Political-Economic Cycles

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Abstract and Keywords

This article provides a survey of the theoretical and empirical work on *political-economic cycles*, such as cycles in economic outcomes induced by electoral and partisan competition. It also reviews the literature on electoral cycles and emphasizes how electoral context may heighten or limit incentives to electioneer. Another survey, which focuses on the theoretical and empirical literature linking economic policy to partisan electoral motivations, is provided as well.

Keywords: theoretical work, empirical work, political-economic cycles, economic outcomes, electoral cycles, economic policy, partisan electoral motivations, electoral competition, partisan competition

1 Introduction

WHEN economic policy-makers are directly elected (or appointed by directly elected officials), how do electoral and partisan incentives structure economic policy-making? Suppose, for example, that voters prefer candidates expected to deliver greater economic well-being. Voters may evaluate candidates on recent experience, perhaps on aggregate performance. As a result, incumbents seeking re-election have powerful incentives to improve voters' economic fortunes, or to signal or feign such ability. If voters weigh recent pasts more heavily than distant periods, the incentives to manipulate economic policy to improve the likelihood of re-election sharpen as elections approach. Such *electioneering* may result in cycles of economic expansion and contraction that follow electoral cycles.

Alternatively, voters may evaluate candidates primarily in partisan terms. Competing parties may, as a result, cultivate ties to different voter segments, and nurture reputations for policy-making that favors those segments. Under some conditions, partisan ties create incentives for incumbents of different parties to implement distinct economic policies. Patterns of *partisaneering*, i.e. the manipulation of economic policy to benefit a partisan

constituency, are evident in cycles of emphasis on (p. 546) different macroeconomic policy tools that track shifts in the partisan composition of governments.

While political economists have long incorporated democratic policy-makers' strong electoral and partisan motivations into theoretical models of the strength, nature, and timing of economic policy-making (e.g. Nordhaus 1975; Hibbs 1977; Tufte 1978), supportive consensus generated through empirical research has been more limited. For example, evidence of partisan cycles in real economic performance is typically stronger than the evidence supporting similar electoral cycles, but Clark (2003) strongly dissents. More puzzling, perhaps, is that while there seems to be relatively strong and consistent evidence of electoral and partisan cycles in nominal outcomes (like inflation), the empirical evidence also seems to suggest that electoral and partisan cycles in fiscal policy are stronger than any in monetary policy (Drazen 2001). Although the more recent rational expectations (RE) models (Cukierman and Meltzer 1986; Rogoff and Sibert 1988; Rogoff 1990)—in which voters are rationally foresighted and therefore aware of incumbents' incentive to *electioneer* or *partisaneer*—may account for some of these empirical patterns, several questions remain. Most critically, how can one account for the great inconsistency in results across all these empirical explorations of such similar phenomena? Relatedly, (how) can one account for the apparent differences in relative strengths of electoral or partisan effects, and (how) can one explain incumbents' choices over different policy instruments?

At least in part, we argue, the neglect of variations in the *(a) international and domestic, (b) political and economic, (c) institutional, structural, and strategic contexts* in which elected, partisan incumbents make policy contributes to the limited empirical validation of both modern RE and classical political-economic cycle studies. (We use *context* or *contextual* to refer to this set of factors.) The magnitude, regularity, and content of political-economic cycles will vary with these *contexts*. Factors that vary across policies, countries, and times to yield such *contextual* effects include the nature and relative effective intensities of popular demands for economic policy and outcomes and of policy-makers' re-election and partisan incentives; the inter-, intra-, and extragovernmental allocation of policy-making control across multiple actors; and policy efficacy and maneuverability. For example, small, open economies, in which policy-makers retain less autonomy over some policies, or in which some policies may be less economically effective, likely lessen political-*macro*economic cycles. Where policy-making control is concentrated among a few highly disciplined partisan actors (e.g. Westminster), political-economic cycles may be sharp and clearly defined. Similarly, electoral rules may affect the relative political benefits of demographic v. geographic targeting of spending, and sharpen some political-economic cycles while blunting others. As these examples suggest, *contextual* variations structure policy-makers' incentives and abilities to manipulate policies and outcomes for electoral and partisan gain, and contextual variations modify the political-economic efficacy of such manipulations, again in many different ways across democracies, elections, and policies.

Political-economic cycles offer an ideal forum for exploring such *contextual* interactions: In all democracies, all policy-makers and policies ultimately must survive (p. 547) evaluation in partisan electoral contests. As a result, political-economic cycles should always emerge, but to degrees and in characters heavily *context conditioned*. Researchers, therefore, who wish to understand the implications of electoral and partisan incentives for economic policy-making should (Alt and Woolley 1982)—and increasingly have (as this review reveals)—incorporate the *context-conditionality* of electioneering and partisaneering in their analyses.

This entry surveys theoretical and empirical work on such *political-economic cycles*, i.e. cycles in economic outcomes induced by electoral and partisan competition.[1] In particular, we find the evidence to suggest that closer attention to the *context* in which economic policy decisions are made offers important and promising opportunities for future research. In the next section, we review, briefly, the literature on electoral cycles, building on Hibbs's discussion of electoral cycles (this volume), and emphasize how electoral context may heighten or inhibit incentives to electioneer. Then, turning to partisan cycles, we present a survey of the theoretical and empirical literature linking economic policy to partisan electoral motivations. Here too the opportunities for the incorporation of contextual factors, we suggest, seem very promising.

2 Electoral Cycles

Hibbs's discussion (this volume) presents details of important past and current developments in the theoretical and empirical study of electoral cycles. For our purposes—the review of political-economic cycles and evidence of their *context conditionality*—it will suffice to discuss this literature only briefly, emphasizing some features that Hibbs does not, and to refer our readers to Hibbs's chapter for a more thorough treatment.

2.1 Adaptive, Retrospective Citizens

Nordhaus (1975) showed how incumbents might use monetary policy to manipulate the well-known inverse relationship between inflation and unemployment (i.e. the Phillips curve) to win votes from myopic voters. Nordhaus's model of electoral cycles can be summarized in the following way: (1) Economic actors have adaptive expectations; that is, expected inflation rates are based (only) on past inflation. As a result, an expectations-augmented Phillips curve characterizes the economy. Simply put, Phillips curves give the relationship between inflation and unemployment; the expectations augmentation holds that only deviations of inflation from expectations, derived from past experience, will move unemployment rates. One implication of (p. 548) this set-up is that policy-makers can affect economic growth through the manipulation of inflation rates in the short run but not in the long run. (2) Voters are naive in the senses that they favor incumbents who preside over low inflation and high employment/growth without fully appreciating this economic relationship and that they weigh recent outcomes more heavily in their retrospective evaluations. (3) Incumbents (*a*) seek re-election and (*b*) control Phillips-curve

stimulatory policies. Therefore, incumbents conduct stimulatory policy to improve real outcomes in pre-electoral periods, becoming contractionary post-election to combat the ensuing inflation and to prepare to stimulate again for the next election. Applying Tufte's (1978) murder-mystery analogy, 2 and 3*a* give *motive*; 1 gives *opportunity*; and 3*b* gives *weapons* for incumbents to *electioneer*. Drazen (2001) extends this logic formally to macroeconomic policies more generally, including fiscal policies.

As Hibbs (this volume) and others (e.g. Drazen 2001) make clear, that incumbents benefit from favorable economies has unequivocal empirical support (e.g. Kramer 1971; Tufte 1978; Fair 1978; and Hibbs 1987*a*, for presidential elections; Tufte 1975, 1978 for congressional elections; and Madsen 1980; Lewis-Beck 1988 for European democracies). In the United States, Alesina, Londregan, and Rosenthal (1993) find, notably, that voters reward/punish incumbents consistently with naive retrospective voting, rather than *rational* retrospective voting, in which voters may adjust their evaluations of incumbents' records in a way that acknowledges policy-maker incentives to electioneer (RE models are discussed below). Such *economic voting* being so well established, scholars moved to explore its *context conditionality* (e.g. *Electoral Studies* 2000). Hibbs (this volume) considers some of this research in his discussion of how “clarity of responsibility” may structure incentives to electioneer.

The strength of the evidence in support of economic voting stands in sharp contrast to evidence supporting electoral outcome cycles, especially evidence of cycles in real outcomes. Alt and Chrystal (1983), Alesina and colleagues,[2] and Hibbs (1987*a*), for instance, conclude that evidence from the USA or OECD democracies offers inconsistent support for electoral policy cycles and very little for outcome cycles, especially real-outcome cycles.[3] More widely viewed, the evidence for classic electoral outcome cycles is indeed mixed, but not uniformly unfavorable. For example, not counting Nordhaus and Tufte or these partisan-theory protagonists, Franzese (2002*a*) finds fourteen articles by ten authors reporting some cycles, and eight articles by six authors reporting weaker or no signs.

What is important for the purposes of our discussion, however, is a pattern that seems to pervade these seemingly inconsistent results. Nordhaus (1975), to take an example from the very start of this literature, found significant electoral unemployment cycles in just three of nine countries 1947–72, but the relative significance across countries suggests that closely contested elections, strong, unified executives, and (p. 549) domestic policy autonomy induce the strongest cycles. That is, empirical evidence hinted the importance of *context conditionality* for electoral cycles *ab initio*. Some of the inconsistencies in empirical evidence for electoral cycles likely emerged also from the implicit assumptions throughout these studies that all incumbents seek re-election equally in all elections and that all equally control policies equally effective toward that goal. Re-election incentives, control over policies, and political-economic policy efficacy are not constant, however; they vary considerably across *contexts*.

An even more serious limitation in these empirical searches for electoral cycles in macroeconomic outcomes derives from the following proposition: election-motivated incumbents will prefer policies that are more targetable and timeable (by incumbents, to voters), manipulable (by incumbents), palpable (to voters), and attributable (by voters, to incumbents) (Franzese 2002*a*). Following Tufte (1978), some policies that meet these criteria include direct benefits, such as transfers, tax cuts, or delayed hikes, spending increases or delayed cuts (especially public works), and public hiring/firing. In fact, only breadth of potential beneficiaries favors *macroeconomic* manipulation as an effective electioneering weapon, and, importantly, electioneering through policies that deliver direct benefits renders irrelevant the Phillips-curve exploitation on which the adaptive retrospective models rely and less relevant the distinction between adaptive and retrospective expectations entirely. And, indeed, evidence for electoral cycles in these sorts of policies is more consistently favorable.

Likewise, the timing of policy initiation or implementation and, in most parliamentary democracies, of elections themselves may be more easily manipulated by incumbents—and so more useful for electioneering—than either transfers or macroeconomic manipulation. Where incumbents can call early elections, policy-makers might more easily schedule elections to coincide with economic expansions than vice versa. Ito and Park (1988) and Ito (1990) find strong signs of strategic election timing in Japan (as do Alesina, Cohen, and Roubini 1993). Similarly, Chowdhury (1993) finds strategic timing in India, as do other more broadly comparative studies. Nevertheless, there remains little evidence of strategic election timing in other OECD democracies. As India and Japan are dominant-party systems, this pattern raises another possibility: early elections can occur for two reasons. On the one hand, as suggested above, incumbents may choose to call early elections to capitalize on favorable economic conditions. On the other hand, however, early elections may be forced upon incumbents because some of the coalition partners abandon the government, causing its collapse. If economic conditions are especially bad, coalition parties may try to avoid being punished at the polls by distancing themselves from the current government. Reasonably, therefore, we may expect economic conditions in endogenous election timing countries to exhibit greater variation across election years compared to non-election-year variance than that ratio in countries where elections are exogenously scheduled. Furthermore, opportunistic election timing to *strong* economies should be more prominent in single-party than in coalition government systems (Smith 1996, 2000). Finally, having endogenous election timing as an option should also (weakly) lessen the use of all other *electioneering weapons*; that is, given the additional weapon of moving the date of elections, other electioneering tools need be used less.

(p. 550)

As that last consideration illustrates, all of this might imply a kind of *Ramsey Rule* for incumbents' electoral (and/or partisan) manipulation: assuming policies have decreasing marginal political-economic benefits, incumbents will manipulate all policies in direct proportion to their relative net-benefit elasticities (Franzese 2002*a*). Simply stated, incumbents will use all policy tools, in proportion to their effectiveness in satisfying their elec-

toral goals. More specifically, an *electioneering Ramsey Rule* implies electoral cycles in policy composition as well as levels (Mani and Mukand 2000; Chang 2001), more prominent cycles in direct-delivery policies than less direct policies and outcomes, and that the degree and character of such policy composition *electioneering* are *context conditional*.

Returning to the example of coalition governments (or multiple sets of incumbents, more generally), incentives to *electioneer* may be modified by common-pool problems (in which total public revenue may be administered by several different and competing policy-makers; Goodhart 2000), agency problems (which arise when an actor, or set of actors, act on behalf of others, to further their goals and interests, e.g. Alt 1985), or veto-player problems (which arise when some actors can reject policy actions of others, e.g. Franzese 2002*b*). Similarly, coordination problems between central banks and governments (Cusack 2001) or other delegation and bargaining issues (Franzese 2003) may limit the *electioneering* effectiveness of different policy tools. Exchange rate regimes and international goods and financial market exposure (Franzese 2003; Clark 2003) and fiscal solvency also limit *electioneering* maneuverability (Blais, Blake, and Dion 1993; Franzese 2002*b*). Notably, Drazen's (2001) proposed active-fiscal/passive-monetary RE political cycles account is consistent with many of these expectations and empirical patterns.

Overall, this pattern—very strong support for direct transfers cycles, also strong in other policies and inflation around or after elections, and weakest in real outcomes—appears most clearly when specifications are conditioned by electoral competitiveness and other *contextual* variations, and it also receives more consistent support in developing than in developed democracies. The most promising approaches therefore, incorporate such *context conditionality* (Alt and Woolley 1982); conversely, factors like the presence of coalition partners, or autonomous central banks, when omitted, contribute to some of the apparent empirical weakness of electoral cycles. That is, when empirical specifications allow only unconditional electoral cycles, fail to control for competitiveness, and/or analyze less direct policies, support for policy cycles is weaker, although still stronger than for outcome cycles. Thus, electoral cycles do seem to be highly *context conditional*, rather than being of fixed magnitude and fixed content.

2.2 Rational, Prospective Citizens

Viewing this evidentiary pattern, economists naturally questioned the adaptive expectations and exploitable Phillips-curves assumptions. Voters and economic actors can easily foresee elections and policy-makers' incentives, so electoral cycles should (p. 551) not exist or should have no real effects under RE (although incentives for direct transfers may remain). If policy-makers do not possess any informational advantages over voters, then they cannot effectively signal their competence through pre-electoral stimulation, and, as a result, there are no incentives for Phillips-curve exploitations. However, if some actors apply adaptive expectations, then exploitable Phillips curves exist to that degree; likewise, if some voters evaluate naively retrospectively, their vote share gauges incumbents' broader *electioneering* incentives. Moreover, if some performance-affecting incumbent characteristics persist over time and if voters cannot fully observe these characteristics,

rationally prospective actors would nonetheless evaluate retrospectively. Therefore, with incomplete citizen RE, classical electoral outcome cycle models should have some, albeit irregular or muted, validity.

As Hibbs (this volume) describes, RE competence signaling electoral cycle models are distinguished from complete information RE models in that elected policy-makers enjoy an information advantage—in particular, knowledge of their own competency—over voters. This informational advantage results in smaller, less regular cycles, especially in real outcomes. The empirical record may fit, but determining whether the correct degree of "smaller, less regular" cycles manifests, even if that degree were theoretically determinate, would be empirically difficult. Moreover, many *context-conditional* considerations would also imply smaller, less regular cycles, especially in an evidentiary record generated by studies that omitted such conditionality. Thus, empirical research does not contradict RE *competence*-signaling electoral cycles; cycles do seem less regular and smaller than models in which voters naively reward (or punish) policy-makers for good (or bad) economic performance suggest. However, the evidence is inconsistent with rational retrospective voting (Alesina, Londregan, and Rosenthal 1993); *context-conditional* cycles theories, whether RE or myopic, would also predict smaller, irregular cycles, especially as previously estimated; and smaller, irregular cycles would also obtain if political-economic actors in reality had *varying* information and rationality. The case for RE electoral cycles is more strongly theoretical than empirical: voters' prospective, RE evaluations probably do limit the degree to which incumbents manipulate economic policies and, a fortiori, outcomes for electoral advantage, but RE alone cannot (fully) explain the patterns in the accumulated empirical record. That is, observed cycles can be reconciled with RE, but RE may not (fully) explain observed cycles. *Context*, including the information environments in which political economic actors operate, remains a critical determinant of incentives to *electioneer*.

2.3 Further Discussion

One component of *context conditionality* that is especially neglected in electoral cycle studies is that of electoral challengers, who play little direct role in most models. Higher-quality challengers, for instance, may lead incumbents to expect closer elections, yielding greater *electioneering* in quality-challenger elections and in systems that usually produce such. Similarly, higher-quality challengers modify incumbent (p. 552) incentives to signal competence. More competent incumbents signal more because they can better distinguish themselves from expected average challengers, perhaps suggesting that quality challengers would incite *less* electioneering. This may offer some empirical leverage on (and bodes poorly for) *competence* signaling RE models.

Furthermore, *electioneering* seems to occur empirically both immediately before and after elections, and, indeed, is more pronounced and more certain just after (at least in transfers and deficits; Franzese 2002*b*). Challengers may explain this too. Incumbents can act on pre-electoral promises and therefore must do so to maintain credibility; winners can and almost always do fulfill their promises (Pomper 1971; Rose 1980; Alt 1985;

Gallagher, Laver, and Mair 1995) for like reasons; and, *ceteris paribus*, candidates who promise more with greater credibility win. Therefore, given that electioneering may have some costs so that incumbents must estimate how much electioneering is optimal to undertake, the empirical pool of pre-electoral policy-makers will contain some incumbents who promised-cum-delivered too little/insufficiently credibly, and so lost; whereas post-electoral pools contain winners, returning incumbents and entering challengers, who (on average) will have promised, and so now must enact, greater largesse. Thus, the election essentially filters for credibility × promised largesse. Therefore, especially as newly seated governments are the most productive (*honeymoons*), post-electoral largesse is greater and more certain than pre-electoral. Note, finally, that this could also explain some weaknesses in early studies, which compared pre-electoral periods to all others, including immediate post-election periods.

In this section, we have considered empirical and theoretical research that evaluates the extent to which electoral cycles structure the incentives of economic policy-makers. While this has been a topic of extensive theoretical development, important inconsistencies in the support lent by empirical research remain. We have emphasized how the *context* in which policy-makers operate may structure their incentives to *electioneer*, and how failure to incorporate this context may generate misleading estimates of the effects of electoral incentives in economic policy-making. Although empirical evidence is more consistently supportive of partisan cycles, in which incumbent parties manipulate policy to benefit their constituencies (but see Clark 2003), the accounts provided there too are sensitive to these *contextual* considerations. In the next section, we review theoretical accounts of partisan incentives, as well as the related empirical research.

3 Partisan Cycles

3.1 Adaptive, Retrospective Citizens

In partisan models of political economics, candidates contest and voters adjudicate elections in partisan terms. Parties cultivate ties to different voter groups and nurture **(p. 553)** reputations for policy-making that favors those groups. Parties and voters value these ties and reputations, so incumbents conduct recognizably distinct partisan policies, yielding appreciably distinct economic outcomes. That parties do so distinguish themselves is somewhat unexpected theoretically: The Hotelling–Downs–Black (1929/1957/1958) model predicts that, in two-party competition at least, parties will converge, in policy terms, on the pivotal median voter. We might therefore expect the economic policies of all parties to reflect the interests of this voter.

Theoretically, however, partisan divergence can emerge as equilibria of several reasonable representations of electoral competition. Electoral uncertainty/incomplete information, especially regarding median voters' preferences, allows policy-interested parties to drift from *expected* medians at finite expected vote cost, yielding divergence, more as such uncertainty rises (Wittman 1977; Calvert 1985; Roemer 1992). Divergence can also

arise if pre-electoral promises are not credible; candidates may find it optimal to renege on their promises post-election: with two parties, no entry, and one-stage games (e.g. no re-election), winners have no incentive to implement medians' preferences if theirs differ, so voters believe victors will enact victors' preferences whatever they might promise. Under these conditions, any degree of divergence is sustainable. In repeated games, however, parties can build reputations, which may foster some, but incomplete, convergence. With free entry, moreover, any number of candidates could enter anywhere, so low-cost-entry systems can sustain multiple parties of any divergence. More realistically, with some (non-preclusive) entry cost, multiple *citizen-candidate* equilibria (Besley and Coate 1997) arise. One, that only the median enters, returns the Hotelling–Downs–Black result, but the others, in which two candidates equidistant from the median enter, can sustain widening divergence as entry costs grow. Divergence, therefore, is an empirical matter.

Empirically, partisan economic policy/outcome differentiation is obvious. Tufte (1978), for example, finds US party platforms contrast *more* on economic and labor issues than on most others. Democrat and Republican voters divide similarly, though less sharply. Inflation and unemployment concerns, particularly, are highly cyclical and common to all, but persistent partisan differences manifest, mirroring the socio-economic characteristic of each party's constituency. Hibbs establishes left/right priorities most thoroughly, stressing relative unemployment/inflation aversion. Hibbs (1987*a*) shows, exhaustively and indisputably, that *lower* ends of occupational, income, and societal *hierarchies* face greater, more cyclical unemployment risk, and that tax-and-transfer systems only partly mitigate this risk. While unemployment's aggregate costs are large and obvious, Hibbs (and most others) find no evidence that inflation, *short of hyperinflation and distinct from relative prices and inflation variability*, harms almost any *real* outcome, including average income tax rates; aggregate real revenues, growth, investment, or savings; or the non-residential/housing investment mix. The only appreciably deleterious inflation effects appear in profitability, capital, and stock returns. Therefore, objectively, to the extent that these effects of inflation are felt more by upper classes, and to the extent that upper classes face less unemployment risk, they will have *relatively* more dislike of inflation than unemployment than do lower classes. Hibbs's partisan theory, in fact, requires only that this *ratio* of **(p. 554)** unemployment–inflation aversion among lower classes exceed that ratio among upper classes. Indeed only the ratio of perceived, and not necessarily objective, aversions matters, which Hibbs thoroughly demonstrates, estimating that Democratic voters penalize incumbents 1.1 times as much for 1 per cent unemployment as for 1 per cent inflation, substantively and statistically significantly greater than Republican voters' penalty ratio of .65.

Thus, different voter groups suffer disproportionately from unemployment or inflation; public perceptions reflect this objective difference; and incumbents' electoral approval follows suit, yielding differing partisan incentives to combat unemployment or inflation. More generally, party platforms differ on a range of economic issues; voters recognize and act on these differences; and parties enact policies accordingly. Therefore, left parties seek higher growth/employment and will accept higher inflation if need be to get them; right parties behave oppositely. (Left parties will also expend greater equalization

efforts.) Hibbs assumes monetary, fiscal, and other policies have sizable short- to medium-term[4] impact, so these policy differences should manifest in outcomes also.

Supportive evidence is plentiful relative to that for electoral outcome cycles. Hibbs (1977, 1987*a*) estimates 1.5–2 per cent higher unemployment and 5.3–6.2 per cent lower real growth under US Republican administrations than under Democratic. Democrats also contributed 60± per cent of the 1948–78 reduction in 20/40-ratio income inequality. Beck (1982) finds these estimates inflated by about 1/3, but qualitatively concurs. Hibbs (1987*b*), Paldam (1989), and others find similarly in broader OECD samples. Alesina and his various colleagues (see n. 2 above) also find evidence of partisan cycles in the USA, as well as in the OECD countries. Several of these studies find *context-conditional* partisan cycles. Considerable consensus exists, therefore, about the role of partisanship in cycles of worsening nominal outcomes (like inflation) and improving real (unemployment, growth, etc.) and distributional outcomes under left governments, in US and comparative data. (Clark and colleagues[5] dissent, finding *context-conditional* cycles that favor electoral more than partisan models.)

An enormous literature analyzes empirical evidence of cycles in partisan policy. Imbeau, Petny, and Lamari (2001), for instance, meta-analyze 37 out of 600 partisan-policy studies that address economic policy, spanning welfare, education, health, social security, privatization, intervention, public employment, spending, revenue, debt/deficit, etc., yielding 545 coefficients of these, 72.5 per cent sign intuitively (e.g. left parties supporting policies favorable to their traditional constituencies), with 24.8 per cent significant at $p \leq .10$; 26.6 per cent have wrong sign, 8.3 per cent significantly; 0.9 per cent report no relation. This is a fair record, particularly when the varying and sometimes simplistic structure of the component studies is considered. The strongest partisan effects emerge from more sophisticated analyses, post-1973 samples, and regard government *size*: revenue, spending, employment (especially), or (p. 555) social welfare (less so). These results suggest that partisan cycles, like electoral cycles, follow a *Ramsey Rule:* all/most policy tools are used to meet partisan ends, although certain tools are preferred, and the extent and the mix of usage of policy tools exhibit strong *context* dependence.

Summarizing, empirical research demonstrates that nominal outcome effects exhibit partisan cycles most strongly, although partisan cycles in distributional outcomes are also evident and even real-outcome partisan cycles receive moderate support. Broad partisan policy cycles are also consistently and strongly evident, with strongest evidence for public employment but also some for spending and revenue. Finally, partisan cycles are found more consistently in social or welfare policies, tax structure, and monetary policy, than in fiscal policy. Naive left-deficit, right-surplus arguments,[6] for example, have least support.

In sum, empirical evidence of partisan policy and outcome divergence, in the expected directions, recurs frequently. Estimates vary and standard errors are sometimes large (statistical significance low), however, which could suggest that partisan divergence is small as Clark and colleagues (see n. 5 above) contend. To us, the more likely explanation for this variation in estimated coefficients and these sometimes large standard errors in the

empirical record are the insufficient sample sizes/variations, the inappropriate/inadequate controls, and the mis-specification of *context-conditional* relations as unconditional characteristic of most empirical studies. We emphasize especially the last of these because, in all cases, and perhaps especially in monetary and fiscal policy, the overall pattern of empirical results suggests highly *context-conditional* partisan cycles.

3.2 Rational, Prospective Citizens

Unlike the electoral cycles case, empirical support for partisan cycles seemed strong, so no particular empirical puzzle motivated RE partisan theory. Rather, Alesina's (1987, 1988) *rational partisan theory* (*RPT*) filled theoretical needs, providing a framework logically consistent with modern RE economics, particularly with the latter's conclusion that fully expected macroeconomic policies (like those of the traditional political-macroeconomic policy cycles) are ineffective.

RPT's crucial insight is the *electoral surprise*. The minimal model can be summarized so: The economy is characterized by RE so that only unexpected policy affects outcomes; e.g. an RE-augmented Phillips curve, i.e. with forward-looking expectations that incorporate the full model rather than adaptive expectations. Two competing parties have or represent different preferences, and enact different policies if elected. Similarly, voters' preferences over inflation and unemployment vary, and they will vote for the party expected to deliver them highest utility. Under these conditions, economic actors' (voters') rational inflation expectations will average the two parties' (p. 556) preferences (which are known), weighted by the rationally expected probability each wins. After the election, expectations adjust to the actual winning party but only as quickly as nominal contracting (e.g. wage-bargaining contracts) allows. Thus, unless winners were perfectly foreseen, actual election outcomes produce surprise policy, yielding short-term real-outcome shifts that fade as elections recede and contracts slowly adjust to the actual winner.[7]

Alesina and Rosenthal (1995) and Alesina, Roubni, and Cohen (1997) collect and advance Alesina and colleagues' (see n. 2 above) political-economic cycles work, contrasting evidence in support of electoral cycles and partisan cycles, in their RE and non-RE variants, from political-economic data across postwar US and OECD democracy samples. They find the data consistently favor RE models, indicate strong partisan, although few discernible electoral, cycles in macroeconomic outcomes, and suggest electoral and partisan macroeconomic-policy effects. The wider empirical literature, however, is more equivocal.

Recall that RE competence-signaling and non-RE electoral cycle theories have similar predictions, except that RE limit cycle size, regularity, or duration. The differences between RE and non-RE partisan theories of macroeconomic outcomes are also subtle: in non-RE partisan theory, policy-makers exploit stable Phillips curves to shift macroeconomic outcomes permanently. In *RPT*, only unexpected policy creates real effects, so when the left wins, inflation rises but real outcomes rise only insofar as the election winner and so the policy shift was unforeseen. Post-election, expectations adjust to incorporate the higher inflation, returning real outcomes to natural rates over time as new con-

tracts come online, but inflation remains higher. The opposite pattern unfolds if the right wins. Thus, RE and non-RE partisan theories differ primarily in whether real partisan effects persist or fade. In US and/or OECD data, Alesina and colleagues (see n. 2 above) find indicators equal to (1, −1) in the first 8± quarters (2± years) of (left, right) governments empirically dominate traditional indicators equal to (1, −1) over governments' whole terms. They interpret this as supporting the short-term real effects predicted by RE models. By contrast, inflation is permanently higher under left governments in both RE and non-RE models—a pattern which the data, explored in this manner, also support.

Empirical dominance of short-term indicators is indisputable; yet strongly concluding for *RPT* on this basis is premature (Franzese 2000). For one, the estimated cycles differ little substantively. More critically, much besides RE could explain shorter-term partisan effects. For example, Alesina, Roubini, and Cohen (1997) describe how left parties first apply expansionary policy, then, observing rising inflation, a potential electoral liability, switch to contractionary policies; rightist governments (p. 557) proceed oppositely. These paths, which the *mid-term balancing* of Alesina and Rosenthal (1995) would also produce, for instance, yield shorter-term cycles; *honeymoon* effects would also, as would any diminishing returns from stimulation. Finally, and most troubling for *RPT*, substantively and statistically stronger US real-growth partisan cycles emerge, before 1972, but significant right/left inflation differences, which produce *RPT*'s real cycles, emerged only after 1972.[8] Furthermore, Alesina, Roubini, and Cohen (1997) also explore US money growth, nominal interest rates, budget deficits, and transfers, finding some, but weak, partisan differences in monetary policy, though evidence is stronger in 1949–82 in nominal interest rates. (Evidence of pre-electoral monetary policy effects is also lacking, but possibly only because exchange rate regimes were ignored in that analysis.) Problematically, the partisan indicator in these policy studies lags two quarters, but the real-effects findings mentioned above assumed lags of just 1–2, implying that real effects emerge *before* monetary policy changes. This sequence directly suggests Drazen's (2001) active-fiscal/passive-monetary cycles in which fiscal policy drives partisan real-outcome cycles and nominal cycles arise from monetary accommodation of the fiscal manipulations. Also, the finding for monetary policy effects only in 1949–82 and the earlier finding of dampened inflation cycles through 1972 leave only a narrow 1973–82 window for partisan cycles to emerge from surprise inflation. Finally, the Phillips-curve slope required to produce the estimated real effects from the estimated monetary effects is implausibly steep.[9]

RPT also predicts more specifically that real-outcome effects should be proportional to electoral surprises. Alesina, Roubini, and Cohen (1997) very cleverly apply option-pricing theory to measure electoral surprises and find partisan unemployment effects in monthly US data proportional to these measures. However, they test for cycles proportional to surprise size (so measured) only against the absence of cycles; i.e. the alternative is no partisan effect rather than a simple partisan cycle. Moreover, *RPT* cycle amplitude actually depends on electoral surprises *times expected inflation differences between incumbents and challengers* rather than just the size of electoral surprises, as these models specified. The empirical models thus implicitly assume equal incumbent–challenger polarization across all elections. This would bias estimates if, e.g., victory probabilities relate to distances be-

tween candidates, which they would in *RPT* or most other reasonable models. Data from prior-office voting records of most presidential candidates, which could gauge the requisite distances, exist. Of course, the issues raised above—missing policy links behind the observed (p. 558) policy cycles, congressional influence, and varying exchange regime—apply to this analysis also.

Summarizing, Alesina and colleagues (see n. 2 above) clearly establish short-term real-outcome and long-term nominal-outcome partisan cycles, but the *RPT* model's explanation for these cycles is not well established empirically. In particular, monetary policy and nominal-outcome patterns cannot easily explain real-outcome patterns. Regarding policies, Alesina and colleagues find strongest partisan effects in two-party/bloc countries—which is intuitive since these systems produce greater right–left government alternations—and in redistributive policies like transfers—also completely intuitive. They find only weak signs of pre-electoral tax manipulation and, weaker still, of pre-electoral spending manipulation.

3.3 Further Discussion

Other empirical studies of *RPT* report more mixed results. Sheffrin (1989), for example, finds US monetary cycles, but not significantly consistent with *RPT* in the USA or elsewhere. Using over 100 years of American data, Klein (1996) finds political events associated with ends of slumps and booms, consistent with *RPT*, although Klein's study does not directly test *RPT*. Carlsen (1998, 1999) and Carlsen and Pedersen (1999) investigate nominal rigidities and electoral surprises, which *together* should produce *RPT* cycles, and compares measures reflecting their combination with those analogously derived from Hibbsian partisan theory. The results are weakly positive for US inflation cycles, supporting both versions of partisan theory, negative for US real outcomes, and mixed elsewhere; Carlsen and Pedersen (1999) find clear *RPT* support in the UK, some *RPT* support in Canada and Australia, classical partisan-theory support in the USA, and inconclusive findings in Sweden and Germany. Finally, Faust and Irons (1999) find evidence to support Alesina and colleagues' proposition that the first two years of new administrations exhibit the distinctive real outcomes *RPT* predicts (right-worse; left-better) but also that little of this distinctiveness can be attributed to partisan monetary policies, echoing some of the above discussion.

Others stress more theoretical limitations. Following Rogoff (1988), Garfinkel and Glazer (1994) ask whether US bargainers, in order to avoid election surprises that would alter the real terms of nominal contracts, would simply defer contracts to post-election, finding that some contracts do exhibit significant post-electoral kyphosis. This suggests that bargainers do perceive electoral-economic uncertainty sufficient to warrant altering their contracting behavior, supporting *RPT*'s theoretical basis, but that very alteration in behavior mutes any monetary-surprise-induced real cycles, weakening *RPT*'s explanation for partisan real-outcome cycles. Ellis and Thoma (1991) emphasize instead that, because election timing in most parliamentary systems is endogenous, partisan surprises there are more continuous and irregular, and likely somewhat smaller, than in exogenous elec-

tion timing systems. Ellis and Thoma (1995) find evidence of current account, real exchange rate, and terms of trade cycles supporting hypotheses derived from their model reflecting this consideration. (p. 559) Heckelman (2001), relatedly, models rational economic agents facing uncertainty regarding election timing and election winners. Real effects here depend on partisanship in current and previous periods, time since the last election, and incumbent popularity. In this RE model, unlike in Alesina's *RPT*, lefts/rights spur/dampen real output throughout their term, and these real effects rise rather than diminish over the term. Drazen (2001), finally, questions *RPT*'s emphasis on monetary policy, giving an active-fiscal/passive-monetary RE model that predicts political-economic cycles more consistent with the full policy and outcome evidentiary pattern described above.

4 Conclusion: *Context-conditional* Political-Economic Cycles

In all democracies, partisan electoral contests determine economic policy-makers. That partisan and electoral motivations influence economic policy-making, therefore, is not surprising. As discovered repeatedly above, however, cycles induced by electoral and partisan incentives receive strongest empirical support when researchers recognize their *context conditionality*. Franzese (2002*a*) summarizes this argument thusly: "Incentives and capacity for, and effects of, *electioneering* or *partisaneering* should vary predictably across policies and across domestic and international political-economic institutional, structural, and strategic *contexts*." Many specific hypotheses regarding *context-conditional* political-economic cycles are suggested there. To give a few examples here: given our *Ramsey Rule*, and subject to boundary conditions, policy-makers will use all instruments in proportion to their relative efficacy, producing cycles of varying amplitude in all policies and outcomes, and in policy composition (Chang 2001) and outcome mixes (Tufte 1978). Coalitions may have lesser *motive* given their collective-action/common-pool problems (Goodhart 2000) and lesser *opportunity* given their veto-actor problems (Franzese 2002*b*; Tsebelis 2002) to *electioneer*. Where political systems produce unified single-party governments, election timing may be an ideal *weapon*. Broad redistributive policies (e.g. transfers) may be good *weapons* given multimember districts, but distributive (pork-barrel) policies may be more effective given single-member districts, which make victory depend on winning narrower constituencies. *Motives* to *electioneer* per se, and relative to *motives* to *partisaneer* (Schneider and Frey 1988), vary with expected election competitiveness. Systems with less effective accountability mechanisms (see Powell 2000) may yield muted *electioneering/partisaneering motives* as well (Powell and Whitten 1993; Shi and Svensson 2001). *Motives* may also vary across elections with the share of power at stake (Tufte 1978), so systems that concentrate elections on key policy-makers (e.g. UK) would induce sharper cycles (Alt 1985; Goodhart 2000; Franzese 2002*b*). Incumbents' policies also depend on strategic *contexts* like (p. 560) opposition strength and partisanship or replacement risk (Hicks and Swank 1992; Franzese 2002*b*).

Opportunity to *electioneer/partisaneer* also varies, with multiple incumbents and internal and external constraints on policy maneuverability being central. Accumulated debt limits fiscal policy maneuverability (Blais, Blake, and Dion 1993; Franzese 2002*b*); government seat shares and party discipline augment it (Acosta and Coppedge 2001); private or public foreign-borrowing ability enhances it (Corsetti and Roubini 1997). Multiple policy-makers likely limit maneuverability in general (Tsebelis 2002; Alt 1985; Roubini and Sachs 1989; Perotti and Kontopoulos 1998; Franzese 2002*b*). Maneuverability also hinges on delegation, agency, and bargaining issues under shared policy control.[10] In monetary policy especially, many (Clark and colleagues (see n. 5 above) most thoroughly) have considered the implications of central bank independence, fixed exchange rates, and/or capital mobility in this regard. Fiscal policy contracts or delegation may have similar effects (Hallerberg and von Hagen 1998).

In sum, the empirical evidence surveyed here (see also Franzese 2002*a*) clearly supports models of political-economic cycles that are *context conditional*. Political economists should, therefore, recognize in the study of political-economic cycles generous opportunities to explore how international and domestic, political and economic institutions, structures, and strategic *contexts* shape the electoral and partisan incentives for public policy-making.

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Notes:

(1) It borrows from and condenses Franzese 2002*a*. Some points made there are neglected here, and some points made here are elaborated and substantiated further there. Citations are also far more extensive there.

(2) Alesina and Sachs 1988; Alesina and Roubini 1992; Alesina, Cohen, and Roubini 1992, 1993; Alesina, Londregan, and Rosenthal 1993; Alesina, Roubini, and Cohen 1997; Alesina and Rosenthal 1995.

(3) Alesina and colleagues argue the post-election inflation they find may arise from RE pre-electoral policy cycles of the Rogoff 1990 sort. However, virtually any pre-electoral fiscal activism would spur post-electoral inflation (Drazen 2001).

(4) He explicitly denies any long-run inflation–unemployment trade-offs but stresses that stabilizing inflation and spurring growth/employment often conflict.

(5) Clark et al. 1998; Clark and Hallerberg 2000; Hallerberg, Vinhas de Souza, and Clark 2002; Clark 2003; Clark, Golder, and Golder 2002.

(6) Left-activist (counter-cyclical), right-passivist (less counter-, a-, or pro-cyclical) views find more support (Cusack 1999; Franzese 2005).

(7) Two of the most interesting results from *RPT* logic lie beyond this article's scope. *Institutional balancing* (e.g. divided government) arises as moderate voters seek to produce moderate policies from polarized parties by giving control of different institutions (e.g. executive and legislature, central and local governments) to each. US *mid-term cycles* emerge because pre-electoral uncertainty about partisan control of the presidency leaves voters balancing against a weighted average in on-year congressional votes, but resolution of that uncertainty allows them to balance against a known president in off-year congressional elections, leading some moderate voters to switch their vote. Mid-term losses should therefore be larger after more unpredictable elections, which evidence supports (Scheve and Tomz 1999).

(8) Under Bretton Woods (the pre-1972 system), the USA (as the Nth currency) retained autonomous and extremely effective monetary policy. Fiscal policy would have been less effective. So the real cycles should have come through strong partisan monetary cycles, which would have been clearly evident in inflation.

(9) In these policy cycle studies, Alesina and colleagues also find no pre-electoral deficit or transfers effects and few partisan transfers effects. However, they ignore post-electoral effects; samples here are small; and context conditionality is largely ignored. They do find statistically significantly higher deficits under the right, though, a result they attribute to the right strategically increasing debt to reduce any future left's fiscal maneuverability. Early empirical results directly addressing such strategic debt manipulation theories are not promising, though (Lambertini 2003; Franzese 2002*a*).

(10) Franzese 1999, 2002*b*, 2003 offers a useful empirical formulation for such scenarios, including probably all principal–agent relations. In abstract, specify the agent's policy-reaction function, $g(X)$, the principal's, $f(Z)$, and some function, $1 \geq h(I) \geq 0$, reflecting the theoretical arguments regarding *contexts* that determine the costs (monitoring, enforcement, opportunity, etc.) that the principal must pay to induce the agent to follow $f(Z)$ instead of $g(X)$. Then, in most strategic models, equilibrium policy will be $y = h(I) \cdot g(X) +$

$\{1 - h(I)\} \cdot f(Z)$, which will be empirically estimable by non-linear least-squares or maximum likelihood for sufficiently distinct I, X, and Z and/or $f(\cdot)$, $g(\cdot)$, and $h(\cdot)$.

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