal efficacy; *n.b.*, all else equal fiscal-policy preferred to monetary (b/c g not in Loss function, L , but π is).

(2) *CapImmob* $\Rightarrow 0 < \phi, \mu < 1$;

(3) *CapMob, Fix* $\Rightarrow \phi = 1, \mu = 0$;

(4) *CapMob, Flex* $\Rightarrow \phi = 0, \mu = 1$.

c) *Order of Play*:

(1) All learn game structure (E or $\sim E$; R or L ; CBI or $\sim CBI$, all parameters of model); *n.b.*, actually no role for π^e here; game as modeled entirely b/w CB & govt, no citizens.

(2) Govt chooses g ; then bank chooses π . Note:

(a) Actually, bank chooses π given expects g from govt optimize \Rightarrow some $\pi(g)$; symmetrically, govt chooses g knowing this is how bank will act.

(b) [game somewhat odd for $CBI=0$ case; because then govt would optimize over g & π]

3. *Implications*: As before but CB not only not act *electorally* or *partisan-ly* but leans monetarily against govt if indep & retains mon. auton.

4. *Predictions*:

- a) If *CapImmob*, fiscal manipulation regardless of *E.R.* or *CBI*, but *CBI likely dampens*. [note: fiscal policy Pareto-preferred *ceteris paribus* in this model.]
- b) If *CapMob*, fiscal manipulation under *Fixed E.R.* but not under *Flex E.R.*, regardless of *CBI*. [note: fiscal 100% ineffectual under *Flex* in this model.]
- c) If *CapImmob*, monetary manipulation in contractionary direction [more generally, monetary counters fiscal policy] if *CBI*.
- d) If *CapMob*, monetary manipulation in expansion dir only if $\sim CBI$ & *Flex E.R.*

5. *Main Difference from Non-strategic (Decision-Theoretic) Model*: *CapMob*, *Fix*, & *CBI* \Rightarrow fiscal effective & CB constrained from countering \Rightarrow fiscal cycles, if anything, greater outcome cycles w/ *CapMob* than w/o .

6. [TABLE 3: *n.b.*, absolute (none, all) statements mostly due to dichotomized conditions & extreme resolution of assignment problem (all fiscal policy); viewed as relative statements should hold though.]

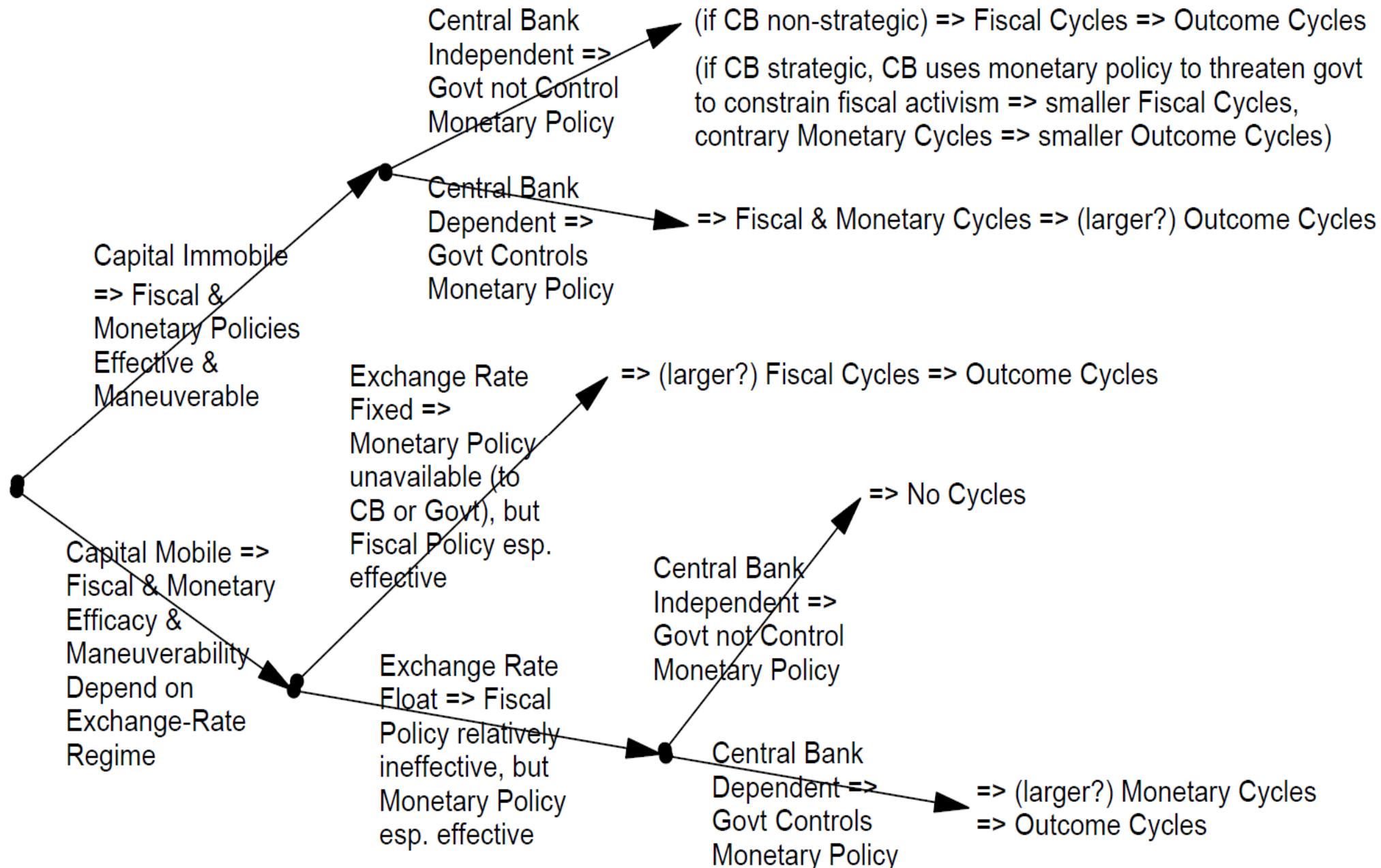
TABLE 3. The Expected Effect of an Increase in Left Governance or the Onset of an Election under Various Conditions

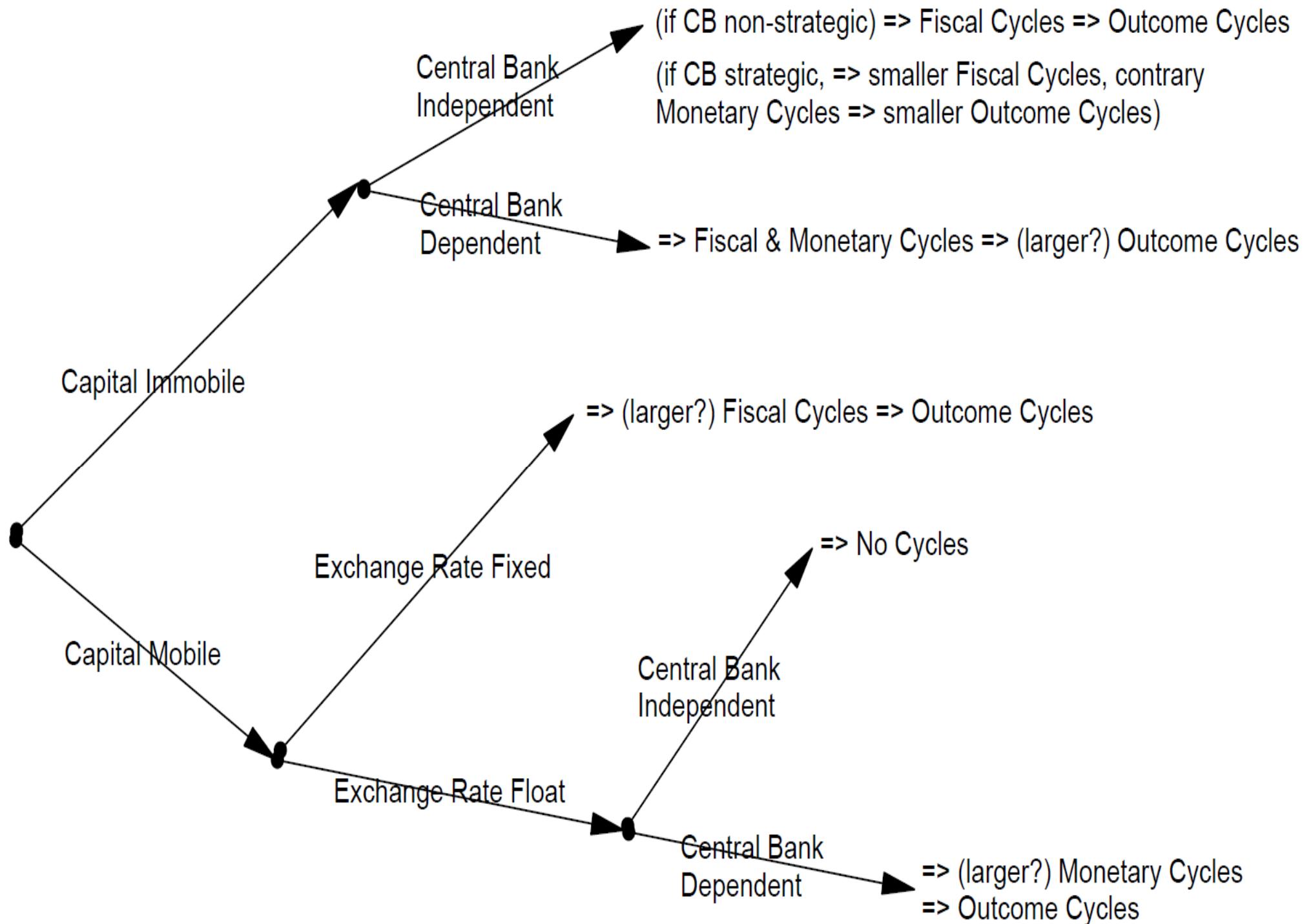
	No Central Bank Independence	Central Bank Independence
No capital mobility	<i>Fiscal policy:</i> expansion <i>Monetary policy:</i> indeterminate <i>National income:</i> expansion	<i>Fiscal policy:</i> (smaller) expansion <i>Monetary policy:</i> contraction <i>National income:</i> (smaller) expansion
Capital mobility and fixed exchange rates	<i>Fiscal policy:</i> (larger) expansion <i>Monetary policy:</i> none <i>National income:</i> expansion	<i>Fiscal policy:</i> (larger) expansion <i>Monetary policy:</i> none <i>National income:</i> expansion
Capital mobility and flexible exchange rates	<i>Fiscal policy:</i> none <i>Monetary policy:</i> expansion <i>National income:</i> (smaller) expansion	<i>Fiscal policy:</i> none <i>Monetary policy:</i> none <i>National income:</i> none

7. NOTE: *CBI*, *CapMob*, *E.R.* all viewed as exogenous.

8. ***Policymaking Highly Context-Dependent***; misleading at best to explore [theoretically or] empirically w/o consider context

F. Diagrams summarizing Clark's Central-Bank-Independence, Capital-Mobility, & Exchange-Rate-Regime Conditional Electoral and Partisan Cycles Theory (1st w/ steps elab'd; 2nd just upshots):





G. Determinants Domestic Policy Autonomy: **DEF's & MEAS's**

1. **Capital Mobility:**

a) *What*: System or Country Characteristic? Legal or Behavioral?

(1) *Sources*:

- (a) [Science & Tech] Information/communication (& other) technological advances;
- (b) [Econ] Financial-instrument/market advances (e.g., Eurodollar, futures, etc.);
- (c) [Pub Pol] Removal capital controls; (d) [All of above] Increased trade.

(2) Will use Capital Controls: explicit legal barriers cross-border flows [issues: seems directly discretionary policy; as policy-choice, likely endog. to E(effects CapMob); still...]

b) *When*: b/w '60s-'80s; '70s transition period; by '78 seems prominent; key bellweather=1972 \$-gold-window closure & Bretton Woods collapse.

- (1) BW system of fixed e.r., to IMF SDR's, which heavily \$, which nominally tied gold.
- (2) Under BW system, ctry's much use of capital controls (which helped maintain some domestic monetary autonomy despite that peg).
- (3) With BW collapse, ctry's started eliminate these capital controls too.

c) *Measures*:

- (1) Correlation of Domestic Savings & Investment. [WHY?] [Problems: S&I both procyclical, so corr. anyway; large-ctry S&I affect world; path may seem oddly volatile]
- (2) Counts of Capital Controls [Probs: above, plus: only legal barriers; crude gauge, little variation, & in too-rough step-like way] [Hays uses share transact.'s not subj to controls]
- (3) [Other options, notably (a) *interest-rate parity* and (b) *value actual cap flows*, also imperfect.
 - (a) For (a), E(Δe) part difficult gauge & adds noise; [*covered interest-parity*: diff. get data many ctrys & yrs]
 - (b) For (b), as ↑mob, ↑response to i disparity, but also ↓ disparity.⇒unclear how should relate]

d) *Data:* FIGURE 4. [Luckily for researchers, measures correlate highly & tell approx same story.]

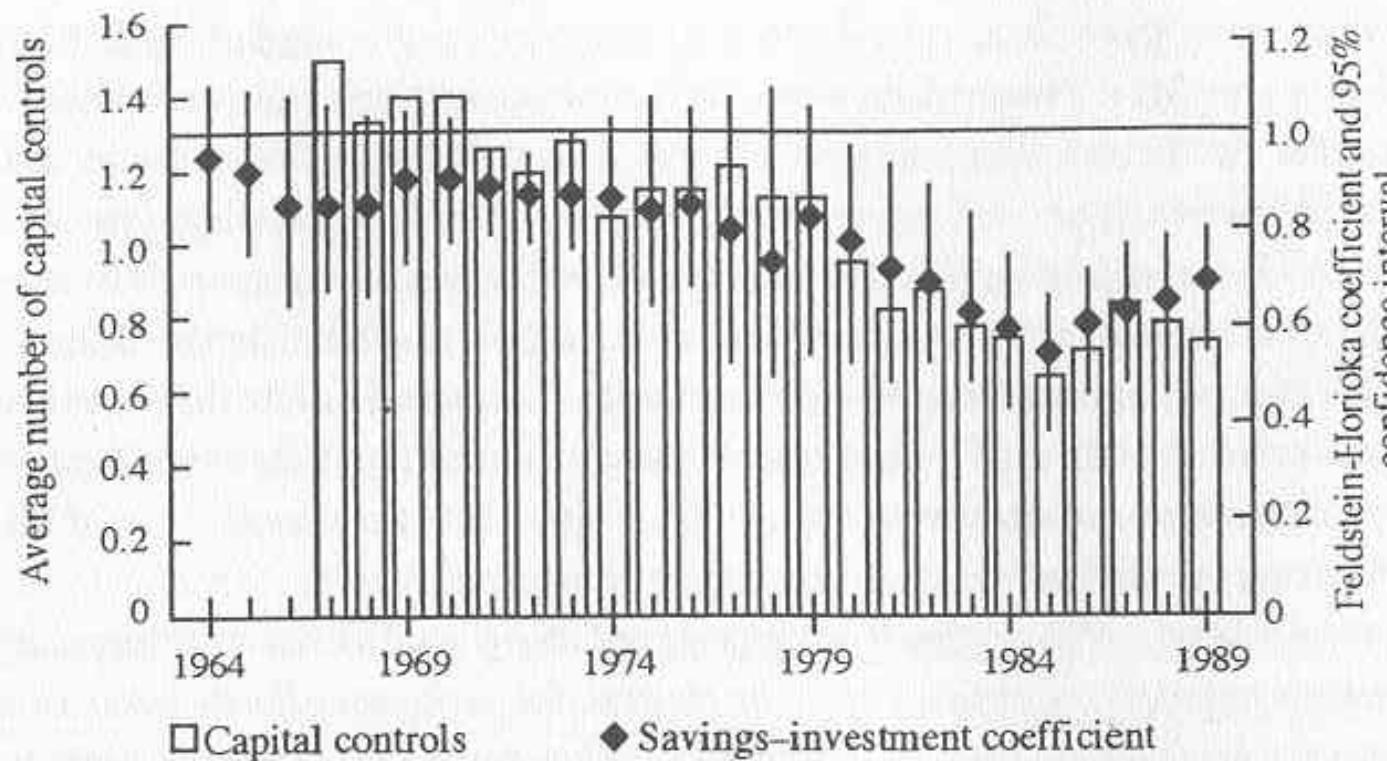


Fig. 4. Alternative measures of capital mobility for 18 OECD countries. (From Clark and Nair Reichert 1998.)

$$(R^2 = .91)$$

2. Exchange-Rate Regimes:

a) *What & When & Where:*

- (1) WWII-'71=Bretton Woods: all [most] to \$ [to IMF SDR's≈\$] which tied to gold.
- (2) Heterogeneous since: simple pegs; crawling pegs; unilateral baskets; group baskets; managed float; flexible; etc. Great mix; considerable variation across & some w/in ctrys.
- (3) Snake—Tunnel—ERM/EMS—EMU—Euro; a few other patterns.

- b) *Measure*: official, stated policy [so assumes official = or ≈ effective policy]
 c) *Data*: TABLE 4.

TABLE 4. Participation in Fixed Exchange Rate Regimes after 1972 and before 1990

	Snake	EMS	Pegged
Australia	—	—	—
Austria	—	—	1973–89
Belgium	1973–78	1979–89	—
Canada	—	—	—
Denmark	1973–78	1979–89	—
Finland	—	—	1977–89
France	Intermittent	1979–89	—
Great Britain	—	—	—
Greece	—	—	—
Ireland	—	1979–89	1973–78
Italy	—	1979–89	—
Japan	—	—	—
Netherlands	1973–78	1977–89	—
New Zealand	—	—	1973–79
Norway	1973–78	—	1979–89
Spain	—	—	—
Sweden	1973–77	—	1977–89
United States	—	—	—
West Germany	1973–78	1979–89	—

Source: Coffey 1984; IMF, *International Financial Statistics*, various years; OECD 1985.

3. Central Bank Independence: [DEF]

a) *What:*

(1) Legal (*de jure*) or Behavioral (*de facto*) [in developing countries, studies have shown only latter seems matter; in developed ctrys, same studies find results using either measure].

(2) Legal CBI: features of central-bank statute(s)/provisions, such as...

- (a) Appointment, dismissal, tenure-length of CB decision-makers;
- (b) Procedures of dispute resolution;
- (c) Objectives of monetary policy as defined in bank law;
- (d) Whether bank may or must buy govt bonds & under what terms.

b) *Where & When:* until recently, very rarely changed; seemed almost a constitutional feature. More change, a trend toward indep., since 1990s:

(1) A conventional wisdom arose (part of rational-expectation revolution in economics) that, if bank credibly anti-inflationary with monetary policy, no real cost. So indep. ctrl bnk reduces inflation at no real cost. Ctry's w/ dep CB's began create indep ones.

(2) ECB/Euro project: when there were still separate monetary-policymaking CB's, part of project toward the Euro & 1 ECB was progress toward indep of previous dep banks. Then, with the shift to 1 ECB, it designed heavily indep (& along lines German BB).

c) *Measures:* 5 common indices [others also exist]

d) *Data:* TABLE 5.

TABLE 5. Alternative Measures of Central Bank Independence

	AS ^a	BP ^b	GMT ^c	CWN ^d
West Germany	4	4	14	0.69
Austria	—	—	9	0.63
Greece	—	—	4	0.53 ^e
Denmark	2.5	2	8	0.50
United States	3.5	3	13	0.49
Canada	2.5	2	11	0.45
Ireland	—	—	7	0.44
Netherlands	2.5	2	10	0.42
Australia	2	1	9 ^e	0.36 ^e
United Kingdom	2	2	6	0.34
Sweden	2	2	—	0.29
France	2	2	7	0.29
Finland	—	—	—	0.28
Italy	1.75	1.5	5	0.25
New Zealand	1	1	3	0.24
Japan	2.5 ^e	3 ^e	6	0.18
Spain	1.5	1	5	0.17
Norway	2	2	—	0.16
Belgium	2	2	7	0.16
Median	2.0	2.0	7.0	0.30
Mean	2.23	2.03	7.6	0.36

Note: All indexes are constructed so that higher numbers indicate greater central bank independence.

^aIndex created by Alesina and Summers (1993) by rescaling and combining the Bade and Parkin (BP) and Grilli, Masciandaro, and Tabellini (GMT) indexes.

^bIndex proposed by Bade and Parkin (1982) and extended by Alesina (1988b).

^cSum of economic and political indexes provided by Grilli, Masciandaro, and Tabellini (1991).

^dIndex created by averaging Cukierman, Webb, and Neyapti's (1992) aggregate legal measure for the period 1960–89.

^eIndicates an above-median score for a country that is below the median on at least one other index.

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

A. “There’s not a dime’s worth of difference between the Republicans and the Democrats” (G. Wallace, ’68 *Indep* Cand)

1. Remember Blair & Schroeder; but was that new?
2. Mitterand’s U-turn in early ‘80s; opening bell or that not new either?
3. Wilson’s ('64-70; '74-76) austerity program in Sterling crisis? \Rightarrow **need:**
4. *Systematic analysis:* whether&when Left discernibly more interventionist
 - a) Several prev. studies: \uparrow integ not clearly erode partisan diff's, maybe even \uparrow .
 - b) Clark's reanalysis: suggests little difference to begin, & integration not Δ this;
 - c) & also indirect support for electoralist model over partisan model [perhaps].
 - d) [but recall: our emphasis more on Mundell-Fleming conditional monetary or fiscal cycles in global & institutionalized pol-econ; less on partisan vs. electoral.]

B. Hibbsian Partisan Model & Prior Evidence

1. Fiscal & Monetary Policy Differences: Expected Left tendencies...
 - a) Tax Capital (more than Labor) & More-Progressive Tax System;
 - b) Pro- Social-Welfare & Redistribution;
 - c) More Counter-cyclical & Expansionary Fiscal Policy;
 - d) Greater taxes, larger govt overall; less debt- & inflation-averse.

2. Partisan v. Downsian Perspectives:

- a) *Partisan*: either intrinsic pol pref's or survival depends on diff constituencies
- b) *Downsian*: must appeal median, regardless of partisan preferences:
 - (1) *Alesina & Rosenthal*: Downs.=choose policies to win; Part.=try win to choose policies
 - (2) ***Clark: that's pithy, but D.&P. need not differ whether party goals diff, but rather whether electoral competition induces policy-actions converge***

3. Prev Empirical Work: Tax, Spend (esp. welfare),& overall fisc (deficit):

a) Tax Size (Gov't Revenue share of GDP):

- (1) Generally supportive cross-sectional or long-run partisan differences (Cameron '78; Hibbs '77; Wildavsky '74; Huber, Ragin, & Stephens '93; Hicks & Swank '01)
- (2) TSCS analyses more mixed—support or ambiguous—but stat problems or challenges
 - (a) In fact, some evidence, beginning '80s, L *more* aggressive T-cut ["Nixon to China"; Downsian "position jumping"; or just more to cut where been L gov?]

(3) ***Clark: Cross-ctry long-run or avg L↔R partisan diff's not issue here; the Q is whether L↔R change in govt, controlling for median, ⇒ policy-Δ.***

(4) ***⇒ examine effect of w/in-ctry party-Δ better test, esp. if control median.***

(5) ***[ELAB: Clark not much challenge view when/where voters want R/L, elect R/L, & then get R/L, but Q whether govt control by R/L causes pol Δ]***

b) Tax Composition:

- (1) *Capital Tax*: No, evidence actually contrary: L less; R more. [*return to this puzzle in Hays*]
- (2) *Income Tax (& not Consumption)*: generally supportive to mixed/ambiguous

c) Spending:

- (1) Castles ('82): L= \uparrow Gov Cons, PubEd, PubHealth; R= \downarrow total spend, welfare, social transfers & subsidies, PubEd, PubHealth;
- (2) Gen'ly Supportive Cross-ctry/long-run evidence since; TSCS mixed & often flawed
- (3) Some evidence that C-Dems different Secular Conserv, w/ C-Dems less anti-welfare.
- (4) Iversen '97, & others: some evidence not amount spend much as content & mode; e.g., w/in soc safety-net, R more-exclusively via direct trans, L by gen'l Gov-Cons [*why?*]

d) Overall Fiscal Stance: i.e., Deficits & Debt:

- (1) Alesina & Perotti: not simple & straightforward: Deficits & Debt: Ctr>L>R; Probability(VeryTightPol): L>C,R; Prob("Successful Adjust"): L,R>C
- (2) Boix: L \Rightarrow \uparrow D only in '73-'82 period [*Why?*] Clark: CapMob & flex \Rightarrow \downarrow fiscal effect, so need more; [problem w/ other parts of these arg.'s; still need other explanations?] [see also Franzese '02]
- (3) If control *fiscal institutions* (Clark & Hallerberg; Hahm et al.; Hallerberg & von Hagen) & other political-economic conditions, hard find any simple relation partisanship & deficits/debt. [see, e.g., Franzese '02]
- (4)[Cusack '99,'01: (not the work Clark replicates & reconsiders below): better evidence that L/R not \uparrow/\downarrow debt, but L/R \uparrow/\downarrow activist, i.e., \uparrow/\downarrow Keynesian counter-cyclical (meaning respond more/less to macroecon conditions). [Franzese '07, '10 finds support this also.]]

4. [Franzese's Summary of previous results:

- a) *Tax*: fairly supportive overall T; $\frac{1}{2}$ pro- (inc-tax), $\frac{1}{2}$ anti- re (cap-tax): tax mix.
- b) *Spend*: mostly supportive both size & mix of spend, esp. mix, although some evidence L may be effective cutter in some circumstances.
- c) *Def&Debt*: very mixed, little support of anything simple re: L/R \Rightarrow D&D [Some support Left more Keynesian countercyclical than Right.]

5. Social-Democratic/Corporatist Model of Partisan Effects:

- a) Left & Labor often closely tied & some versions partisan arguments emphasize their combination &/or interaction explicitly in shaping policies &/ or outcomes
 - (1) E.g., Labor power via strike threat/activity; Left preferred pub-pol includes “*social wage*”; LftLab \Rightarrow high Social-Wage/low-Strike equilibrium;
 - (2) E.g., Lange & Garret ‘85 ff(et al.): **[DEF & EXPLAIN:]** *Encompassing, Coordinated, Tri-Partite Bargaining interacts w/govt partisanship \Rightarrow macro policy & efficiency*:
 - (a) *Coord Barg* \Rightarrow Lab restraint, if credible reason believe some of benefit directed back to Lab; Left Govt provides such credible commitment: Lft+Lab \Rightarrow \uparrow MacroPolActive & \uparrow Efficiency
 - (b) *Highly Decentralized Bargain* \Rightarrow Lab restraint if expect non-expansionary policy: Right + weak Lab \Rightarrow \downarrow MacroPolActive & \uparrow Efficiency
 - (c) *Left government+Decentralized labor* \Rightarrow lack of restraint \Rightarrow \uparrow MacroPolActive, but \downarrow Efficiency
 - (d) *Right government+Centralized labor* \Rightarrow lack of restraint \Rightarrow \downarrow MacroPolActive, and \downarrow Efficiency

b) Evidence:

- (1) That Union density or coordination [distinguish] \Rightarrow \uparrow SocWelfare, etc.: gen’ly good
- (2) That Left+Labor \Rightarrow fiscal or monetary policy & effect as argued: quite mixed.

6. Open-Economy Considerations re: Partisan Effects:

- a) [We'll see all this much more closely in Hays '09 to come]
- b) *Embedded Liberalism*: \uparrow Trade exposure $\Rightarrow \uparrow$ risk & anxieties of workers (voters), especially in small, concentrated economies $\Rightarrow \uparrow$ (a pro-trade) Left & Labor eqbm-coalition, & associated policies & outcomes
- c) n.b., high Cap controls/CapImmob; as \uparrow *CapMob*, convergence arg's have 2 big negative implications for this *Postwar Settlement (Class Compromise) on KWS* [see Rodrik '97 & later work; and Hays '09 again]:
 - (1) \uparrow competition for capital \Rightarrow Welfare State now less affordable
 - (2) \uparrow competition for capital \Rightarrow Keynesian activism now less effective
- d) Evidence:
 - (1) Rodrik'97; Cusack'97; Hallerberg&Basinger'98: mixed to not much evidence convergence;
 - (2) Hicks &Swank ('98,'01) some evidence *CapMob* & *FinLib* undermine Left-Labor eqbm
 - (3) Garrett: as *CapMob* \uparrow , gen'ly *more* beneficial LftLab effect, so expect divergence, not convergence, from globalization pressures.
 - (4) *Clark*: Reconsider Cusack quickly, then Garrett thoroughly.

C. Reconsider Cusack ('97): Party v. Voter Position Effect on G-Spend

1. Estimate Model Like: $G = \gamma_0 + \gamma_1 P + \gamma_2 (P - V) + \varepsilon$

- a) P : measure of the left-to-right position of the current government
- b) V : some measure left-to-right position voters (vote-wtd avg of *parties* prev elect)

c) *Interpretation:*

(1) γ_1 =response of policy to govt partisanship (preferred policy), controlling for how far govt's preference is from electorates' preferences

(2) γ_2 =response of policy to distance govt's partisan prefs from voters' prefs

(a) $\gamma_2 < 0 \Rightarrow$ right parties prefer smaller G than left parties do

(b) $\gamma_2 > 0$ (assuming $\gamma_1 < 0$) \Rightarrow both parties moderate toward voter prefs

(c) if $\gamma_2 = -\gamma_1$, then parties fully moderate to voters' position

(3) *Easier Interpretation:*

(a) $dG/dP = \gamma_1 + \gamma_2$ = effect rt wrd govt Δ , *controlling for, holding constant, net of voters' location*

(b) $dG/dV = -\gamma_2$ = effect rt wrd voter Δ , *controlling for, holding constant, net of govt location*

2. Findings [Table 6]:

- a) $dG/dP \approx 0$: seems little effect govt partisanship, once net voter position [in fact, most estimates slightly > 0 —probably insignificant, but can't tell; might suggest some small *Nixon-to-China* effect: right must moderate (slightly) more than left to maintain its credibility w/ voters]

- b) $dG/dV < 0$: policy responds intuitively to left-right preferences voters
- c) $\gamma_1 < 0$: parties *pref's* clearly diverge, just little policy effect net of voters' position
- d) *Summary*: seems primarily that Voter Preferences \Rightarrow Govt Partisanship \Rightarrow Partisan Policies; not much L/R *govt* effect controlling for voters' location.
- e) [Perhaps Clark's strongest evidence of no partisan difference, however: Voter pref measure entirely based on party location; smoother (better?) measure than P of that location, & lagged 1 yr (better?); the two measures are highly correlated.
 \therefore not clear how strongly should rely this finding re: distinction in coefficients; we know statistically when two corr'd measures same or almost-same thing, estimated coeff on better-measured term inflated & that on worse is deflated, perhaps even to reverse its sign.]

TABLE 6. Relationship between Government Spending and Government Center of Gravity (γ_1) and the Difference between Government and the Electorate's Center of Gravity (γ_2)

	Full Sample		Subsample	
	γ_1	γ_2	γ_1	γ_2
Entire period	−.65 (.14)	.70 (.17)	−.62 (.16)	.60 (.17)
1955/1961–73	−.79 (.15)	.89 (.19)	−.72 (.16)	.78 (.19)
1974–79	−.67 (.15)	.71 (.19)	−.60 (.16)	.62 (.19)
1980–89	−.69 (.15)	.74 (.19)	−.64 (.16)	.56 (.19)

Source: Cusack 1997.

Note: Full sample includes Australia, but excludes all observations prior to 1961. Numbers in parentheses are standard errors, deduced from the *t*-scores reported by Cusack (1997). All parameters are significantly different from zero at the .01 level or better.

D. Reconsider Garrett ('98): Partisan Politics in the Global Economy

1. Garrett's Arguments:

a) *Left+Lab* \Rightarrow pro-growth, employment, & equality [& less anti-inflation]: by public-spending, deficit, tax, monetary, & redistributive policy.

(1) [& also that these *Left* policies work better when strong, coordinated labor movement, *Lab*, to cooperate, acting supportively in wage bargaining.]

b) Globalization \Rightarrow \uparrow cap. compet. \Rightarrow \uparrow cost govt intervene; *OR* \Rightarrow \uparrow economic dislocate \Rightarrow \uparrow pub demand govt intervene; *OR* both \Rightarrow empirical Q which wins

2. G's Model & Measures: [...] some important implications of including $\mathbf{a}_i + \mathbf{a}_t$ like this...]

$$\begin{aligned} a) \quad POL_{it} = & \mathbf{a}_i + \mathbf{a}_t + \text{CONTROLS}_{it} + rPOL_{i,t-1} + b_1 LLP_{it} + b_2 \underline{\text{Trade}}_{it} \\ & + b_3 \underline{\text{CapMob}}_{it} + b_4 LLP_{it} \times \underline{\text{Trade}}_{it} + b_5 LLP_{it} \times \underline{\text{CapMob}}_{it} + e_{it} \end{aligned}$$

$$b) \Rightarrow \Delta POL / \Delta LLP = [\text{effect of LLP on POL}] = b_1 + b_4 \underline{\text{Trade}} + b_5 \underline{\text{CapMob}}$$

c) Measures:

- (1) LLP: Left-Labor Power = Left-Party Cab-Share + lab-mrkt org'l encompassing score
- (2) CapMob: Capital Mobility = # cross-border cap-mrkt restricts [n.b., 93% smpl ≤ 2]; $Trade = (X+M)/GDP$ [n.b., almost all smpl $\geq 30\%$, $\leq 120\%$].

(3) POL: Policies: 5 spend, 5 tax, 2 overall AD stance (fisc: deficits; mon: int rates)

- (a) Spend: Total, Transfers, G-Consumpt, Industry Subs, Cap Spend
- (b) Tax: Tot Rev, IncTax Rev, Consumpt Tax, Corp Tax, Employer SS Tax

3. Predictions of [Simple] Partisan Model (Tab 7); Results (Tab 8):

TABLE 7. Predictions of the Partisan Model

Indicator	Predicted Relationship with <i>Left-labor power</i>
Total spending	+
<i>Spending on</i>	
Income transfers	+
Civilian government consumption	+
Subsidies to industry	+
Capital expenditures	+
Total revenues	+
<i>Revenues from</i>	
Personal income tax	+
Consumption taxes	-
Corporate income taxes	+
Employer contributions to social security	+
Macroeconomic policy	
Budget deficits	+
Interest rates	-

TABLE 8. The Estimated Effect of *Left-labor power* on Government Spending Conditioned upon the Degree of Trade and Capital-Market Openness

	Total Spending (1)		Income Transfers (2)		Civilian Government Consumption (3)		Subsidies to Industry (4)		Capital Spending (5)	
	<i>Cm = Cmg</i>	<i>Cm = Cml</i>	<i>Cm = Cmg</i>	<i>Cm = Cml</i>	<i>Cm = Cmg</i>	<i>Cm = Cml</i>	<i>Cm = Cmg</i>	<i>Cm = Cml</i>	<i>Cm = Cmg</i>	<i>Cm = Cml</i>
	(a)	(b)	(a)	(b)	(a)	(b)	(a)	(b)	(a)	(b)
<i>Left-labor power (Llp)</i>	0.082 (0.192)	-0.829*** (0.252)	0.068 (0.089)	-0.197** (0.106)	0.134* (0.097)	-0.168* (0.120)	-0.096** (0.051)	-0.156** (0.070)	0.081 (0.129)	0.038 (0.155)
<i>Trade</i>	-0.043* (0.024)	-0.043* (0.024)	-0.008 (0.011)	-0.008 (0.011)	-0.016* (0.009)	-0.016* (0.009)	-0.008 (0.007)	-0.008 (0.007)	-0.016 (0.012)	-0.016 (0.012)
<i>Capital mobility (Cm)</i>	-0.885*** (0.298)	-0.885*** (0.298)	-0.193 (0.151)	-0.193 (0.151)	-0.382** (0.155)	-0.382** (0.155)	-0.067 (0.083)	-0.067 (0.083)	-0.044 (0.181)	-0.044 (0.181)
<i>Trade · Llp</i>	0.008** (0.004)	0.008** (0.004)	0.001 (0.002)	0.001 (0.002)	0.001 (0.001)	0.001 (0.001)	0.003*** (0.001)	0.003*** (0.001)	0.000 (0.002)	0.000 (0.002)
<i>Cm · Llp</i>	0.228*** (0.058)	0.228*** (0.058)	0.066*** (0.028)	0.066*** (0.028)	0.075*** (0.028)	0.075*** (0.028)	0.015 (0.016)	0.015 (0.016)	0.011 (0.036)	0.011 (0.036)
Lagged dependent variable	0.806*** (0.025)	0.806*** (0.025)	0.859*** (0.030)	0.859*** (0.030)	0.860*** (0.026)	0.860*** (0.026)	0.785*** (0.040)	0.785*** (0.040)	0.709*** (0.052)	0.709*** (0.052)
<i>GDP growth</i>	-0.399*** (0.029)	-0.399*** (0.029)	-0.168*** (0.016)	-0.168*** (0.016)	-0.138*** (0.012)	-0.138*** (0.012)	-0.014* (0.007)	-0.014* (0.007)	-0.052*** (0.016)	-0.052*** (0.016)
<i>Unemployment</i>	0.086* (0.045)	0.086* (0.045)	0.068*** (0.019)	0.068*** (0.019)	0.008 (0.019)	0.008 (0.019)	-0.022* (0.012)	-0.022* (0.012)	-0.038* (0.022)	-0.038* (0.022)
<i>Old-age population</i>	0.241** (0.106)	0.241** (0.106)	0.134** (0.055)	0.134** (0.055)	0.006 (0.056)	0.006 (0.056)	-0.017 (0.025)	-0.017 (0.025)	-0.064 (0.055)	-0.064 (0.055)
Constant	5.291*** (1.651)	8.833** (1.744)	-0.141 (0.858)	0.630 (0.907)	1.972*** (0.751)	3.502*** (0.773)	0.642* (0.376)	0.909** (0.378)	1.873** (0.885)	2.047** (0.861)
<i>F_{DW}</i>	0.60	0.60	1.31	1.31	0.65	0.65	0.65	0.65	7.49	7.49
Prob. > <i>F</i>	0.661	0.661	0.267	0.267	0.629	0.629	0.629	0.629	0.112	0.112
Observations	350	350	350	350	350	350	350	350	350	350
Number of countries	14	14	14	14	14	14	14	14	14	14

Note: Columns 1a–5a use Garrett's coding for the capital-mobility measure; columns 1b–5b use transformed capital-mobility measure.

Panel-corrected standard errors are in parentheses.

The term *F_{DW}* is the test statistic for Durbin-Watson's *m*.

p* < .10, *p* < .05, ****p* < .01, one-tailed test for variables involving *Llp*, two-tailed otherwise.

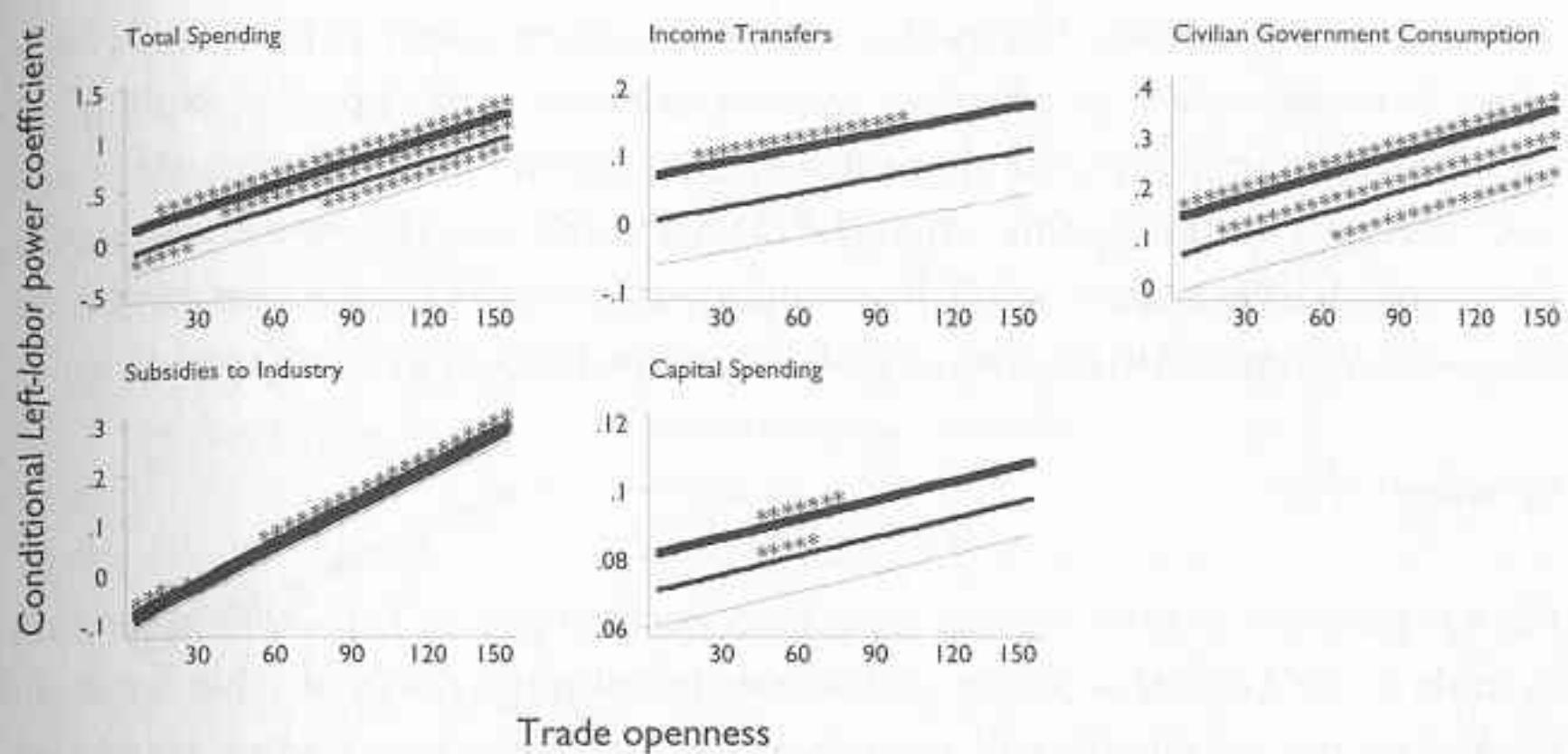


Fig. 5. The estimated effect of *Left-labor power* on government spending at various levels of trade and capital-market openness. Darker lines denote increased capital-market liberalization. (Note: * indicates coefficient is significant at $p < .10$, one-tailed.)

a) Spend:

- (1) Esp. recalling that $Trade > 30$, this remarkably GOOD for G's arg.
- (2) Least strong for Transfers & Capital Spending, but results basically Partisan as expect (mostly signify so as **) & ↑ in both *CapMob* & *Trade* (mostly signify so), so this would suggest “globalization \Rightarrow ↑ public-demand for social policy” side of arg dominating

b) Tax:

- (1) Considerably more mixed, less significant, & less good for G's arg.
- (2) Perhaps some partisanship in *Total Tax* as expected, but differences ↓ in *Trade* (convergence), while ↑ (slightly) in *CapMob* which is odd.
- (3) Income Tax ↑ in LLP, but significant only in mostly non-sample value-ranges, & convergence in *Trade* (significant) and *CapMob* (insignificant) here.
- (4) Consumption Tax & Corporate Tax: find opposite naive partisan story, find divergence & convergence respectively, but insignificantly so in both cases

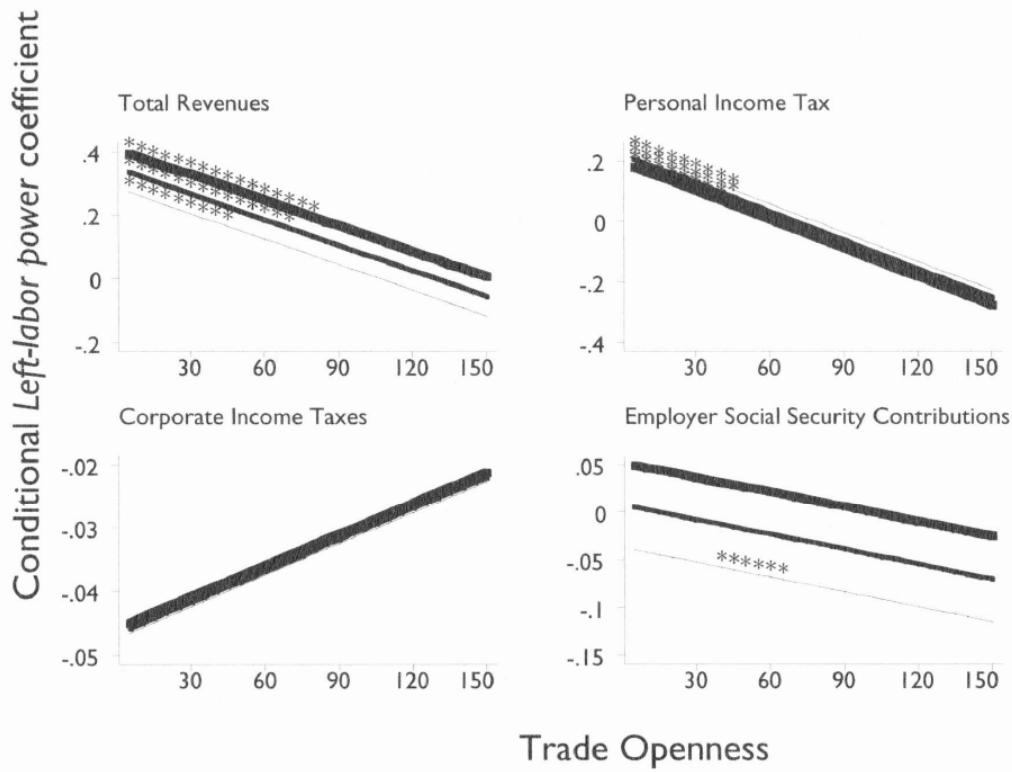


Fig. 6. The estimated effect of *Left-labor power* on government revenues at various levels of trade and capital-market openness. Darker lines denote increased capital-market liberalization. (Note: * indicates coefficient is significant at $p < .10$, one-tailed.)

(5) Employer Social-Security contributions mostly partisan as expected but not significant & these converge (significantly).

(6) \Rightarrow Conclusion:
Simple partisan tax-level & tax-instrument stories not well supported except for *Total Tax*, but some evidence of tax-competition & convergence (in trade only though, & (weakly) opposite in cap mob, which odd & very odd, respectively).

c) *Overall AD Policy Stance*: Deficits & Interest Rates (real 1-yr G-Bonds)

(1) [Garrett's IntRate model problematic:

(a) controls inflation (badly endog.), & US IntRate (\Rightarrow spatial dynamics & further endog.), & CBI (supposed to dampen partisan policies, not just an additive control), and...

(b) Policy instrument is ***nominal*** int-rates, which hard to back out of equation, but still...]

d) **Conclusions: pretty good for partisan policy & for Garrett on fiscal policy; perhaps some signs convergence on monetary policy,**
[but again convergence responding trade-open, not cap-mob (weakly opposite),

which is odd (& very odd)].

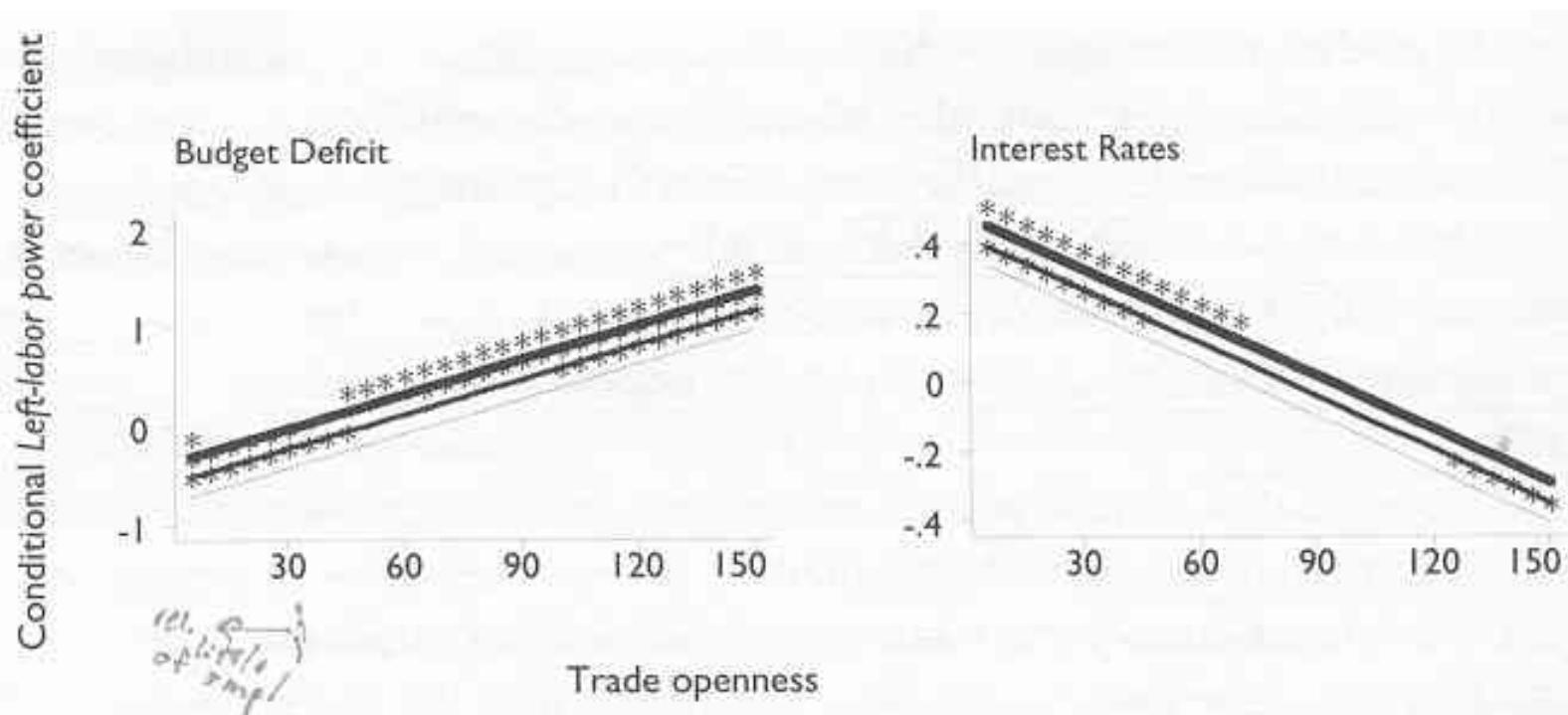


Fig. 7. The estimated effect of *Left-labor power* on macroeconomic policy at various levels of trade and capital-market openness. Darker lines denote increased capital-market liberalization. (Note: * indicates coefficient is significant at $p < .10$, one-tailed.)

e) CLARK: Reconsider Spend, Tax, & AD Pol, conditional also upon Exchange-rate regime:

$$(1) \text{ Model: } \text{POL}_{it} = \mathbf{a}_i + \mathbf{a}_t + C_{it} + r\text{POL}_{i,t-1} + b_1 \text{LLP}_{it} + b_2 \text{CapMob}_{it} + b_3 \text{Flex}_{it} \\ + b_4 \text{LLP}_{it} * CM_{it} + b_5 \text{LLP}_{it} * Flex_{it} + b_6 CM_{it} * Flex_{it} + b_7 CM_{it} * Flex_{it} * LLP_{it} + e_{it}$$

$$(2) \Rightarrow \Delta \text{POL} / \Delta \text{LLP} = b_1 + b_4 CM_{it} + b_5 Flex_{it} + b_7 CM_{it} * Flex_{it}$$

E. ELABORATION: All of Clark's empirical models some version of this:

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

Where EP ($ElYr$ or $PrtGov$) is either an electoral indicator ($ElYr$) or a govt-partisanship ($PrtGov$) indicator, and Policy is a fiscal or a monetary policy.

F. Models: Interpretation

1. In these models, the effects of Partisanship (i.e., size of partisan cycles), or the effects of an Election year (i.e., size of electoral cycles) depend on the combination of CapMob, Exchange-Regime, and CBI conditions according to:

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

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. CBI is irrelevant under these conditions. That is:

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

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

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:

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

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

$$\Rightarrow +\beta_4 + \beta_5 > 0 \text{ and } +\beta_4 + \beta_5 = -(\beta_7 + \beta_{12})$$

And so on...

But best for intuitive interpretation is to plot $d\text{POL}/dEP$ (effect of election-years or partisanship, size of electoral or partisan cycles) over ranges of values of CBI, CapMob, and E.R (see below)...

4. OK, back to Clark's Reconsider Spend, Tax, & AD Pol, conditional upon CBI, CapMob, and Exchange-Regime:

a) Model: $POL_{it} = \alpha_i + \alpha_t + C_{it} + r POL_{i,t-1} + b_1 LLP_{it} + b_2 CapMob_{it} + b_3 Flex_{it}$
 $+ b_4 LLP_{it} * CM_{it} + b_5 LLP_{it} * Flex_{it} + b_6 CM_{it} * Flex_{it} + b_7 CM_{it} * Flex_{it} * LLP_{it} + e_{it}$

b) $\Rightarrow dPOL/dLLP = b_1 + b_4 CM + b_5 Flex + b_7 CM_{it} * Flex_{it}$

c) Simple Convergence Story $\Rightarrow b_4$ & $b_4 + b_7$ opposite sign as b_1 (so cap-mob dampens political cycles, fiscal and monetary alike, regardless of exchange-rate regime)

d) Clark's Mundell-Fleming Story:

(1) fiscal convergence under flex, not fix [i.e., capital mobility dampens political fiscal cycles under float (b/c fisc relatively ineffective there) but not fix (b/c esp. effective there)] $\Rightarrow b_4 + b_7$ opp. sign b_1 , but not b_4

(2) [mon convergence under fix, not flex (b/c cap mob makes monetary cycles impossible under fix, but makes monetary policy extra effective under flex) $\Rightarrow b_4$ opp sign b_1 , but not $b_4 + b_7$]

(3) [Notes: M-F logic may not apply solely to G or to T, but jointly to G-T; ignoring CBI complication for now; and recall the sample range mostly $CM \leq 2$]

e) Conclusions **[see results 2 slides down]**: Largely similar to before...

(1) Cleanest results on Spending side, where looks Garrett-like, little difference by Exchange-Rate Regime, although *Individual Subsidies* insignificant & *Capital Spending* odd (& insignificant)

(2) Tax results mixed to counter the naïve partisan story; only *TotRev* remotely supports simple partisan story & only at high mobility; simple partisan story on *CapTax* and *EmpSS* looks increasingly wrong, only last shows any difference by exchange-rate regime.

(3) *Budget Deficit* & *Interest Rate* give some support partisan+M-F story

5. Conclusion [my version]:

a) Points where agree w/Clark:

- (1) Evidence of large partisan diff's in macroec policy not overwhelming.
- (2) Simple partisan tax story finds very little support in evidence.
- (3) Simple partisan convergence or divergence stories also at best mixed support.
- (4) Fisc. & mon. (Agg Demand) policies do seem conditional on combo *CapMob & E.R.*
- (5) Electoral cycle evidence [to come] more cleanly supports Clark's Mund-Flem model.

b) Points Clark may overstate:

- (1) Partisan differences in spending & responses to globalization seem largely as G argued, and, or albeit, largely unconditional on exchange-rate regime.
- (2) Partisan differences Capital/Employ Tax may actually be significantly opposite simple partisan story, & Garrett, & Clark—not just a null result: needs explanation.
- (3) Signs of Clark's Mund-Flem partisan cycles in Deficits & Interest Rates better than the book credits;
- (4) *CapMob* constrains MonPol *even in Flex*, just more so w/ *Fix* than w/ *Flex*; also signs that *CapMob* similarly constrains FiscPol *even in Fix*

Conditional Left-labor power coefficient

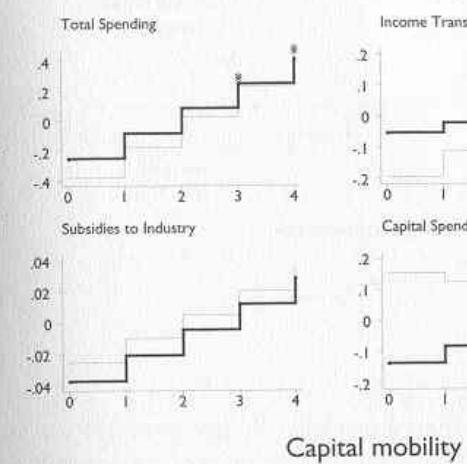


Fig. 8. The estimated effect of *Left-labor power* on government spending under various degrees of capital-market openness and alternative exchange rate regimes. Darker lines denote flexible exchange rate. (Note: * indicates coefficient is significant at $p < .10$, one-tailed.)

Conditional Left-labor power coefficient

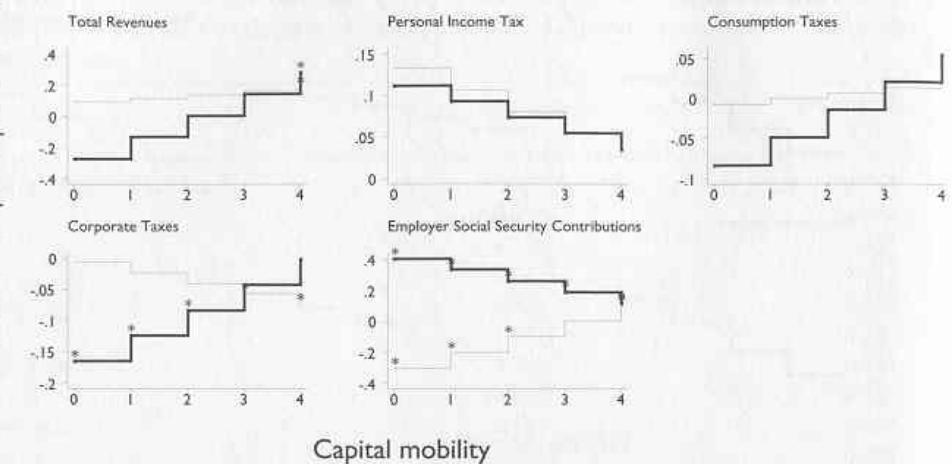
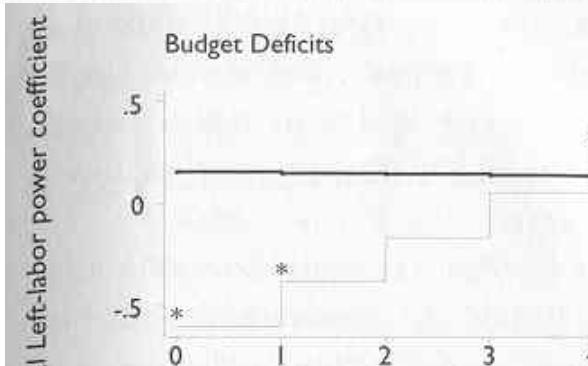


Fig. 9. The estimated effect of *Left-labor power* on government revenues under various degrees of capital-market openness and alternative exchange rate regimes. Darker lines denote flexible exchange rate. (Note: * indicates coefficient is significant at $p < .10$, one-tailed.)



Capital mobility

Fig. 10. The estimated effect of *Left-labor power* on macroeconomic policy under various degrees of capital-market openness and alternative exchange rate regimes. Darker lines denote flexible exchange rate. (Note: * indicates coefficient is significant at $p < .10$,

VI. Elections and Fiscal & Monetary Policy (Ch. 4)

A. Intro/Motivation:

1. If not [so much] partisan, then electoral?
2. Again, prev. lit ambig., can considering CapMob, ER, CBI \Rightarrow sense?
3. Clark et al.'s previous work:
 - a) CBI constrains electoral cycles; CapMob & Fix also constrains
 - b) Leaves an open and a more-refined question:
 - (1) Fiscal policy not necessarily constrained by these conditions;
 - (2) CBI constrains monetary cycles when *CapImmob*, or *CapMob&Flex*, but should not be able to do so when *CapMob&Fix* (beyond constraining effect that mobility & peg already).
4. \Rightarrow Reconsider w/ this fuller story: [n.b., some Δ s from partisan chpt:]
 - a) [Database: 1973-89 quarterly for monetary, 1981-92 annually for fiscal]
 - b) [CBI not considered in partisan case; considered here.]
 - c) [Now only *CapMob*, post-BW, post-OPEC era; & assume *CapMob* constant]
 - d) [Monetary-policy instrument now more appropriately d(M1)]
 - e) [No time-period dummies in monetary-policy models]
 - f) [*Partisan* tests used Left+Lab combo; *Electoral* tests use pure EleYr indicator.]
 - g) [In all, seems uneven, with mostly better chances for electoral than partisan.]

B. Electoral Policy-Cycle Hypotheses

TABLE 14. Electorally Induced Cycles in Macroeconomic Policy Instruments under Various Structural Conditions

	No Central Bank Independence	Central Bank Independence
Capital mobility and fixed exchange rates	Fiscal cycles; no monetary cycles	Fiscal cycles; no monetary cycles
Capital mobility and flexible exchange rates	Monetary cycles; no fiscal cycles	No fiscal or monetary cycles

C. Electoral Cycles in Monetary Policy:

$$1. \text{ Model: } m_{it} = b_0 + \sum b_j m_{it-j} + e_{it} + \dots$$

$$\dots + b_1 E + b_2 CBI + b_3 Fix + b_4 E * CBI + b_5 E * Fix + b_6 CBI * Fix + b_7 E * CBI * Fix$$

$$2. \Rightarrow dm/dE = b_1 + b_4 CBI + b_5 Fix + b_7 CBI * Fix \quad [\text{for dum-var model, } \Rightarrow]$$

$$a) dm/dE \mid_{CBI=Fix=0} = b_1$$

$$b) dm/dE \mid_{CBI=Fix=1} = b_1 + b_4 + b_5 + b_7$$

$$c) dm/dE \mid_{CBI=1; Fix=0} = b_1 + b_4$$

$$d) dm/dE \mid_{CBI=0; Fix=1} = b_1 + b_5$$

e) Only 1st should be distinguishable from 0 [$\Rightarrow b_1 > 0$; and $b_4, b_5 \approx -b_1$; and $b_7 \approx b_1$]

3. Results (Table 16):

- a) Gen'ly as expect: CBI & Fix each gen'ly constrain monetary electoral cycles, but some possibility *Fix|CBI* actually allows (which is odd). [n.b., “statistically insignificantly different from 0” & “equals 0” are very different things]
- b) Fig 11(next): continuous measure CBI \Rightarrow similar flavor, tho slightly less clean

TABLE 16. Conditional Effects of Elections
on Monetary Policy

Central Bank Independence	Exchange Rates	
	Flexible	Fixed
Calculated from column 1 in table 15		
High	-0.118 (.429)	0.866 (.655)
Low	1.071** (0.499)	0.859** (0.413)
Calculated from column 3 in table 15		
High	-0.202 (0.540)	0.159 (0.922)
Low	1.56** (0.725)	0.533 (0.553)

Note: The coefficients are conditional coefficients with conditional standard errors in parentheses.

* $p < .10$, ** $p < .05$, one-tailed test.

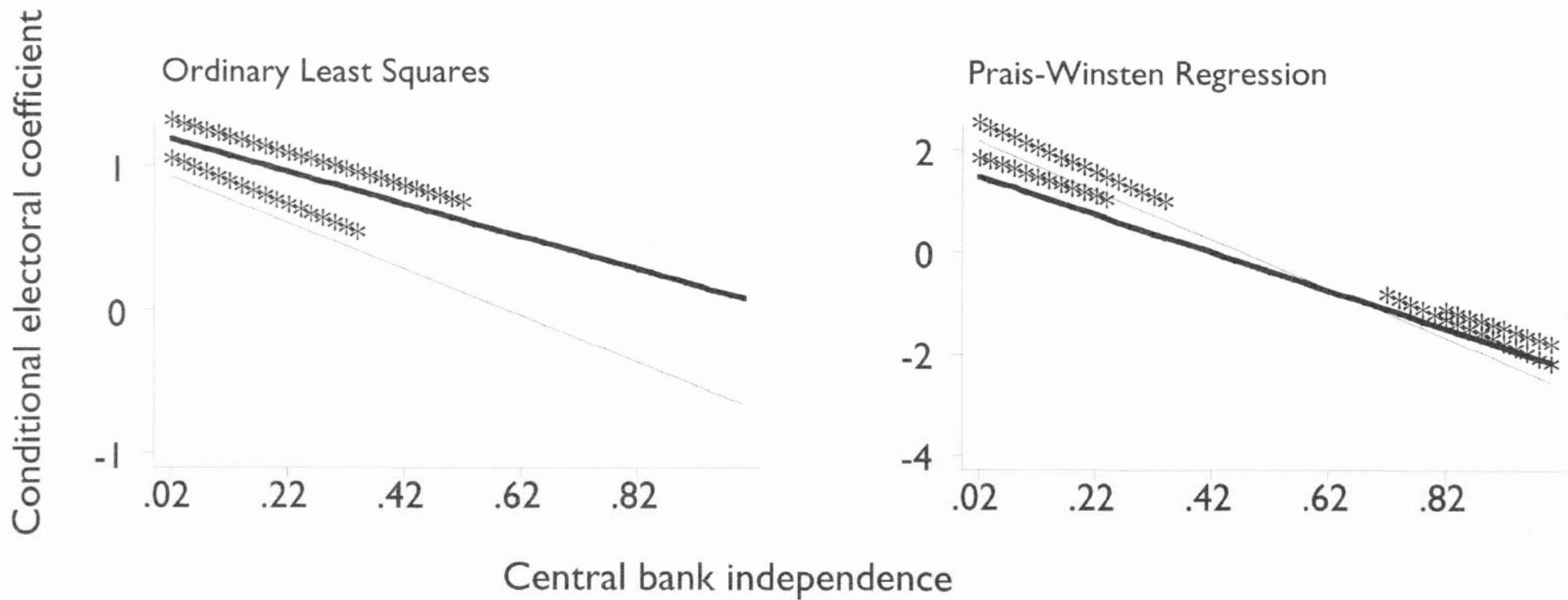


Fig. 11. The estimated effect of an election on the money supply under fixed and flexible exchange rates and various degrees of central bank independence. Darker lines denote ~~fixed~~^{floating} exchange rate. (Note: * indicates coefficient is significant at $p < .10$, one-tailed.)

D. Electoral Cycles in Fiscal Policy

1. Model A:

$$dD = \mathbf{a}_1 + b_4 dD_{t-1} + b_5 dU + b_6 D_{t-1} (r - y) + b_7 GovType + b_1 E + b_2 Flex + b_3 E * Flex + e$$

2. Model B:

$$dD = \mathbf{a}_1 + b_8 dD_{t-1} + b_9 dU + b_{10} D_{t-1} (r - y) + b_{11} GovType + b_1 E + b_2 CM + b_3 Flex \\ + b_4 E * CM + b_5 E * Flex + b_6 CM * Flex + b_7 E * CM * Flex + e$$

3. Model A $\Rightarrow d(dD) / dE = b_1 + b_3 Flex$; hyp: $b_1 > 0, b_3 \approx -b_1$

4. Model B $\Rightarrow d(dD) / dE = b_1 + b_4 CM + b_5 Flex + b_7 CM * Flex$;

[Hypoth: $b_1 > 0, b_7 < 0, b_4 \geq 0, b_5 \approx 0$; Clark not explicitly state]

5. Results (Table 17 (next),

Figure 12 (right)): Esp. if use reasonably accurate measure of E, EleYr (i.e., mine... ☺), quite nicely supportive of Clark/M-F electoral budget cycles.

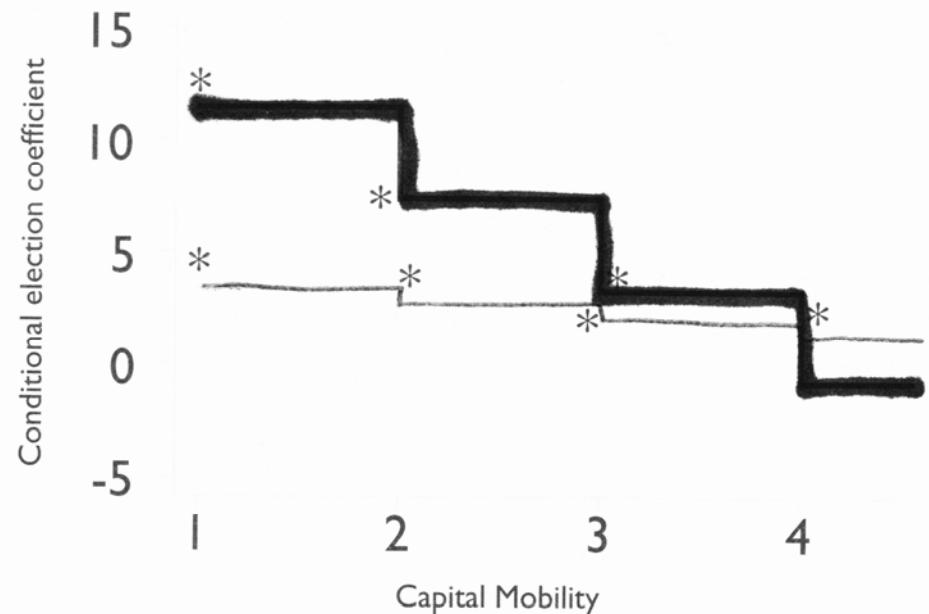


Fig. 12. The estimated effect of an election on government debt under fixed and flexible exchange rates and various degrees of capital-market openness. Darker line denotes flexible exchange rate. (Note: * indicates coefficient is significant at $p < .10$, one-tailed.)

TABLE 17. The Conditional Effects of Elections on Changes in Gross Debt in the Period 1982–92

	Coding of Elections		
	Standard (1)	Franzese (2)	Franzese (3)
<i>Election</i>	0.49 (0.60)	1.52** (0.75)	4.239 (3.341)
<i>Capital mobility</i>			0.549* (0.292)
<i>Flexible</i>	-0.20 (0.60)	0.14 (0.64)	-0.420 (3.839)
<i>Election · Flexible</i>	-0.26 (1.18)	-1.42 (1.25)	-0.742 (0.855)
<i>Election · Capital mobility</i>			11.320 (8.681)*
<i>Capital mobility · Flexible</i>			0.000 (0.972)
<i>Election · Capital mobility · Flexible</i>			-3.342* (2.253)
<i>d Debt</i> _{i-1}	0.47*** (0.10)	0.48*** (0.10)	0.442** (0.109)
<i>d Unemployment</i>	1.27*** (0.22)	1.27*** (0.22)	1.212** (0.216)
<i>d GDP</i>			
<i>d Debt costs</i>	0.38** (0.15)	0.39*** (0.14)	0.389** (0.142)
<i>Government type</i>	-0.17 (0.24)	-0.16 (0.25)	-0.257 (0.256)
<i>Intercept</i>	0.67 (0.59)	0.35 (0.63)	-1.098 (1.302)
Conditional coefficients			
<i>Election Flexible = 0</i>	0.49 (0.60)	1.52* (0.75)	
<i>Election Flexible = 1</i>	0.22 (0.85)	0.10 (0.98)	
<i>F_{DW}</i>	0.57	0.57	0.06
Prob. > <i>F</i>	0.66	0.69	0.99
Observations	206	206	206
Number of countries	19	19	19

Note: The dependent variable is the change in the gross-debt-to-GDP ratio. Following de Haan and Sturm, I do not include country dummy variables, although their inclusion does not affect the qualitative results. Note that the political variables (election, the three variables for the type of government, strong finance ministers, and negotiated targets) are evaluated according to a one-tailed test.

The term *F_{DW}* is the test statistic for Durbin-Watson's *m*.

p* < .10, *p* < .05, ****p* < .01.

E. Implications:

1. European Economic & Monetary Union

a) Concerns about fiscal excess arise from:

(1) *Fixed E.R.* (1 currency now) & *CapMob* \Rightarrow fiscal-policy dominant (although ECB in Frankfort may not monetary reinforce fiscal or to same degree as had domestic CB).

(2) *Moral Hazard / Common Pool:*

(a) if govts believe EU bailout, then \uparrow incentive to borrow (deficit).

(b) each individual country only a portion of the solvency of Euro \Rightarrow common pool \Rightarrow “over-fishing” that common resource, in this case, borrowing.

b) EU Moves to Limit these Problems:

(1) *Maastricht Treaty* explicitly banned EU bailout of member states;

(2) *Stability & Growth Pact* procedures monitor & punish excess deficits.

c) Whether work [enforce proved difficult & weak], this evidence is didn't affect Electoral [& maybe partisan] budget-cycles: timing of EU censure & action allows plenty room for domestic Electoral [& maybe partisan] cycles.

(1) *Alternatives*: negotiated budget targets or delegate to strong finance min (H&vonH).

(2) *Federal systems*: signs financial markets, *via* debt-interest premia, can induce states to self-regulate by anti-deficit &/or other tight rules in budgeting legislation (Poterba *et al*)

d) [VERY RECENTLY, Feb/Mar '12, midst Eur debt crises, esp. Greek, further moves strengthen & add teeth these procedures monitor & punish excess def's.]

2. Implications for *Policy-Tool Choice*: Given *CapMob* [& *CBI*], choose *E.R.* to max macro-policy maneuver & efficacy?
3. *Mon-Insts Choice*: Given *CapMob* [& *ER*], how choose *CBI* [would be joint...]
 - a) If *Flex*, $\uparrow CBI \Rightarrow \downarrow$ policy efficacy & autonomy [b/c only fiscal left & it ineffect.]
 - b) If *Fix*, $\uparrow CBI \Rightarrow$ no loss autonomy or efficacy [b/c only fiscal effective & mon dedicated to *Fix* either way]. \Rightarrow relatively cheap to buy some added credibility?
 - c) [If *CBI*, $\uparrow Fix \Rightarrow$ no loss autonomy (b/c CB had monetary anyway), maybe **gain** efficacy (b/c only fiscal effective & now CB can't move to counter)?]
 - d) [If *CBI*, $\uparrow Flex \Rightarrow$ **lose** fiscal efficacy, & **no gain** monetary autonomy b/c CB has that either way.]

F. A couple of final thoughts:

1. Why, if fiscal cycles under *Fix+CBI* (& *CapMob*), & fiscal policy should be effective, found no outcome cycles under these conditions?
 - a) Monetary blunt, macro instrument; Fiscal better suited to targeting; so these fiscal cycles not macro demand-manage cycles much as cycles of targeted policy?
 - b) [This wouldn't really work within the M-F macro logic, though.]
2. [Fiscal *is* better target though; &, n.b., partisan evidence too on fisc.]