

Politics and the Macro Economy

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Do macroeconomic conditions influence the electoral prospects of candidates? Do governing incumbents use their powers of office to influence macroeconomic conditions so as to improve their electoral prospects? The evidence currently available seems pretty strongly to support an affirmative answer to the first question. There is more controversy about the second question, and for good reason. If the second question is answered in the affirmative, it is possible that the very process of democratic competition for office might interject instability into the economy. This possibility contrasts starkly with the traditional view of macroeconomic policy, where a central role of the state is construed as acting to keep stable what would otherwise be an unstable market economy. Rather than being an antidote or corrective for economic instability, politics might be a source of instability.

This essay explores some recent scholarship on the relation between political competition and economic stability. It starts by setting forth the traditional, Keynesian vision of the corrective or stabilizing state. This vision located the state as outside or exogenous to the economic process. Public choice scholarship has relocated the state to an endogenous position within the economic process, and in so doing has raised the prospect of the destabilizing state. The resulting hypothesis of a political business cycle starts from a consideration of the impact of macroeconomic conditions on the electoral support that incumbents can expect to receive. At this point the literature on the political business cycle reaches a fork. One branch of scholarship explores the theme that incumbent politicians may act opportunistically to manipulate macroeconomic conditions in

a search for electoral support. The other branch explores how election outcomes, particularly in tightly contested elections, might inject exogenous shocks into the economy that upset the macro economy. The existing literature on politics and the macro economy overwhelmingly adopts such conventions of modern macroeconomics as the presumption that the standard macro variables are simple objects of choice and that macro variables operate upon one another. This convention contrasts sharply with an alternative vision, where macro variables are not objects of choice but rather are simply emergent outcomes of complex patterns of human interaction, and where macro variables do not act upon one another because they are simply some aggregate representations of some traces of human interaction. The final section of this essay explores some lines of inquiry that stem from this alternative, coordinationist approach to macro phenomena, and which do not seem to fall out of the conventional, choice-theoretic approach to macro phenomena.

The Traditional Vision of Politics and the Macro Economy

Prior to the Keynesian revolution in economic thought, the vast preponderance of economists thought that a market economy possessed self-corrective forces. Movements away from price stability and full employment would set those forces in motion, reversing those movements and restoring price stability and full employment. For instance, if people generally decided to increase their money balances, aggregate spending would initially fall and unemployment typically increase. But corrective forces would also be set in motion. Falling demands would lead to falling prices. With falling prices, the real value of money balances would rise, which would increase people's desires to spend. The best that

government could do in this case was to act as a wakeful night watchman in maintaining an orderly institutional framework within which people organized and conducted their commercial activities. Disorder at the macro level was self-correcting within the framework of the market economy, provided only that the state do its part to maintain that framework.

The proper relationship between politics and the macro economy was tightly confined in the classical system of thought. The characterization of this relationship changed dramatically with the emergence of the postwar Keynesian consensus that a market economy did not possess powerful self-corrective forces. According to this consensus, which took great support from the deep depression and slow recovery that plagued the 1930s, a stable, fully employed economy is a fragile state which self-correcting forces do not guarantee will remain in equilibrium. With a market economy being inherently unstable, the obligations of the classical night watchman state were expanded to incorporate an obligation actively to secure stability and full employment.

This Keynesian formulation of the relation of politics to the macro economy came to command such an overwhelming consensus during the 1940s, 50s and 60s that it is now reasonable to denote this as the traditional or received formulation, which in turn will be contrasted below with some more recent formulations. This traditional formulation entails both economic and political presuppositions. A market economy is presumed to be highly volatile, due primarily to sudden and unpredictable shifts in spending on capital goods. If the animal spirits suddenly surge, spending on capital goods will expand and the economy will boom. But when those spirits dim, investment spending will plummet and a bust will ensue. Such classical mechanisms as the real balance effect and price adjustments were

regarded in the traditional post-war consensus as ranging between non-existent and weak.

The promotion of a stable and fully employed economy became the province of the state, as the sole repository in society of both the knowledge of what was required to maintain stability and of the will to take the required action. The role of the state was to calm the animal spirits, to lean against the wind. With its acute economic antennae placed throughout the economy, the state would recognize the surging or ebbing of the animal spirits nearly instantly, and soon thereafter would follow with the proper corrective antidote.

In the face of ebbing animal spirits, the state would increase its spending by running budget deficits; the state would counteract a sudden outbreak of lethargic spending among private citizens by becoming an eager spender. Alternatively, should private citizens suddenly become excessively eager spenders, the state would absorb the harm that might otherwise result by becoming a lethargic spender through accumulating large budget surpluses. Where the self-corrective tendencies of the market process were slow and unreliable, the state was smart, reliable, and quick.

The traditional approach to macroeconomic policy entails presumptions both about knowledge that politicians or their agents possess and about the incentives they have to use their knowledge. The traditional approach presumes that politicians can acquire knowledge that would be necessary to promote economic stability. It further presumes that such knowledge will always and necessarily be put to good use, as illustrated by the pursuit of a program of the state acting to counteract the forces of instability that would otherwise destabilize a market economy. These traditional economic presumptions have come

under strong challenge from what is now known as the new Classical macroeconomics, which represents a reaffirmation of the Classical presumption of a strongly self-correcting market process, though formulated with contemporary analytical tools and techniques. While I shall return to some of these issues in the final two sections of this essay, these macroeconomic issues lie mostly outside the scope of this essay.

What is central to this essay are the political presumptions regarding the conduct of macro policy. The public choice literature in this regard has proceeded along several lines, not all of them mutually consistent, but all of them coming to generate a substantial shift in scholarly orientation concerning the relation between politics and the macro economy. What emerges in one fashion or another in this revisionist literature is a recognition that political forces and processes may inject instability into an otherwise stable economy, in sharp contrast to the traditional formulation of the state stabilizing an otherwise unstable economy. The reason for this is that the promotion of instability may present higher political rewards than the promotion of stability. Rather than the state acting to stabilize an otherwise unstable market economy, the state may act to destabilize an otherwise stable market economy.

While early statements of how political processes might generate economic instability were articulated by Michael Kalecki (1943) and Johan Akerman (1947), substantial interest in the topic emerged only in the mid-1970s. A sample of writings from this period, arranged chronologically, include George Feiwel (1974), Yoram Ben-Porath (1975), Allen Meltzer and Marc Vellrath (1975), Bruno Frey and Friedrich Schneider (1975), William Nordhaus (1975), Robert Gordon (1975), Assar Lindbeck (1976), Bruno

Frey (1976), Duncan MacRae (1977), Richard Wagner (1977), Ray Fair (1978), and Edward Tufte (1978). While these writings differ over a number of particular details regarding the impact of politics upon the macro economy, they are united by a recognition that the actual conduct of public policy will be governed by the interests of those who occupy positions of power. Public policy is conducted by political realists and not by disinterested philosophers.

Macro Conditions and Electoral Success

Should an incumbent politician look forward fearfully or zestfully to the next election? There have been a large number of scholarly efforts, some of which have been cited above though many others have been published as well, that have sought to gauge electoral success against such economic indicators as the common macro variables as the rates of inflation, unemployment, and economic growth. There is a simple intuition behind such studies: people don't like inflation or unemployment, but they do like rising income. If citizens are thought to blame or credit politicians for the state of those macro variables, it might seem as though a politician's electoral prospects would be strengthened by falling inflation and unemployment prior to an election, as well as by rising economic growth.

By now, a large body of evidence has been accumulated in support of the claim that macroeconomic conditions prior to an election seem to exert some influence over electoral prospects or outcomes. Two approaches have been taken to describing the connection between macro conditions and electoral success. One approach, illustrated by Frey and Schneider (1978), has focused on measures of political popularity prior to an election, and

has sought to relate variations in such popularity to variations in macro conditions. The general tenor of these studies is that incumbent popularity varies negatively with the rates of inflation and unemployment and positively with the rate of economic growth. Changes in macroeconomic conditions would seem to bring about changes in the evaluation of incumbent politicians by citizens.

An incumbent who receives a higher popularity score than his challenger may not win when the votes are counted, for any of a number of reasons, and a good number of other studies have sought to assess the effects of these aggregate variables upon actual election outcomes. Once again, the same general pattern results, only the dependent variable is some measure of vote share or seats won. Whether measured by popularity prior to an election or by votes cast in an election, reductions in inflation and unemployment would seem to be good for incumbents, as would an increase in the rate of growth. To be sure, not all the studies achieve identical results. Some authors have found only two of the three macro variables to be statistically significant. For instance, Gerald Kramer (1971) examined the share of the vote received by the incumbent party in American congressional elections between 1896 and 1964, and found only inflation and growth to be significant. Unemployment was not found to exert any significant effect. Allen Meltzer and Marc Vellrath (1975) likewise found only two of the three macro variables to be statistically significant in their examination of voting in presidential elections. These were inflation and unemployment, indicating only one variable of significance--inflation--common to both Kramer and to Meltzer and Vellrath.

There are also studies that have found only one of the macro variables to be

statistically significant. In his examination of voting in presidential elections, Ray Fair (1978) found only the rate of economic growth to be statistically significant. Alternatively, George Stigler (1973) found only the rate of inflation to be statistically significant in his examination of congressional elections. This pattern of variability in the details of the findings of particular studies can be found across the wide range of studies that have been conducted. For instance, Friedrich Schneider and Bruno Frey survey and summarize a large number of such studies conducted across many nations in their essay in Thomas Willett (1988, pp. 239-75). As Schneider and Frey report, some authors found all three macro variables to be significant, others found only two to be significant, and a few found only one to be significant. There were also differences over which one or two of the macro variables were found to be significant.

There are obviously differences in the details of these particular studies. Nonetheless, a uniformly strong general impression emerges from an examination of these studies as well. There is nearly unanimity in the signs of the estimated coefficients. An increase in inflation is found to decrease incumbent vote share or popularity, even if some studies find this effect to be statistically significant while others do not. It is the same for an increase in unemployment, as well as a decrease in the rate of growth. These studies overwhelmingly tell the same tale. An incumbent who faces a forthcoming election while inflation and unemployment are decreasing and growth is rising should sense his prospects to be rising, even if he cannot be sure of which of the variables to thank for his good fortune.

Politics and the Control of Macro Conditions

To find that popularity or votes vary with macroeconomic conditions in the manner specified above carries no implications for politically-generated business cycles unless politicians can control, or at least influence, those conditions. The literature on political business cycles has accepted such a presumption, at least as a short-run matter, though the ability of incumbent politicians to generate desired macro conditions might be quite limited.

Macro variables are not direct objects of anyone's choice, but are simply incidental by-products of the interactions among the choices of individual market participants. A price level or a rate of inflation is not an object of direct choice. A central bank can choose how many government bonds it holds, but the effect on prices of an increase in central bank holdings of government bonds depends also on the interactions among market participants along many dimensions. Similarly, a rate of unemployment is not a direct object of choice. A government can choose to modify the conditions according to which unemployment compensation is granted, and changes in government bond holdings by a central bank may change the volume of economic activity, but the connection between policy measures and unemployment will be intermediated in various ways through the interactions among market participants. Any political effort to manipulate macroeconomic conditions would surely be an inexact art and most certainly not an exact science. Nonetheless, so long as there might be some scope for incumbents to manipulate macro conditions to enhance their electoral prospects, it is plausible that such efforts at manipulation would occur.

The main vehicles for exerting political influence over macro variables are through monetary and fiscal measures. Suppose an incumbent party wanted to lower the rate of unemployment prior to an election. Under contemporary monetary systems, this would be accomplished by having the central bank increase its holding of government bonds. In a parliamentary system of government where the central bank is a branch of the Treasury, this might be relatively simple to do. But in a presidential system with an independent central bank, this would be much more difficult to accomplish.

Fiscal measures are an alternative for securing a reduction in unemployment. In this case, a budget deficit would be created, either through increasing spending or through reducing taxes. Again, such a policy change would surely be generally easier to accomplish in a parliamentary system of government than in a presidential system, particularly if the presidential system operated with a bicameral legislature. The expansionary impact of any budget deficit also depends on taxpayer reactions to the deficit. In the limiting case of complete Ricardian equivalence, an expansionary fiscal policy will be impossible, as the increase in government spending will be offset by a reduction in private spending.

A Simple Model of Opportunistic Macro Manipulation

Models of political business cycles assume that incumbents can influence aggregate economic variables and will seek to do so, at least if their electoral prospects are insecure.

Of the many formulations of political business cycles, the one developed by Nordhaus

(1975) is particularly notable for its expository completeness in setting forth a model whereby democratic politics induces economic instability. To be sure, Nordhaus' model has come under strenuous criticism for both its economic and political elements, and I shall explore these criticisms below. Still, a consideration of this simple model of a politically-induced business cycle provides a nice point of departure for exploring a wide range of considerations concerning the relation between politics and the macro economy.

The central features of a simple model of a political business cycle are illustrated in Figure 1. That figure combines the two primary ingredients noted above: the impact of macro conditions on electoral prospects and the ability of the incumbent party to generate alternative values for macro variables. The impact of macro variables on electoral prospects is illustrated by the three curves O_l , O_m , and O_h . These denote the odds of success in the forthcoming election. O_h denotes relatively high odds of success, say as illustrated by 56:44 odds of success. O_m denotes moderate odds of success, say as illustrated by a 50:50 chance of success. O_l denotes low odds of success for the incumbent government, perhaps only 44:56 odds of success. The shape of this odds function shows that inflation and unemployment are both evaluated negatively by voters. It also shows that there is a trade off in voter evaluation of macroeconomic conditions. An increase in unemployment by itself will reduce the odds of electoral success for an incumbent. But there is some reduction in inflation that will offset the vote-losing impact of the increase in unemployment.

The ability of the incumbent government to influence macroeconomic variables is illustrated by the two sets of Phillips-curve relationships, with p_1 and p_2 denoting the idea

that there is a tradeoff between inflation and unemployment in the short-run, while P denotes the absence of any such tradeoff in the long run. From here, it is a simple matter to illustrate the claim of a political business cycle, as laid out by Nordhaus. Suppose the macro economy is characterized by position A prior to an election. There is no inflation, and unemployment is at its natural rate. If these macro conditions carried forward to the election, the incumbent would face 50:50 odds of success. This situation might, for instance, describe a vision of a well-working economy with a well-performing night watchman state in a two-party system. Each party is regarded as equally competent in organizing the provision of night watchman services, voters are indifferent between the parties, and electoral outcomes are random—and presumably with some voters showing up to cast their indifferent ballots for any of several reasons that have been discussed in the literature on the paradox of voting.

If the incumbent party could undertake a well-timed inflationary program, it could move the economy to B and increase its odds of electoral success to 56:44. The inflation would lose the incumbent fewer votes than the reduction in unemployment would gain for it. However, this reduction in unemployment is only temporary. Once the inflationary surprise has been anticipated, the natural rate of unemployment will be restored. The macro economy will now be described by C, with a higher rate of inflation than at A but with no change in unemployment. If the election were held in the presence of these kinds of macro conditions, the incumbent's odds of success would be only 44:56. Alternatively, the incumbent party could conduct a deflationary program after the election. The initial impact of this program would be to lead to macro conditions described by D, with unemployment

well above its natural rate but with no inflation. An election at this time would be disastrous for the incumbent. But if the incumbent has a good or a lucky sense of timing, the natural rate of unemployment will have reasserted itself prior to the next election, as illustrated by a return to the macro conditions described by A.

This simple model thus generates a pattern of recurrent expansions and contractions, of booms and busts, whose timing coincides with the electoral cycle. In the traditional Keynesian formulations of the role of the state, the promotion of economic stability was seen as an important task of the state. The market economy was regarded as inherently unstable, and it was viewed as the task of government to provide the ballast necessary to maintain stability. The idea of a political business cycle stands this traditional claim on its head. The state is no longer viewed as the ballast to be used to promote stability, but rather is seen as injecting instability into the economy because such injection enhances the electoral prospects of incumbents. The original formulations that are characterized by Figure 1 have been disputed in several respects, which in turn have led to a number of revisions and reformulations of the relationship between politics and the macro economy. Most of these reformulations can also be addressed in terms of Figure 1. Some of them question the odds functions, and dispute the proposition that the ABCD cycle offers the electoral gains that Figure 1 portrays. Other lines of reformulation question the ability of incumbents to manipulate macro conditions to their liking, and also dispute the adequacy of the macro-dominated foundations of the various explanatory efforts.

Most of the formulations of a political business cycle that are captured by such a construction as Figure 1 assume that the predominant interest of politicians is to be reelected. Much of the basis for this assumption lies in the median voter proposition that comes out of the spatial model of voting and political competition. In that model, voters are arrayed along some single-dimensioned, left-to-right spectrum. Under a wide variety of circumstances, two competing candidates will tend to locate close to one another in an effort to secure the vote of the median voter. The median voter model, which was given its modern articulation by Anthony Downs (1957), assumes that competing parties in a two-party system are nearly identical. The pursuit of electoral success leads the two parties to seek the support of the median voter, which draws the two parties close together. In this formulation, parties are construed as selecting and designing their programs so as to secure support from the median voter. The content of programs is chosen instrumentally in the hope of reflecting more fully than the opposition party the pre-existing preferences of the median voter.

Political programs in this formulation are adopted opportunistically. If one of the candidates thinks the preferences of the median voter have shifted, he will shift his proffered programs in response. In articulating their programs, candidates are trying simply to guess the location of the median voter. Knowledge is always incomplete, of course, and some divergence between candidates may result simply because those candidates make different judgments about the probable location of the median voter. Nonetheless, the specific content of the programs of competing political candidates is adopted opportunistically to secure the support of the median voter. The generation of a

business cycle of the form described by Figure 1 is a plausible outcome, in light of the presumptions of that model. This can be accomplished directly by treating Figure 1 as a representation of the median voter's choice between candidates. If macro conditions are those described by A, the median voter will flip a coin to decide between the candidates. If macro conditions are those described by B, the median voter will make his selection by drawing from an urn that contains 100 tickets, 56 of them containing the incumbent's name.

An alternative conceptualization of political candidates is that they start with desired programs they would like to implement, and then seek to get elected. In this conceptualization, politicians are viewed as holding programmatic beliefs and then seeking election to implement those beliefs. If they are elected, they will proceed with that implementation. If they are defeated, they may run again, they may try different ways of articulating and explaining their program, and they may try any of a number of other things to improve their subsequent prospects. What they will not do, however, is abandon the core of their programmatic beliefs. In this formulation, politicians are partisan but are not opportunistic. They would not violate their ideological presuppositions in an effort to enhance their electoral prospects. Hence, they would not use their powers of office to generate a business cycle of the form described by Figure 1.

This does not mean that partisan politics will be free from destabilizing tendencies. An alternative branch of literature about politically-induced business cycles is summarized by the notion of partisan business cycles, and is illustrated nicely by such works as Alberto Alesina and Howard Rosenthal (1995), Alberto Alesina and Nouriel Roubini (1997), Douglas Hibbs (1987), and William Keech (1995). While partisan models of political

competition can generate an election-oriented cyclical pattern similar to that of the opportunistic models, the partisan cycles are generated by a different process than the opportunistic cycles.

In keeping with the character of partisan models, suppose that economic growth can be described by the the simple expectation-augmented Phillips relationship

$$Y_t = \bar{Y} + g(p_t - p_t^e) \quad (1)$$

In this expression, Y_t is actual growth in output during period t, \bar{Y} is the natural rate of growth in the economy, and the remainder of the equation shows that deviations of the actual from the natural rate of growth depend on the direction and size of the deviation of actual from expected inflation. Save for deviations of actual from expected inflation, the rate of growth would be steady at its natural rate. With reference to the opportunistic model described by Figure 1, so long as actual and expected inflation continued to be zero, the economy would remain at the natural rate of unemployment represented by A, and with a corresponding natural rate of growth in output.

In the opportunistic model of the political business cycle, the approach of an election encourages the incumbent party to inject an inflationary surprise into the economy. This leads to the initial movement to B in Figure 1, and would lead to an actual rate of growth that exceeded the natural rate in Equation 1. The same type of cycle results in the partisan model, only for a different reason. In the partisan model, incumbent politicians do not inject inflationary surprises to enhance their electoral prospects. Politicians remain faithful to their core ideological beliefs, and it is the election itself, in conjunction with some

characteristic features of the organization of economic activity, that generate electorally-related cycles.

The idea behind a partisan business cycle can be seen most easily by assuming that a forthcoming election is widely regarded as a toss-up. This locates the initial situation as similar to that illustrated by A in Figure 1, where the forthcoming election would be a toss-up as well. Only in the partisan framework the contending politicians differ in their ideological beliefs and values, and do so in a way that translates directly into implications for macro variables. To maintain the expected inflation of zero that characterizes A in Figure 1, suppose one party's program calls for a mild inflation while the other party's program calls for a mild deflation. With the election being a toss-up, the expected value of the rate of inflation after the election would be zero prior to the election.

The partisan models usually ground alternative programs regarding inflation between the two parties in terms of the implications of changes in unemployment for the distribution of income. Suppose the two parties differ in the income levels of their supporters. The party of the left, L, draws its support from the lower part of the income distribution. The party of the right, R, draws its support from the upper part of the income distribution. The reason why the L party would enact an inflationary program after the election is that this would transfer income to its supporters, under the presumption that reductions in unemployment inject greater equality into the distribution of income, and also because L-supporters tend to be debtors. Likewise, the R party would enact a deflationary program because the resulting increase in unemployment would inject more inequality into the distribution of income, and also because R-supporters tend to be creditors. (To be

sure, no party promotes a deflationary program these days. With respect to macro variables, contests are over alternative rates of inflation and not over inflation or deflation. Whether the expected value of post-election inflation is zero or some positive number, however, is analytically irrelevant, and I have used the zero expectation simply to maintain conformity with the construction in Figure 1. For a cogent statement in support of falling prices as output expands, see George Selgin (1997).)

Prior to an election that is generally regarded as a toss-up, the expected value of post-election inflation is zero. (More, generally, the expected value would be an average of the different inflation rates attributed to the two parties, as weighted by the probabilities attached to each party's chance of winning the election.) The election thus acts as an inflationary surprise to expectations. If L wins the election, actual inflation will exceed expected inflation, unemployment will fall and growth will exceed its natural rate. If R wins the election, actual inflation will fall short of expected inflation, unemployment will rise, and growth will fall short of its natural rate. The election of L generates a post-election boom while the election of R generates a post-election bust. As time passes and inflationary expectations adjust to the electoral surprise, the natural rates of unemployment and growth are restored, only with a higher rate of inflation if L is elected than if R is elected.

Besides differing in the process by which elections induce cycles, the opportunistic and the partisan models differ in the weight of their normative implications. In the opportunistic models, electoral contests are waged for the support of the median voter. Opportunistic cycles feed the median voter a diet of boom and bust. Analogizing from the life cycle and tax smoothing hypotheses, there would be strong grounds to claim that the

median voter would prefer stability to periodic cycles of boom and bust. The booms and busts are shocks injected into the economy that serve only to promote the electoral prospects of incumbents, and to do so in a context where both candidates are nearly identical. Opportunistic cycles represent efforts by incumbents to manipulate voter assessments. To be sure, a good deal of the argument against opportunistic cycles has rested on the claim that voters who supported opportunistic incumbents would be acting with irrational myopia. The construction in Figure 1, after all, has a voter continually supporting an incumbent whose policies diverge from those he prefers.

In contrast, partisan cycles involve no manipulation but are an unavoidable by-product of contested elections whose outcome is in doubt until the ballots are counted. So long as election outcomes are uncertain, an election will inject surprise into the economy. This will generate the macro consequences noted above, only in this case as an unavoidable facet of a democratic process. Partisan cycles are consistent even with the presumption of fully efficient democracy associated with Donald Wittman (1995). They are a cost of democracy, pretty much as voting machines and poll watchers are costs of democracy. There is no reason to think those costs are excessive, and it is hard to see how they could be eliminated without eliminating democracy as well.

It is safe to say that most of the empirical work at this time finds stronger support for partisan models of electoral cycles than for opportunistic models. Alesina and Roubini (1997) provide a clear examination of this literature, using data from both the United States and the OECD nations. The weight of their evidence, and that of much of the other literature, favors the partisan model, though supporting evidence can also be found for the

opportunistic model (see, for instance, Haynes and Stone (1990) and Kiefer (1997)).

Furthermore, there would seem to be no necessary reason to frame the issue as one model or the other being the right one. Bruno Frey and Friedrich Schneider (1978) offer a blend of the opportunistic and partisan models. This formulation allows politicians both to aspire to hold office so that they can enact their preferred programs, as the partisan model holds, and to be willing to resort to electoral manipulation if they are otherwise facing a severe threat to their continuation in office, as the opportunistic model holds. In this set up, partisan forces would always be present, and opportunism in turn would enter the picture ever more strongly as the incumbent's electoral prospects became ever more doubtful.

Interest Group Politics and Macro Conditions

One influential body of public choice scholarship on rent seeking and interest groups has characterized the political process as primarily involving competition among interest groups, where winners in this competitive process are able to gain advantages through imposing costs on losers (Buchanan, Tollison, and Tullock, eds., (1981), McCormick and Tollison (1981), and Rowley, Tollison, and Tullock, eds. (1988)). This focus on the centrality of interest groups does not rest easily with the literature on politics and the macro economy. Or at least the place of interest groups is largely a missing ingredient in that literature.

The standard macro formulations embody a kind of neutrality proposition, according to which what matters is the aggregate size of the measure but not to whom in particular it

accrues or is distributed. In keeping with the literature on political business cycles, an incumbent might face a 55 percent chance of electoral success if the unemployment rate is 5 percent while facing only a 45 percent chance of success if the unemployment rate were 10 percent. There are, however, many different ways that unemployment can be reduced by five percentage points. The macro neutrality proposition would hold that it is politically irrelevant how this is accomplished. The interest group formulation would claim that it is highly relevant politically how this is accomplished.

To be sure, the details regarding relevance would depend on some particular features of the election system. Suppose unemployment is distributed equally across nine electoral districts. Three of those districts are considered safe for the incumbent party and three safe for the challenging party. It would make no sense for an incumbent party to be concerned with the unemployment rate in the three districts safe for the challenger, and perhaps only modest sense to be concerned with the three districts considered safe for the incumbent. The incumbent party rather would rationally seek to concentrate the program in the three contested districts. If the program is successful, the aggregate rate of unemployment will fall. But that aggregate decline will have been driven by an interest group process of rational discrimination and not by macro neutrality.

The change in rate of unemployment, or other macro variables, would be just incidental by-products of the microeconomic process of attempting to construct winning coalitions. Any relationship found between macro conditions and electoral success will conceal more than it reveals. What it would appear to reveal, a direct link between macro conditions and electoral success, would be misleading because it would mask the real link

between economic conditions and electoral success. This real link would stress the construction of winning coalitions through shifting the structure of relative prices, on both product markets and factor markets, in favor of supporting interest groups, by imposing disabilities upon the remainder of society.

The literature on partisan business cycles moves a short distance away from the presumption of macro neutrality through its focus on parties differing according to the segment of the income distribution to which they appeal. In these formulations, the party of the left appeals to people in the lower part of the income distribution while the party of the right appeals to people in the upper part. Different policies toward inflation are regarded as ways of rewarding these different constituencies. An unexpected increase in inflation will temporarily transfer income downward, while an unexpected reduction in inflation will temporarily transfer it upward. There are some troubling features to this formulation. For one thing, it is not apparent that variations in unexpected inflation are the best means of implementing these partisan programs. If the interest genuinely resides in modifying the shape of the distribution of income, a far more direct means to do this would be through changes in general taxes and subsidies. In this case, the party of the left would increase fiscal progressivity while the party of the right would reduce it. This kind of partisan politics would carry only second-order implications for macro conditions.

More than this, the stylized fact that in two-party systems the median income of supporters of the party of the left is lower than the median income of supporters of the party of the right does not warrant the conclusion that the central political fault line resides at the middle of the income distribution, with everyone below that line being supporters of the left

and everyone above that line being supporters of the right. The leading political figures from all parties are well educated and relatively wealthy. People in the top two income quintiles can be found who support either party, and it is the same for people in the bottom two income quintiles. Income levels do not provide a sufficient basis for the formation of political coalitions.

An army must have generals and privates, and lots of people in intermediate grades. A political coalition must likewise have high-powered organizers as well as common clerks. The generation of political pressure, as well as the execution of a military campaign, requires a wide variety of talents and capacities. Some of those will be rare and highly desired, and so command a high price. Other of those talents and capacities will be in wide supply and of relatively low importance, and so command a low price. The generation of political pressure within an interest group framework will cut across income lines.

Coordination, Cycles, and Emergent Macro Phenomena

The expectation-augmented Phillips curve illustrated by Equation 1 conceals the emergent character of macro phenomena, and perhaps leads to an excessive focus on cycles as the point of contact between politics and the macro economy. Coordination and not cycles may be the more appropriate point of contact, and with cycles forming just one type of miscoordination. The formulation of Equation 1 would seem to be troubling for any recognition that macro phenomena simply emerge out of the interactions among the constituent units that comprise the macro universe. A rate of growth emerges out of the

interactions among market participants and their choices. If we ask what are the objects of expectation that are relevant for market participants, probably only rarely would we find that a rate of inflation would be an object of anticipation. Bond traders and other dealers in financial paper might place high importance on anticipations of future price levels. But these kinds of activities comprise only a small part of the universe of economic activities. For someone who owns an auto repair shop and is trying to decide whether to expand his facility or to move to a new location where a larger facility is already in place, his expectation about the future general price level is surely far down his list of concerns, and I doubt whether it would appear at all. And it would surely be the same for the vast preponderance of commercial decisions where people are making choices to commit resources today when the results of those choices will not be known until some future time. There would be different particular objects of expectation, depending on the particular activity about which expectations are being formed.

A modern economy is constituted as a dense network of generally, though not universally, coordinated transactions. A rate of growth emerges out of the interaction of individual plans of action. There is no reason to expect smooth stability in all this, as Joseph Schumpeter (1912)(1939) recognized. Indeed, the abandonment or revision of plans is evidence quite to the contrary. Moreover, there is a great deal of complementarity among plans, which means that individual decisions to revise or abandon plans would not be independent of other people's decisions. In practical terms, this means such things as that carpenters will not just be involved with building structures (as part of the execution of a plan), but will also be engaged in various remodeling activities (as part of the revision of a

plan) that would not have been necessary had things proceeded as originally planned.

Further, much of the injection of new plans, as well as revision of previous plans, will stem from the creation of new products, methods for marketing products, and the like. There will be many reasons why plans do not fit together perfectly, and thus call for continual revision.

An emphasis on coordination and emergent phenomena reduces the importance of a focus on cycles and leads to two propositions: (1) variability in economic time series is not a necessarily sign of poor economic performance and (2) constancy in economic time series is not necessarily a sign of good economic performance. The first claim means that observed instability might be a sign of avoidable and correctable miscoordination, but it might also be a sign of progress in an interdependent world with capital complementarity. There would thus be two types of cycles, one that was consistent with the orderly coordination of economic activities in a complex environment and another that emanated from disruptions to the processes of orderly coordination.

The second claim means that just because stability is observed in aggregate variables does not mean coordinative processes are working as well as they might. Consider first of all a simple micro-level illustration of what I have in mind. A ceramist makes tile murals. Suppose by working hard she can assemble 1,000 tiles in a month. In one case, everything goes well and at the end of the month she has 1,000 useable tiles to put into her murals. There are also many things that can go wrong in this process. The clay may dry too quickly and crack. The kiln temperature may not rise exactly as anticipated, with the result being that some glazes do not show the colors that were intended. As a result the ceramist has to divert some of her time away from making finished tiles into

responding to the various exogenous shocks to her studio. For instance, rather than putting some clay tiles into a kiln to be fired, she may have to rehydrate that clay and start over. Because of these diversions required to respond to the shocks that disrupted her anticipations, she may be able to make only 700 tiles. But this does not mean that she is 30 percent unemployed. Rather it means that she has shifted into a different pattern of activity.

Suppose we analogize the ceramist's situation to standard macro formulations of shocks to the economy. The first instance is one of full employment equilibrium. In the second instance, her studio is hit with negative shocks that she had not anticipated. Yet full employment continues to exist, only with a different pattern of activities in the face of disruptions than when those disruptions are absent. Miscoordination implies errors in plans, at least as regarded from a posture of omniscience. A rise in the volume of miscoordination means that there will be some shift of human activity away from executing original plans into activities that revise or reorient plans that have proven unsatisfactory.

An economy can be represented by a network of human activity, some of which is engaged in executing original plans and some of which is engaged in rectifying plans that have judged to have been unsatisfactory. This distinction between types of activity is, of course, an analytical and not an empirical distinction. There is no way, at least so far as I know, that a census could be taken to determine how many people are employed in executing plans and how many are employed in revising plans that have been judged unsuccessful. Yet this analytical distinction follows from the claim that the degree of coordination is a variable that can be influenced, for good or for bad, depending on a

variety of institutional arrangements and policy measures. An increase in the volume of miscoordination in a society will shift the pattern of activity in a society, but it need not alter the total volume of activity. It is conceivable that miscoordination could increase without any impact on aggregate time series. Miscoordination induces revisions in plans. Labor is shifted from the execution of plans to the revision of plans. It is conceivable that this shift of labor can be accommodated within an unchanged aggregate volume of employment.

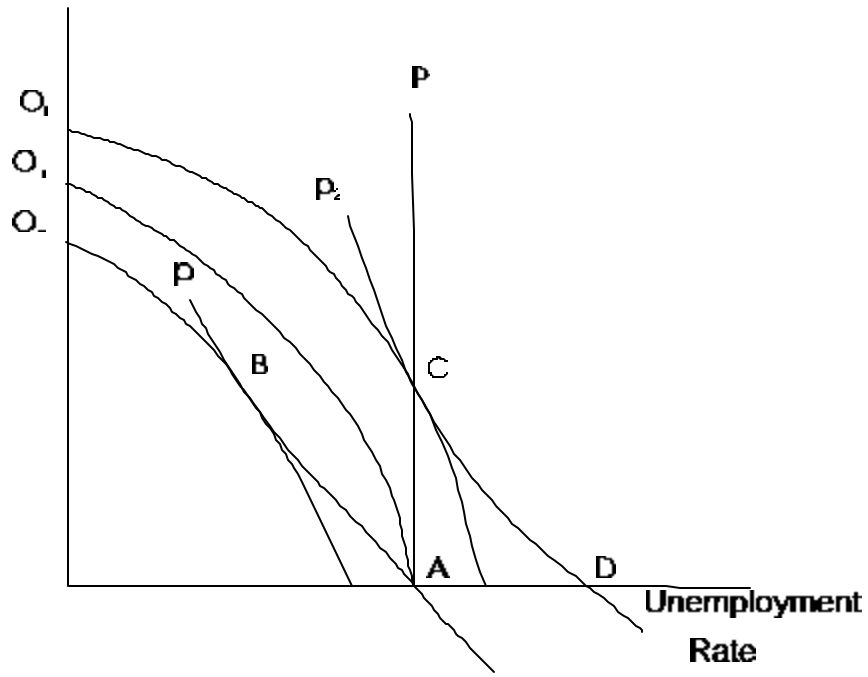
Using a normative language, cyclical variability may be either good or bad. It depends on the source of the cyclicity. In like manner, the absence of cyclical variability can be either a good thing or a bad thing. It depends on the degree of coordination that is present. A benevolent policy maker would seem to face an insoluble problem of knowledge. It would be necessary to be able to distinguish good cycles from bad, a task rendered even more difficult by a recognition that both features may be present at the same moment. It would also be necessary to know when aggregate stability is a sign of a smooth coordination of plans and when it rather means merely a rapid movement between the execution of plans and the revision or reassembly of plans.

The active promotion of stability in aggregate time series is neither per se desirable nor is it possible. Aggregate outcomes are emergent outcomes and not direct objects of choice. There is no sense to a policy aimed to prevent cycles, any more than it would be sensible to prevent traffic delays. What is sensible is to seek to preclude unnecessary cycles or disturbances to the coordination of economic activity. Policy for a coordinationist macroeconomics would be of the same genre as policy generally, and would be concerned with providing and maintaining a framework within which people can order their activities.

The pursuit of a truly activist stabilization policy will be both impossible and mischievous. Appropriate macro policy cannot aim to achieve particular values for macro variables, for these variables are not object of choice. Appropriate macro policy would thus seem to be indistinct from appropriate micro policy, with both involving the creation and maintenance of a constitutive framework within which people can generate orderly patterns of economic activity. Whether such policy measures are, or could be, consistent with rational political conduct is a topic that will surely continue to animate public choice scholarship.

Figure 1

Inflation Rate



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