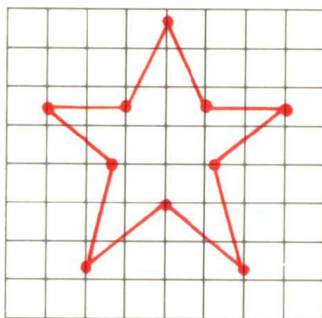
THE AMERICAN POLITICAL ECONOMY

MACROECONOMICS AND ELECTORAL POLITICS



DOUGLAS A. HIBBS, JR.

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The American Political Economy

Macroeconomics and Electoral Politics

Douglas A. Hibbs, Jr.

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In memory of my father and my mother—
Douglas A. Hibbs, Sr., and Lillian C. Hibbs

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Several skilled technical typists have wrestled with the manuscript over the last couple of years. Two deserve special mention. Joy Mundy, one of the smartest people I met at Harvard among the ranks of students, staff, or faculty, typed (or "text edited") the early drafts of the first half of the book. Joanne Klys, another person of exceptional intelligence, typed most of the final draft of the book. Joanne also served as an indispensable research assistant, maintaining complex computer data bases and running many a nonlinear regression.

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Introduction: A Framework for the Analysis of Macroeconomics and Electoral Politics

> From one important point of view, indeed, the avoidance of inflation and the maintenance of full employment can be most usefully regarded as conflicting class interests of the bourgeoisie and proletariat, respectively, the conflict being resolvable only by the test of relative political power in society and its resolution involving no reference to an overriding concept of the social welfare.
>
> —Harry G. Johnson

The American political economy is, one hardly need say, a very broad and rich topic. This book deals with only part of the terrain, though I think it is a very important part: the connections between public opinion and electoral behavior, and macroeconomic policies and outcomes. This volume was conceived on the assumption, amply demonstrated by casual observation as well as by systematic research, that the macroeconomic policies pursued by political administrations operating in a democratic setting rarely originate with idealized, apolitical "golden rule" norms. Rather, macroeconomic policies, which critically affect economic outcomes, are responsive to and are constrained by the electorate's reactions to economic events. In a democratic society, then, macroeconomic policies and outcomes reflect the intersection of both economic and political forces. This interdependence is usefully thought of in terms of a political-economic system of the *demand for* and *supply of* economic outcomes.[1] The main features of this framework are illustrated in Figure I.1.

Containing inflation at politically acceptable rates of growth and unemployment has been the most important economic problem confronted by American policy authorities for almost two decades. Although there is no stable, long-run (traditional Phillips-curve) tradeoff between inflation and unemployment in the American

macroeconomy, by and large economists and politicians alike understand that achieving low unemployment levels (and high growth rates) and stabilizing inflation are often conflicting goals. It is frequently difficult to make substantial progress on one without running great risks with respect to the other.[2] Faced with demand shifts, supply shocks, labor-cost push, and other inflationary events, political administrations repeatedly have been forced to choose between accommodating inflationary pressures by pursuing expansive monetary and fiscal policies, thereby forgoing leverage on the pace of price rises in order to preserve aggregate demand and employment, and leaning against such pressures by tightening spending and the supply of money and credit, thereby slowing the inflation rate, at the cost of higher unemployment and lower growth.

An important political-economic issue, then, is why the fiscal and monetary "discipline" exhibited by policy authorities varies over time and presidential administrations, especially during major episodes of inflationary pressure. Put another way, why are policy authorities less inclined to "supply" unemployment and more inclined to "supply" inflation (and conversely) at some times than at others? The choices implied by this question have important class-linked distributional consequences affecting the relative and absolute economic well-being of socioeconomic groups, and important electoral consequences affecting the political well-being of politicians and parties. Not surprisingly, therefore, these choices have been the focus of intense controversy and conflict among key actors in American political and economic life.

The economic interests at stake during inflations and recessions, the ways in which class-related political constituencies perceive their interests and respond in the opinion polls and in the voting booth to macroeconomic fluctuations, and the ways in which the economic interests, preferences, and priorities of political constituencies are transmitted to macroeconomic policies and outcomes observed under the parties are the main themes of this book.

I.1 Macroeconomic and Institutional Background

Part I begins with an account of postwar American macroeconomic performance in historical perspective. Chapter 1 identifies three striking features of the postwar macroeconomy that stand in sharp contrast to the prewar experience: comparatively high rates of growth, stabilization of macroeconomic fluctuations, and near-continuous inflation (though at widely varying rates). Special attention is given to

the institutional changes and policy innovations enhancing macroeconomic stability and individual security in the decades after the Great Depression of the 1930s, which in turn increased the inflationary expectations and behavior of firms, unions, workers, and consumers.

Understanding the electorate's reactions to economic outcomes, which are treated in Part II, requires knowledge of the aggregate costs and distributional consequences of macroeconomic fluctuations. Accordingly, Chapters 2 and 3 are devoted to detailed analyses of the costs of unemployment and inflation, respectively. The costs of unemployment are unambiguous and therefore are easily established. After reviewing the aggregate costs—which amount to at least 2 percent of a year's Gross National Product (GNP) per extra percentage point of annual unemployment—Chapter 2 deals with the livelier question of how those costs are distributed across individuals. As one would expect from the sociological incidence of unemployment, the main losers from recessions tend to be located at the lower ends of the income and occupational-class hierarchies. Although the tax and transfer system succeeds, as intended, in offsetting an important fraction of the income losses of those directly affected by a rise in the aggregate rate of unemployment, recessions nevertheless have pronounced class-linked distributional consequences.

The costs of inflation, which are covered in Chapter 3, are much more controversial than those of unemployment. For decades inflation has been a *bête noire* of affluent conservatives, although, as Part II shows, many citizens of modest means and status also view rapidly rising prices as a significant problem. Yet there is little or no evidence that postwar inflations have adversely affected the American economy's aggregate real output or income performance. Relative to those of unemployment, the distributional consequences of inflation also appear to be rather small; and, if anything, they seem to disadvantage the rich rather than the poor. The lengthy analysis in Chapter 3 suggests that public aversion to inflation is based largely on difficult-to-measure psychological factors. It is also based on confusion, sometimes abetted by policy authorities, of the real income losses imposed by international energy price increases, with the rate of inflation per se.

I.2 The Demand for Economic Outcomes

As Figure I.1 indicates, mass political support for the president and his party—as reflected by votes on election day and by poll ratings during interelection periods—depends on, among other things, cur-

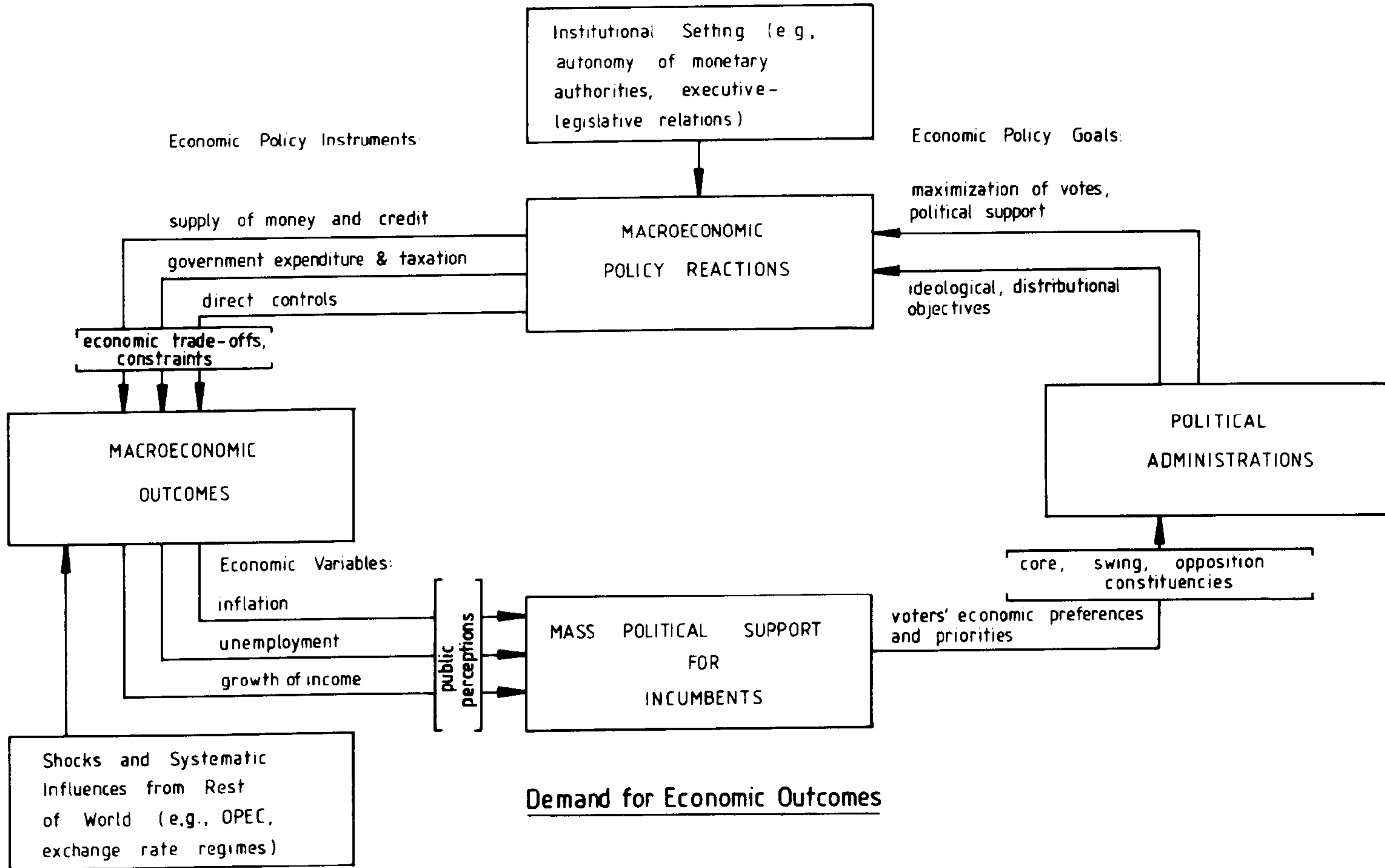

Figure I.1 A simplified political-economic system of the demand for and supply of macroeconomic outcomes.

rent, past, and perhaps anticipated future economic performance.[3] The response of mass political support for incumbents to economic conditions reveals information about the electorate's economic priorities and relative preferences (as between, most importantly, higher inflation and higher unemployment) and constitutes voters' *demand* for economic outcomes. These issues are taken up in Part II.

In Chapter 4 I analyze opinion survey data that assess the public's relative concern about inflation and unemployment during the 1970s and 1980s. Analyses of the aggregate survey responses, presented in the first half of that chapter, yield a reasonably good picture of the combinations of inflation, unemployment, and real income growth in the economy that typically give rise to anti-inflation-oriented versus anti-unemployment-oriented majorities in the electorate. Because the costs of unemployment fall most heavily on down-scale groups (which make up the core constituency of the Democratic party) and the costs of inflation are distribution neutral except at the highest income levels, relative concern about inflation and unemployment varies across electoral groups. Disaggregated opinion data, discussed in the last section of Chapter 4, show that Democratic partisans, blue-collar workers, and low-income classes are in all situations less inflation averse (more unemployment averse) than are Republicans, white-collar workers, and high-income classes.

Direct evidence on the political consequences of macroeconomic events is presented in Chapter 5. In this chapter the impact of economic (and noneconomic) performance over time on mass political support for presidents among partisan groups in the electorate, as registered in Gallup polls, is investigated. The analyses are embedded in a dynamic nonlinear model of political choice, which is derived from the theory of utility maximization and is based on the idea that voters evaluate a president's performance relatively rather than absolutely. The complexity of the model makes this one of the most technically demanding chapters of the book. Yet the analytic setup allows me to address some very important issues concerning the structure and formation of the electorate's implicit demands for economic outcomes. Among these are (1) the rate at which past as opposed to current performance is discounted when the electorate makes contemporaneous political evaluations of the president; (2) the weight that voters, when making current political judgments about the president, appear to give the cumulative economic and noneconomic record of political parties in comparison to that given to the performance of discrete administrations and to the unique appeal of

particular incumbents; and, most significantly, (3) the relative weights voters place on inflation and unemployment outcomes. Estimation results for the political support equations show that the implicit preference (or demand) for low inflation is pronounced among all voter groups. However, as one would anticipate from the distributional analyses in Chapters 2 and 3 and the public opinion data in Chapter 4, Democratic partisans in the electorate have greater sensitivity to unemployment relative to inflation than do Republicans or Independents.

Chapter 6 rounds out Part II by demonstrating the decisive contribution of economic performance to recent presidential election outcomes. In this chapter I show that Ronald Reagan's back-to-back victories in 1980 and 1984 had little or nothing to do with conservative tides or ideological shifts to the right in the electorate. Rather, voters (predictably) punished Carter and the Democrats in the 1980 elections for the poor economic performance of 1979–1980, and rewarded Reagan and the Republicans in the 1984 contests for the vigorous economic expansion of 1983–1984. The cyclical timing of macroeconomic events in relation to the 1980 and 1984 elections, as well as the contrasting priorities placed on unemployment and inflation (and redistribution) by the Carter and Reagan administrations, leads naturally to the analysis of the politically motivated supply of economic outcomes in Part III.

I.3 The Supply of Economic Outcomes

Political administrations may attempt to maintain a comfortable level of mass political support over the electoral term, to maximize votes on election day, and also to pursue ideological and distributional goals reflecting the distinctive preferences of their core electoral constituencies (Figure I.1). The economic policy reactions of administrations to voters' economic preferences and priorities (or demands) determine the politically driven *supply* of economic outcomes. The impact of political forces on the formulation and implementation of macroeconomic policies is subject to institutional arrangements, which include the degree of autonomy of monetary authorities from elected political officials, executive-legislative relations, federalism, and so on. Furthermore, the impact of macroeconomic policies on macroeconomic outcomes is constrained by the structure of economic relations (for example, short-run Phillips curves) and international economic influences (for example, OPEC oil supply shocks). Therefore, domestic

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