

Political-Economic Cycles

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INTRODUCTION

When economic policymakers are directly elected (or appointed by directly elected officials), how do electoral and partisan incentives structure economic policymaking? 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 policymaking 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 different macroeconomic policy tools that track shifts in the partisan composition of governments.

While political economists have long incorporated democratic policymakers' strong electoral and partisan motivations into theoretical models of the strength, nature, and timing of economic policymaking (e.g. Nordhaus 1975, Hibbs 1977, Tufte 1978), supportive

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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 1987; 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 policymakers' reelection and partisan incentives; the inter-, intra-, and extra-governmental allocation of policymaking control across multiple actors; and policy efficacy and maneuverability. For example, small, open economies, in which policymakers retain less autonomy over some policies, or in which some policies may be less economically effective, likely lessen political-*macroeconomic* cycles. Where policymaking 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

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vs. geographic targeting of spending, and sharpen some political-economic cycles while blunting others. As these examples suggest, *contextual* variations structure policymakers' 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 policymakers and policies ultimately must survive 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.³ 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' 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.

ELECTORAL CYCLES

Hibbs' discussion (this volume) presents details of important past and current developments in the theoretical and empirical study of electoral cycles. For our purposes —

³ It borrows from and condenses Franzese (2002a). 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.

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’ chapter for a more thorough treatment.

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’ 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 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 *naïve* in the sense 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 reelection 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 3a give *motive*; 1 gives *opportunity*; and 3b gives *weapons* for incumbents to *electioneer*. Drazen (2001) extends this logic formally to macroeconomic policies more generally, including fiscal policies.

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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 (1987a) for presidential elections, Tufte (1975, 1978) for congressional, and Madsen (1980), Lewis-Beck (1988) for European democracies. In the

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United States, Alesina et al. (1993) find, notably, that voters reward/punish incumbents consistently with *naïve* retrospective voting, rather than *rational* retrospective voting, in which voters may adjust their evaluations of incumbents' records in a way that acknowledges policymaker 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 & Chrystal (1983), Alesina and colleagues⁴, and Hibbs (1987a), e.g., conclude that evidence from the US or OECD democracies offers inconsistent support for electoral policy-cycles and very little for outcome-cycles, especially real-outcome cycles.⁵ More widely viewed, the evidence for classic electoral outcome-cycles is indeed mixed, but not uniformly unfavorable. E.g., not counting Nordhaus/Tufte or these partisan-theory protagonists, Franzese (2002a) finds 14 articles by 10 authors reporting some cycles, and 8 articles by 6 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 3 of 9 countries 1947-72, but the relative significance across countries suggests that closely contested elections, strong, unified executives, and 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 reelection equally in all elections and that all equally control policies equally effective toward that goal. Reelection incentives, control over policies, and political-

⁴ Alesina & Sachs (1988), Alesina & Roubini (1992), Alesina et al. (1992, 1993a,b, 1997), Alesina & Rosenthal (1995).

⁵ Alesina and colleagues⁴ argue the post-election inflation they find may arise from RE pre-electoral policy-cycles of Rogoff (1990) sort. However, virtually any pre-electoral fiscal activism would spur post-electoral inflation (Drazen 2001).

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 & timeable (by incumbents, to voters), manipulable (by incumbents), palpable (to voters), and attributable (by voters, to incumbents) (Franzese 2002a). 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 (esp. 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, policymakers might more easily schedule elections to coincide with economic expansions than *vice versa*. Ito & Park (1988) and Ito (1990) find strong signs of strategic election timing in Japan (as do Alesina et al. 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.

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 2002a). Simply stated, incumbents will use all policy tools, in proportion to their effectiveness in satisfying their electoral goals. More specifically, an *electioneering Ramsey Rule* implies electoral cycles in policy composition as well as levels (Mani & 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 2002b). 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 et al. 1993, Franzese 2002b). Notably, Drazen's (2001) proposed active-fiscal/passive-monetary RE political cycles account is consistent with many of these expectations and empirical patterns.

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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 condition 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 & 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.

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 policymakers' incentives, so electoral cycles should not exist or should have no real effects under RE (although incentives for direct [transfers](#) may remain). If policymakers 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 naïvely 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 policymakers enjoy [an](#)

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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 naïvely reward (or punish) policymakers for good (or bad) economic performance suggest. However, the evidence is inconsistent with rational retrospective voting (Alesina et al. 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. I.e., 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*.

Further Discussion

One component of *context-conditional* that is especially neglected in electoral-cycle studies is that of electoral challengers, who play little direct role in most models. Higher-quality challengers, e.g., 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 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 2002b). 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 et al. 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 policymakers 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 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 policymakers. 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 policymakers 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 policymaking. Although empirical evidence is more consistently supportive of partisan cycles, in which of 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.

PARTISAN CYCLES

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 reputations for policymaking 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, 1983; 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 reelection), 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-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

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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 socioeconomic characteristic of each party's constituency. Hibbs establishes left/right priorities most thoroughly, stressing relative unemployment/inflation aversion. Hibbs (1987a) 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 nonresidential/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' partisan theory, in fact, requires only that this *ratio* of unemployment-inflation aversion among lower classes exceed that ratio among upper classes. Indeed only the ratio of perceived, and not necessarily objective, aversions matter, which Hibbs thoroughly demonstrates, estimating that Democratic voters penalize incumbents 1.1 times as much for 1% unemployment as for 1% 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-term⁶ impact, so these policy differences should manifest in outcomes also.

Supportive evidence is plentiful relative to that for electoral outcome-cycles. Hibbs (1977, 1987a) estimates 1.5-2% higher unemployment and 5.3-6.2% lower real growth under US Republican administrations than under Democratic. Democrats also contributed 60±% 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 (1987b), Paldam, (1989), and others find similarly in broader OECD samples. Alesina and his various colleagues⁴ also find evidence of partisan-cycles in the US, 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 colleagues⁷ dissent, finding *context-conditional* cycles that favor electoral more than partisan models.)

An enormous literature analyzes empirical evidence of cycles in partisan policy. Imbeau et al. (2001), e.g., 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. 72.5% sign intuitively (e.g. left parties supporting policies favorable to their traditional constituencies), with 24.8% significant at $p \leq .10$; 26.6% have wrong sign, 8.3% significantly; 0.9% 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 social-welfare (less so). These results suggest that partisan cycles, like electoral cycles, follow a *Ramsey Rule*: All/most policy

⁶ He explicitly denies any long-run inflation-unemployment tradeoffs but stresses that stabilizing inflation and spurring growth/employment often conflict.

⁷ Clark et al. (1998), Clark & Hallerberg (2000), Hallerberg et al. (2001), Clark (2003), Clark et al. (2002).

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. Naïve left-deficit, right-surplus arguments,⁸ 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 colleagues⁷ 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 misspecification 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.

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.

⁸ Left-activist (counter-cyclical), right-passivist (less counter-, a-, or pro-cyclical) views find more support (Cusack 1999; Franzese 2004).

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' 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.⁹

Alesina & Rosenthal (1995) and Alesina et al. (1997) collect and advance Alesina and colleagues'⁴ 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 favors 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, policymakers exploit stable Phillips Curves to shift macroeconomic

⁹ 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).

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 contracts 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 colleagues⁴ 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 et al. (1997) describe how left parties first apply expansionary policy, then, observing rising inflation, a potential electoral liability, switch to contractionary policies; rightist governments proceed oppositely. These paths, which the *midterm balancing* of Alesina and Rosenthal (1995) would also produce, e.g., 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 1972.¹⁰ Furthermore, Alesina et al. (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.)

¹⁰ Under Bretton Woods (the pre-1972 system), the US (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.

Problematically, the partisan indicator in these policy studies lags 2 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.¹¹

RPT also predicts more specifically that real-outcome effects should be proportional to electoral surprises. Alesina et al. (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 between 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 policy cycles, congressional influence, and varying exchange-regime—apply to this analysis also.

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Summarizing, Alesina and colleagues⁴ clearly establish short-term real-outcome and long-term nominal-outcome partisan-cycles, but the *RPT* model's explanation for these cycles are not well established empirically. In particular, monetary-policy and nominal-

¹¹ In these policy-cycle studies, Alesina and colleagues also find no pre-electoral deficit or transfers effects and little 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 1999, Franzese 2002a).

outcome patterns cannot easily explain real-outcome patterns. Regarding policies, Alesina and colleagues⁴ 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.

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 US 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 & 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 US, and inconclusive findings in Sweden and Germany. Finally, Faust & 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 & 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 & Thoma (1991b) 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-election-timing systems. Ellis & Thoma (1995) find evidence of current-account, real-exchange-rate, and terms-of-trade cycles supporting hypotheses derived from their model reflecting this consideration. 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.

CONCLUSION: CONTEXT-CONDITIONAL POLITICAL-ECONOMIC CYCLES

In all democracies, partisan electoral contests determine economic policymakers. 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 (2002a) 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, policymakers 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 (Tufté 1978). Coalitions may have lesser *motive* given their collective-action/common-pool problems (Goodhart 2000) and lesser *opportunity* given their veto-actor problems (Franzese 2002b, Tsebelis 2002) to

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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 multi-member 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 & 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 & Whitten 1993, Shi & Svensson 2001). *Motives* may also vary across elections with the share of power at stake (Tufte 1978), so systems that concentrate elections of key policymakers (e.g., UK) would induce sharper cycles (Alt 1985, Goodhart 2000, Franzese 2002b). Incumbents' policies also depend on strategic *contexts* like opposition strength and partisanship or replacement risk (Hicks & Swank 1992; Franzese 2002b).

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 et al. 1993; Franzese 2002b); government seat-shares and party discipline augment it (Acosta & Coppedge 2001); private or public foreign-borrowing ability enhances it (Corsetti & Roubini 1997). Multiple policymakers likely limit maneuverability in general (Tsebelis 2002, Alt 1985, Roubini & Sachs 1989, Perotti & Kontopoulos 1998, Franzese 2002b). Maneuverability also hinges on delegation, agency, and bargaining issues under shared policy-control.¹² In monetary policy especially, many (Clark and colleagues⁷ 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 & von Hagen 1998).

In sum, the empirical evidence surveyed here (see also Franzese 2002a) clearly supports models of political-economic cycles that are *context-conditional*. Political economists should,

¹² Franzese (1999, 2002b, 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 reflecting *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 nonlinear least-squares or maximum likelihood for sufficiently distinct I , X , and Z and/or $f(\cdot)$, $g(\cdot)$, and $h(\cdot)$.

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 policymaking.

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