PS 641, Wk 12: Policymaking–Macro Political Economy

I. Premise:
  A. Increasingly unified study of PE of macro policymaking, policies, and outcomes (recent textbook compilation: Drazen '00, Persson & Tabellini 2000)
  B. Υ *Opportunity*: Explore in (a) electoral and partisan cycles in economic policies and outcomes, (b) special- versus general-interest politics, and the political economy (c) of growth and (d) of public opinion how the international and domestic institutional, structural, and strategic contexts of political competition condition policymakers' incentives, abilities, & effectiveness in managing economic policies & outcomes.

II. Classical Electoral and Partisan Cycle Theory & Evidence
  A. Coarse Overview:
    1. Democratic policymakers Υ strong partisan & electoral incentives regarding amount, nature, & timing of economic(-policy) activity
       a. Many ˆ expect government control effective economic policies Υ economic-outcome cycles: electoral calendar periodicity & incumbent partisan character
       b. Empirics typically Υ
          (1) Stronger partisan than electoral shifts in real economic performance
          (2) Stronger & more persistent electoral & partisan fiscal, monetary, & other policy than real-outcome cycles.
    2. Υ PE-GE (rational expectations in citizens' & policymakers' economic & political behavior) to explain empirical pattern (anomalies remain)
    3. Both under-emphasize variation in context–international & domestic, political & economic, institutional, structural, & strategic–in which elected partisan incumbents make policy
    4. Υ Opportunity: context-conditional electoral & partisan cycles offer
       a. Much promise for resolving anomalies
       b. Ideal substantive venue for theoretical & empirical advancement in C&IPE and in comparative democratic politics more generally
  B. Introduction
    1. Democracy Υ voters elect key econ pm's or elected officials appoint
       a. Voters prefer candidates they expect, perhaps via experience, to deliver greater material well-being…

       (1)   Υ incumbents powerful incentives to improve voters' economic fortunes, or to signal or feign ability to do so.

       (2)   Υ incentives sharpen near elections if voters weigh recent more heavily than distant past, which they may do myopically or rationally.

  b. Candidates wage & voters adjudicate electoral contests in partisan terms

       (1)   Competing parties cultivate strong ties to differing segments of voting public & nurture policymaking reputations favoring those segments & ideology

       (2)   Parties & voters value these partisan ties & reputations,

       (3)   Υ incumbents conduct recognizably distinct partisan policies, which may Υ appreciably distinct macroeconomic outcomes

2. *Classic E&PBC*: Nordhaus '75, Hibbs '77, Tufte '78[1]: govt control of effective econ policies + partisan electoral competition Υ observable, regular cycles in economic policies & outcomes w/ electoral-calendar timing & incumbent-partisan nature.

3. *Empirics:* stronger for partisan than electoral cycles in real economic performance; stronger & more persistent in electoral & partisan fiscal, monetary, & other policy than real outcomes

4. Υ *PE-GE models of E&PBC's* (Alesina '87, '88; Chappell & Keech '88; Rogoff & Sibert '88; Rogoff '90; Alesina & Rosenthal '95; Alesina et al. '97)[2] add RE to citizen & policymaker pol&ec behavior

  a. Can explain some of empirical pattern; yet critical anomalies & insufficiencies

  b. E.g., patterns & magnitudes of cycles of policies & outcomes do not accord well & don't follow known contextual variation in policymakers' incentives, control, or maneuverability (Drazen 2001; Franzese 2000, 2002a)

5. Both rational- & adaptive-expectations political-cycle studies typically underemph contextual variation (a) international & domestic (b) political-economic (c) institutional, structural, & strategic contexts in which elected, partisan incumbents make policy.

  a. Magnitude, regularity, & content of E&PBC's will vary w/ contexts reflected in differing combinations of conditions (a), (b), (c). In some {a,b,c}...

       (1)   ...domestic policymakers may retain less autonomy over some policies, or

       (2)   ...some policies more effect & ˆ more useful & ˆ used for electoral or partisan purposes, or

       (3)   ...some polities concentrate policymaking control in fewer, more disciplined

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[1] *Electoral*: Schumpeter '39, Kalecki '43, Ben-Porath '75, Lindbeck '76, Mosley '76, '78, MacRae '77, Frey & Schneider '78ab, McCallum '78, Chappell & Peel '79, Golden & Poterba '80, Beck '82a, '87, Lachler '82; *Partisan:* Beck '82bc, Alt '85, Hibbs '86, '87ab, '92, '94, Havrilesky '87. *Reviews:* Alt & Chrystal '83; Willett '88.

[2] *RE:* Cukierman & Meltzer '86, Nordhaus '89, Terrones '89, Ellis & Thoma '91ab, '95, Alesina & Roubini '92, Alesina et al. '92, '93a, '97, Garfinkel & Glazer '94, Alesina & Rosenthal '95, Sieg '97, Lohmann '98, '99, Carlsen & Pedersen '99, Faust & Irons '99, Gonzalez '99ab, '00), Cusack '00, Heckelman '01. *Reviews:* Paldam '97, Gärtner '00, Persson & Tabellini '90, '94, '00, '01), Drazen '00, '01, Olters '01.

partisan actors... *(Etc.)*

    b. Such contextual variation conditions pm's incentives, abilities, & efficacy in manipulating policies & outcomes for electoral & partisan gain in manifold ways–*which scholars can model!*–across democracies, elections, & policies[3]

6. **Context-conditional E&PBC's offer**

    a. Much promise in redressing lingering anomalies and insufficiencies

    b. Ideal venue for furthering recent theoretical & empirical advances in C&IPE:

        (1) Specifically, positive PE of macroeconomic policy

        (2) Generally, comparative democratic institutions & policymaking

    c. Need to unify more closely lit's represented by, e.g.,

        (1) *PS MPE:* Keech '95, Boix '98, Garrett '98, Iversen '99, Clark '02, RJF '02a

        (2) Comparative elect'l & govt'l instit's: Cox '97, Laver&Shepsle '96, Tsebelis '02

        (3) *Ec MPE:* Drazen '00, Persson & Tabellini '00, Grossman & Helpman '01

7. *E&PBC's* **ideal forum for exploring such institutional, structural, and strategic-contextual interactions because, in all democracies,**

    a. All policymakers & policies ultimately must survive electoral evaluation (indirectly for appointed, bureaucratic, other nongovernmental pm's); and

    b. All democratic competition manifests as partisan, representative, electoral competition, in which all parties develop, adapt, & maintain ideological rep's

    c. ˆ *Policy & Outcome E&PBC's* should emerge in all democracies, but to degrees & in characters heavily conditioned by multiple interactions of int'l & domestic, political & economic, institutional, structural, & strategic contexts

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[3] Moves toward explicit theories of institutional, structural, and strategic-contextual conditional policymaking may begin to answer Alt & Woolley's (1982) challenge from two decades ago.

C. Classical and modern studies of *E&PBC's*:

1. Alesina's Useful Classification:

POLICYMAKER MOTIVATIONS	*CITIZEN EVALUATIONS AND EXPECTATIONS*	
	Adaptive, Retrospective	**Rational, Prospective**
(Opportunistic) Office-Seeking	Nordhaus '75; Tufte '78	Rogoff & Sibert '88
(Partisan) Policy-Seeking	Hibbs '77, '87ab	Alesina et al. '87, '88, '93

   a. Adaptive, Retrospective Actors Models
      (1) Classic (Nordhaus '75, Lindbeck '76, Tufte '78) electoral macroecon cycles
         (a) pm's office-seeking & cits' adaptive expectations & retrospective evaluations
         (b) Y regular pre-electoral stimulatory macroeconomic policies, which spur real economy pre-election and defer any resulting adverse effects to post-election
      (2) Classic (Tufte '78) electoral cycles directly manipulable policies & outcomes
      (3) Classic (Hibbs' '77, '87ab) partisan cycles in policies & outcomes
   b. Rational, Prospective Actors Models
      (1) *Incumbent competence* (Rogoff & Sibert '88, Rogoff's '90, P&T '90) reproduces electoral cycles in policies & outcomes w/ private-actor rational foresight
      (2) *Election-induced surprises* in govt partisanship, & ˆ policy, reproduces (short-term) economic-outcome cycles from partisan policy cycles (A '87, '88; ALR '93; AR '95; ARC '97)
   c. Context-conditional *E&PBC's* policy & outcome: international & domestic political-economic institutional, structural, and strategic context

2. The Nordhaus Model (ARC: 17-22) [Also Lindbeck '76, MacRae '77]

   a. Economic Assumptions
      (1) Expectations-Augmented Phillip's-Curve Economy [can derive, but n.b....]:

$$y_t = \overline{y} + \gamma\left(\pi_t - \pi_t^e\right); \qquad \gamma > 0$$

      (2) Inflation-Expectations Adaptive [just error-correction/partial-adjustment]:

$$\pi_t^e = \pi_{t-1} + \lambda\left(\pi_{t-1}^e - \pi_{t-1}\right); \qquad 0 < \lambda < 1$$

   b. Political Assumptions
      (1) 2 identical, office-seeking candidates/policymakers, incumbent & challenger
      (2) Voters [identical] (dis)like growth, employment (inflation, unemployment), and discount past heavily
      (3) Policymaker controls policy instrument that affects aggregate demand
      (4) Timing of elections exogenously fixed
   c. => ARC Figure 2.1, p. 21
      (1) As election approaches, incumbent boosts AD Y growth 8, inflation 8 *[but assumed moderately and with some lag]*
      (2) As expectations catch up post-election, growth 6 ⑥ w/ B 8 *[more substantially]*
      (3) Returned incumbent then restrains AD Y B 9, although under some assumptions

not back to original level.

   d. [Issues:
      (1)   Identical candidates & voters?
      (2)   Multiparty elections & governments?
      (3)   pm's control multiple instruments w/ varying effect & to varying degree?
      (4)   Italicized require very specific relative effects & time-lines for AD policy. That *B-B* ⇒ real effect very suspect ⇒ monetary policy unlikely as modeled
      (5)   What are challengers doing in all this? What if they won?
      (6)   Exogenous election timing?]

3. Electoral Outcome-Cycle Empirics:
   a. That incumbents benefit from favorable macroeconomy absolutely clear:
      (1)   *US Presidential Elections, Strong & Unequivocal*: Kramer '71, Stigler '73, Arcelus & Meltzer '75, Bloom & Price '75,[4] Tufte'78, Fair '78, '82, '88, Hibbs '87a, ALR '93, AR '95: growth (tightest), inflation, unemployment(weakest)
      (2)   *US Congressional Elects, but Smaller & Weaker*: Tufte '75, '78; ALR '93; AR '95
      (3)   *Comparative:* Lewis-Beck '88 GE, FR, IT, SP, UK; Madsen '80 DE, NO, SW
      (4)   *Presiding over highly visible & popular policies* (e.g., Brender '99 deficit reduction)
      (5)   ⇒ Research on how institutional-structural context modifies *economic voting*:
        (a) Powell&Whitten '93 1-party disciplined govts more than multiparty or undisc'd
        (b) [Extension: expect voters to hold central govts more tightly accountable for macro outcomes in unitary than federal systems ⇒ sharper incumbent incentives to electioneer in disciplined, single-party-govt, & unitary systems than in others.]
        (c) See Electoral Studies (2000) for two full issues of reviews and extensions, many of which also suggest context-conditional electoral cycles.
   b. Opportunistic, office-seeking electoral cycles in (esp. *real*) outcomes weaker
      (1)   Partisan-cycle theory protagonists:
        (a) Alt & Chrystal (1983: 125), "no one could read the political business cycle literature without being struck by the lack of supportive evidence."
        (b) Hibbs (1987a) also doubts electoral cycles, arguing US presidents require popular support consistently, not just around elections, to pass agendas through Congress
        (c) Alesina et al.: US or OECD democracies ⇒ inconsistent for electoral policy cycles & very little for electoral outcome cycles, esp. real side.
          i) E.g., A&Roubini '92:
            a) Quarterly obs. on 18 OECD democracies. Base models, essentially maintained later:
            b) Regress growth on lags, control for world growth, and indicator for N-1 quarters pre-election, experimenting with N = {4,6,8} and estimating country by country.
            c) ⇒ no support for office-seeking electoral real-outcome cycles, whereas inflation tends to increase after elections.
            d) Conclude: Pre-electoral stimulatory policies ↑ INF, which, they argue, might support Rogoff's (1990) model of political budget cycles. (But Drazen '01: virtually any pre-electoral fiscal activism would spur post-electoral inflation.)
            e) Citing others: strong for electoral cycles in certain policy instruments, notably transfers.
          ii) Alesina et al. '92, '93a: similarly method & dataset ⇒ little sign of pre-electoral real outcome cycles, but some evidence of monetary expansion around, fiscal loosening before, and inflation increases after elections.
         iii) Later work (ALR '93, A&R '95, ARC '97) enhances econometric sophistication of rational-

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[4] Interestingly, Bloom & Price (1975) find voters asymmetrically rewarded incumbents less for economic booms than they punish them for busts.

partisan-cycle empirical models (see below), but electoral-cycle empirical models, samples, or findings essentially unaltered.

(2) Electoral-cycle theory protagonists:

    (a) Nordhaus '75: Significantly more pre- (post-) election years of falling (rising) than of rising (falling) UE in just 3 of 9 countries 1947-72. Relative significance[5] could support view that closely contested elections, strong & unified executives, & domestic policy autonomy induce strongest electoral outcome cycles.

    (b) Tufte '78: finds cycles esp. in real disposable income *(combines policy & outcomes)*, but also INF & UE in US data & some in a simple cross-national study

        i) Alt & Chrystal (1983: 120-2) question many Tufte results, esp. re: US real outcomes: "Not all of Tufte's evidence can or should be discredited. Sometimes there is observable evidence of a cycle and sometimes not."

        ii) A&C: irregularity of electoral cycles may suggest Mosley's '76 *satisficing* electioneering, public demand & hence policymaker action on economy heighten only when key PE conditions breach voters' attention filters. Mosley '78: some support for this early, simple alternative to later, sophisticated RE *competence-signaling* sporadic electoral cycles

(3) From wider view, evidence certainly mixed but less uniformly unfavorable:

    (a) Signs of elect outcome-cycle: Paldam '79, '81; Golden & Poterba '80; MacRae '81; **Haynes & Stone '88,'89,'90,'94**; Willett '88; Grier '89; Klein '96; Schuknecht '96.

    (b) Very Weak or No Sign: Lachler '78, '82; McCallum '78; Beck '82a, '87; Thompson & Zuck '83; Ahmad '83; Lewis-Beck '88; (& Alt, Hibbs, Alesina et al., noted above).

(4) In all cases, evidence of INF (& other nominal-outcome) increases around or after elections strongest of electoral-outcome-cycle results. (See Edwards '93 & Remmer '93 on INF & other monetary cycles in developing countries.)

(5) Usual approach: election-year (or quarters) dummy(ies) Y issues

    (a) Incentive & ability to manipulate not constant! (i.e., context-conditional cycles)

    (b) H&S '88, '89, '90, '94: any electioneering policies, and so any electoral outcome cycle, surely follow smoother path than election-period dummies could well approximate. 3-eqtn model of PC, AD, and policy reaction-function Y strong signs of 4-year UE-INF patterns in U.S. 1951-80 data, with peaks and troughs that seem consistent with the presidential election cycle. (See also Grier '89 & Klein '96)

    (c) Franzese '02a:

        i) Usually insufficient attention to timing of elections w/in years & relative to fiscal years

        ii) US electoral-cycle & seasonally adjusted data? 4-year-cycle dummies, but 1/3 Senate & all House elected every 2nd November & President every 4th Y likely purge $(1/3)(1/3)(1/2)+(1/3)(1/2)+(1/3)(1/4)=11/36$. 30.5% of electoral cycles pre-estimation

        iii) For this & other political-institutional reasons (see below), some US electoral cycles, on which most studies focused, may be small & so hard to uncover in data.

        iv) With challengers, post-election years at least as stimulatory, & more consistently so, than pre-election years (see below); ˆ pre- to post- comparison badly mis-specified.

(6) Recent work extends outcome purview to financial mrkts (Tufte mentioned)

    (a) Bernhard & Leblang '99: no sign election timing & exchange-rate regime choice correlate in parliamentary democracies

    (b) Leblang & Bernhard '00b: economic actors make probabilistic assessments of govt will end by election or dissolution. Comparing probability to actual event, find speculative attacks more likely when political surprise greater.

    (c) Leblang '02: speculative attacks on developing-country currencies also more likely during periods surrounding elections.

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[5] US p. 0.01, NZ p. 0.03, GE p. 0.09, FR p. 0.25, SW p. 0.39, UK p. 0.62, AL p. 0.70, JA p. 0.70, CA p. 0.87.

- (d) Bernhard & Leblang '02 identify 3 periods that contain key political information: campaign period (election announcement to day), negotiation period (election day to cabinet formation), and dissolution period when cabinet membership reshuffles: find greater forward-exchange-rate biases during these periods.
- (e) Leblang & Bernhard '00a: in GARCH framework, these periods also correlate with greater exchange-rate variability
- (7) Summary & Lessons (Learning from "failure")
  - (a) On balance: empirical literature Ɣ
    - i) some, but inconsistent & weak, evidence for electoral cycles in macroecon outcomes,
      - a) w/ that for real cycles generally weakest (but not wholly absent)
      - b) INF & other nominal outcomes (e.g., exchange rates) more clearly rise around or after elections, although regularity & magnitude may have varied across countries (Drazen '01)
      - c) Electoral cycles in certain economic policies, & especially in direct transfers, stronger & more regular, both statistically & substantively
      - d) That voters evaluate incumbents on past economic performance (apparently myopically) unequivocally supports existence of Tufte's "motive."
    - ii) Ɣ Economists, ˆ, naturally sought explanation for this pattern–stronger for nominal than real electoral outcome-cycles & strongest for electoral policy cycles–in Tufte's "opportunity," i.e., in adaptive-expectations, which produced exploitable Phillips curve
    - iii) But slippage as likely from implicit (& false) assumptions in most empirical work:
      - a) all incumbents seek re-election equally in all elections
      - b) all equally control policies that are equally effective in pursuing those aims
      - c) macroeconomic (growth, UE, INF) manipulation among key tools for this pursuit
  - (b) Lessons:
    - i) Don't do dumb, i.e. dummy, things! (if you can do better, & you usually can)
    - ii) Learn from insignificance, & from patterns of magnitudes & (in)significance.
    - iii) Rumors of electoral cycle (esp. policy-cycle) empirical demise (greatly) exaggerated; n.b., such apparent demise could condemn empirical as easily as theoretical models

4. Tufte & Electoral Policy-Cycles

- a. **Background:** Incumbs gain electorally from recent good macro conditions, so "incumbents may seek to determine the *location* and the *timing* of economic benefits in promoting the fortunes of [selves], their party, and friends" (p. 4)
  - (1) "The single most important fact about politicians is that they are elected. The second…is that they usually seek re-election..." (Tufte 1978, p. xi).
  - (2) "[This] simple fact of competition, especially when competition is informed by political ideology, explains a great deal of what goes on in the political world and…in important parts of the economic world also" (p. xiv).
  - (3) Brougham on (competitor) Pitt: "A Government is not supported a 100th part so much by the constant, uniform, quiet prosperity of the country as by the damned spurts Pitt used to have just in the nick of time," (p. 3)
  - (4) To which add Reagan's "Are you better off now than you were four years ago?" and Clinton's "It's the economy, stupid!"
- b. *Tufte's electoral-cycle mystery:* candidates' motives, opportunities, & weapons
  - (1) *Motive:* Incumbent politicians desire re-election and believe that delivering strong pre-election economic conditions to voters will achieve it.
    - (a) "economic movements in the months immediately preceding an election can tip the balance and decide the outcome of the election," and,
    - (b) b/c electorate rewards/punishes incumbents for material gains/losses, "short-run spurts…in months immediately preceding an election benefit incumbents" (p. 9).
  - (2) *Opportunity:* policy control and outcome manipulability

(a) Incumbents control macro policies that can exploit Phillips curve relations *and*

(b) Discretionary policies that can target & time benefits to voters near elections

(3) *Weapon:* Incumbents aim to deliver carefully timed economic benefits to key voters *[timing & targeting likely context-conditional]* Y prefer easily maneuverable policy instruments with clearly palpable and attributable (to incumbents) benefits to large numbers or specific groups of voters.

c. Implications:

(1) ***Preferred Weapons:*** transfers (soc. sec., veterans' benefits, other direct payments), tax cuts or delayed hikes, specific spending increases or delayed cuts (esp. public works), & public hiring or delayed firing *[context conditional]*

(a) "The quickest way to…[accelerate growth in] real disposable income is to mail more people larger checks; i.e., for transfer payments to increase" (p. 29).

(b) N.b., adaptive expectations & Phillips-curve exploitability largely irrelevant here

(c) Indeed, evidence for policy electoral cyclicality, esp. transfers but also other fiscal & monetary, among strongest, & best-replicated later across many country-times.[6]

(2) Argues accelerating real-disposable-income growth (being γ-t) reasonable summary indicator of electioneering across a range of policies

(a) Evidence less strong (see above): Only 8/15 election years in sample accelerating real-disposable-income growth *per capita*.

(b) Eisenhower & Exceptionality[7]

(3) Also claims higher UE in 12-18 months before presidential elections (1946-76) than around them (Fig. 1-2), but weak & problematic (see A&C '83)

(4) *State of the Union Addresses:* content-analysis, 1946-69 Y social-welfare & allocative policies 2nd-most prominent issues mentioned (behind foreign policy), & prominence rises over presidents' first terms, dominating by year 4; pattern repeats, but less starkly, in 2nd terms.

(5) Mentions, vaguely, that stock & financial markets notoriously attentive to election-year politics (see Leblang & Bernhard '00a,b; B&L '02)

(6) "Credit-Taking" and "Kyphosis" in election-year policymaking (Figs. 2.1-7)

(a) 9/13 soc. sec. payment increases from 9/50 to 6/76 in even-number yrs (Table 2-1)

(b) 8/9 within-year payment increases in even-number years (Table 2-1)

(c) Since '54, notice of increase comes with signed presidential message (Fig. 2-1) lest voters "misallocate" credit.

(d) Within-yr benefit hikes usually in Sept. & within-year tax hikes in Jan. (Fig. 2-2).

(e) Other examples of incumbents "making an election-year prank of the social security system and payroll tax" (p. 143). [N.b., A&C '83: some tales exaggerated]

    i) Veterans' payments also tend to peak in the fourth quarter of election years (Fig. 2-3)

    ii) Normally, transfer payments peak in December (7/8 odd-number yrs; Fig. 2-4), but in 4/7 even-number yrs, October or November was maximum (Fig. 2-5)

    iii) Soc. Sec. checks arrived around 3rd day of month:

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[6] Wright '74; Ben-Porath '75; Maloney & Smirlock '81; Beck '87; Ames '87; Alesina '88; Keech & Pak '89; Sheffrin '89; Alesina & Roubini '92; Alesina et al. '92, '97; Krueger & Turan '93; Schultz '95; Fouda '97; Price '98; Brender '99; Franzese '99, '02a,b; Gonzales '99a,b, '00; Moyo '99; Schuknecht '99, '00; Khemani '00; Shi & Svensson '01; Block '01a,b; Block et al. '01; Harrinvirta & Mattila '01; Clark '02.

[7] He suggests excluding the "abnormally" fiscally conservative Eisenhower administration [exceptional statistically at p. 0.026], leaving 8/11. However, Eisenhower's exceptionality suggests conditional electoral cycles, so begs a systematic theory to explain how current political climate or incumbents' beliefs might alter electoral cycles.

a) "octokyphosis" in 1964 & 1970, with elections early in first week of November,

b) "novemkyphosis" in 1962 & 1972, with elections on November 6 and 7.

iv) Congress likely enacted automatic (COLA) increases partly in response to voter concern, after 1972's shenanigans, over kyphotic & other electioneering tendencies.

a) Yet, still, new system collects soc.-sec. taxes starting Jan until yr's req fulfilled, which for many voters precedes November;

b) In 1978, after COLA restrained discretionary soc.-sec. increases, Congress shifted fiscal yrs from Jul 1-Jun 30 to Oct 1-Sep 30. (Spending tends to heap at fiscal-yr changes, 8 near end of yr, as agencies strive to spend remainders, and again near start of yr, with new programs.

(7) Incumbents can apply influence of office to adjust bureaucratic collection & disbursement processes to induce electoral kyphosis w/o new legislation.

(a) Subtlety in implementation yet palpability & attributability in receipt of such schedule-shifting electioneering places it among office-seekers' preferred tools.

(b) Moreover, powerful presidents can more effectively entice bureaucracies to shift timing ϒ more-popular presidents can induce more kyphosis *[context-conditionality]*

(c) Also ϒ to test Rogoff '90 implication that more-competent incumbents electioneer more, will need to distinguish competence from popularity/bureaucratic influence.

(8) Electoral cycles & endogenous election timing:[8]

(a) Where incumbents can call early elections, pm's might more easily schedule elections to coincide with economic expansions than vice versa (fn. 16, p. 14).

(b) As dev'd democracies' economies increasingly sync, elections elsewhere (almost all endogenous) would increasingly sync w/ US elections (exogenous) (Ch. 3).

i) Of G7 nations, only Italy greater growth in its than in US election yrs, & all saw more growth in their own election years than in non-election years (Table 3-1, Fig. 3-1).

ii) From 1959-70, 13 of 22 non-US G7 elections in odd yrs, but only 1 of 12 in 1971-76.

(c) Later more systematic analysis:

i) Thompson & Zuck '83: little evidence of such sync'ing

ii) Ito & Park '88, Ito '90: strong evidence of strategic election timing in Japan

iii) Alesina et al. '93: also in Japan but little support for the idea elsewhere

iv) Chowdhury '93 work on India, & most of later, more comparative studies listed above, uncovered stronger support.

(d) Pattern of Results (some strategic election timing, esp. in India & Japan: dominant-party systems), raises other considerations:

i) Early elections b/c incumbents opt for them, which likely when economic conditions especially good, or b/c coalition supporters abandon incumbents, which may force elections in some systems. Coalition partners might abandon govt when economy becomes especially bad, seeking to avoid taint of presiding over recession.

ii) If so, then economic conditions in countries w/ enodogenous election-timing may exhibit greater variation in election yrs compared to variation in non-election yrs than the same comparison will reveal in exogenous-election countries.

iii) Also, opportunistic election timing to *strong* economies should occur more regularly in single-party than in coalition governments (see also Smith '96, '00).

d. ˆ, in Tufte's View:

(1) Incumbents' several instruments for securing electoral advantage:

(a) Fiscal & monetary policies to manipulate exploitable Phillips curves,

(b) More-direct transfers to large or strategic groups,

(c) Policy timing

(d) Election timing.

(2) Across policies & outcomes, theory and suggestive evidence that

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[8] See Chappell & Peel '79; Lachler '82; Ito & Park '88; Ito '90; Balke '91; Cargill & Hutchinson '91; Ellis & Thoma '91b; Alesina et al. '93; Chowdhury '93; Smith '96, '00; Heckelman & Berument '98; Reid '98; Heckelman '01.

(a) Manipulating real disp. inc. *p.c.* > UE among incumbs' pref'd tools (p. 57),

(b) Incumbs prefer transfers to broad macro policy or outcome manipulation,

(c) They most prefer policy timing, or, in some settings, election timing.

(3) Ɣ **An electioneering *Ramsey Rule*:** incumbents use all available policy tools for electoral gain in proportion to their utility toward that end.

(a) *Ramsey Rule* (public finance): with multiple revenue-generating instruments of positive & increasing marginal costs available to fund some task, using all the instruments in inverse proportion to their marginal costs is optimal.

(b) Ɣ Electoral cycles in composition as well as in amount of public activity,

(c) Ɣ More-prominent cycles in policies than in outcomes,

(d) Ɣ More prominent cycles in some policies than others, and

(e) Ɣ Amount & character of policy-composition electioneering also *context conditional* (see Rogoff '90, Mani & Mukand '00, Chang '01).

e. Tufte '78 also mentions several other complications, some of which later conditional-electoral-cycles studies (see below) explore more closely:

(1) A single incumbent does not usu. hold full economic policymaking control; ˆ to electioneer, policymakers (plural) may have to surmount

(a) Common-pool (e.g., Goodhart 2000), agency (e.g., Alt 1985), and/or veto-player (e.g., Franzese 2002a, ch. 3) problems in coalitions;

(b) Coordination problems b/w central banks & govts (e.g., Cusack 2000); &/or

(c) Other delegation and shared policymaking issues (e.g., Franzese 2002b).

(2) Degree of pm discretion varies across policies by international & domestic institutional-structural setting:

(a) CB autonomy, global-economic exposure, & exchange-rate regime; see Bernhard & Leblang '99, '02; Franzese '99, '02b; Oatley '99; Boix '00; Clark & Hallerberg '00; Leblang & Bernhard '00a,b; Clark '02.

(b) Role of reserve assets (fn. 1, p. 69) &, by implication, monetary & fiscal solvency more generally, to policymakers' maneuvering room for electioneering, presaging, e.g., Blais et al. '93, '96 & Franzese '02a:ch.3.

(3) pms' & voters' beliefs *re:* economic reality (& *re:* others' beliefs) condition policies most-used for electioneering (recent ec-voting lit, e.g., Suzuki '92).

(4) Incumbs incur political costs if voters perceive them manipulating economy opportunistically (p. 23); given this cost, speculates that expected closeness of elections should augment electioneering. Many before & since: Wright '74, Frey & Schneider '78ab, Golden & Poterba '80, Schultz '95, Price '98.

(5) Electioneering asymmetric: governments defer some actions & hasten others in election years (*kyphosis*); recent work stresses electoral assymetry *re:, e.g.*:

(a) Reform or exchange-rate policy in dev'ing dem's (Frieden & Stein '01)

(b) Tax cuts or spending hikes in dev'd dem's (e.g., Harrinvirta & Mattila '01).

(6) His presidential-campaign case study illustrating spiral of candidate promises and counter-promises to raise transfers (pp. 35-36) suggests direct role for challengers in ratcheting electoral promises (p. 60) & founds Franzese's ('02a:chs. 2-3) explanation of some of his findings.

(7) Stresses most that political stakes, so electioneering incentives & electoral-cycle sizes, vary systematically across elections.

(a) For US, e.g., incumbent stakes highest in on-yr elections w/ incumbents seeking reelection, followed by on-yr elections w/o incumbents, then off-yr, & last non-election

yrs. (Table 1-3) growth in real disp. income *per capita* supports this ranking.

  (b) Not thoroughly explored since whether number & importance of policymaking offices at stake, which varies by election, affects cycle size.

 f. So, why electoral policy manip not even greater & more regular?

  (1) (E.g., Why opposition not sabotage? Actually, sorta do, but more-directly in delay/oppose policies favoring incumb constituencies.)

  (2) Essentially, b/c most pro-manipulation conditions do not always obtain (summarizes key context-conditional arguments presaged):

   (a) *Expected closeness of election:*
    i) Political costly if voters see incumbents as manipulating economic policy or, worse, economy, for political gain.
    ii) Such manipulation may limit maneuverability for future policy action or efficacy.
    iii) $\hat{}$ incumbents manipulate only in proportion to value of buying a few marginal votes, e.g., only to degree expect a close electoral contest.

   (b) *Variable political stakes by election:*
    i) As incumbs greater&more-unified stakes in election, electioneering more pronounced,
    ii) e.g., more in elects w/ greater shares of powerful offices contested & to degree incumb well-characterized as unitary actor.

   (c) *Shared policy control, conflict of interest among policymakers:*
    i) Shared policy authority: separation of powers, federalism, or bureaucracy (incl. CB)
    ii) If so, then bargaining, agency, coordination, & collective action will dampen or o/w complicate electioneering, esp. insofar as these entities serve different constituencies

   (d) *Maneuvering room:* Prior policy & outcome legacies (e.g., debt or monetary reserves) & policymaking inertia limit current ability to electioneer in certain policies.

   (e) *Incumbent character, ideology, competence, and beliefs:* (vague or self-explanatory)

   (f) *Varying issue saliency & policy efficacy:* Across elections & electoral cycle, diff outcomes have greater saliency w/ voters, & diff policies more accessible & effective in addressing them [depending on context]

   (g) *Endogenous election timing:* Election timing a policy option in electioneering
    i) ⋎ other instruments used less where election times endogenous, &
    ii) ⋎ frequency & conditions under which call strategic election also vary contextually

  (3) Plus several universal limits (suggests yet more C&IPE hypotheses):

   (a) Political control of economy usually operates only at margins; aggregate of private-sector actions determines most economic conditions.

   (b) Uncertain lead and lag times of policy implementation and effects thereof

   (c) Mutual agreements to "depoliticize" some econ policies (e.g., econ data collect & report; CB's?) limit access to or utility of some policies for electioneering.

   (d) Economic theory: pm's cannot easily ignore consensus among theoreticians (concerning free trade, no price floors or ceilings, etc.).
    i) Only strong political pressure can overcome such consensus, although well-organized groups, for example, may be able to apply sufficient pressure (Olson '65, '82).
    ii) Council of Economic Advisers gives economic consensus institutionalized voice in US; similar institutions of varying influence exist in all democracies.[9]

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[9] Some potential costs of *Political Control of the Economy*: Stop-go economies; "making an election-year prank of the social security system and payroll tax"; short-termism or myopic bias toward policies with immediate, highly visible benefits & deferred, hidden costs & away from policies w/ opposite; special-interest biases toward policies with small costs on many and large benefits for few and away from the opposite; and replacement of economically optimal with politically optimal adjustment paths (p. 144). Tufte acknowledges all of these costs. He discounts Nordhaus' prediction that Phillips-Curve exploitation implies "politically determined policy...will have lower unemployment and higher inflation than is optimal," noting that the data indicate voters are strongly inflation-

g. Issues & Lessons from Tufte's Treatment:
  (1) A&C '83 (p. 122): "Eclecticism is part of Tufte's problem" referring to tendency (reflecting intellectual climate of time? or near-exclusive 1-country focus?) to add these modifications to explain his data or examples entirely.
  (2) Applies conditionality *ad hoc* to explains too much, so that "whatever happens can probably be interpreted as supporting one of [T's args]" (A&C, p. 122).
  (3) Convert such *ad hoc* conditional hunches into theories of systematic variation in electoral-cycle magnitude or content Υ testable comparative hypotheses! I.e., model or at least control for such conditionality (Alt & Woolley '82).
    (a) Each consideration that conditions theory should, but often does not, also structure empirical analyses.
    (b) Omission may contribute to *ad hoc* sense &, *via* mis-specification, to apparent empirical weakness.

h. Other Empirical Work on Electoral Policy Cycles:
  (1) Even pre-Tufte, lit not only that certain policies should 8 or 9 around elections, but that closer elections should generate more such electioneering.
    (a) Cross-section of federal govt expend during 1930s, Wright '74 shows states w/ more competitive presidential races (in past voting history) received higher shares of federal spending on average.
    (b) Frey & Schneider combine office-seeking & partisan (see below) motivations to argue that govts that expect lower p(reelection) stress electoral relative to partisan aims more than those that expect better p(reelectoral).
      i) Vulnerable govts ˆ pursue "common" fiscal policies, ones "clearly preferred by a majority" of voters, pre-election, but victors become more ideological post-election
      ii) Frey & Schneider '78ab, '79; S&F '88 find support in German, UK, & US data
      iii) Pommerehne & Schneider '80 find Australian govt expend & transfers 1960-77 related positively, & total tax revenues negatively, to electoral vulnerability
      iv) Schultz '95 finds strong evidence of electoral cycles in UK transfers policy conditioned by expected closeness of elections
      v) Price '98 finds similarly in exploring his nonlinear modification of Schultz
  (2) When empirical specifications assume unconditional electoral policy cycles, or fail to control electoral closeness, or analyze less-direct policies, support for electoral policy-cycles weaker, although still stronger than for outcomes.
    (a) Alesina '88, e.g., finds some weak evidence of US electoral cycles in transfers
    (b) Keech & Pak '89 for US veterans' payments
    (c) Maloney & Smirlock '81 find non-defense spending rises some when new presidents take office, controlling for UE gaps; suggesting slightly more Keynesian spending in election years.
    (d) Golden & Poterba '80 find electoral-cycle indicators & pres popularity insignificant (mostly right signs) determinants of bdgt surpluses.

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averse and know right-wing parties reduce inflation, so that they could simply elect the right if concerned about inflationary bias. He offers several prescriptions for these ills, of varying practical and philosophical interest: reduce incumbent flexibility in calling elections (although the Ramsey-Rule logic actually argues he should rather suggest increasing flexibility), randomize election dates, desynchronize electoral and fiscal calendars, raise public attention to and knowledge of electioneering, or dilute political control of economic policy. Tufte is highly critical of the depoliticization movement. He notes its "well-financed" arrival after the events of 1972 and calls proposed cures "obtuse" in removing economic policy from political control, one place where democratic ideals seem most realized in practice, merely to reduce the particular problem of electoral economics.

(e) Hicks & Swank '92 find welfare spending in OECD dem's 1960-82 insignificantly correlated w/ pre-electoral indicators but highly responsive to participation rates, which may suggest conditionality.

(f) Thus, record for electoral transfers-cycles imperfect but mostly strong, esp. considering electoral-cycle specification weaknesses (Haynes & Stone '88, '89, '90, '94, & Franzese 2002) stress, which persist here, & esp. when empirical models allow cycles conditional on expected closeness.

(3)　Other Policies:

(a) Alesina and colleagues report monetary expansion around, fiscal laxity before, and inflation surges after US or OECD-country elections.

(b) Grier '87, '89 &, less sig'ly, Sheffrin '89 also find US elect monetary cycles

(c) Beck '87 finds higher US money growth around elections, yet no electoral monetary-reserve or Fed-Fund-rate cycles; suggests fiscal & other pol's more than monetary activism induce monetary & inflation cycles (see Drazen '01)

(d) Franzese '99, '02ab finds context-conditional post-electoral inflation surges, & pre- & post-electoral transfers & debt surges (transfers stronger) in OECD

(e) Clark & Hallerberg '00, Hallerberg '02, & Hallerberg et al. '01 find context-conditional electoral cycles in, respectively monetary pol, fiscal pol, & both

(f) Almost uniform support in dev'ing dem's for elect cycles in many diff pol's, although instruments vary: Ben-Porath '75, Ames '87, Edwards '93, Krueger & Turan '93, & Remmer '93; Schuknecht '96, '99, '00; Fouda '97; Brender '99; Gonzales '99ab, '00; Moyo '99; Grier & Grier '00; Khemani '00; Shi & Svensson '01; Block '01ab. Block et al. '01 review.

i.　Patterns of support:

(1)　Almost unassailable for direct-transfer cycles, strong in other policies & in inflation around or after elections, but weakest in real-outcome cycles

(a) Favors Drazen's '01 AFPM version of rational electoral & partisan cycles.

(b) Favors context-conditional, esp. Ramsey-Rule approach to electoral cycles.

(2)　That pattern + remarkably strong support in dev'ing dem's also suggest context-conditional cycles rather than fixed-magnitude, fixed-content cycles.

j.　The Forgotten Challengers:

(1)　Challengers play very indirect roles in all these models. Examples:

(a) Higher-quality challengers must lead incumbents to expect closer elections, so that closer elections generate more electioneering also suggests greater electioneering in elections w/ higher-quality challengers & in systems that often produce them.

(b) Challenger quality would modify incumbent incentives to signal competence, but how incentives change depends heavily on exact info assumptions.

i) Typical result that more-competent incumbents electioneer more, being better able to distinguish themselves from challengers that voters expect to be average, suggests that more-competent challengers incite less electioneering.

ii) May Ⴤ empirical leverage on (& does not bode well for) competence-signaling models

(2)　Franzese '02a finds electioneering in transfers & in deficits occurs both year before &, more pronounced & certain, year after elections. Argues:

(a) Campaigns involve incumb. & chall. counter-promises of largesse (Tufte '78)

(b) Incumbents can fulfill their pre-electoral promises & ˆ must to maintain credibility; winners can & almost always do likewise[10] for like reasons;

(c) *Ceteris paribus*, candidates who promise more w/ greater credibility win.

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[10] Pomper '71, Rose '80, Alt '85, and Gallagher et al. '95:ch.13 all report strong electoral-promise redemption.

(d) ˆ Pool of pre-electoral policymakers will contain some incumbents who promised &/or delivered too little, or were insufficiently credible, & who ˆ lost;

(e) Pool of post-electoral policymakers contains winners, incumb's *& chall's*, who promised, & so now must enact, greater largesse.

(f) Election ˆ filters for credibility × promised largesse.

(g) Thus, especially if newly seated govts most productive (an empirical regularity), post-electoral electioneering greater & more certain than pre-electoral.

(h) N.b., this could also explain:

    i) Some weaknesses in studies that compare only pre-electoral periods to all others

    ii) The generally stronger findings for inflation cycles than other outcomes

5. Classical Partisan Cycles in Economic Policies & Outcomes (Hibbs)

  a. As w/ electoral-cycle theory, basic tenets of partisan theory simple:

    (1) Expectations-augmented Phillips-curve economy,

    (2) Inflation expectations adaptive,

    (3) Policymaker controls instrument that affects aggregate demand,

    (4) Exogenous election timing, and, unlike electoral-cycle theory:

    (5) Cand's & voters *not* identical

      (a) Cand's contest & voters adjudicate elections in partisan terms

      (b) Competing parties cultivate strong ties to diff grps of voters & nurture reps for policymaking that favors those groups & accords w/ their ideologies.

      (c) Parties & voters value these partisan reputations & ties, so

    (6) Incumbents conduct recognizably distinct partisan policies Y appreciably distinct economic outcomes.

  b. Given Downs' '57, must first demonstrate parties pursue differing outcomes, & that this translates into enacting differing policies in office.[11]

D. **Hibbs, *The American Political Economy***

  1. **(Intro)** Motivation & Theme:

    a. "…avoidance of inflation & maintenance of full employment can be most usefully regarded as the conflicting class interests of bourgeoisie & proletariat…the conflict being resolvable only by test of relative political power in society & its resolution involving no reference to any overriding concept of social welfare" (H.G. Johnson)

    b. "This book deals with…connections b/w public opinion & electoral behavior, & macroeconomic policies & outcomes…macroeconomic policies & outcomes reflect intersections of both economic & political forces. This interdependence is usefully conceived in terms of demand for & supply of economic outcomes" (p. 1)

      (1) Perhaps no stable, long-run trade-off INF & UE (no std Phillips Curve), but achieving low UE (& high dY) & stabilizing INF often conflicting goals:

      (2) "Faced with demand shifts, supply shocks, labor-cost push, & other inflationary events, political administrations repeatedly…forced to choose b/w accommodating inflationary pressures by pursuing expansive monetary & fiscal policies, thereby foregoing leverage on pace of price increases to preserve agg. demand & employ., & leaning against such pressures by tightening spending & supply of money & credit, thereby slowing inflation rate, at cost of higher UE & lower growth" (p. 2).

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[11] Actually, Hibbs starts even sooner, w/ characterizing post-WWII economy, but we pick it up there…

c. *Main Themes:* "…economic interests at stake during [booms & busts], ways…class-related political constituencies perceive their interests & respond in…polls & voting… to macroecon. fluct's, & ways…econ. interests, preferences, & priorities of political constituencies transmit to macro. policies & outcomes observed under parties" (p 2)

2. Overview of Book:

   a. Striking features of postwar US macro performance in historical perspective

     (1)   Three notable features

       (a) Comparatively high real growth (absolutely & *per capita*)

       (b) Comparatively stable macroeconomy: fluct's quite muted compared to prewar eras

       (c) Near-continuous INF—price level rises steadily postwar; long-run flat before

     (2)   H stresses key instit'l & policy changes since Great Dep as underlying) s:

       (a) Enhanced macro. stability & individ. security through the *Keynesian-&-Welfare State*

       (b) => altered private-sector (firms', workers') expect's => 8INF expect. & pressure

       (c) Monetary policy & institutional changes (off gold std, then off Bretton Woods) allowed these pressures to produce sustained inflation.

     (3)   Understanding electorate's reaction to these & other econ outcomes requires knowledge of outcomes' aggregate costs/benefits & distribution thereof.

       (a) Main losers from UE & recessions = those at low end of occupation & income hierarchies; this only partly mitigated by tax-and-transfer (T&T) system.

       (b) Inflation: [first we will have to be sure we know what it is…]

         i)   little evidence that inflation hurts aggregate output,

         ii)   distributional consequences also generally small compared to unemployment's,

         iii) if anything it hurts the very wealthy (being asset holders)

         iv) => public's strong inflation aversion must stem largely from psych. factors &/or confusion b/w nominal infl. & relative (real) price moves, which pm's may abet

   b. Demand for & Supply of Economic Outcomes

     (1)   Some questions addressed regarding the "demand side":

       (a) How does support for pres. & her party depend on current, past, & perhaps E(future) perf.?

         i)   public response (polls & votes) reveals info. about its priorities & relative preferences

         ii)   and constitutes voter's demand for economic outcomes

       (b) How relative concern over INF & UE varies across electoral groups: Dem's, blue collar, lower income more UE-averse, less infl-averse than Rep's, white collar, & higher income; **n.b., the relevant comparison is:**

[(UE aversion)/(INF aversion)]$_i$ relative to [(UE aversion)/(INF aversion)]$_j$

       (c) Some very precise questions regarding electorate's reaction to economic outcomes:

         i)   Rate at which past performance is discounted,

         ii)   wt on cumulative party performance relative to that of particular admin's & pres's,

         iii) relative weights on unemployment & inflation.

     (2)   Some questions addressed regarding the "supply side":

       (a) Policymakers seek to…

         i)   …maintain comfortable support level during term,

         ii)   …maximize votes at election time,

         iii) …serve ideological & distributional goals of their core constituencies,

       (b) …as constrained by institutions such as…

         i)   …central bank autonomy,

         ii)   …executive-legislative relations,

iii) ...federalism,
(c) ...and by economic reality & conditions such as...
   i) ...*e.g.*, the shape of the Phillips curve *etc.*,
   ii) ...international conditions, influences, and institutions.

  c. **Four basic policy options:** monetary, fiscal, direct controls, rhetoric & persuasion. Regardless of which, must adopt theory of how economy works

3. Working roughly in New Keynesian mode, Hibbs' core arg:
   a. **Two central political influences on macro policy = partisanship & electoral incentives**
      (1) Left seeks lower UE, higher dY, & will accept higher INF to get them
      (2) Right seeks lower INF & will accept higher UE & somewhat lower dY...
      (3) Also, democrats will exhibit greater efforts at equalization & Republicans less
   b. H: partisan influences decidedly more potent, at least in US, than electoral

4. **(Chapter 1)** Postwar Macroeconomic Performance:
   a. In Historical Perspective: Figures 1.1-1.6 tell the tale
      (1) Relatively greater (Fig. 1.1) & more stable postwar growth (Fig. 1.2 & Table)
      (2) Postwar UE lower than pre-depression, but not dramatically (Fig. 1.3); UE dramatically more stable (Table below Fig. 1.3, Fig. 1.4)
      (3) Inflation
         (a) Postwar steady 8 price-level sharp contrast to flat prices Civil-WWI: p stable in peace, 8 in war, & return, but bit higher (Fig 1.5)
         (b) Postwar greater inflation-rate stability less obvious but there (Fig. 1.6 & its Table)
      (4) International Perspective: very little of the US postwar experience unique
   b. Hibbs has interesting explanation for 3 big facts of postwar macro experience
      (1) High, sustained real-income growth unexplained in my view
         (a) H argues +/- explicitly later that successful KWS implementation spurred this
         (b) KWS: Keynesian macro policy + auto. stabilizers in tax-&-transfer & related sys
      (2) Macro stability & individual security stems very directly from KWS
      (3) Opportunity for sustained inflation opened by removal of gold standard; motive force is actually the stability & security achieved by KWS.
   c. As usual, offers much direct evidence relating to these arguments [see text]

5. The Costs of Unemployment **(Chapter 2)**
   a. Definition, measurement, & interpretation (see notes)
   b. Aggregate Costs of Unemployment
      (1) Economically, obvious: UE/ unused human resources/ lost output/income.
      (2) Political impact even greater:
         (a) UE / rate: given that people get & lose jobs, 5% UE usually means about 12.5% to 15% of labor force will have been w/o work for at least part of that year
         (b) Vicarious experience of those who know or see those unemployed themselves
         (c) Those who face increased risk of UE
      (3) Even estimated psychological, social, & even medical costs of UE appreciable
         (a) National levels of all of following found related to UE (in obvious ways) by various researchers: stress, mental health, suicides, cardiovascular & renal disease, crime
         (b) Summary estimation (in '70s): +1% UE/yr => 30,000± more deaths in that yr.
      (4) **Okun's Law**: tight empirical relationship b/w output growth-rate & dUE

(a) Using 1950–1983 Annual Data **(equation 2.1, p. 50)**:

$(\ln Q_t - \ln Q_{t-1})$ $\quad = \quad +0.036 \quad\quad -0.021\ (U_t - U_{t-1})$

    Std. Errs.: $\quad\quad\quad$ (0.002) $\quad$ (0.002) $\quad\quad\quad\quad\quad$ $R^2 = 0.82$

(b) => each 1% UE for 1 yr associated w/ 2.1% slower growth of real GNP that yr; today that would translate to something well over $1,000/household per % UE per yr.

(c) Value of extra "leisure" added by that amount of UE should be netted. Best estimates suggest #25%. (Can't be 100% or UE'd would have preferred leisure to possible earnings, & so would not have been seeking work & so not officially UE)

  c. The Incidence of Unemployment

    (1) Table 2.3: UE rates by socio-economic, demographic group **(Table 2.3, p. 53)**

      (a) ***Occupational divide*** dramatic: esp. white/blue-collar divide; gap cyclical; 9 some

      (b) ***Gender gap*** too, but relatively small (disappears controlling for gender differences in occupation => gender gap in UE incidence directly reflects gap in job types

      (c) Large ***race divide***, & it shows little sign of diminishing. It's also cyclical.

      (d) Mammoth ***difference across age groups***. Again, cyclical.

      (e) Diff's gen'ly cumulate: minority, youth, blue-collar UE *really* high & *really* cyclical

    (2) **(Table 2.5 p. 58)**: changes in pre- & post-T&T income due to 1% rise in UE (assesses effectiveness of T&T in reducing individual hardship of UE)

      (a) **Conclusion 1**: T&T system does (or did) exactly what it was supposed to do

        i) reduced the private impact of UE,

        ii) did so more for the very poor than the relatively well-off,

        iii) may have had undesirable side-effects, but certainly accomplished primary task.

      (b) **Conclusion 2**: T&T system worked almost equally across racial groups above poverty level, but noticeably less well for minorities living below poverty level than for non-minorities below poverty level (though at least some help to both).

      (c) **Conclusion 3**: T&T system offset losses of female heads of households less well than male, but also true that 1%UE created less income losses for female HoH's to start (b/c more female HoH income comes from non-market activities)

  d. Summary:

    (1) However you measure, UE has massive aggregate costs.

    (2) Also however you measure, UE has markedly different impact across demographic, occupational, & income groups.

    (3) The T&T system offsets some but not-near-all of these two facts.

6. The Costs of Inflation **(Chapter 3)**

  a. **Definition:** pervasive increase in money prices of <u>all</u> goods & services (on average); i.e., decline in purchasing power of money

    (1) **Must distinguish from relative price movements**: not of some price or set of prices, but *all* prices, on avg, against value of money

    (2) Technical measurement issues, which, of course, inevitably political, as with UE, because resolution different ways benefits some, hurts others (see notes)

    (3) Problems w/ Price Indices (& ˆ Inflation measures), esp. w/ CPI (see notes)

  b. Brief History of Postwar US INF: Core INF about 1.5% in early 60s; took 3 big upward jumps in period since until early 80s; then came plummeting back

    (1) LBJ 1965-68:

      (a) Vietnam + Great Society + Little or No Tax Increase

        i) ==> Debt & Inflation, and

        ii) ==> Real economic boom

        iii) Money-supply growth was fully supportive

      (b) By early 1969, UE was 1.5% points below the "natural rate"

        i)   ==> underlying inflation had risen to 4%

        ii) ==> LBJ finally eased off a bit, introducing a 10% income tax surcharge

(2)   RMN I 1969-72:

  (a) Standard conservative deflation

        i)   Cut deficit by 2%

        ii) Burns (Nixon's appointed Fed Chair) cut real money-growth first to .5% then to -2%

  (b) ==> 1970-71 recession

        i)   UE rose to 6%

        ii) Only .75% above natural rate, so not much anti-inflation was achieved in the early go

==> Postwar Generality: Each 1% UE above "natural rate" for 1 yr => .5% INF decline

  (c) In August 1971, Nixon & Burns reverse tack (we've heard this story in Tufte)

        i)   8/71 wage & price restraints imposed (only time in US history, I believe)

        ii) "Gold Window" closed August 1971

        iii) then goes for pre-election stimulus like never before (these big numbers at the time:)

              a) 1.5% deficit in '71, then 1.7% in '72

              b) Real money-supply growth of 2.4% & 3.7%

        iv) => boom, then INF once price controls lifted (after election of course: late '73, early 74)

(3)   Then food-price shocks in late '72, early '73, followed by OPEC I in 10/73

  (a) => massive redistribution of global wealth from consumers of food (non-agricultural sector) & energy (US) to producers of it (agr. sector, & OPEC)

  (b) = *relative p shock*: one key to INF political impact: how/why folk confused by this

(4)   GRF (Aug.) 1974-76:

  (a) "Whip Inflation Now"

        i)   Deficit cut 1% of GDP

        ii) Burns more than accommodates: real money-supply growth -5.6% in '74 & -4.2% in '75

  (b) Essentially same "policy blunder" made in early stages Great Depression:

        i)   Problem = adverse relative-price shock on imported supply-item; fiscal & monetary contraction will predictably exacerbate unavoidable real losses associated w/ that. It did:

              a) => worst recession since great depression: UE to 8.5% & didn't come back down past 7.7%

              b) => this was 2.5% over "natural rate", so inflation did decelerate by 1.5% to less than 6%

        ii) GRF eases some as election nears, but UE still all-time high: INF (partly) whipped, but pol-econ issue that nothing domestic policy could do about real-price shock but decide who pays its price

        iii) Ford explicitly chose UE sufferers over INF: "UE affects 10% of pop.; INF affects all"

(5)   JEC 1977-80:

  (a) Completely diff set of constituencies, ˆ completely diff set of economic priorities

  (b) Early Term:

        i)   Real money-growth +1.1% in '77, deficit +2%

        ii) ==> UE fell 2% from end of '76 to beginning of '79

        iii) Still above "natural rate", so inflation remained stable despite the decline

  (c) Beef-price 8 (relative) ("Where's the Beef?") & CPI creeps 8 (general) in response, JEC began to ease off accelerator some, then OPEC II hit:

        i)   Oil prices 8 $156$35, creating same type supply-induced initially rel. then gen. INF...

        ii) Carter, presumably to reassure financial markets, had named Volcker Fed Chair (in '78)

              a) Volcker increases discount rate (a rare action) twice in '78-'79, 1% (large amount) each time

              b) No monetary accommodation: 3% real money-growth slow in '79, unprecedented 6.5% '80

              c) If Volcker wanted Carter out of office, he set things up nicely:

        iii) Again, the results were predictable:

              a) domestic policy couldn't do anything about lost domestic income created by oil-price shock

              b) strong monetary anti-inflation would stop general inflation, but it works by creating recession & UE ==> Carter faced electorate w/ UE rising, INF high, & growth falling => i.e. lost

(6)   RWR I 1981-84: (H reserves thorough discussion of Reagan I for conclusion)

  (a) Fiscal Deficits:

        i)   Defense 8 to replace soc. spend. (*winning cold war* replaces *achieving Great Society*)

        ii) Tax cuts, esp. tax cuts on bus. & on marg. tax-rate at high end of income distribution

           iii) This was supposed to pay for itself (Laffer Curve), it didn't ("laughable curve" actually)

      (b) Monetary Contraction: the great Volcker deflation continued because...

           i) RWR, his constituency, & advisers ideologically & self-interestedly committed to it

           ii) New economic theory suggested that if deflation credible & announced, no real costs

      (c) => '81-'82 greatest recession since Great Depression. After 4 yrs tight money & 3 of postwar record UE, INF finally subsided by 1984

    (7) N.b., after each inflationary episode deflated, INF did not return back to previous level but remained point or two higher

c. *Objective* (*measurable*, *observable*, *actual* not *perceived*) Costs of Inflation

    (1) Inflation vs. Relative-Price Increases

      (a) Relative Prices large aggregate & distributional effects; these often confused w/ INF

      (b) INF little or no discernable agg. effects; some distrib. effects at very high-income

    (2) Distributional Impact of Inflation

      (a) On quintile distribution of income: none to slight shift from top 40% to bottom 40%

           i) doesn't matter whether one continuously adjusts quintile groups for potentially differential inflation rates among products purchased by different groups

           ii) again, if anything, luxury-good inflation exceeds necessity inflation in most times

      (b) Simulations seem to indicate that INF costs substantial over time (say, -15% over 5-yr period) only for top 0.01% of income distribution

      (c) Nor any long-run "bracket creep" to mention: even b4 auto INF-adjust's to income tax, discretionary changes / w/ INF ==> INF was/is real-income-tax-burden neutral

           i) $Ln(Tax Revenue)=-10.9+1.017ln(PQ)+.432ln(Q)$ [p. 95]

           ii) Again, if anything, slight tendency for inflation to increase tax liabilities of upper end

      (d) If adjustments of labor pay recompense lags that of capital, then inflation would worsen the "functional" distribution of income ==> once again, if anything, slightly the opposite is true. If anything, nominal payments to capital adjust more slowly than nominal payments to labor.

      (e) In sum: distributional effects are small, against the top 40% & for bottom, & if large for anyone it is against a group up around the 0.01 percentile. This last is so b/c...

    (3) Impact on Corporate Profitability

      (a) Inflation has negative effect on after-tax profitability of business or after-tax return on capital, & therefore on after-tax stock returns

      (b) ==> negative relations b/w INF & stock returns seems to have operated via INF impact on after-tax profitability (& perhaps monetary responses to INF)

           i) Consider re: 1990s: "...recipe for high after-tax corp. profitability & swiftly rising equity share prices realized during 1960s was conjunction of brisk growth, little idle capacity, & moderate INF that did not undermine pro-investment tax policies legislated by Congress..." (p. 107)

           ii) [Think about financial deregulation & retirement shareholding from PE view]

    (4) Aggregate Impact of Inflation

      (a) No evidence that INF *per se* reduces savings rates or investment

           i) odd b/c it does change relative price of present & future consumption, so should

           ii) INF has two effects; evidence suggests they roughly cancel:

               a) income effect: price of future goods higher so must save more to have same real amount later

               b) substitution effect: price of present goods lower relative to future goods so one substitutes

      (b) No evidence that INF shifts investment composition from non-residential to resid.

           i) Mortgage borrowing tax-deductible (at nominal rates) but interest income tax-liable (nominal); should => INF shifts incentives to residential from non-res. capital-formation

           ii) apparently this has been offset by

               a) tendency for mortgage borrowing to be rationed rather than nominal rates continuing to rise

               b) convention fixed nominal pays => real mortgage costs front-loaded in high INF periods

               c) relative energy-prices rising in the two major inflations => smaller homes bought

      (c) In short, no discernible aggregate costs either

(5) **Summary:** objectively, INF little agg. or distrib. cost, that little effect seems on net to hurt higher-end income relative to lower & corporate vs. consumer

    (a) => puzzle why population as whole so obsessed w/ INF (rel p/ agg p confusion?)

    (b) *True* costs of INF, according to Hibbs, are those associated w/ policymaker reactions to it. Aiming to reduce INF, pms have induced or abetted every postwar contraction.

    (c) => Q: what explains diff ° to which pm's opted to stifle econ to "Whip INF Now"

    (d) Along way, must address how so many misunder-stood & -stand impact of INF

7. Public Concern About Inflation & Unemployment **(ch. 4)**

    a. Divide answers to Gallup: "…most important problem facing ctry today?" into *Int'l & Defense Issues*; *Domestic Political & Social Issues*; & *Economic Issues* => last dominant since '74, some retrenchment lately, still 60%

    b. Among economic issues, UE & INF enduringly prominent

        (1) Inflation higher in personal than sociotropic evaluations

        (2) Evidence people evaluate pms more on sociotropic considerations [Why?]

        (3) **[Figs. 4.2 & 4.3]** Salience of UE relative to INF & v.v. responds to obj. cond's

Inflation Concern$_t$ = +45.4   -6.88 U^{Gap}_t -6.72(U^{Gap}_t-U^{Gap}_{t-1}) +2.36 p_t +1.39 (p_t-p_{t-1})   -.569 r_t

Standard Errors   (6.16) (1.15)   (3.14)   (0.62) (1.61)   (0.77)

(% saying INF > important UE +.5 equally import.) = g(UE-UE$_n$, CPI inflation, per capita real Y^{disp} growth)

So, despite surprisingly strong—though still objectively unexplainable—general aversion to inflation, bulk of *variation* in relative concerns of voters for UE & infl. is due to objective variations in UE

    c. Moreover, relative aversion of voters toward UE & INF differs persistently by income, occupation, & partisanship **[Figures 4.5-4.7 & Table 4.1]**

8. Macroeconomic Performance & Mass Political Support: H's Dynamic Model of Presidential Approval **(ch. 5)**

Ln[%Approve/(1-%Approve)]=…+w@Cumulative, Discounted, Relative Incumbent-Party Performance)

+(1-w)@Cumulative, Discounted, Relative Administration Evaluation)

+Fixed Administration-Specific Advantage/Disadvantage

    a. Y=ln(Approval%)-ln(1-Approval%) =

    …+w@@3g^k(D$_t$D$_{t-k}$)X$_{t-k}$}+(1-w)@@3g^k(I$_t$I$_{t-k}$)X$_{t-k}$}+S…

        (1) w vs. (1-w) estimates degree to which respondents evaluate presidents on basis of their party's cumulative performance relative to the opposing party's, discounted, vs. by their administration's cumulative performance relative to all other administrations, discounted

        (2) g measures rate at which past performances, both of this president & of comparison group (past presidents of other party or past presidents), are being discounted by voters ("fade out of memory")

        (3) DD term = indicator of whether this quarter & one k periods ago were governed by presidents of same party. If so, that past performance adds to cumulative party-evaluation; if not, that past performance detracts from it.

        (4) II term doing same thing, only it indicates whether quarter k periods ago was governed by present president (adds to cumulative performance) or a previous one (subtracts from it)

        (5) X terms are just all the different factors on which presidents are thought to be evaluated: Vietnam, Rally Events, Watergate, Inflation, per capita real Y^{disp} growth, Unemployment, Energy Prices

        (6) S term is some fixed unique characteristic of each president. H calls this the

"shadow" evaluation of hypothetical opponent, but acknowledges that in practice it contains a lot more than that.

b. I reproduce the information in Table 5.1 below:

Among Democrats, 1961.1-1984.1 (R^2=0.98)

$\ln[(\text{App})/(1-\text{App})] = ...0.985(\text{JFK})+0.652(\text{LBJ})-0.165(\text{RMN})+0.154(\text{GRF})+0.408(\text{JEC})-0.765(\text{RWR})$
          (0.042)   (0.040)   (0.034)   (0.057)   (0.037)   (0.033)

$+.697\{3.834^k D_t D_{t-k}(-.084\text{VIET}_{t-k}+.223\text{RALLY}_{t-k}-.026\text{WTRGT}_{t-k}-.028\text{INF}_{t-k}+.011\text{dRY}_{t-k}-.030\text{UE}_{t-k}+.002\text{OILP}_{t-k})\}$
(.021) (.005)   (.003)   (.007)   (.001)   (.001)   (.001)   (.002)   (.0004)

$+(1-.697)\{3.834^k I_t I_{t-k}(-.084\text{VIET}_{t-k}+.223\text{RALLY}_{t-k}-.026\text{WTRGT}_{t-k}-.028\text{INF}_{t-k}+.011\text{dRY}_{t-k}-.030\text{UE}_{t-k}+.002\text{OILP}_{t-k})\}$
   (.021) (.005)   (.003)   (.007)   (.001)   (.001)   (.001)   (.002)   (.0004)

Among Republicans, 1961.1-1984.1 (R^2=0.96)

$\ln[(\text{App})/(1-\text{App})] = ...-0.818(\text{JFK})-0.852(\text{LBJ})+1.43(\text{RMN})+1.45(\text{GRF})-0.554(\text{JEC})+1.44(\text{RWR})$
          (0.045)   (0.045)   (0.047)   (0.070)   (0.045)   (0.055)

$+.748\{3.771^k D_t D_{t-k}(-.069\text{VIET}_{t-k}+.290\text{RALLY}_{t-k}-.017\text{WTRGT}_{t-k}-.039\text{INF}_{t-k}+.018\text{dRY}_{t-k}-.025\text{UE}_{t-k}+.0011\text{OILP}_{t-k})\}$
(.033) (.012)   (.005)   (.010)   (.001)   (.002)   (.002)   (.004)   (.0006)

$+(1-.748)\{3.771^k I_t I_{t-k}(-.069\text{VIET}_{t-k}+.290\text{RALLY}_{t-k}-.017\text{WTRGT}_{t-k}-.039\text{INF}_{t-k}+.018\text{dRY}_{t-k}-.025\text{UE}_{t-k}+.0011\text{OILP}_{t-k})\}$
   (.033) (.012)   (.005)   (.010)   (.001)   (.002)   (.002)   (.004)   (.0006)

Among Independents, 1961.1-1984.1 (R^2=0.92)

$\ln[(\text{App})/(1-\text{App})] = ...-0.038(\text{JFK})-0.321(\text{LBJ})+0.476(\text{RMN})+0.891(\text{GRF})-0.089(\text{JEC})-0.019(\text{RWR})$
          (0.049)   (0.052)   (0.040)   (0.072)   (0.047)   (0.038)

$+.783\{3.842^k D_t D_{t-k}(-.062\text{VIET}_{t-k}+.246\text{RALLY}_{t-k}-.020\text{WTRGT}_{t-k}-.031\text{INF}_{t-k}+.015\text{dRY}_{t-k}-.015\text{UE}_{t-k}+.0017\text{OILP}_{t-k})\}$
(.028) (.007)   (.003)   (.001)   (.001)   (.002)   (.001)   (.002)   (.0005)

$+(1-.783)\{3.842^k I_t I_{t-k}(-.062\text{VIET}_{t-k}+.246\text{RALLY}_{t-k}-.020\text{WTRGT}_{t-k}-.031\text{INF}_{t-k}+.015\text{dRY}_{t-k}-.015\text{UE}_{t-k}+.0017\text{OILP}_{t-k})\}$
   (.028) (.007)   (.003)   (.001)   (.001)   (.002)   (.001)   (.002)   (.0005)

9. Conclusions:
   a. Obvious partisan pattern to "shadow evaluations" of each president
      (1) Dem's like Dem's & Rep's like Rep's—this in addition to their differential responses to each of the other variables
      (2) On average, a net pro-Republican presidential edge of about 9%
   b. Lag structure
      (1) Relatively homogenous across D, R, I groups; approx. = 0.82
      (2) Decay Rate:
         (a) => about 18% of total impact of each factor is felt immediately (within 1 quarter)
         (b) About 55% by 1 year, 80% by 2 years, 96 by 4 years.
         (c) Last Q of 4-yr term weighted 24X as heavily as first; last year 11X as heavily as first.
   c. Weight on cumulative, relative, discounted, party performance relative to cumulative, relative, discounted, administration performance in pres evaluation:
      (1) Also relatively homogenous; . 0.75 (but excludes admin. fixed effects, S)
   d. The Honeymoon Effect:
      (1) Natural result of the lag structure & the discounting of past evaluations
      (2) Estimates suggest "honeymoons" higher & decay more steeply in new admin's representing partisan shifts than for admin shifts within party
   e. See **Table 5.3** for some calculations of the impacts of non-economic variables
      (1) "Rally-Round-the-Flag Effects": primarily international events produce...
         (a) Bipartisan behavior in Washington,
         (b) Decreased media criticism of White House & Congress,
         (c) Increased focus on president as C-in-C Y emphasis on national unity behind pres
         (d) Often regardless of "good" or "bad" news, int'l events 8 president's approval rating

      (2)   VIETNAM:

          (a) Severely hurt LBJ, also RMN but less b/c Dem's disliked pres more for casualties

          (b) 1000/qrtr sustained for 1 yr => -4.4% (from R's) to -6% (from D's) approval

      (3)   EVENTS:

          (a) Sizable impact of a typical int'l event [+4.5% (from D's) to +6.9% (from R's)]

          (b) Occur at rate of ±1.5/yr, but JEC hit by 5 events 1979.4-1980.1 (Iran/Afghanistan)

              i)   Hibbs estimates these provided +24% gain among Dem's during the campaign, helping a previously weak JEC overcome a strong challenge from Ted Kennedy in the primary

              ii) Events receded in time for election, & JEC became first elected incumbent to lose re-election bid since Hoover lost to FDR.

      (4)   WATERGATE:

          (a) Coded here as series of "events": each qrtr during scandal given score from 1 to 3 depending on degree to which RMN personally implicated by revelations that qrtr

          (b) From 1972:2-1974:3, RMN loses b/w 17%-21% approval from accum revelations

  f. Pres. cut some, but not much, slack for prob's due to OPEC I/II oil-price 8

  g. PARTISAN DIFF'S in PRES EVALUATION on ECON PERFORMANCE

MARGINAL RATE OF SUBSTITUTION	*PARTISAN GROUP*		
	Democrats	*Republicans*	*Independents*
-(UE^Gap^/Infl.)	**-1.1**	**-0.65**	**-0.49**

  h. Indeps' eval's much more sensitive to all factors than D's & R's b/c their evals usu. nearer break-point b/w just approve & just disapprove. [Implications?]

10. Interp. '80 (Carter v. Reagan) & '84 (R v. Mondale) Elects **(ch. 6)**

  a. Q: Some claimed & claim these elections revealed shift of electorate to right on "federal government's role in domestic social & economic affairs" (p. 186)

  b. However, elections could also be seen as

      (1)   Usual loss by incumb presiding over awful economic conditions &

      (2)   Usual win by incumb presiding over good/strongly-improving conditions

  c. Careful exam of micro & macro evidence from those elections in comparison w/ previous ones indicates quite clearly that latter explanation is more sound.

  d. [I'd argue that what may have transpired is more like a sequence:

      (1)   Beginning with economy-inspired victories & losses,

      (2)   Which produced 12 years of Republican presidency,

      (3)   Led to 12 years of policies, which, with other exogenous economic, social, & political changes, produced a structural transformation of US electorate,

      (4)   So that now public likely *is* more right on such issues than pre-Reagan

  e. **Figure 6.3** summarizes point well: economy alone does nice job explaining (could easily have predicted) 1980 & 1984 outcomes—nothing odd about them, *e.g.* no necessary indication of any rightward shift.

  f. Micro evidence: survey data reveals no clear rightward shift in public opinion, generally or specifically, at least 'til '84

11. Party-Cleavage Model of Economic Policy & Outcomes (**ch. 7**)

  a. (Core constituencies of) Parties diff preferences over economic outcomes; in particular, left seeks to avoid UE relative to INF more than the right & *v.v.*

(1) Comparatively, US left & right are... ...than spectrum in other democracies
- (a) more heterogenous, less unified,
- (b) less distant from each other ideologically,
- (c) and more to the right

(2) ...but distinction still quite clear & obvious, & has been at least since FDR
- (a) Evidence from party-elite survey in 1976 of top problems:
- (b) Democrats identified UE #1 & INF #2
- (c) Reps: INF #1, Gov Size, Defense, Devp. Energy Resources, Crime, & UE #6

b. Voters very easily recognize which party "theirs", & act upon differences
- (1) Some indication occupational diff's in "structural class voting" 9, but...
  - (a) Income divisions in "structural voting" has, if anything, increased.
  - (b) Clear voter distinctions b/w parties remains core to US politics (& elsewhere).
- (2) Introspection

c. Policymakers are partisan, have some control of various policy instruments that can effect trade-offs b/w certain econ. outcomes, & will use these instruments according to their reputations & their constituents' interests.

d. **Conclusion:** if a-c, then gov policy, & macroeconomic & distributional outcomes will all exhibit strong partisan dimensions.

e. Clarifications & caveats regarding the partisan differences:
- (1) *Relative*, not necessarily absolute.
- (2) Party positions not fully fixed; ultimately respond to incentives emanating from electoral competition.
- (3) Parties will respond to "dominant" problems, even if require actions distasteful to party's ideological base.

f. The Unemployment Model
- (1) Parties Target Different UE levels: $U^T_t = b_0 + U^N_t + b_1 DEM_{t-1}$
  - (a) Targets are relative to "natural" UE rate [?]
  - (b) Party setting target embodied in policies that currently matter is party in office *last* qrtr. 1-period lag intended to capture time to enact policy:
    - i) Behavioral Lags: those involved in the formation & formulation of policies.
    - ii) Institutional Lags: those involved in the implementation of a formulated policy.
    - iii) Structural Lags: those involved in process by which implemented policies have their effects on economy; *i.e.*, lags given by structure of economic reality.
- (2) "Partial-Adjustment Model" of Unemployment:

$$U_t - U_{t-1} = d(U_t) = N_1(U^T_t - U_{t-1}) + N_2[d(U_{t-1})] + b_2(RealShocks_{t-1}) + e_t$$

  - (a) Point simply that U doesn't adjust instantaneously to policy changes, nor instantaneously to exogenous shocks (like OPEC I & II).
  - (b) Rather, (first RHS term) admin wants to move U from U_{t-1} to where they'd like it to be, U^T_t, but only N_1 of this will happen this period b/c UE sticky.
  - (c) The rest of the U movement this period comes from three sources:
    - i) Inertia: N_2 of last period's movement lingers for this period: $N_2[d(U_{t-1})]$,
    - ii) Shocks: real shocks beyond govt's control like oil prices: $b_2(RealShocks_t)$
    - iii) Random Factors: whole bunch of stuff that might affect U but outside model: e_t
- (3) Sub 1 into 2 & solve => a simplified model of the theory's predictions:

$$U_t = N_1 b_0 + (1 - N_1 + N_2)U_{t-1} - N_2 U_{t-2} + N_1 U^N_t + N_1 b_1 DEM_{t-1} + b_2(RealShocks_{t-1}) + e_t$$

  - (a) Says simply that today's U is some constant (the first term) plus some function of...
    - i) ...past U (the next two terms),

        ii) ...the natural rate of U (the fourth term),

        iii) ...the partisanship of last quarter's administration (the next term), and

        iv) ...any real and/or random shocks occurring this & previous periods (the last two terms)

    (b) Can estimate as usual, negative coefficient for DEM_{t-1} supports for partisan model

g. Development of Real Output, Q, Model is perfectly analogous to U Model:

$$\ln(Q_t)=N_1b_0+(1-N_1+N_2)\ln(Q_{t-1})-N_2\ln(Q_{t-2})+N_1\ln(Q^N_t)+N_1b_1DEM_{t-1}+b_2(RealShocks_{t-1})+e_t$$

h. **Table 7.3 & Figure 7.3** present & demonstrate the results.

12.   Further Partisan-Cycle Evidence:

    a. Beck '82b: Hibbs' '77 results exaggerate US partisan differences by about 1/3 & UE actually higher under some Ds than some Rs (Hibbs '83 replies), but Hibbs' basic conclusions emerge unscathed.

    b. Haynes & Stone '94 also find partisan outcome cycles in US, again stressing that dummy-variable specifications assume more discrete policy & outcome shifts than empirically likely, which may obscure actual cycles &, here, cloud comparisons of traditional & rational partisan theories (see below).

    c. Hibbs '87b, '92, '94; Paldam '89 find appreciably distinct economic outcomes under left & right govts in US & in broader samples of OECD democracies,

    d. Alesina et al. concur on existence of US & OECD partisan outcome cycles

    e. Alt '85, Alvarez et al. '91, Beck et al. '93: partisan patterns in UE or growth in OECD countries depend on institutional & strategic context (see below).

    f. In sum, partisan outcome cycles of worsening nominal and improving real and distributional outcomes under left govts generally emerge readily from US & comparative data, although Clark & colleagues find conditional-cycle explorations favor electoral more than partisan (see below).

13.   Classical Partisan Cycles in Economic Policies

    a. [Far too many to review in detail.]

    b. In general, US & comparative evidence most strongly supports partisan effects on size of govt, in public employment, revenue, or spending terms.

    c. Also moderately supports partisan distinctions in some specific policy areas, namely social and welfare, tax-structure, and monetary policy.

    d. Considerably less support for naive views of left (right) as unconditional deficit (surplus) producers.

    e. In all cases, perhaps esp. in monetary & fiscal-deficit policies, evidence seems to suggest partisan govts' recourse to these policies depends heavily on their international & domestic pol-econ inst'l, structural, & strategic context.

    f. Of which, Schmidt '97 is an early, partial review.

E. *JBL:* Rational, Prospective Expectations; Partisan Policymakers

    1. In contrast to electoral cycles, no particular empirical puzzle motivated the introduction of rational expectations into partisan theory.

        a. Evidence solid for partisan cycles in real & nominal outcomes & sufficient if not unequivocal for some policy cycles that could produce those outcomes.

        b. *Rational partisan theory* ˆ filled more-pressing theoretical needs, providing a

framework logically coherent w/ modern rational-expectations economics, wherein fully expected macroeconomic policies, as traditional electoral or partisan policy-cycle models assume, are ineffective.

2. Issues w/ Empirical Case for RPT:
   a. Substantive diff in estimates not great (see Franzese '00)
   b. RE not only explanation for shorter partisan effects. E.g.:
      (1) "Democratic administrations, which are expansionary in the first half, observe by midterm a significant increase in the inflation rate. Because a high inflation rate may become a significant electoral liability, Democratic administrations contract the economy so that by the election year one observes a growth slowdown and a reduction in the inflation rate. Conversely, Republican administrations that had anti-inflationary recessions in their first half pursue low inflation and accelerating growth in the second half, a combination that may give them an electoral benefit." ARC '97, p. 62
      (2) Uner RE or AE, described policy pattern, which would result from midterm balancing they predict for example, Y shorter-term outcome pattern.
      (3) "Honeymoon effects" would also produce this pattern under either theory.
      (4) So would any diminishing returns from stimulation & anti-inflation policies.
   c. Worst for RPT, ARC '97, p. 87 report substantively & statistically stronger real-growth partisan cycles pre-1972, the Bretton Woods (fixed exchange-rate) era, than after; yet they also find that inflation differences across right & left administrations emerged only after 1972 (p. 90). Inflation surprises induced by elections are supposed to cause the short-term real partisan cycles...
   d. Given their lags, real effects emerge before monetary-policy or INF moves; suggests Drazen's '01 AFPM cycles (Beck '82c, '87; Berger & Woitek '87, '02)
   e. Even ignoring timing issue, Phillips-curve magnitude needed not realistic.
   f. Using option-pricing theory to measure electoral surprise, find that measure to correlate with unemployment in monthly U.S. data, most strongly when using 24- to 36-month-long surprise measures (t?#3.5-3.8). Issues:
      (1) Longer-duration finding further 9 substantive diff b/w RE & non-RE
      (2) Test surprise measures only against absence–i.e., alternative hypothesis is 0 partisan effect–rather than exploring if surprise measure improves on dummy
      (3) Separate results reported say little about which dominates b/c shift to monthly data for former triples sample...
      (4) Theory actually states that ***degree of electoral surprise multiplied by expected difference in inflation between incumbent and challenger*** produces real effects:
         (a) Empirical model implicitly assumes that difference equal in all U.S. elections.
         (b) False, of course, & Y biased estimates if, e.g., p(elect)=f(ideological distance), which any reasonable model (including, e.g., AR '95) implies.
         (c) Direction of bias hard to predict, and small # pres elects suggests impact could have been large. Use nominates?
      (5) Complications above–e.g., missing policy links from observed outcome cycles to effects, congressional influence, exchange regime–also plague this
   g. Most of above recurs in comparative part, plus some new concerns.

        (1)   E.g., ARC '97, p. 196 find no significant partisan effects on real interest rates, which implies real effects of partisan monetary-policy diff must originate in wage rigidity & diff b/w expected & actual INF, *yet*

        (2)   Partisan INF diffs statistically weak & concentrated in post–BW/pre–EMU window, whereas partisan real-outcome differences are not.

3. Other empirics on RPT more mixed

   a. Sheffrin '89: finds signs of US monetary cycles, but not significantly consistent w/ RE partisan theory in US or elsewhere.

   b. Klein '96 estimates duration of economic cycles in 100+ years of US data, & finds certain political events associated w/ ends of slumps & booms, consistent with, but not directly testing, RE partisan theory.

   c. Carlsen '99 gauges nominal rigidities & electoral surprises, whose combined magnitude should track that of RE partisan cycles, & compares such measures directly w/ those analogously derived from Hibbs' partisan theory

        (1)   Results weakly positive for US inflation cycles, supporting both versions.

        (2)   Carlsen '98, though, finds negatively for US real outcomes,

        (3)   Carlsen & Pedersen '99 report mixed results when comparing RE w/ classic partisan cycles comparatively.

           (a) Find clearly for RPT in UK, and some support in Canada & Australia,

           (b) but US data support classical partisan theory, &

           (c) results in Sweden & Germany are inconclusive.

   d. Faust & Irons '99 note: whereas political economists routinely find presumed monetary-driven partisan &/or electoral cycles, macro-econometricians continue to debate size, timing, and existence of monetary effects.

        (1)   Ask, ˆ, whether (a) political-cycle models mis-specify & so mislead or (b) their results might indicate that elections and partisan shifts offer valid exogenous instruments for estimating monetary-policy real effects.

        (2)   They confirm"distinctive 1st 2 yrs" result, but find that it persists even when analysis controls for partisan monetary policies, economic conditions, & other political effects, suggests that perhaps election-induced monetary surprises do not cause the short-term nature of the cycle.

4. Others stress more-theoretical limitations in basic RPT:

   a. Rogoff '88 asked, if elections such sizable real effects, bargainers don't simply defer signing contracts to post-elections or sign election-conditional contracts.

   b. Garfinkel & Glazer (1994) find 2-year or shorter contracts exhibit post-electoral kyphosis in the United States. Suggests bargainers perceive sufficient electoral economic uncertainty to merit shifting contract schedules, but those endogenous reactions also mute real cycles that electoral surprises can induce.

   c. Ellis & Thoma '91b note that, b/c parliamentary govts may change at any time, partisan surprises more continuous & irregular in parliamentary democracies.

        (1)   E&T '95 find current-account, real-exchange-rate, and terms-of-trade cycles that support their model of open-economy parliamentary democracies.

        (2)   This could reflect cycles in international-oriented policies directly, or certain combinations of domestic-oriented monetary and fiscal policies indirectly.

d. Heckelman '01: model wherein rational economic agents face uncertainty regarding election timing and who will win if an election occurs.

    (1)   This continual electoral uncertainty has real economic effects, but size and direction of those effects depend on (a) which party holds power in current and previous period, (b) time since last election, & (c) party popularity.

    (2)   Left spurs (& right dampens) real output *throughout their electoral term*, and these partisan differences *increase until the next election*.

e. Adolph '01 shows how strategic partisan govt responses to conservative CB's & to wage/price bargainers Υ permanent partisan effects even in RE models.

f. Drazen '01: questions monetary-policy mechanism in RPT, showing how an AFPM model can produce, w/ fully rational & prospective actors, policy & outcome cycles more consistent w/ pattern of evidence sketched above.

F.   *Context-Conditional E&PC's in Policies & Outcomes*

1. To some significant ° in all modern dem's at all times, candidates compete in elections & voters evaluate them in partisan econ terms.

a. Υ Partisan, elected pm's strong incentives to enact policies, aiming to produce outcomes that will buy votes & curry favor from their constituencies.

b. ˆ E&PC's in policies & outcomes should be ubiquitous in dem policymaking

c. Tend to generate greatest theoretical interest & insight & to receive strongest empirical support when researchers recognize their *context conditionality*

2. Parse: "incentives for, capacity for, and effects of *electioneering* or *partisaneering* should vary predictably across policies & across domestic & int'l pol-econ institutional, structural, and strategic contexts"

a. ***Incentives*** to electioneer or partisaneer (Tufte's *motive*) may vary predictably from ***policy to policy across domestic political institutional contexts***.

    (1)   Some policies or outcomes can purchase votes or curry partisan favor more effectively, & how policies or outcomes rank in such efficacy may vary w/ political-economic institutions, interest structures, and strategic context.

        (a) ***Ramsey Rule***: s.t. boundary conditions, partisan incumbents will use all effective instruments in proportion to their relative efficacy.

        (b) Υ cycles of varying magnitude & regularity in all policies *cum* outcomes, as well as cycles in ***policy composition*** (e.g., Chang '01) & outcome mixes (e.g., Tufte '78).

    (2)   Examples:

        (a) Incumbs ***more prone to manipulate direct transfers than macro policies***, at least to electioneer, ***& perhaps timing of policy implementation more than policies***

        (b) ***Coalitions*** may find influencing timing easier than changing policy if collective-action probs (e.g., Gooodhart '00) they must overcome to effect timing change do not outweigh veto-actor probs (e.g., Franzese '02a, Tsebelis '02) to change policy

        (c) Where political institutions produce ***unified, strong single-party govts*** (e.g., India, Japan, & perhaps UK), ***manipulation of election timing*** seems more accessible & effective than manipulation of policies or of their timing (compare Thompson & Zuck '83; Ito & Park '88; Ito '90; Alesina et al. '93; Chowdhury '93; Smith '96, '00).

        (d) General-interest ***redistributive policies*** (e.g, transfers) may better serve partisan & electoral goals ***in multi-member-district systems***, but special-interest ***distributive policies*** (e.g., public

works) *in single-member-district* (P&T '00, Chang '01).

(e) Incentives to electioneer *per se*, & perhaps relative to those to partisaneer (Schneider & Frey '88), vary w/ *strategic context, e.g. expected closeness of elections* (Wright '74, Tufte '78, Frey & Schneider '78ab, Golden & Poterba '80, Schultz '95, Price '98).

(f) Inst'l, struct'l, or strategic cond's that ⅄incumbents' *effective electoral accountability* (Powell & Whitten '93) also mute incentives to manip (Shi & Svensson '01).

(g) Election/partisaneering incentives vary cross elections by *share policymaking power at stake* (Tufte '78). Dem systems that concentrate pm election chronologically (e.g., UK) ⅄ sharper E&PCs (Powell '82, Alt '85, Goodhart '00, RJF '02a).

(h) *Partisan strategic context*:
   i) Hicks & Swank '92: policies depend on *incumb & opposition partisanship & strength*.
   ii) RJF '02a: strategic-context-conditional partisan fiscal policy: only elect'ly insecure right/left run surpluses/deficits in accord w/ naive partisan thry fiscal policies; fairly secure right/left govts run deficits/surpluses (cf. Persson & Svensson '89, Al&Tab '90, Tab&Al '90, Aghion & Bolton '90).

b. *Varying policymakers' ability to manip policies/outcomes* for elect/party gain

(1) PE-GE stress limits RE on macroecon policy (real) effect. If ID sit's induce *more forward-looking & better-informed cit's*, ⅄ systematic conditional arg

(2) *Allocation of policymaking control across multiple actors* and *internal and external constraints on policy maneuverability*.

(a) Blais et al. '93, '96: *prior debt* limits partisan fiscal-policy maneuverability;

(b) Acosta & Coppedge '01: *degrees of unified incumbent power*, as gauged by govt seat-share & party discipline, augment maneuverability;

(c) Corsetti & Roubini '97: *private or public ability to borrow abroad* magnifies political deficit biases.

(d) Tsebelis '02: *multiple veto-player policymakers* w/ diverse preferences inherently limit policy maneuverability in general.
   i) Alt '85 & Franzese '02a explore (diff'ly) fisc-pol implications of coalitional & divided govts (Roubini & Sachs '89, Grilli et al. '91, A&Perotti '96, Perotti & Kontopoulos '98).
   ii) *N.b.: veto players do not cause policy (debt, spending lvls); rather retard adjustment rates.*

(e) Various *delegation, agency, and bargaining* issues in "*multiple hands on the wheel*" scenarios of shared or constrained policy control.
   i) In monetary policy esp., *central-bank autonomy, fixed exchange rates, &/or capital mobility* may hinder domestic policymaker autonomy or o/w dilute electoral or partisan cycles in policies or outcomes (Lohmann '92, '97; Jonsson '95; Simmons '96; Boix '98, '00; Garrett '98; Franzese '99, '02b; Oatley '99; Way '00; Clark et al.).
   ii) Hallerberg & von Hagen '98: similar implications of *fiscal-policy contracts or delegation*

(3) Empirical models of E&P P&O cycles recognizing institutional & structural constraints on policymaker maneuverability typically ⅄ strong results.

(4) N.b., policymaker abilities to manipulate different policies will be differently constrained or abetted by above considerations; thus (Ramsey Rule again):

(a) electioneering and partisaneering instrument choice will vary accordingly

(b) P&O compositional as well as P&O level cycles should occur.

c. *Systematic variation in effectiveness across policies and contexts*.

(1) From Tufte & Hibbs, recognized that esp. macroecon policies & outcomes can have varying efficacy as electioneering & partisaneering tools; until recently, just comments that, e.g., *Phillips-curve slopes* can vary & should induce varying magnitudes of E&P P&O cycles if they do.

(2)   Conduct & effects of electoral & partisan policies might be conditioned by

    (a) ***labor-market organization and corporatism***:

        i)   Alvarez et al. '91: partisan govts produce differing outcome cycles depending on labor-organizational structure, (later, Beck et al. '93 weaken some empirical claims).

        ii) Simmons & Clark '97: few signs that corporatism modifies left-govt relations to any of 24 economic policies.

        iii) Boix '00; Garrett '98: partisan effects conditional on ***both*** labor-market & int'l institutions & structures

        iv) Cusack '00 & Adolph '01: effects of partisan or electoral fiscal, monetary, & other policies depend on CBI & on CBI-labor-market structure combo.

    (b) ***int'l exposure, capital mobility, and exchange-rate fixity***: Clark and colleagues

        i)   Clark et al. '98: CBI and loss of national policy autonomy (i.e., fixed exchange and mobile capital) each constrain occurrence of electoral real-outcome cycles in OECD countries, finding evidence for cycles only when neither constraint is present.

        ii) Clark & Hallerberg '00:

            a) When capital mobile, electoral cycles in fiscal policy occur only w/ fixed exchange rates.

            b) Electoral monetary cycles likely only if neither of Clark et al.'s '98 constraints present.

            c) No support for partisan monetary or fiscal policy cycles, Mundell-Fleming conditional or otherwise (contra, e.g., Oatley '99).

        iii) Hallerberg et al. '01: results hold also for post-transition Eastern European economies.

III. *Methods:*

Franzese, R, Kam, C. 2002. "Modeling & Interpreting Interactive Hypotheses in Regression Analysis: A Brief Refresher and Some Practical Advice." (http://www-personal.umich.edu/~franzese)