ps343: Comparative Political Economy of Developed Democracies

Mid-Term Study Guide (Winter 2011)

I. Tufte, *Political Control of the Economy*
  A. Building Blocks of the Argument:
    1. Motive:
      a) Policymakers desire to retain office; i.e., incumbents desire re-election
      b) Voters myopically reward good economic performance &, more generally, delivery of economic benefits, and punish bad with electoral support or its denial.
    2. Opportunity: Policymakers...
      a) ...control some policies,
      b) ...that can affect voters' & other key actors' (perceptions of) econ experience,
      c) ...for which (perceived) economic experiences voters' and other actors' can & do credit/blame the incumbent.
    3. Weapons:
      a) Desirable characteristics of policies for electioneering, i.e., *Tufte's –ables*: (How? By whom? To whom?)
        (1) Targetable
        (2) Timeable
        (3) Manipulable, i.e., maneuverable
        (4) Palpable, i.e., palpably effective
        (5) Attributable
      b) Therefore, among most desirable specific policy tools:
        (1) Transfer payments (SS, veteran's benefits, other direct mailing of checks from government to populace).
        (2) Tax cuts (& delayed tax increases, i.e., deficits). Recent innovation: tax-cut rebates paid in advance!
        (3) Certain kinds of spending plans, esp. public works (and delayed spending cuts).
        (4) Increases (or delayed cuts) in public employment.
      c) Tufte's suggested summary indicator: growth real disposable income per capita [Why want a summary? What implications of using a summary?]

4. Conclusion: ⇒ policymakers “electioneer”, i.e., manipulate policies to produce perceived economic upturns & benefits before elections and obscure or delay until after elections any economic downturns & costs

B. Extensions, conditioners, & modifications: [for each, be able give some examples, explain how might alter simple, base electoral-cycle hypothesis]

1. Economic-policy control not necessarily unified in single policymaker
2. Degree of policymaker discretion, control, & maneuverability of policy, efficacy of policy, varies from policy to policy, situation to situation.
3. Endogenous election-timing
4. Expected closeness of coming election [why & how should this matter?]
5. Political stakes involved in particular elections varies across elections
6. To attempt to manipulate the economy may be politically costly (p. 23) [How so? What might be costly about it?] [What does this imply about electoral cycles?]
7. What is *kyphosis* and why does Tufte argue we might see kyphotic distribution of certain public-policy programs around election months?

C. Another Extension: A *Ramsey Rule* for Political Economy – [know the implications we derived for electoral cycles] Given multiple tools available to achieve some objective, here *electioneering* to win elections [and some other conditions about those tools' effectiveness], generally the case that (implications of the Ramsey Rule):

1. Use *all* the tools.
2. Use the tools *in proportion to their relative marginal returns* (tools with most effective profile of net effects (benefits-costs), most).
3. As need/desire to achieve the objective ↑↓, use of *all* tools ↑↓ accordingly, again *in proportion to their relative marginal returns*.

D. International Election Cycles?

1. Why did Tufte argue we might increasingly see elections in other Western democracies synchronized to the U.S. electoral calendar?
2. What does international economic integration and endogenous election-timing have to do with this?

E. Partisan flavor to electoral-competition motivated econ policies; Tufte's versions:

1. Parties of the Right would rank goals this way (according to Tufte):
    a) Low taxes
    b) Low inflation
    c) Modest and balanced budgets
    d) Oppose equalization
    e) Accept more UE for less INF

2. Parties of the Left would rank goals this way (according to Tufte):
    a) Equalization
    b) Low unemployment
    c) High wages
    d) Larger budgets (stress balance less)
    e) Accept higher INF for lower UE
3. (Not important that you be able to replicate contents or order of Tufte's list, but should be able to list some commonly expected differences in economic-policy emphases of left and right.)

II. Hibbs, *The American Political Economy*

A. (Ch. 1) Macroeconomy & Macroeconomic Policy Intro

1. 3 Striking Features Postwar rel. Prewar Econ
    a) Stronger real performance: growth & unemployment
    b) Far more stable macro- & micro-economy
    c) Consistently higher INF, i.e., P upward trend
2. Explanation & how macroecon demand-management policy works & how used
    a) Crucial Institutional Changes
        (1) Off gold standard => Monetary Policy & money growth possible
        (2) Central Bank Acts (in US, Fed Res Act 1951):
            (a) Lender Last Resort: FD(SL)IC => No panics
            (b) CB to manage macroecon & currency value
            (c) Lrg network fed loan guarantees, subsidies, etc. => socialization of invest risk ↑invest & growth
        (3) SocSec, Welf, UE insure, etc. soc empl & inc risk => ↓individ pain of "econ vicissitudes"
    b) Policy Shift: Keynesian Demand Management
        (1) Automatic Stabilizers (e.g., inc tax, UE insure) => ↓multiplier: $Y=C+I$, $C=cY$ => $Y=(1\ c)^{-1}I$ *vs.* $Y=cY^{disp}+I=c(Y-t_{net}Y)+I$ => $Y=(1-c+ct)^{-1}I$
        (2) Active Stabilizing Monetary & Fiscal Policy
            (a) Monetary: $dM(V)=(dP)(dQ)$, with short-run equilibration of dM mostly by dQ and/but that fading in long-run into mostly equilibration by dP.
            (b) Fiscal: $Y=(1-c+ct)^{-1}[I+\Delta(G-T)+(X-M)]$ &, note, fiscal stimulus, i.e. deficit tax & spend policies, $\Delta(G-T)$, => ↑Y^d and ↑P
        (3) How these shifts explain performance shift:

(a) Micro & Macro Stability: FDIC + the KWS (i.e., Soc Insure + Auto & Active Keynesian mon & fisc. stabilizing policy)

(b) Growth: Stability + fed borrow & invest support ↑I & dY

(c) Inflation: dM can sustain dP b/c off gold std, & does b/c stability "err on the high-side bargaining"

B. (Ch. 2) Costs of Unemployment
   1. Aggregate Costs: Obvious, large, and broad
   2. Distribution of Costs: Intuitively, "lower" ends of Soc-Ec hierarchies higher and more-cyclical UE
   3. Redistribution & unemployment insurance: broadly work (worked?) as intended but not nearly fully alleviates costs.

C. (Ch. 3) Costs of Inflation
   1. Aggregate Costs: At least for moderate-to-low INF, no or very little aggregate real costs found in evidence.
   2. Distribution of Costs: Also, more surprisingly, not much evidence of any sizable distributional effects; if anything, small adverse effect for top-20%, &, if large for anyone, only large adverse for top <1%.

D. (Ch. 4) Voters' Percepts & Perceived Costs UE & INF
   1. Salience of economy & of UE & INF therein high.
   2. "Biggest problem for nation": UE v. INF response to this question tracks well the ratio of those 2 objective rates
   3. Voters' relative aversion UE & INF differs persistently by income, occupation, & partisanship (in intuitive direction)

E. (Ch.5) Partisan Political Action (Opinion) in Response to those Perceptions
   1. Obvious pattern of "shadow evaluations" (partisan 'bias')
   2. Relatively homogenous myopia: about 20% decay/qrtr => about 50% of effect w/in year, 80% w/in 2yrs, 95% w/in 4yrs
   3. Relatively homogenously "partisan-team evaluators", as opposed to "incumbent-individual evaluators": about 75%-25%
   4. "Honeymoons" & "Rally 'Round the Flag" also evident
   5. Crucial Estimate: –(UEcost/INFcost)≈ -1.1 Dem; -.65 Rep; -.49 Ind.

F. (Ch. 6) '80 & '84 Elects: Elect Cycle or Voter Shift?
   1. Macro Evidence: '80 & '84 fit rest elect-cycle pattern well
   2. Micro Evidence: No sign right-shift until maybe toward end of period, which might suggest:

a) Standard electoral cycle (economic voting under the econ circumstances of 1976-92) => 12 yrs right-govt => policy shifts that move voters right?

G. (Ch. 7) Partisan Cycle Economic Policy & Outcomes

1. Logic of the Argument
    a) Parties have established reputations for serving different constituencies
    b) These constituencies have differing relative aversions of real & nominal macroeconomic costs
    c) Policymakers control policies that can affect this trade, at least short-run
    d) Voters know this and support accordingly.
    e) => Partisan cycle: real-, nominal-, & distribution-affecting policies and real, nominal, & distributional outcomes
2. Evidence: Partial-adjustment models UE, dY, & Inc Ineq (20/40 ratio) support.

H. (Ch. 8) Electoral vs. Partisan Cycles

1. Hibbs argues weakest link in Tuftean style Electoral-Cycle argument is claim that incumbents need support max'd at election time; H argues need throughout.
2. Re-estimates partisan models from ch. 7 w/ election indicators, finds strongest signs, though still weak-ish, of elect cycles in real disp inc per cap, but finds generally stronger & more-robust partisan cycles.

I. [(Ch. 9) The Reagan Revolution: didn't cover all of this in *Winter 2010*, so not all expected for exam. In gray = not covered this term.]

1. The Critic's Story:
    a) Laffer Curve & tax cuts => deficits (public borrowing)
    b) Rational-expectations monetary economics & Volker-Reagan deflation
    c) a+b => ↑↑↑ real e.r. => beach-head effect (inter alia)
    d) Politically: easy sell, especially in relevant audiences.
2. The True-Believer's Story:
    a) Laffer Curve & tax cuts => works; just takes decades, so not see until Clinton years…
    b) Neoclassical monetary economics & Volker-Reagan deflation: again, true believer argues works; just needed time to establish firmness of resolve
    c) a+b => ↑↑↑ real e.r. => beach-head effect (inter alia); for believer, this was necessary response to shifting US comparative advantage
    d) Believer argues: politically difficult sell, but was wise policy in long run.
3. Evidence: hard to distinguish; former is far easier case to make, but if (want to) believe latter, difficult to disprove.

III. <u>CLARK: Capitalism, Not Globalism</u> [In gray = not yet covered this term, so not for midterm].

A. ***Glblztn/IntlCapInteg & Convergence Args & Evi***

1. ***Standard Argument***: Trade & Cap-Mob sharpen capital's threat v. domestic gov'ts to flee "excessive & inefficient" tax & pub policies, forcing welfare/tax-state retrenchment & Tax-burden shifts from more-mobile cap (esp. financial) to less-mobile labor (esp. skilled-manual). Elaboration:

a) ↑inter-jurisdictional competition undermines tax-policy autonomy of individual tax authorities (e.g., US states), inducing tax-rate converge, esp. taxes on more-mobile assets.

b) Such inter-jurisdictional competition intensifies as cap increasingly liquid & mobile cross borders ⇒ virtually unmitigated race to some (ill-defined: below) bottom.

c) Central exemplar: striking post-70s ↑ int'l cap mobility & steady postwar ↑ trade integ. forcing welfare/tax-state retrench & shift tax burden from rel. mobile (cap, esp. financial) to rel. immobile (labor, esp. less-flex-spec).

2. Several ***Counter Arguments***:

a) ***evidence mixed*** on whether tax & other econ policy actually constrained/converging

b) General Gist of Most Theoretical Counters: ***Maneuvering Room*** b/c…

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

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

(3) ***Left-PubInvest & Right-Minimalism close enough*** to equally efficient economically & each suff'ly pol. effective for left/right, so either sustainable.

(4) Varieties of Capitalism: Institutions & Public Policies ⇒ comparative advantages ⇒ divergence (not convergence).

(a) ⇒fixed-cap mob. & trade integ. spurs specialization (of pub. policy & PE-inst'l struct. also) & not convergence;

(b) ⇒Only liquid-cap mobility spurs int'l tax-competition, & this ⇒ tax policies strategically interdependent & the race to a "bottom" not nec'ly≥0

(5) ***Domestic pol-econ & institutional constraints shape domestic policy-response to integration*** (e.g., capital endowment & majoritarian v.consensus democracy).

(6) ***Strategic Interdependence:*** insofar as any these considerations constrain 1 state, they ease capital-competition for their competitors

$\Rightarrow$ tax policy interdependt.

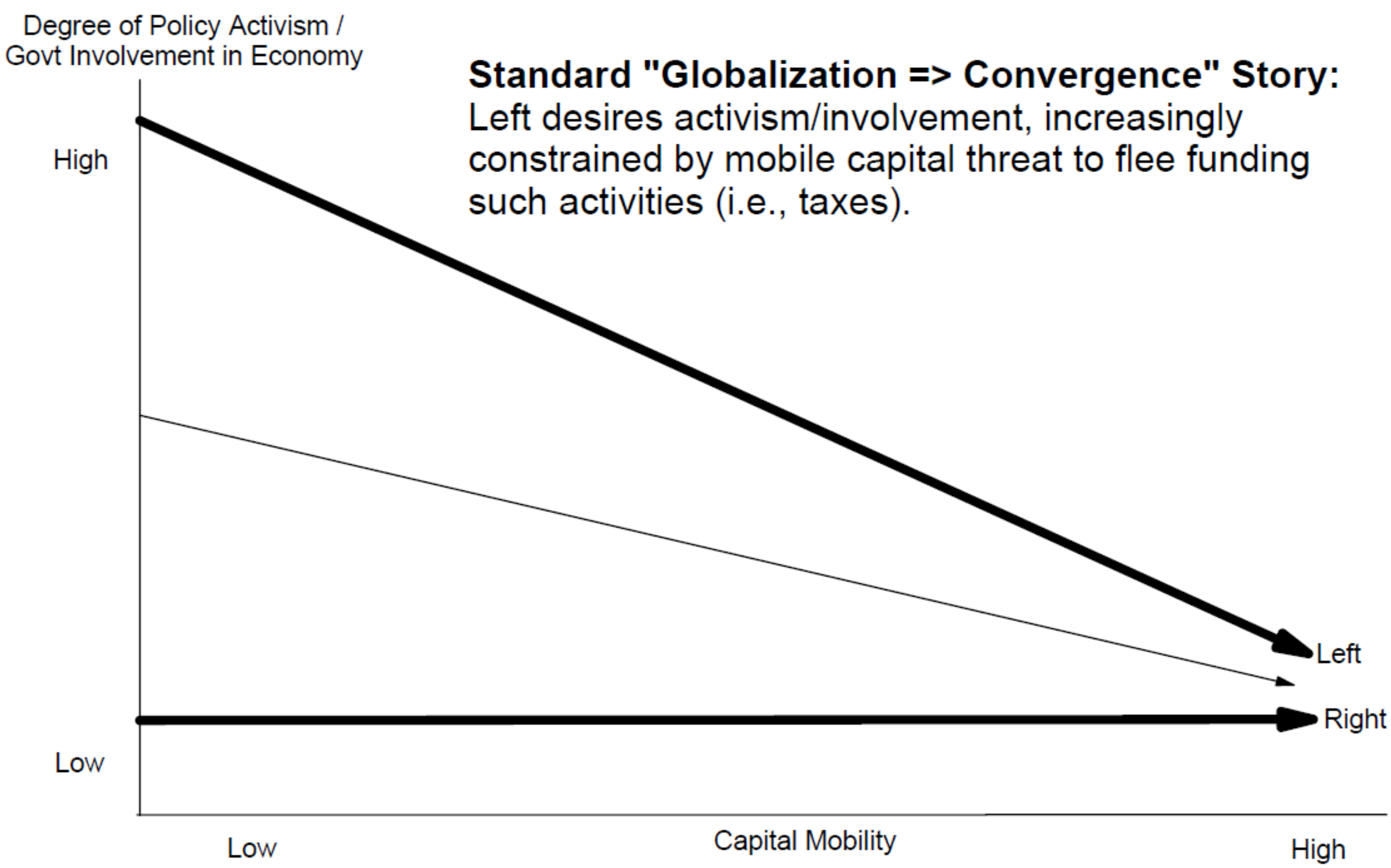
c) Clark's Counter: Never any [macro] partisan divergence in the first place for capital mobility to constrain/converge

(1) partisan convergence = "hallmark of [macro] economic policymaking in democratic capitalist societies &, consequently, predated recent rise in cap mob" (p.2)

(2) "domestic political consequences *globalization*—partisan convergence, constraints … to anticipate response of *footloose* capital…are not recent effects of changes in international economy. Instead, …enduring features of process of economic policy choice in polities dominated by private investment & electoral politics" (p. 2).

(3) Sum: ***Priviliged Position of Capital + Downsian Electoral Competition*** $\Rightarrow$ ***partisan convergence on preferred policies capital***

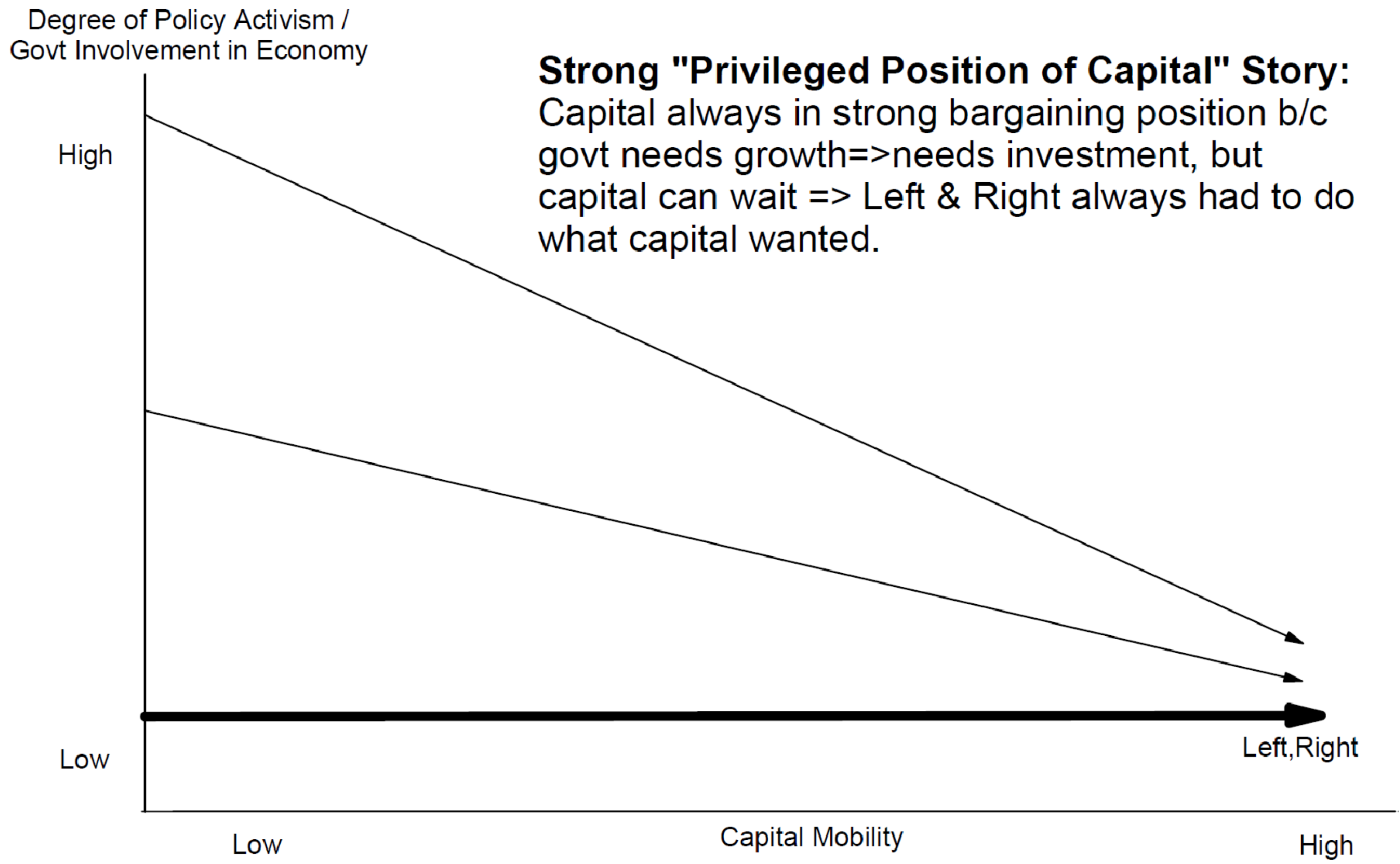
Pictures of Alternative Theories 'Convergence'



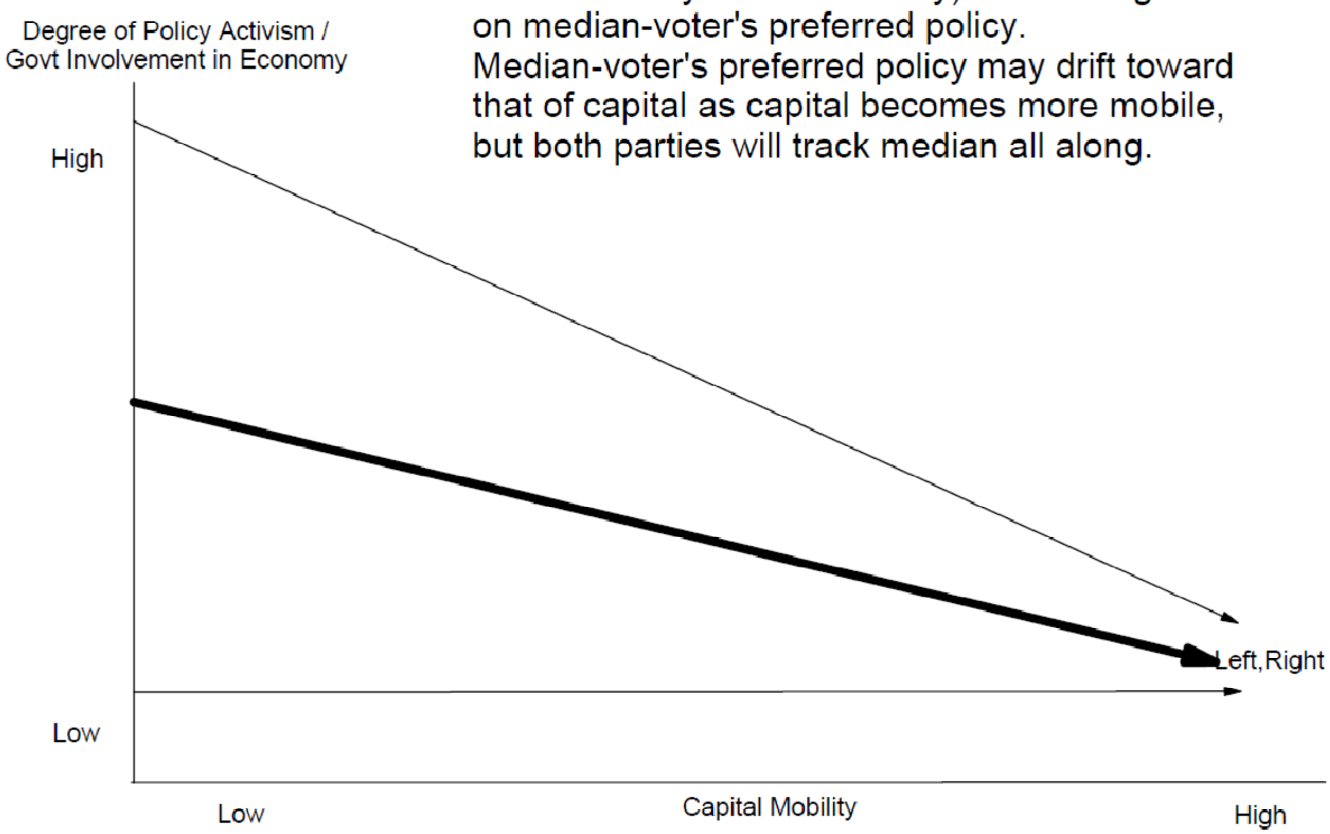
(Top line is left party/constituency preference; bottom is right party/constit.

Middle line is median-voter's pref. **Bold** is policy under that partisan govt.)

Strong "Privileged Position of Capital" Story: Capital always in strong bargaining position b/c govt needs growth=>needs investment, but capital can wait => Left & Right always had to do what capital wanted.



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.



B. Downsian Electoral Competition: Partisan Convergence & Divergence

1. ***Median-Voter Theorem (MVT) & Partisan Convergence***
    a) MVT: 1-dimension, binary vote-choice, sincere simple-proximity voting, "single-peaked" preferences ⇒ Median-Voter *Rules*
    b) MVT ⇒ strong centripetal tendency (convergence) of electoral compete
2. ***Theoretical reasons partisan divergence can emerge:***
    a) ***Multiple Dimensions***=>no necessary converge to dimension-by-dimension median
    b) ***Electoral uncertainty*** *(esp. re: med-vote pref)*: if uncertain where median is or how best to appeal thereto, then can only locate to *expected* median ⇒ can move from median w/ only some drop in probability win rather than with drop all the way to zero for any move at all from median. So parties choose to trade some probability of winning for being able to implement something to their prefs away from the median if win.
    c) ***Abstention***: if folks abstain when parties drift too far from them, & many voters away from median, then parties drift from median to draw in these extreme voters.
    d) *(Lobby-IntrstGrp)* ***Extra-Electoral Influences***: if resources beyond votes (e.g., $) matter for winning, & if those with such resources more extreme than median, then parties some incentive to drift from median to get those other resources. Note: need abstention & $ can help draw to polls or uninformed voters & $ can help inform/sway or some such for anything besides votes to matter.
    e) ***Credibility***: Divergence can also arise if pre-electoral promises must be credible, i.e. post-electoral optimal for winners to implement. Logic: w/ 2 parties, no entry, & 1-stage games (e.g., no reelects allowed) winners no incentive to implement med prefs if theirs differ, so voters only believe victors will enact victors' own preferences ⇒ full divergence. In repeated elections, prtys can build rep's for keeping word, allowing them to promise ⇒ some (not full) convergence ⇒ more divergence the less able parties are to commit (the lower credibility).
    f) ***(Potential) Entry & Multiple Parties***:
        (1) Free entry ⇒ no eqba; entry free, *any # prtys enter anywhere*. Roughly: systems w/ lower-cost entry [know what such sys may be] could sustain more prtys w/ greater degrees divergence.
        (2) Even just *potential of entry* ⇒ entry-deterrence reason to existing parties to diverge.
        (3) Note: by most entry/entry-threat logics, the parties diverge equistantly about the median, so median remains indifferent between the alternatives (disliking all equally).
    g) ***Swing Voters***: Parties target policies and craft their programs to appeal to swayable voters not their certain supporters. This usually taken to mean

moderates & so this taken as one version of the argument for why we might see strong convergence & not partisan policy divergence. However, abstainers of certain sorts or entry threats as explained above can imply that swing voters are out toward the extremes also ⇒convergence to degree more swayable voters centrist & extremes less swayable/more committed to their extreme & certain actually to vote for them.

C. Main Gist of Book: ***Implications of Central Bank Independence (CBI), Capital Mobility (CM), and Exchange-Rate Regimes (ER) for Domestic Democratic Policymaking***, using horse-race b/w electoralist & partisan models macroecon policymaking as venue for empirical explore.

1. ***Institutional-Structural Context of Macroecon Policy Choice: CBI, CM, & ER***

a) ***Capital Immobile*** ⇒domestic policymakers retain maneuverability & efficacy macro policies and ⇒exchange-rate regime irrelevant to maneuverability & efficacy macro policies

(1) ⇒***If CB independent***, then monetary policy unavailable (may even lean against fiscal)⇒fiscal cycles, with fiscal policy effective⇒ outcome cycles (but not so much in inflation)

(2) ⇒***IF CB dependent***, then govt retains both fiscal & monetary policy⇒both fiscal and monetary cycles, both effective (& having both can be more effective) ⇒outcome cycles (probably larger ones than with CBI)

b) ***Capital Mobile***⇒exchange-rate regime relevant to relative maneuverability & efficacy of fiscal vs. monetary macro policies

(1) [Notation: m=money supply; i=interest rate; I=invest; def=deficit; AD=aggregate demand; X-M=exports-imports=trade balance]

(2) ***If ER Fixed***⇒ *monetary unmaneuverable; fiscal hypereffective.*

(a) ↑m ⇒↓i⇒(↑I, but also) depreciation, which monetary policy-maker must fight by ↓m ↑i back (⇒↓I back) too keep ER fixed;

(i) alternative, shorter route to answer: if Fix & CapMob, then i must be held at rate nec. to maintain peg to foreign currency: domestic monetary policymakers have effectively delegated monetary policy control to foreign monetary policy makers.

(ii) Note: CBI irrelevant: bank or govt must maintain peg.

(b) ↑def⇒↑AD&↑i⇒appreciation, which must fight by ↑m↓i to keep peg (i.e., fiscal stimulus forces monetary policy to accommodate also, so doubly effective)

(c) ⇒expect fiscal cycles & not monetary cycles; fiscal cycles effective, so expect outcome cycles (maybe weaker cycles in inflation because of the exchange-rate peg)

(3) ***If ER Flexible/Float*** ⇒ *fiscal [relatively] ineffective; monetary*

hypereffective.

(a) ↑m ⇒↓i⇒↑I, & also depreciation, which ⇒↑(X-M) also, so monetary doubly effective.

(b) ↑def⇒↑AD, but also ↑i⇒appreciation, which ⇒↓(X-M) so fisc [rel] ineffective.

(c) ⇒fiscal ineffective, monetary available & doubly effective ⇒CBI matters

(d) ***If CB dependent***⇒expect monetary cycles (not fiscal) & money effective so expect outcome cycles

(e) ***If CBI***⇒then monetary unavailable & fiscal ineffective⇒ expect no policy or outcome cycles.

c) Summary:

(1) ***Cap Immobile***⇒ER irrelevant, domestic policies maneuverable & effective

(a) ***CBI:*** no monetary, fiscal only & effective

(b) ***CB*** dependent: monetary & fiscal & both effective

(2) ***Cap Mobile***⇒ER matters

(a) ***ER Fix*** ⇒(CBI irrelevant and) no monetary, fiscal only & it is especially effective.

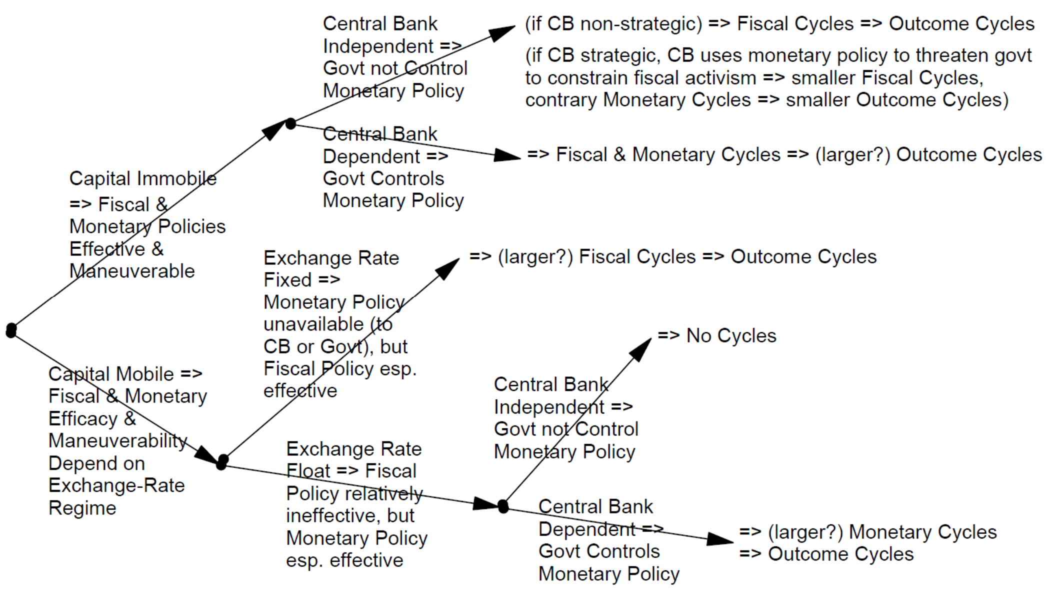
(b) ***ER Float*** ⇒ fiscal ineffective, only monetary⇒CBI relevant

(i) ***CBI***⇒no monetary, fiscal also ineffective, so no cycle

(ii) ***CB dependent***⇒no fisc., but mon. & it very effective

Flow Chart of Clark's Capital-Mobility, Exchange-Rate-Regime, & Central-Bank-Independence Conditional, i.e., Mundell-Fleming-Conditional, Electoral & Partisan Cycles

[you should be able to fill the last step, the theoretically predicted outcomes in terms of policy and outcome cycles, given the first parts]:



2. ***Findings:***
    a) ***Broadly support this expected Mundell-Fleming (M-F) pattern***
    b) ***Mostly weak results for partisan cycles***, although some positive signs on spending side & on composition of fiscal activity, and these findings in accord with Clark's M-F expectations
    c) ***Stronger, clearer, more consistent support M-F conditional elect. cycles***
3. Notes:
    a) ***Democratic Policymaking Highly Context-Dependent***: misleading at best to explore theoretically or empirically w/o consider context
    b) ***Clark's Study All at Macro Level***: given policymaker incentives toward more-targeted, surgical policies, we might, in fact, have some ideas here about how constraints or ineffectiveness in macro policy might spur micro-manipulations even more & vice versa.
    c) ***Only One Context Produces no Political Cycles***, but it does not follow that this one context is "best" in some normative sense for society. Depends on your interests. Depends on how much of 'the problem' you think is citizens, unified & homogenous, against policymakers & how much citizens v. citizens with conflicting interests as represented in policymaking by partisan representatives.