ECONOMIC IMPACT OF POLITICAL CYCLES – THE RELEVANCE OF EUROPEAN EXPERIENCES FOR ROMANIA

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Abstract

The research was dedicated to the analysis of the interactions between political processes and economic activities. Explicitly, the research focussed on the theoretical and empirical study concerning the economic impact of political cycles and, especially, to evaluate the relevance of European experiences for Romania.

The analysis was focused to the following subjects: to overview the existent literature on the interactions between political processes and economic activities – political implications of the economic status (the so-called vote – popularity function), and economic impact of the political behaviours – the political business cycles (section 1); to analyse specific features of the vote – popularity functions and the political business cycles in the developed economies and, especially, in the European Union Countries, by over viewing relevant empirical studies (section 2); to survey the literature concerning models and empirical evidences of the interactions between political processes and economic activity for the developing countries (section 3) and for the East European Candidate Countries (section 4); to analyse the interactions between the political processes and the economic dynamics in Romania – macroeconomic signals of the political business cycles, and estimation of regional vote-popularity function (section 5); to discuss the consequences of political business cycles for the processes of transition and the European integration (section 6).

JEL classifications: C52, D72, J64, O11, P26, R50

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1. Defining the Interactions between Political Processes and Economic Activity

The political business cycle can be seen as a business cycle that results (a) from the manipulation of policy tools (fiscal policy, monetary policy) *by incumbent politicians in hope to stimulating the economy just prior to an election and thereby greatly improving their own and their party's re-election chances* or *(b) from the competition amongst political parties with the different ideologies*. On that account, the theory of political business cycle investigates the relationship between political cycles and economic cycles, namely how the timing of elections, the ideological orientation of governments and the nature of competition amongst political parties influence unemployment, economic growth, inflation, and the use of various monetary and fiscal policy instruments.

The two main types of the political business cycles are: *election cycles* generated by governments manipulating the economy to maximise re-election chances (opportunistic cycles models), and *partisan cycles* generated by the change of governments pursuing different goals (Alesina, Roubini and Cohen, 1997). Also, in literature, models based on the *syntheses* between *opportunistic and partisan* political behaviour have been build (Fray & Schneider, 1978). Further on, to set out from the opportunistic-ideological spectrum of political motivation, the models of the political business cycles can be classified according to the expectations that individuals are assumed to hold.

This classification allows us to identify four variants in the political business cycle literature (Garratt & Jackson, 1996, and Nowaihi & Garratt, 1998): (i) the pure opportunistic political business cycle; (ii) the strong partisan theory; (iii) the rational opportunistic political business cycle, and (iv) the weak (rational) partisan theory (Table 1)

In the famous terms of Anthony Downs (1957, p.28), parties "formulate p olicies in order to win elections, rather than win elections in order to formulate policies". Inspired by Niccolo Machiavelli (1469-1527), and Anthony Downs (1957), the *pure (traditional) opportunistic political business cycle model*) is associated with the work of Nordhaus (1975). The term 'pure' is a consequence of Nordhaus's assumption that political parties are interested not in satisfying ideological goals but only in manipulating the economy to win elections. The election period is taken to be of fixed length so that there are periodic elections. The economy is described by the Phillips curve relationship between inflation and unemployment, such that a greater trade-off in the long run than in the short-run exists. Nordhaus's model was meant to show that if voting was based on economic performance in the recent past and if expectations of inflation were backward-looking, an opportunistic incumbent who controlled monetary policy would find optimal to induce an inflation-unemployment cycle corresponding to the length of his term, with a boom just before an election and a recession afterwards (Paldam, 1997 and Nannestad and Paldam, 1997, 1999).

The opportunistic political business cycle approach omitted an ideological dimension from the utility function of politicians. The *models of partisan cycles* stress that the policies of the parties are influenced by party ideologies, so that different governments systematically pursue different goals and hence different policies. And different policies lead to different outcomes (Nannestad and Paldam, 1999). Partisan theory has categorised political parties as being of the Left or Right (Hibbs, 1977). In order to defend the workers' interests, the Left-wing party will prioritise unemployment over inflation and undertake monetary and fiscal policies, which promote growth and welfare. While defending the entrepreneurs' interests, the Right-wing party will prioritise inflation over unemployment. Monetary and fiscal policy will be tighter than under a Left-wing party (Nowaihi and Garratt, 1998). Consequently, unemployment is permanently lower, and growth and inflation are permanently higher with the Left-wing party in office than with Right-wing governments (Alesina, Roubini and Cohen, 1997).

Table 1: The typology of the political business cycles

			The behaviour of electors is based on:	
			retrospective analysis	*prospective analysis*
The behaviour of policymakers is motivated:	*opportunist*	*context-dependent models (Fray and Schnaider, 1978)*	Traditional opportunistic political business cycles (Nordhaus, 1975)	Rational opportunistic political business cycles (Rogoff and Sibert, 1988; Rogoff, 1990; Persson and Tabellini, 1990)
	partisan		Traditional partisan political business cycles (Hibs, 1977)	Rational partisan political business cycles (Alesina, 1987)

The *rational opportunistic political business cycles models* (Cukierman and Meltzer, 1986, Rogoff and Sibert, 1988, Rogoff, 1990, Persson and Tabellini, 1990) combine the classical hypothesis of the opportunistic behaviour of policymakers with the ideas of competence and asymmetric information. Under certain assumptions about the rational behaviour of voters, these models imply multiyear cycle in growth and unemployment, but this cycle is not regular. Inflation starts to increase prior to an election and remains high few quarters afterwards, falling afterwards (same as for the traditional opportunistic models), but the effects of political business cycle are smaller and shorter-lived. The vote share of the incumbent is increasing in past growth and decreasing in past unemployment, and the specific pattern of this relationship depends on voters' information.

The model of the *rational partisan theory* is primarily associated with the works of Alesina (Alesina, 1987). In rational partisan theory, different voters have different preferences over inflation and unemployment (like in traditional partisan theory), but here they vote for the party that delivers the highest expected utility. Empirical implications of these behaviours are: short-run partisan effects after elections – unemployment

temporarily lower than normal and growth temporarily higher than normal for about two years after an electoral victory of the left; the opposite outcome after an electoral victory of the right; unemployment and growth return to their natural rates in the second part with both types of government; deviation of growth and unemployment from natural rates is correlated with the amount of electoral surprise; inflation is permanently higher when the left is in office relative to when the right is in office.

Another general issue concerns the *possibility of joining partisan and opportunistic models*. The result is the so-called *context-dependent models*. In these models the extent to which policy makers' controls over macroeconomic outcomes or policies can vary significantly depending on the specific circumstance. Thus, in their model, Fray and Schneider (1978) Frey and Schneider attempt to outline a popularity function and a policy function. The political popularity function expresses a party's support as a function of the unemployment, inflation and economic growth rates, while the latter embodies the responsive ideological preferences of the incumbent government. They suggest that partisan politicians, when in office, become opportunistic when elections approach if they are relatively unpopular – if government's actual popularity is in excess of the critical popularity then government holds a popularity surplus; if government's popularity falls short of the critical level then government holds a popularity deficit; a popularity surplus motivates government to act ideologically while a popularity deficit motivates them to act opportunistically. Namely, if popularity is low, then economic variables are manipulated to increase the chances of re-election, whereas with high popularity the government follows its supporters' and own ideology by being responsive. Therefore, Frey and Schneider's model emphasises utility maximising instead of vote-maximising governments. Popularity is sought so that the ideological programme can be followed.

From a similar approach Schultz (1995) notes that political manipulation on the macro economy can be very costly, and the incumbent's incentives to manipulate the economy can vary from elections to elections contingent upon their political needs. According to Fray and Schneider (1978), Schultz argues that the incumbent will not necessarily manipulate the economy if his expected probability of winning next election is relatively high. This idea has confirmed too, by Price (1998) studies.

2. Empirical studies concerning the political business cycles in the European Union Countries

2.1. The methodology

Empirical implications of different models of political business cycles are carried out in economic literature starting with the different consequences of each model. Following the schema lay out by Alesina, Roubini and Cohen (1997):

a) If the *opportunistic traditional models* of the political business cycles are correct, then we expect:

- Expansion in the year or two before the elections; Gross National Product growth above normal, unemployment below normal in the election year;
- Inflation begins to increase immediately before or immediately after the election;

- Recession (or downturn) after the election, with gradual reduction of inflation;
- No differences in policies and outcomes between different governments;
- Incumbents reappointed when growth is high and unemployment low in election years.

b) If the rational *opportunistic models* of the political business cycles are correct, then we expect:

- Short run manipulations of policy instruments immediately before elections: increase in deficits, inflation, and money growth in the two-three quarters before each election;
- Tightening of monetary and fiscal policies after elections;
- No systematic, multi-years effects on growth and unemployment except for, possibly, some minor effects immediately before the election;
- Incumbents reappointed when growth is high and unemployment low in election years.

c) If the *traditional partisan model* of the political business cycles is correct, then we expect:

- Growth permanently higher, unemployment permanently lowers when the left is in office;
- Inflation permanently higher during the tenure in office of lef t-wing governments than with right-wing governments.

d) If the *rational partisan model* of the political business cycles is correct, then we expect:

- Short-run partisan effects after elections: unemployment temporarily lower than normal and growth temporarily higher than normal for about two years after an electoral victory of the left; the opposite outcome after an electoral victory of the right; unemployment and growth return to their natural rates in the second part of both right and left-wing terms of office;
- Deviation of growth and unemployment from natural rates is correlated with the amount of electoral surprise;
- Inflation permanently higher when the left is in office relative to when the right is in office.

To test the existence of the political business cycles, generally is running the following regression model (Alesina and Roubini, 1990, 1992):

$$y_t = a_0 + a_1 y_{t-1} + a_2 y_{t-2} + \ldots + a_n y_{t-n} + a_{n+1}\mathrm{PDUM}_t + \varepsilon_t \qquad (1)$$

In the equation (1), y_t is the stacked vector of time-series data on output growth, unemployment or inflation, and PDUM is a political dummy that captures the implications of the different theories.

For example, in order to test the Nordhaus model on quarterly data, Alesina and Roubini (1990, 1992), Alesina, Cohen, and Roubini (1992) and Alesina, Roubin i, and Cohen (1997) include in their models a PDUM dummy variable equalling 1 in the election quarter and in the $T-1$ quarters before the election, and 0 otherwise (where *T* may equal 4, 6, or 8). As the measure of economic activity they consider the year-over-year growth rate of Gross National Product or an unemployment measure (the exact specification depending on the model and data set).

In accord with a same model, Alt (1985) finds evidence consistent with the partisan political business cycle theory loo king at unemployment in twelve OECD

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countries. Alesina and Roubini (1990, 1992), Alesina, Cohen and Roubini (1992) found evidence in favour of the rational partisan theory for a sample of OECD countries and no evidence was found in developed economies outside the U.S. for Nordhaus style political business cycles for unemployment or economic growth. Alesina, Roubini, and Cohen (1997) reject an opportunistic cycle in real activity for a sample of 18 OECD countries over the period 1960-93. Because the partisan theory implies that inflation will be higher under Democratic administrations, Cohen (1993) tests whether changing probabilities of electing a Democrat, as derived by polling data before U.S. elections affect short - and long-term interest rates. The post-electoral increase in inflation predicted by the Nordhaus model receives support in some countries and not in others (Drazen, 2000).

2.2. Evidences of the political business cycles in the European Union Countries

In a series of three influential papers, Alesina and Roubini (1990, 1992), Alesina, Cohen, Roubini (1991), Alesina, Roubini, Cohen (1997) studied whether the dynamic behaviour of Gross National Product growth, unemployment and inflation is systematically affect by the timing of elections and of changes of governments. The sample includes the period 1960 to 1987[1], for 11 countries from European Union (Austria, Belgium, Denmark, Finland, France, Germany, Ireland, Italy, the Netherlands, Sweden, United Kingdom) and 7 another OECD economies (Australia, Canada, Japan, New Zealand, Norway, Switzerland, and the United States). The economic data are quarterly observations on inflation (yearly rate of change of the consumer price index), output growth (the rate of change of real gross national product, or gross domestic product), and unemployment. The political data are election dates, the dates of change of governments, and the political orientation of various governments.

Their main results can be summarized as follows: (a) the *political business cycles* hypothesis, as formulated in Nordhaus (1975) on output and unemployment is generally rejected by the data (with the exception of Japan, they also reject the political business model with endogenous timing of elections); (b) inflation tends to increase immediately after elections, as a result of pre-electoral expansionary monetary and fiscal policies; (c) there are a temporary partisan differences in output and unemployment and a long -run partisan differences in the inflation rate, in according with the *rational partisan theory* (Alesina, 1987); (d) the mentioned studies didn't find evidence of permanent partisan differences in output and unemployment.

To obtain these results, Alesina and Roubini (1990, 1992) ran the tests that are based upon the assumption that output growth, unemployment and inflation are generated by a covariance-stationary stochastic process. Therefore, they ran the panel regressions of time-series cross-section data described by equation (1), where y_t is the stacked vector of time-series data on output growth, unemployment or inflation, PDUM is a political dummy that captures the implications of the different theories and the autoregressive specification (*n*) is chosen using standard econometric techniques.

For the reason that the sample includes small open economies, in their models Alesina and Roubini (1990, 1992), Alesina, Cohen, Roubini (1991), and Alesina, Roubini, Cohen (1997) take into consideration the high degree of interdependent between

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[1] In Alesina, Roubini, Cohen (1997) the sample includes the time period 1960 – 1993.

the economies. The effects of the world economy on domestic economies are captured by add as a regressor in equation (1) a proxy for an OECD average of the same variable.

For testing the **rational partisan theory**, the authors used a political dummy variable symbolised DRPTN, where DRPTN $= +1$ in the N quarters starting with that of a change of government toward the right, DRPTN $= -1$ in the N quarters starting with that of a change of government toward the left, and DRPTN $= 0$ otherwise. In Alesina, Roubini (1990, 1992) the best dimension of n (the degree of autoregressive process) for the output has been find to 2 and the model is running for 15 countries from 18 OECD economies in the sample (Japan and Switzerland are not included since they had no political change in the sample; the Netherlands is not included and the authors didn't suggest an explication). By using a fixed-effect model with constant slopes, the obtained results are presented in Table 2[2].

Table 2: Rational Partisan Theory
Dependent Variable: Rate of Growth of Output (Y)

Independent variables	Model 1		Model 2	
	Coefficient	(t-statistics)	Coefficient	(t-statistics)
Constant	0.13	(0.55)	-0.18	(-0.81)
Y(-1)	0.712	(28.1)	0.610	(17.27)
Y(-2)	-0.062	(-2.55)	-0.01	(-0.28)
YW	0.353	(11.82)	0.305	(9.35)
DRPT6(-1)	-0.41	(-3.48)	-0.62	(-4.42)
USA	-0.45	(-1.49)	0.21	(0.81)
UK	-0.63	(-2.08)	-0.02	(-0.07)
Germany	-0.36	(-1.19)	0.28	(1.09)
France	-0.14	(-0.45)	0.49	(1.81)
Canada	0.12	(0.40)	0.80	(3.06)
Italy	0.04	(0.15)		
Sweden	-0.56	(-1.63)		
Belgium	-0.42	(-1.40)		
Austria	0.14	(0.48)		
Norway	-0.03	(-0.10)		
Finland	0.05	(0.15)		
Ireland	0.46	(1.13)		
Australia	0.03	(0.10)	0.007	(2.67)
New Zealand	-0.48	(-1.59)	0.120	(0.48)
Denmark	-0.39	(-1.29)		
R^2	0.61		0.60	
S.E.	2.24		1.61	

In the previous table, Y is the rate of GNP growth in quarter t, YW is the world growth average, N $= 6$, and the remaining regressors are country dummies. The one-

[2] Alesina A., Roubini N., 1992, Political Cycles in OECD Economies, in Review of Economic Studies, 59, p.671

quarter lag in the political dummy is consistent with a reasonable interval between change in regime and change of policy.

In Alesina, Roubini, Cohen (1997) the model is running for all the 18 OECD economies and the time period is 1960 – 1993. The founded results are similar to Alesina A., Roubini N. (1990, and 1992).

According to Alesina A., Roubini N. (1990, p.13-14 and 1992, p. 670) and Alesina, Roubini, Cohen (1997, p.149-152), the political dummy variable DRPT6 is statistically significant and she has the correct sign. This means that:

> *A change in government to the right leads to a transitory fall in output growth, and a change to the left leads to a transitory increase in output growth.* More precisely, *about eighteen months after a change of regime toward the right (left) the rate of growth of GNP is about 1.3% below (above) normal rate* (Alesina A., Roubini N., 1992, p.671).

The regressions with DRPT4 and DRPT8 yield analogous results (these regressions are explicitly presented only in Alesina, Roubini, Cohen, 1997, p.150-151). The same models are running by Alesina, Roubini (1990, 1992), Alesina, Cohen, Roubini (1991), and Alesina, Roubini, Cohen (1997) for unemployment and inflation.

> In the authors' opinions, *the results concerning the unemployment and the inflation rate were accordingly to rational partisan theory of political business cycles*. For example, *they find that about six quarters after a change of regime toward the right (left) the unemployment rate is about 1.5 percentage point above (below) normal* (1992, p. 672-673). *The effect in inflation rate is rather permanent, than transitory* (1992, p.673-676).

The second group of models is running only for a subset of countries that have a more clearly identifiable *left* and *right* coalitions. In this model, the coefficients on the political dummy variable are much larger in absolute value and even more precisely estimated.

Hibbs's partisan theory implies permanent differences in growth, unemployment and inflation across governments. Thus, for testing the **traditional partisan theory**, the authors ran the same regression models using the permanent partisan dummy variable RADM. The political dummy variable symbolised RADM, is defined: RADM = +1 if a right-wing government is in office (including the quarter of the change of government), and RADM = -1 if a left-wing government is in office (including the quarter of the change of government).

> *The obtained results demonstrate that in the traditional partisan model all the coefficients on the political dummy are insignificant, even though with the right sign (Alesina, Roubini, 1992, p.675). According to the authors' opinion, the test confirms th at the effect of changes of governments on growth and unemployment are transitory (p.676).*

By using other dummy, symbolised ADM, Alesina, Roubini, Cohen (1997) tried to distinguish more finely the centre-right and centre-left governments from those more clearly rightist and leftist (p.155). The ADM dummy variable includes the RADM values for the right- and left-wing governments in office, and additionally, the following two values: ADM = ½ if a centre-right government is in office (including the quarter of the change of government), and ADM = -½ if a centre-left government is in office (including the quarter of the change of government). With this definition of the political variable, in the growth regressions, the coefficients on the political dummy are in significant, even

though with the expected sign. In the unemployment regressions, the coefficient on the permanent partisan dummy (ADM) is significant at the 5 percent level. Despite of this result, the authors reject the traditional partisan theory. This because in the first period of an administration, the ADM variable overlaps with the DRPT variable so that the ADM might be capturing the transitory effects (estimated by DRPT) rather than permanent effects. Another justification of their position is the f ollowing: because the unemployment rate is highly persistent in most OECD countries, such effects from the first period of the term might propagate through the second half even if the partisan effect is due only to the original electoral surprise (accordin g to the rational partisan theory).

In the authors' opinion the results obtained by running political models as the ones described by equation (1) for the OECD panel data indirectly provide empirical support for the inflation bias model of Kydland and Pre scott (1977) and Barro and Gordon (1983):

> *The regressions show that a permanent difference in inflation rate is associated with temporary deviations of output and unemployment from trend; consistently with the models of inflation bias, real effects occur o nly when there are unexpected policy shocks, in this case as a result of electoral surprise (Alesina, Roubini, 1990, p.19; 1992, p.676; Alesina, Roubini, Cohen, 1997, p.165).*

For testing the Nordhaus **opportunistic political business cycles**, usually the political dummy variable of equation (1) take the form: NRDN = 1 in the (N-1) quarters preceding an election and in the election quarter, and NRDN = 0 otherwise. The coefficients of NRDN, with $N \in \{4, 6, 8\}$, are not significant in regressions concerning growth and unemployment carried out by Alesina, Roubini (1990, 1992), Alesina, Cohen, Roubini (1991), and Alesina, Roubini, Cohen (1997). Moreover, in the growth regression the coefficient of the political dummy has the opposite sign from the theory predictio n.

> That is, following the quoted papers, *they aren't reasons for the opportunistic behaviour of the policymakers in the OECD countries .*

The rational model of the opportunistic political business cycles (Rogoff and Sibert, 1988) implies that pre -electoral manipulation of monetary and fiscal policy (used to signal the government competence) entails an increase of inflation immediately after each election. A coefficient of the political dummy used in such model (NPOST = 1 in the N-1 quarters following an elec tion and in the election quarter, and NRDN = 0 otherwise) is significant.

> This result would suggest that *around election, monetary and fiscal policy instruments might be manipulated, even though these policies do not seem to affect real economic activity* (Alesina, Roubini, Cohen, 1997, p.170)

The Alesina and Roubini (1990) results obtained by performing country -by-country regression model of the rational partisan cycle for the 11 European Union Countries are presented in Table 3.

According to these analyses, in Denmark, Germany, and France, all the regression on growth, unemployment and inflation show evidence favourable to the rational partisan theory, although not all the coefficient on the political variables are significant at the usual confidence level (1%, 5% or 10%) in every regression (Alesina and Roubini, 1992, p.679). The results on the U.K. are greatly strengthened if the sample is restricted to the post-fixed rates period. In other countries (Austria, Belgium, Finland, Ireland, the Netherlands, Sweden) the coefficients on the political variables exhibit the correct sign in

either the growth and/or the unemployment regressions. Italia show no significant coefficient in any regressions (Alesina and Roubini, 1992, p.680). No significant results were found in the inflation regressions.

Table 3: Rational Partisan Theory

| Country | Dependent Variable (t- statistics in parentheses) | | | | | |
| | Output growth (Y) | | Unemployment (U) | | Inflation rate ( ) | |
	DRPT N(-J)	(N,J)	DRPT N(-J)	(N,J)	RADM(-I)	(I)
Austria	-1.207 (-1.389)	(6,1)	0.181 (1.981)	(4,1)	0.010 (-0.064)	1
Belgium	-0.027 (-0.061)	(8,2)	0.076 (1.569	(8,2)	0.243 (0.289)	5
Denmark	-0.467 (-1.37)	(4,2)	0.233 (2.835)	(4,2)	-0.457 (-2.92)	4
Finland	-0.852 (-1.65)	(8,2)	-0.003 (-0.048)	(8,2)	0.119 (-0.94)	5
France	-0.802 (-1.390)	(4,1)	0.150 (2.000)	(6,1)	-0.308 (-2.63)	1
Germany	-0.699 (-2.418)	(8,2)	0.120 (3.106)	(6,1)	-0.164 (-1.881)	2
Ireland	-1.190 (-1.44)	(6,1)	-0.013 (-0.199)	(6,2)	-0.135 (-0.777)	1
Italy	-0.205 (-0.249)	(4,1)	0.010 (0.079)	(4,1)	-0.156 (-0.982)	1
Netherlands	0.076 (0.156)	(4,1)	0.205 (1.177)	(4,2)	-0.003 (-0.017)	1
Sweden	-1.226 (-2.23)	(6,1)	0.046 (0.584)	(6,1)	0.082 (0.507)	5
UK	-0.455 (-1.365)	(8,2)	0.116 (1.501)	(6,1)	-0.173 (-1.395)	2

(Alesina A., Roubini N., 1990, *Political Cycles in OECD Economies*, Working Paper No. 3478, National Bureau of Economic Research Working Papers Series, p.34 -35, Table 9, p.36-37, Table 10, p.70-71, Table A-3).

Still, several problems remained unresolved in the Alesina and Roubini (1990, 1992) rational partisan model (Boix, 1997). The methodology employed to test it has been considered unsuited to prove parts of its claims (Hibbs, 1992). The way in which left-wing cabinets manage fiscal and monetary policy after economic agents have adjusted to the initial shock is under specified in the model. Finally (Boix, 1997), the rational partisan theory hardly accounts for the hysteretic behaviour of European unemployment in the 1980s and for the emergence of learning patterns among governments of different ideological traditions. Work by Alvarez, Garrett and Lange (1991) and Beck *et al.* (1993) provide empirical confirmation of the favourable impact of social democratic regimes on growth rates. Alesina and Summers (1993) show how central bank independence reduces inflation.

Another group of studies analyses the impact of political parties and corporatist institutions on policy instruments. Part of the variation in unemployment rates across OECD countries in the 1980s can be explained by the extent of macroeconomi c policies (Nickell 1997). Boix (1998) explored whether the use of different macroeconomic policy instruments distinguishes different parties in office (or distinguished them in particular historical periods), alone or in combination with specific institut ional traits of the domestic economy. The analysis is made for the period that extends from 1962 to 1993, on a sample of 18 OECD countries (Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, Netherlands, Norway, Spain, Sweden, Switzerland, the United Kingdom and the United States).

Boix has summarized the results of the paper as follows: (1) After being relatively loose in the 1960s, monetary policy tightened in the wake of the first economic shocks of the 1970s, particularly in the late 1970s. Real interest rates peaked in the early 1980s and then declined slowly. Fiscal policies became expansionary in the 1970s. Afterwards most OECD countries strove towards fiscal consolidation; (2) Conservative governme nts have pursued relatively restrictive macroeconomic policies -keeping the public budget roughly in balance and real interest rates above the OECD average, except for the 1970s and early 1980s; (3) Social democratic cabinets in corporatist countries have f ollowed somewhat looser monetary policies than conservative countries in the 1960s and 1980s; fiscal policies have been as tight as (or – in the 1960s – even tighter than) those of conservative governments. In the 1970s, however, social democratic corporat ist countries embraced the most counter cyclical budgetary measures across all OECD nations; (4) In decentralized economies, socialist governments have developed a policy mix opposite to social democratic corporatist regimes: fiscal policies have been loos e and, to make up for the lack of stable social pacts and their credibility gap in regard to its anti -inflation preferences, monetary policies have been rather tight (except for the 1970s); (5) The capacity of socialist governments to pursue monetary expan sions is substantially constrained by the level of central bank independence.

In a recent paper, Chang (2001) attempts to re -examine political business cycle models by studying how policy makers' interests are modified by electoral rules and then reflect on the macroeconomic policies. For this purpose, Chang constructed a cross -national time series data that consists of 17 OECD countries (Austria, Australia, Belgium, Canada, Denmark, Finland, France, Germany, Italy, Ireland, Norway, Netherlands, Portugal, Spain, Sweden, Switzerland, and United Kingdom) and covers from the period from 1973 to 1995. The Chnag's study suggests that electoral policy cycles exist, while the characteristic of electoral policy cycles varies under different electoral systems. He suggests that majoritarian systems (proportional systems) provide politicians stronger incentives to increase geographically concentrated spending (public goods spending), and electoral policy cycles of geographically concentrated spending (public good spend ing) are stronger under majoritarian systems (proportional systems). It is concluded that electoral systems are important in mediating the impact of politicians' electoral -oriented strategies on the macroeconomic policy.

Chappell and Veiga (1999) have con structed a data set describing economic conditions and election outcomes in 13 Western European countries (Austria, Belgium, Denmark, Finland, France, Germany, Ireland, Italy, the Netherlands, Portugal, Spain, Sweden, and the United Kingdom) over the 1960 to 1997 period. With this data set, they investigated the performance of a variety of vote function specifications. Their purpose was to assess the relative performance of vote functions motivated by alternative economic paradigms and to account for variat ions in the extent to which incumbent parties are held responsible for economic outcomes (Chappell and Veiga, 1999 p.12). Even if they have been unable to isolate any measures of political responsibility measures that convincingly affect voting, and their inferences about voters' macroeconomic beliefs remain speculative, however they have found some evidence to support the general hypothesis that economic outcomes affect election outcomes. Chappell and Veiga (1999) strongest finding is that voters punish in creases in inflation, especially those that exceed the European average and they find weaker evidence for the hypothesis that voters reward growth of real output (p.13).

In another paper, the same authors (Veiga and Chappell, 2000) provided an empirical appraisal of the influence of politics on the evolution of unemployment rates in 12 European Union countries and the U.S., for the period between 1960 and 1999. The included European Union countries are Austria, Belgium, Denmark, Finland, France, Germany, Italy, Netherlands, Portugal, Spain, Sweden, and the United Kingdom. In their paper, Veiga and Chappell (2000) had in view three major objectives (p.1). The first is to undertake improved and generalized tests of the predictions about unemployment rates made by existing political business cycle models. The second objective is to investigate how the structure of labour markets affects the determination of unemployment and conditions the operation of political pressures. The third objective is to investigate h ow political fragmentation affects the level or variability of unemployment rates.

The obtained results suggest more support for transient cycles predicted by the rational partisan models (with higher unemployment rates prevailing under right parties than left parties) and little support for Nordhaus's opportunistic political business cycle model or Hibbs's partisan model with permanent unemployment effects. But, the support for the rational partisan model is tempered, because Veiga and Chappell (2000) fou nd no evidence of interactions between partisanship and labour market structure (p.17). Since the rational partisan theory relies on some labour market rigidities (specifically, long -term contracts) to produce partisan cycles, the absence of interaction ef fects weakens support for it.

At a microeconomic level, the analysis shows that labour market structure and political fragmentation are important determinants of unemployment. The evidence suggests that more fragmented coalition governments are associated with higher unemployment rates than single party governments, while centralized wage bargaining institutions are associated with lower unemployment rates.

Clark *et al.* (1998) emphasize that common cross -country studies of political business cycle models may be seriously flawed since they do not account for institutional differences that constrain national policymakers. For the most part, the political business cycle models make the simplifying assumptions that (a) the central bank and the government pursue the similar policies, and (b) policymakers have sufficient national autonomy to implement their policies. Both assumptions need not hold in reality, as the following two types of constraints may prevent governments from implementing an opportunistic policy (Leertouwer and Maier, 1999, p.4 -5): (1) *national constraint* (central banks are increasingly made independent therefore one should not expect them to engage in opportunistic behaviour) and (2) *international constraint* (under a regime of fixed exchange rates and high capital mobility, the possibility for autonomous economic policies is reduced; for the European Union countries and especially for the euro -zone, the participation in a fixed exchange rate regime restricts national economic policies and lowers the possibility of political business cycles).

In this idea, Leertouwer and Maier (1999) wish to answer the question of whether the central bank can be held responsible for active opportunistic behaviour. The analysis is made for the period that extends from 1960 to 1997, on a sample of 16 OECD countries (Austria, Australia, Belgium, Canada, Denmark, France, Finland, Germany, Italy, Japan, Norway, Spain, Sweden, UK, US, New Zealand). Their paper focused on policy outcomes for which the central bank can be held responsible, namely the short -term interest rate.

In the authors' opinion (Leertouwer and Maier, 1999, p.6), there are two reasons for using the short-term interest rate: (1) A political business cycle in, say, M1, does not

necessarily imply active central bank behaviour: If, for instance, the incumbent government uses expansive fiscal policy before elections, and the central bank tolerates this behaviour, then obviously a monetary aggregate must reflect pre-electoral manipulation. However, it would be unfair to fully blame the central bank, as the political business cycle was created by the government, and (2) If politicians try to influence a central bank before elections, the demand will in most cases not be formulated in terms of a monetary aggregate (`Increase the growth rate of M1'), but in term of interest rates (`Lower the interest rate!'). In consequence, "to answer the question of whether central banks regularly misuse monetary policy, evidence should be found in monetary instruments" (p.6), therefore in their paper they use short-term interest rates which are tightly controlled by the central banks and reflect their intentions. In conclusion "should political business cycles exist and should they be actively created by central banks, they should be visible in the short-term interest rates" (p.6).

Concerning the international constraint, Leertouwer and Maier (1999) has been investigated the relationship between exchange rate regimes and political business cycles. Their sample runs from the 1960s until 1997 and consists of monthly data for 16 OECD countries (Austria, Australia, Belgium, Canada, Denmark, France, Finland, Germany, Italy, Japan, Norway, Spain, Sweden, UK, US, New Zealand).

With the possible exception of Austria, running of country by country models allows Leertouwer and Maier (1999) to assert that, in analysed 16 OECD countries, the central banks do not manipulate interest rates before elections (at least, the short-term interest rate does not show any sign of a political business cycle). This suggests that either government do not have possibilities to force central banks to yield, or central banks have effectively resisted government's wishes (p.17). By running a panel data regressions, they get more or less the same picture: is no evidence for central banks actively creating political business cycles. Leertouwer and Maier (1999) reject the hypothesis that central banks actively engages in opportunistic behaviour, so that their conclusions are the following: (1) If political business cycles in macroeconomic variables such as unemployment show up, then the central banks should not be blamed. Either their actions have no effect, or they simply do not engage in short-sighted behaviour", and (2) "If one believes that central banks have the power to control interest rates, then one has to reject the idea that central banks help governments to win elections. If electoral cycles in monetary aggregates exist, they could largely be demand-induced (perhaps due to fiscal behaviour), but not due to central bank action" (p.16-17).

In the same type of analysis, Waller (1992) incorporated the discussion concerning the central bank independence into a model with partisan politicians, arguing that instituting this rule should reduce politically induced fluctuations in growth and inflation. Also, Berger and Woitek (1997) found in German economic data signals of an impact from elections and ideology. They find cycles in M1 that could indicate an opportunistic behaviour of the Deutsche Bundesbank. However, their findings indicate that the Bundesbank did not target a monetary aggregate, but rather economic variables such as inflation or output. Therefore Berger and Woitek conclude that the cycle in M1 was demand-driven rather than supply-driven.

3. Empirical Tests Concerning the Political Business Cycles in the Developing Countries

The empirical literature on political budget cycles focuses mostly on advanced industrial countries so that empirical studies of political business cycles in developing countries are still scarce. According to Shi and Svensson (2000), there is no systematic evidence on political budget cycles based on a large cross-section of countries. In particular, there is little robust, systematic evidence of political budget cycles in developing countries, how these cycles compare with those observed in developed countries, and what the sources of the differences may be. Studies using data from developing countries include Block (1999), Magloire (1997), Khemani (1999), Kraemer (1997), Schuknecht (1996, 1998a, 1998b, 2000).

Bates (1988) discussed public investment cycles in Zambia in the 1960s and Krueger and Turan (1993) discussed such cycles in Turkey between 1950-1980. Schuknecht (1996) finds fiscal policy cycles of the Nordhaus - type for a panel of 35 developing countries where governments pursue expansionary fiscal policies before elections and fiscal austerity afterwards. There is also a literature on the political economy of developing countries that discuss the importance of the policy regime (e.g., Krueger, 1992), micro and macroeconomic policy failures (e.g., Krueger, 1993), domestic institutional factors (e.g., Borner, Brunetti and Weder, 1996) or international influences (Frey and Eichenberger, 1994).

Gonzalez (1999a, 2000b) classified some developing economies, mainly in Latin America and Asia, as *imperfect democracies*. In the Gonzalez' opinion (Gonzalez, 2000a, 2000b), while most developed democracies have enjoyed extremely stable political environments during the last 60 years, the group of imperfect democracies has experienced different historical swings and disruptions that in some cases have contributed to make their political systems more democratic, and in some others have drastically reduced the political and civil rights of the country's nationals. In other words (Schuknecht, 1998b), the degree of democracy in each of these countries has displayed some significant variation over time, even if elections may have taken place regularly, in accordance to some specified election calendar. Often enjoying relatively well-organised election processes, these countries satisfied the necessary conditions and data requirements for formal econometric studies to be performed (Shi and Svensson, 2001). For example, Whitehead (1990) has shown that an electoral cycle in total government spending existed in Mexico between 1965 and 1985. Magaloni (2000) has identified opportunistic manipulations in Mexican monetary and fiscal policy between 1970 and 1998. Ames (1987) used a panel regression of 17 Latin American countries between 1947 and 1982 to show that public expenditures increased by 6.3% in the pre-election year and decreased by 7.6% in the post-election year.

Kraemer (1997) investigated the impact of electoral politics on fiscal policy in 21 countries of Latin America and the Caribbean between 1983-1995, finding that fiscal deficits are higher in election years than would otherwise be predicted. Rojas-Suárez et al. (1998) demonstrated a significant deterioration of the election year's fiscal stance for several Latin American countries and emphasises that in a large number of cases such cycles had important destabilising effects. Contrarily, Agenor and Montiel (1996, quoted in Gonzales, 2000a) could not detect any pre-electoral activity in the three most developed Latin American democracies (Costa Rica, Ecuador and Venezuela).

Schuknecht (1998a) studies empirically the impact of the exchange regime on election - oriented fiscal policymaking in 25 developing countries [3] that held elections during at least part of the 1978 to 1992 period. He found significant empirical evidence for fiscal policy cycles only in countries with fixed exchange rates and sufficient reserves. Schuknecht argued that flexible exchange regimes reduce the incentive for go vernments to engage in expansionary fiscal policies before elections because such policies can result in devaluations and inflation that negatively affects government popularity. In the countries with fixed exchange rate regimes, governments have a stronge r interest in opportunistic fiscal expansion before elections, so that improve their re -election chances. This is particularly the case when fixed exchange rates reduce the danger of higher inflation through expansion-induced devaluation, and when adequate reserve levels diminish the short-term balance-of-payment constraint. In Schuknecht's opinion, these findings have important implications for the choice of the exchange regime. For some countries, there are doubts about the usefulness of fixed exchange ra tes for stabilizing the macro economy, unless reforms of the institutional framework reduce the possibility for election-oriented fiscal expansion. "Fixed exchange regimes (with their long -term stabilizing effect) might then be complemented by reforms in t he institutional framework which reduces the scope for election-oriented fiscal expansion. Countries, where the institutional mechanisms to prevent strong election -oriented fiscal expansions are not in place or where institutional reform is not feasible, h owever, might fare better with flexible exchange regimes" (Schuknecht 1998a, p.17).

Gonzales (2000a) tries to explain the emergence of macroeconomic policy cycles in under-developed democracies [4]. Gonzales characterize every economy by an *index of democracy*, $D \in [0; \quad)$; where $D = 0$ stands for an extremely dictatorial regime and D represents an ideal democracy. The country's degree of democracy is reflected in practice by a cost that the voters must bear when enforcing the political turnover after each election (p.1). She also characterizes the economy by an *index of transparency*, representing the likelihood with which the voters learn the politician's competence (p.2). In Gonzales' opinion the transparency is likely to be higher in developed democracies, where information may be more readily available to the public as the free media flourishes with the strengthening of the political and civil rights (p.1). The Gonzales' analysis delivers a provoking (in author opinion) result: "whenever the two indices of democracy and transparency are positively correlated, it is precisely the lack of democracy that gives rise to the election cycles" (Gonzales, 2000a, p.2). The Gonzales' conclusion suggests that the election cycles may not emerge when countries are sufficiently democratic. She shows not only that it is the lack of democracy that may generate the incentives for the cycles to emerge, but also that the magnitude of the distortion driven by political motives has a humped shape relative to the degree of democracy prevailing in a country (Gonzales, 2000a, p.22).

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[3] The analysed countries in Schuknecht (1998a) paper are the following: Argentina, Bangladesh, Barbados, Botswana, Brazil, Costa Rica, Ecuador, Fiji, Gambia, Guatemala, India, Korea, Malaysia, Malta, Mauritius, Mexico, Pa kistan, Peru, Philippines, St. Vincent, Thailand, Trinidad & Tobago, Turkey, Uruguay, Venezuela.

[4] The sample period runs from 1975-1995, in annual frequencies and the countries included are: Argentina, Australia, Austria, Barbados, Belgium, Bolivia, Brazi l, Canada, Chile, Colombia, Costa Rica, Denmark, Dominican Republic, Ecuador, El Salvador, France, Germany, Ghana, Greece, Guatemala, Honduras, India, Indonesia, Israel, Italy, Ireland, Jamaica, Japan, Korea, Madagascar, Malaysia, Mexico, Nicaragua, Norway, Pakistan, Paraguay, Peru, Philippines, Portugal, Senegal, Singapore, South Africa, Spain, Sri Lanka, Sweden, Thailand, UK, Uruguay, USA and Venezuela.

In another paper, Gonzales (2000b) tried to test whether a country's time -varying degree of democracy affects the way in which economic policy is chosen as elections approach. For this purpose, an econometric model is estimated for the case of Mexico's fiscal policy between 1957 and 1997. In Gonzales' opinion, the estimation revealed government's strong systematic use of public spending in infrastructure and current transfers as a mean to earn votes. Gonzales f ound evidence that the increase in investment in infrastructure starts relatively early in the pre -election period (at least 6 quarters prior to the election), continues until at least the last quarter prior to the ballots, and then diminishes as the election quarter is reached. The current transfers tend to be concentrated very strongly during the election quarter only. The model shows that a democratisation process generates two opposite forces affecting the size of the election cycle in public spending (Gonzales, 2000b, p.23-24): as the cost of enforcing the political turnover diminishes, competent governments are enticed to increase the magnitude of the visible component of the government spending before the election to improve their re -election chances, and as the higher level of democracy increases the degree of transparency (i.e. the voters' chances to learn the true value of the office -holder's competence), the political cycle is attenuated. Regarding the Mexican political system, Gonzales affirm that the democratisation process has magnified the risk for the government to lose power, but has not increased the country's transparency rapidly enough to reduce the incumbent's temptation to engage in opportunistic policy -making (Gonzales, 2000b, p.4-5).

According to Gonzales (2000b), the economic literature also documents a strong pre-election use of public investment, specially in developing countries: Khemani (2000) showed that state elections in India were preceded by a government spending spree in road construction; Kraemer (1997) and Schuknecht (1996) had also reported evidence on election cycles in developing countries that relied on the production of public capital. "The heavy dependence on this component of the government expenditures contrasts sharply with the evidence for OECD economies, where personal transfers and taxes have usually been the policy instruments playing a major role around elections" (Gonzales 2000b, p.24).

The differences between developed and developing countries in the size and composition of the electoral policy cycle was systematically analysed in the recent paper of Shi and Svensson (2001).

Shi and Svensson (2001) used a large panel data set, covering 123 developed and developing countries[5] over a 21 - year period, to examine the relationship between

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[5] The analysed countries in Shi and Svensson (2001) paper are the following: Albania, Algeria, Angola, Argentina, Australia, Austria, Bahamas, Bangladesh, Barbados, Belgium, Belize, Benin, Bolivia, Botswana, Brazil, Burkina Faso, Burundi, Cameroon, Canada, Cape Verde, Central African Rep., Chad, Chile, Colombia, Comoros, Congo Dem. Rep., Congo Rep., Costa Rica, Cote d'Ivoire, Cyprus, Denmark, Djibouti, Dominican Rep, Ecuador, Egypt Arab Rep., El Salvador, Equatorial Guinea, Fiji, Finland, France, Gabon, Gambia, Germany, Ghana, Greece, Grenada, Guatemala, Guinea, Guinea -Bissau, Guyana, Honduras, Hungary, Iceland, India, Indonesia, Iran Islamic Rep., Ireland, Israel, Italy, Jamaica, Japan, Kazakhstan, Kenya, Korea Rep., Liberia, Lithuania, Luxembourg, Madagascar, Malawi, Malaysia, Maldives, Mali, Malta, Mauritania, Mauritius, Mexico, Mozambique, Nepal, Netherla nds, New Zealand, Nicaragua, Niger, Nigeria, Norway, Pakistan, Panama, Papua New Guinea, Paraguay, Peru, Philippines, Portugal, **Romania**, Rwanda, Samoa, Senegal, Sierra Leone, Singapore, Slovak Republic, Slovenia, Solomon Islands, Spain, Sri Lanka, St. Lucia, Sudan, Suriname, Sweden, Switzerland, Syrian Arab Rep, Tanzania, Thailand, Togo, Trinidadand Tobago, Tunisia, Turkey, Turkmenistan, Ukraine, United Kingdom, United States, Uruguay, Vanuatu, Venezuela, Zambia, Zimbabwe.

elections and fiscal policy. In their sample, there are 29 developed countries (or, more precisely, high income countries, defined by IFS to have per capita GNP above the threshold USD 9.656 in 1997) and 94 countries classified as developing (i.e., middle- and low-income). Shi and Svensson found evidence of political budget cycles: before elections, whether revenues fall, the government increases spending so as to augment his chances of re-election, leading to a higher deficit in election years. They also show that there are large systematic differences between developed and developing countries in the size and composition of the electoral policy cycle. The election induced fiscal deficit as a share of GDP in an average developing country is more than twice the size of that of an average developed country: in election years the deficit as share of GDP increases by 1.3 percentage points in the average developing country and roughly 0.6 percent in the average developed country (Shi and Svensson, 2001, p.23, and table 4). The difference between developing and developed countries is even larger when using an election variable so that on imposed the restriction that the expansion prior to the election and contraction after the election are of the same magnitude. In this case, the pooled regression indicates that the average developing country experiences a 1.4 percentage points of GDP larger swing in the political budget cycle (Shi and Svensson, 2001, p.24, and table 4).

Shi and Svensson demonstrated that the magnitude of the electoral policy cycle and the difference in policy cycles between developed and developing countries depend on the politicians' rents of remaining in power and the share of informed voters in the electorate: "The higher the rents of remaining in power and the lower the share of informed voters, the stronger the incentives to manipulate fiscal policy prior to elections" (p.31). By running an econometric model, Shi and Svensson estimated that both these institutional features differ significantly between the sample of developed and developing countries: the difference is more than one standard deviation (of the pooled sample) for the mean of the share of informed voters and about two standard deviations for the mean of the rents indicator. Shi and Svensson confirmed by the econometric tests that these differences can explain the systematic differences between developed and developing countries in the size and composition of political budget cycles (Shi and Svensson, 2001, p.25).

In a recent paper, Khemani (2000) (2000, p.32-33) finds evidence for political cycles in public policy in the Indian states: election years have a negative effect on some commodity taxes, a positive effect on investment spending, but no effect on deficits primarily because consumption spending is reduced (Khemani 2000, p.32-33). Also, the elections have a positive and large effect on road construction by state public works departments (the fiscal effects are much smaller compared to the electoral effect on roads).

The paper of Treisman and Gimpelson (1999) focused on recent elections in Russia and examined what policies would be recommended to incumbents by a rational, re-election - motivated, behind-the-scenes political strategist who believes the public to vote retrospectively. They found that certain instruments and means of finance were used more in some elections than others. In this idea, the authors analysed the possibility that rational incumbents will choose a different portfolio of manipulations in different elections, rather than utilised one indicator at a given time. In their opinion, incumbents in any given election have a lot of lines of attack to affect voters' economic position – minimum wage or pension legislation, monetary policy, different types of transfers, public spending, or tax cuts. For example, Treisman and Gimpelson discovered that in

Russia, the government's ways to affect the voters' behaviour are: influence over money supply growth, rates of public spending on social ser vices and job creation schemes, tax rates, the minimum wage, state -provided pension and other benefits. Those measures can be financed by additional taxes or other revenues, additional public borrowing, or additional money creation and each of which, in tu rn, has effects on the economic variables thought to influence voters. Concretely, in the periods before national votes in Russia, incumbents have variously increased real minimum wages or pensions and increased spending on popular programs such as health, education, social policy, and transfers to particular regions (Treisman and Gimpelson, 1999, p.29). Authors' analysis of regional election results does suggest that in regions where public spending was higher or increased relatively more and wage arrears were relatively lower, pro-reform incumbents performed better in all of these four votes.

The conclusions of these analyses are that there are differences between the developed and developing countries in the size and composition of the electoral policy cycle. These differences are explicated on the one hand by the level of institutional development, measured, for example, by the *index of democracy* (what is, according Gonzales, 2000a a cost that the voters must bear when enforcing the political turnover after each election) and the *index of transparency* (representing the likelihood with which the voters learn the politician's competence). On the other hand, a researcher looking for business cycles in any one economic indicator would have to conclude that th e evidence is patchy: incumbents manipulate the economy, and through that the voters' behaviour, but in any given election have a lot of instruments. By this reason, the econometric models are not always the best tools to analyse the political business cyc les in developing countries.

4. The Political Business Cycles in the East European Transition Countries

The empirical literature of political cycles in developing countries has been scarce and, as a result, few studies focus specifically on the East Europ ean Candidate Countries (Fidrmuc, 1996). As historical evidence, I mention the paper of Lafay (1981), which analysed the relationship between economics and politics under communist regime in Bulgaria, Czechoslovakia, East Germany, Hungary, Poland, and Roma nia during 1960's and 1970's year. Most recently, a single country analyses are in Munich and Sorm (1995) for Czech and Slovak elections in 1992, Jackson *et al*. (1996) and Bell (1997) for Polish 1993 election, Pacek (1994) for Bulgaria in 1991, Poland in 1 991, and Czechoslovakia in 1992. Earle *et al*. (1997) and Mateju and Rehakova (1996) analysed as well opinion -poll data from the Czech Republic.

Fidrmuc (1996, 2000) tried to explain the recent political developments in the transition countries of Central and East European Transition Countries by linking them to the economic processes. The basic idea is that the voters' decisions are affected by the state of the economy at the moment of the election, and/or their expectations of future economic developments (the vote-popularity function). The process of economic reform has played a fundamental role in determining the current state of the economy. Therefore, he seeks to identify the relationship between voters' support for economic reforms, and election outcomes. Because only three or four elections have taken place since the fall of communism, Fidrmuc (1996, 1998) used regional data, where both election results as well as explanatory variables are observed at the level of individual counties.

To study the dynamics of political support for the reforms in Central and East European Countries, Fidrmuc (1996) had building two-sector (state and private) model of a transition economy. The main idea of Fidrmuc is that the workers in the private sector always support rapid reforms, while the workers in the state sector and the unemployed will support rapid reforms only at the beginning of the transition. Later, state-sector workers and unemployed will vote for a reduction in the speed of reforms. The reason of this assertion is the finding that, at the beginning, economic reforms in the countries of Central and Eastern Europe enjoyed remarkable support from virtually every part of the society. But, the economic collapse that followed had leading to a quickly decline of the public support for the reforms, and the reformers have been replaced by leftist parties (even post-communists) in the second elections throughout the region. This is because the voters only look backwards, not forwards, when making their choice at the polls (Fidrmuc, 1996, p.2). However, in Fidrmuc's opinion even if the voters vote against the reformers, they do not want to reverse the reforms altogether - only a change in the strategy.

Undoubtedly, the Fidrmuc's approach concerning the causes and the effects of voters' opinions changing has been affected by a frequent narrow-mindedness (especially in the early '90), in keeping with all the right-wing parties are reformers and all the left-wing parties are anti-reformers. In fact, the moving towards left in voters' decisions in the middle '90 may be explains by the fact that the voters penalize the government for poor economic performance by voting for the opposition[6]. And, in majority of Central and Eastern Europe countries, at the beginning of the transition, the left-wing parties had setting up the governments. Consequently, the left-wing parties have been considered as a political alternative. In Romania, the transition was beginning with a left-wing party, and at the 1996 election it has been changed with a political alternative: the right-wing coalition. Fidrmuc admits himself that "although the reformists were voted out of power in Poland, Hungary and Slovakia, the very continuation of the reforms has not been threatened in any of these countries" (p.16).

To demonstrate his theory, Fidrmuc (1996) studied the impact of unemployment upon voters' preferences. The relationship between unemployment and *support for the reforms* is tested empirically using regional data from the Czech Republic, Hungary, Poland and Slovakia. The econometric estimations show negative relationship between the election results of the right-wing parties (pro-reform parties, in Fidrmuc' terms) and unemployment, and positive relationship between the election results of the left-wing parties and unemployment. The results for the nationalist parties are in general weaker and mixed (Fidrmuc, 1996, p.16). In another paper, Fidrmuc (2000) identified more detailed economic groups that support the reform (offer their vote in favour of right-wing parties) respectively, oppose the reform (caste a vote for left-wing parties). While the followers of right parties are private entrepreneurs, white-collar workers and university-educated voters, the left-wing parties cast their votes from the unemployed, retirees, blue collar and agricultural workers.

If indeed the left-wing parties are against reform, then the results found by Fidrmuc show that the continuation of the economic reforms can be put at question if unemployment gets too high. If this hypothesis is not correct, then the results show

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[6] According to Nannestad and Paldam (1994), this is the so-called *responsibility hypothesis*: the voters hold the current government responsible for the state of the economy.

merely that there is a partisan behaviour of the electorate: the poor vote to the left-wing parties, and the prosperous vote to the right-wing parties.

Duch (1999) presented a very interesting analysis of the heterogeneity of economic voting in new post-communist democracies. In Duch's opinion, given the extreme economic turbulence in a transition economy, it would be reasonable to expect that certain socio-economic groups would be more sensitive (and more vulnerable) to economic fluctuations than others. Economic voting in Duch's model will be higher amongst those citizens who are more likely to be affected by the fall-out from structural reforms. In addition, in the post-communist countries, economic performance was highly politicised because of the political controversy concerning the introduction of liberal market reforms. These ideological cleavages represent a basis for heterogeneous economic voting, so that Duch expects those opposed to government market reform initiatives to be more sensitive to fluctuations than those who embrace the government's initiatives. The author reminds that the institutional features mediate economic voting: institutional contexts can either increase or reduce the ability of voters to attribute responsibility for economic performance. For example, "an incumbent government composed of a single party would offer voters a clearer notion of who is responsible for economic outcomes than would be the case for a government coalition composed of numerous parties" (Duch, 1999, p.9-10).

In Duch's model there are two other factors that are likely to generate heterogeneity in economic voting. The first assumption is that there is a positive correlation between levels of information and economic voting. Second, "citizens who are more satisfied with the functioning of nascent democratic institutions are more likely to punish incumbents for economic performance" (Duch, 1999, p.12). In other words, the better-informed electors and those satisfied with democratic institutions are more likely to engage in economic voting.

Duch predicts a relatively weak correlation between national economic performance and incumbents' electoral popularity in the post-communist democracies of East and Central Europe. Also, the author found relatively high levels of dissatisfaction with democracy and lower levels of knowledge about democratic institutions to undermine the relationship between economic performance and incumbents' electoral fortunes (p.20). The economic voting model suggests there is a negative correlation between inflation (CPI) and incumbent vote share loss (measured as the change in vote percentage between the current and previous general election), even if the correlation is not very strong. Duch didn't find a statistically significant correlation between incumbent support as the dependent variable and real GDP. Hence, the author's conclusion is that at the aggregate level there is evidence of relatively low levels of economic voting in new post-communist democracies. Duch extended this analysis by studying the Central and Eastern European Barometer surveys. It has estimated models of intended vote for government coalition parties in nine Central and Eastern European countries [7] for the years 1992, 1994, 1995 and 1996. He agues that the opinions of the politically informed and those who are satisfied with the performance of democratic institutions will accurately reflect political and economic reality. As a result, the conclusions of Duch's analysis are the following: (1) there are systematic differences in how voters respond to the economy and to their personal financial situation and these can have important

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[7] The Central and Eastern European countries analysed in Duch (1999) paper are the following: Albania, Bulgaria, Czech Republic, Hungary, Lithuania, Poland, Romania, Slovakia, Slovenia

aggregate-level political implications and (2) at least in the case of new democracies, economic voting is clearly contingent upon levels of political information and satisfaction with the performance of democratic institutions.

In a seminal book, Williamson (1994) were examined several hypotheses concerning the determinants of successful economic reform. In the opinion of the Williamson team's experts, the three more robust conditions for successful reforms are a *strong political support for the reformer*, a *visionary leadership* and a *coherent economic team* (Williamson, 1994, p.589). That means, even if public support is not a sufficient condition for success, this is helpful in raising the chances that the reforms will be feasible and successful. Starting with this idea, in a recent paper, Hayo (2000) analysed the public support for the creation of a market economy in Eastern Europe. The development of support for market reforms is analysed over time and countries. As a data base, the Central and Eastern Euro barometers surveys are employed, covering up to 21 countries over a time period of 1990-96 and totalling more than 100000 observations on individuals. Moreover, in a number of panel regressions, individual characteristics and macroeconomic determinants of support for reforms are studied.

Hayo demonstrated that the support for the creation of a market economy depends on personal circumstances (age, gender, education, relative income position) and on the success of governments in keeping inflation rates down. Small government budget deficits may also help to strengthen support. Differences in employment, GDP per capita, openness, private sector share and microeconomic transition progress do not show robust effects on people's attitudes towards the creation of a market economy. Even though it is difficult to make policy recommendations based on the individual characteristics of people, however, regarding the macroeconomic variables, Hayo (2000, p.21-22) drew the following policy conclusions: (1) the International Monetary Fund (IMF) focus on keeping inflation down seems to be consistent with the objective of keeping support for market reforms high, despite the fact that the absolute effect of inflation is quite small; (2) unemployment may have some explanatory power at an individual level but it does not help to explain support for market reforms on an aggregate level; (3) the effects of fiscal policy are not entirely clear (although, higher budget deficits seem to reduce support for reforms) and (4) the actual progress in market reforms does not affect opinion much. The Hayo's fourth policy conclusion is, perhaps, influenced by the fact that there is heterogeneity of public's opinions. According to Duch (1999), in a transition economy, it would be reasonable to expect that certain socio-economic groups would be more sensitive (and more vulnerable) to economic fluctuations than others (see above). Hayo found himself some evidence that for high-income respondents progress in price liberalisation and competition regulation as well as a larger share of the private sector improve support for reforms.

Therefore, the core conclusion of Hayo's analysis is that o*nly a package of policies will be highly effective in helping to maintain support for the creation of a market economy. However, a feasible starting point for governments would be to keep inflation rates down and to avoid excessive budget deficits* (Hayo, 2000, p.22).

Hallenberg and Souza (2000) tests empirically whether there have been political business cycles during the time period 1990 to 1999 for the 10 Eastern European accession countries (Bulgaria, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia.). For this purpose, Hallenberg and Souza analysis the role of exchange rates, capital mobility, and central bank independence in restricting or encouraging political business cycles. According to Mundell-Fleming

model, under conditions of capital mobility, it found that both the type of exchange rate regime and the degree of central bank independence affect the instruments used by governments to influence the economy before elections. Namely, countries with dependent central banks and flexible exchange rates have looser monetary policies in election years than in non-election years. In countries with independent central banks, there is a monetary *contraction* in election years[8]. If a country has a fixed exchange rate regime, the government manipulates the economy in election years through running larger budgets instead of through looser monetary policy. Synthetically, the anticipations concerning the effects of exchange rate regime and central bank independence on opportunistic political business cycles, under conditions of capital mobility are presented in Table 4.

In authors' opinion, the results found for the ten Eastern European Accession Countries are remarkably consistent with those presented by Clark and Hallerberg (2000) for a data set of OECD countries. *Monetary political business cycles exist only when the exchange rate is flexible and when the central bank is dependent upon the government*. (Hallenberg and Souza, 2000, p.15). When the central bank is dependent upon the government, there is a strong increase in the money supply in pre-electoral periods. When the central bank is independent, there is a tightening of the money supply (though smaller than the expansion under the alternative regime).

Table 4: Predictions about the effects of exchange rate regime and central bank independence on Opportunistic Political Business Cycles*[)].

	No Central Bank Independence	Central Bank Independence
Capital Mobility and Fixed Exchange Rates	Fiscal Cycles, No Monetary Cycles	Fiscal Cycles, No Monetary Cycles
Capital Mobility and Flexible Exchange Rates	Monetary Cycles, No Fiscal Cycles	No Fiscal or Monetary Cycles

*[)] This Table appears as Table 1 in Hallenberg and Souza (2000, p.5).

Hallenberg and Souza (2000) tested, also, the hypothesis that, when exchange rates are fixed, governments engage in fiscal expansions shortly before elections (fiscal political business cycles). They found evidence that such fiscal expansions are present in Eastern European Accession Countries. The econometric estimation indicates that budget deficit worsens 1.5% in pre-electoral periods in countries with fixed exchange rates. In countries with flexible exchange rates, there is a smaller move downward, but in this case the variable is not significant (Hallenberg and Souza, 2000, p.17).

According to these results, *the authors offered a remarkable analysis concerning the implications for the accession to the European Union*: the study confirms that the Accession Countries' governments act very much like their OECD counterparts. If the country has a flexible exchange rate and the monetary authorities are not independent, then the government may create a political cycles through monetary expansion. But, the accession process assumes that the future member states implement indeed independent central banks. Independent monetary authorities can eliminate such cycles in countries

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[8] In the opinion of Hallenberg and Souza (2000, p.3), "this suggests that newly created independent central banks may use electoral years to send signals to markets that they are truly in dependent".

with flexible exchange rates. Moreover, once the Eastern European states will become members, monetary policy will be set by the European Central Bank (ECB) and exchange rates become fixed. For that reason, political business cycles can be created only by the use of fiscal policy. But, the evidence show that scale of this cycle recorded in Accession Countries in 1990-1999 period has been no worse than in the European Union members states before the Treaty of Maastricht. And the Hallenberg and Souza (2000) conclusion is optimistic:

> "Given that the original members of the euro are a were able to proceed and to meet the Maastricht Criteria despite the presence of such cycles, *there is no reason to believe that the cycles as they now exist in the Accession Countries should lead to any delays in EMU membershi*p" (Hallenberg and Souza, 2000, p.18).

Because, in their opinion, the Stability and Growth Pact (SGP) as it is now constructed does not seem to be a credible constraint to prevent governments from overspending in election years, Hallenberg and Souza (2000) suggested a alternative solution so that such politically motivated fiscal cycles should be diminish or eliminate. This alternative might be for governments to put in place domestic institutions, such as a *strong finance minister* or *negotiated fiscal contracts*.

5. The Political Business Cycles in Romania

The Romanian former Prime Minister Stolojan, in a recent paper (Stolojan, 2000) has argued that while severe crises promote reform, Romanian policymakers missed the linkage between crisis and reform. Romania met two important wind ows of opportunity for a bold and consistent reform, and missed both: December 1989, and November 1996. According to Stolojan' opinion, in a democracy, political parties compete for citizens' votes through the electoral programs based on different politica l ideologies: liberal, social democratic and so forth. However, in transition from the centralised planned economy to a market economy, despite ideological backgrounds, political parties were supposed to arrive at a more consistent and comprehensive view o f the objectives and strategies of economic transition for at least two reasons. First, there are certain objectives (milestones) of transition that cannot be ignored by any political party that has to lead a transition from a centrally planned economy to a market economy. Second, transition has proved to be a long-term process running beyond electoral cycles. Therefore, different governments supported by different political parties or coalitions had to pursue the same objectives for periods of time longer than an electoral cycle. In Romania, as everybody may notice, the transition objectives lack consistency and comprehensiveness between governments. Most governments claimed that the only real economic reform is the one that started with its own administration. To make this concept effective, each government wasted time and resources to change laws and regulations. This induced uncertainty within the business environment that, together with the weak capability of governments for policy-making and implementation, finally transformed Romania into a country of perpetual problems and promises.

From Romania, the democratic experience computes a small number of electoral moments. Therefore, it is not possible yet to build an electoral behaviour econometric model using the political time series. In these circumstances, in the following section, by the examination of the political and economic dynamics during the 1990 -2000 period, I

try only to identify some significant signals concerning the economic impact of the electoral timing. In the next one, I utilise an econometric model to analysis the political behaviour using a regional economic and political data.

5.1. Macro-economic Signals of the Political Behaviour in Romania

To analysis the macro-economic impact of the incumbents' electoral behaviour I have studied the dynamics of the economic structures during the 1990-2000 period. The mainstay hypothesis was that reform process can be signalling by major changes in macroeconomic structures, and inversely, the relative stability of these structures can be a signal of slowing down the reform.

In the Figure no. 1 it is showing the year on year dynamics of the Gross Domestic Product structures. The structures for the years 1985 to 2000 are calculated as a weight of Gross Value Added into the Gross Domestic Product by main activities. The changes index are calculated like the angles between structural vectors and there are normalised so that the change between in1990 is equal 100.
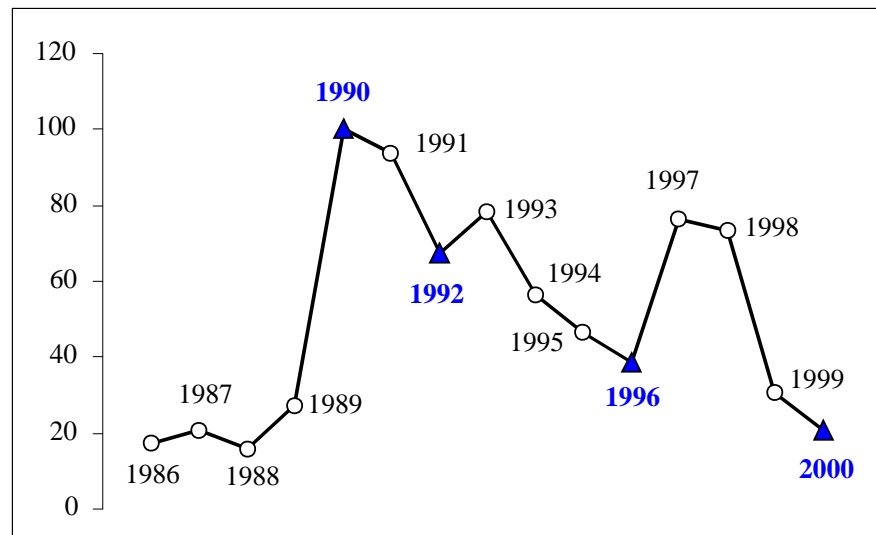

Figure 1: The intensity of structural changes in Romanian economy (changes in weight of Gross Value Added into the Gross Domestic Product by main activities)

Keeping out the structural change from the electoral year 1990 (considered to be the result of one major *election* of Romanian people expressed through the December 1989 Revolution), during the period 1991-2000, the amplitude of the macro structural changes registered the local minimum points in electoral years (1992, 1996 and 2000) and local maximum points in the post-electoral years (1993 and 1997).

In these conditions, I consider that the shape of the structural changes curve pointed up in Figure 1 suggests the following conclusions:

– During the 1985-1989 periods the Romanian economic macro structures were relatively blocked, as a result of socialist model using, through which the economic and political shocks were central controlled by planning centralized administrative measures.

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- The size of the macro structural changes revealed local minimum points for el ection years (1992, 1996, 2000). This could be explained by the fact that the reform process supposes adoption of measures having usually, unpopular effects. And such effects are, without doubt, undesirable for the incumbents, mainly in the election years.

- The maximum intensity of structural changes was recorded in post – electoral years: all political programs proposed the speeding of economic reforms and, consequently, every new government tried to promote measures to speed up some economic changes process.

- The apparent atypical situation of the electoral year 1990 could be explained by the fact that, essentially, the economic evolutions in that year were also the effect of a political option, of a fundamental option of the Romanian people, expressed i n the December 1989 Revolution. The high intensity of the structural changes from 1991 - the post-electoral year- confirms such a hypothesis.

Consequently, I consider that in the evolution of the national economy during the 1990 - 2000 period certain signals of the incumbents' electoral behaviour, can be identified even if with out a support from econometric tools, due to the fact that reliable data series are not available.

5.2. Political – Economic Regional Model for Romania

The democratic experience of Romania, as I showed above, recorded a small number of electoral events. Consequently, is impossible to build an econometric model able to analyse the effects of population and incumbents' electoral behaviour based on the dynamics of macroeconomic series. For this reason different hypotheses regarding the relationship between economic and political system were tested using the data recorded at regional level, for the electoral years 1992, 1996 and 2000 [9].

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[9] In this section I use the following symbols for the Romanian political parties, political formations or their coalitions:

APR	– Alliance for Romania
CDR	– Democratic Convention from Romania
FDSN	– National Salvation Democratic Front
FSN	– National Salvation Front
PD	– Democratic Party
PDAR	– Agrarian Democratic Party of Romania
PDSR	– Social Democracy Party of Romania
PNL	– National Liberal Party
PNTCD	– National Peasant Christian Democratic Party
PRM	– Great Romania Party
PSDR	– Social Democratic Party of Romania
PSM	– Labour Socialist Party
PUNR	– Romanian National Unity Party
UDMR	– Hungarian Democratic Union of Romania
USD	– Democratic Social Union

First of all I was tested the so-called *responsive hypothesis* according to which the *electorate considers that the government is responsible for the state of the economy* and consequently, when the unemployment (and the inflation) record high values, the electoral chances of the governmental party (coaliti on) diminishes, and vice versa: a relatively well economic status leads to the increase of electoral chances of the party in office. From statistical point of view, the hypothesis mentioned above assumes that:

1. There is a negative correlation between the unemployment rate and the votes given to the ruling party

and

2. There is a positive correlation between the unemployment rate and the votes given to those parties (coalition) from opposition, which are considered to be an alternative at government in the electoral year.

However, the distribution of regional votes for the incumbents (parties or coalitions) in the electoral years 1992,1996, 2000 (Fig. 2, 3, …7) don't confirm hypothesis of a significant negative correlation between the unemployment rate and the electoral support. Analogously, a significant positive correlation between regional unemployment rate and electoral support of the parties situated in opposition (the challenger) cannot be observed (see Table 5). The only correct signs (in accordance with the above hypothesis) from the coefficients of correlation were recorded in 2000; as we'll show further, the values taken by the coefficient of correlation can be explained by taking into consideration of a *partisan political business cycle model*.

If the above-mentioned hypothesis could be correct, then the points in Figures 2, 3, and 4, that illustrate the votes for the political parties, political formations or their coalitions witch form the Government depending on the unemployment rate, in 1992, 1996 and 2000 must show a downward trend. Inversely, the points in Figures 5, 6, and 7, that illustrate the votes for the political parties, political formations or their coalitions situated in opposition depending on the unemployment rate, in 1992, 1996 a nd 2000 must show an upward trend. But these figures don't show trends according to the responsive hypothesis.

Table 5: The coefficients of correlation between the regional unemployment rates and the votes (%) carried for the Romanian political parties, po litical formations or their coalitions

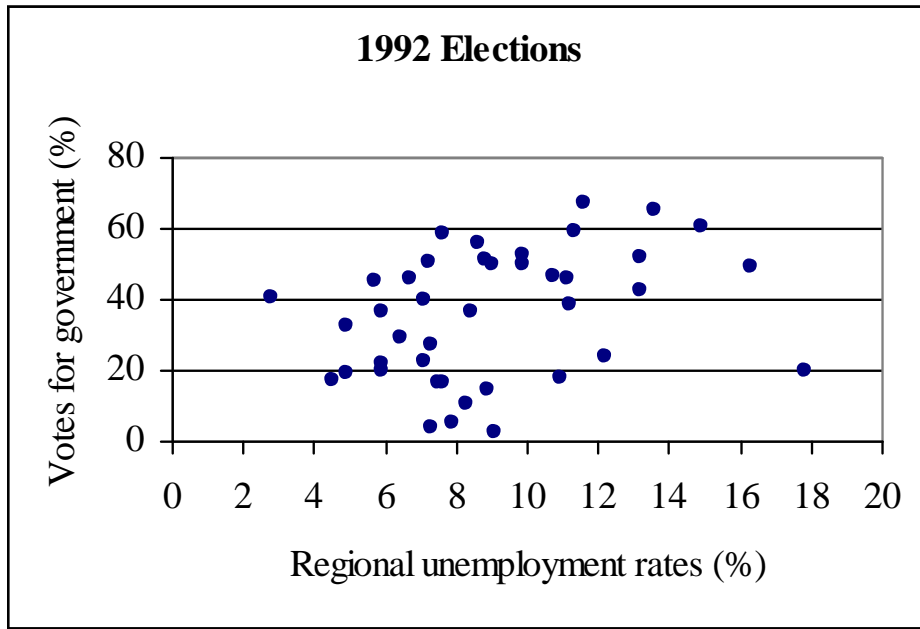| Electoral years	Political parties, political formations or their coalitions witch form the Government	Political parties, political formations or their coalitions situated in opposition
1992	0.31 (FDSN+FSN)	-0.26 (CDR)
1996	0.33 (PDSR)	-0.17 (CDR+USD)
2000	-0.32 (PNL+PD+UDMR)	0.34 (PDSR+PRM)

Figure 2: 1992 – votes (%) for ruling political parties, political formations or their coalitions, depending on the regional unemployment rates
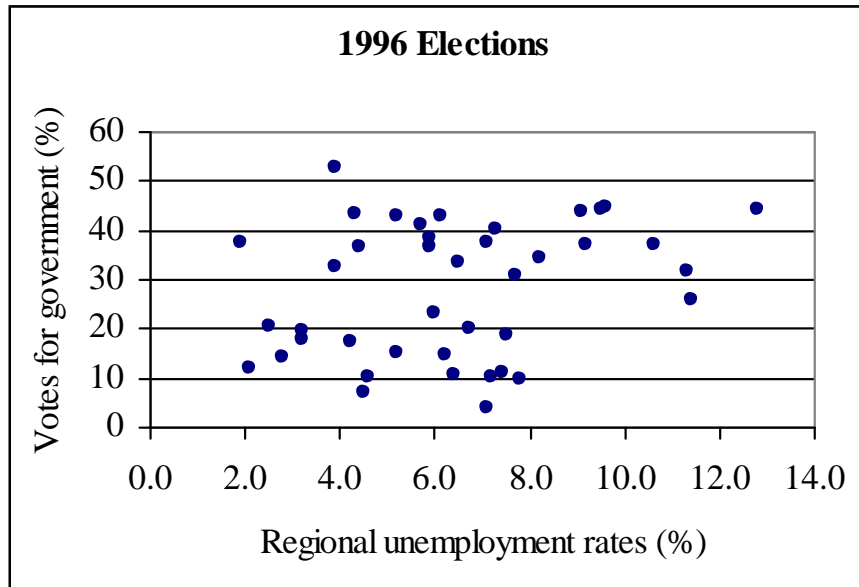

Figure 3: 1996 – votes (%) for ruling political parties, political formations or their coalitions, depending on the regional unemployment rates
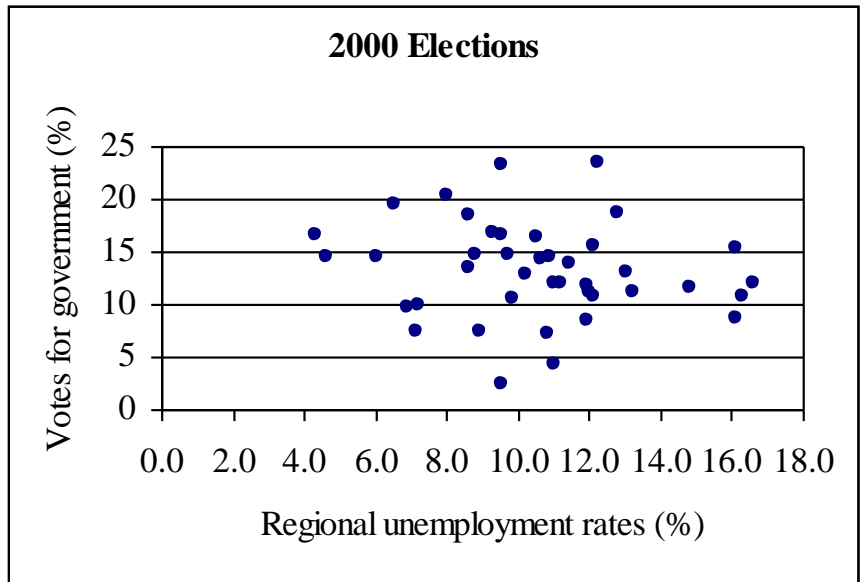
Figure 4: 2000 – votes (%) for ruling political parties, political formations or their coalitions, depending on the regional unemployme nt rates
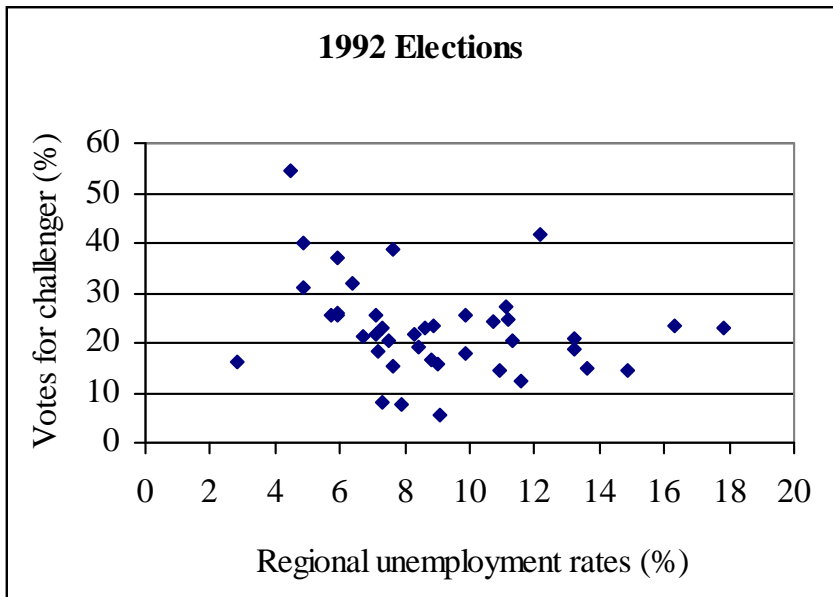

Figure 5: 1992 – votes (%) for political parties, political formations or their coalitions situated in opposition depending on the regional unemployment rates

1996 Elections

Figure 6: 1996 – votes (%) for political parties, political formations or their coa litions situated in opposition depending on the regional unemployment rates
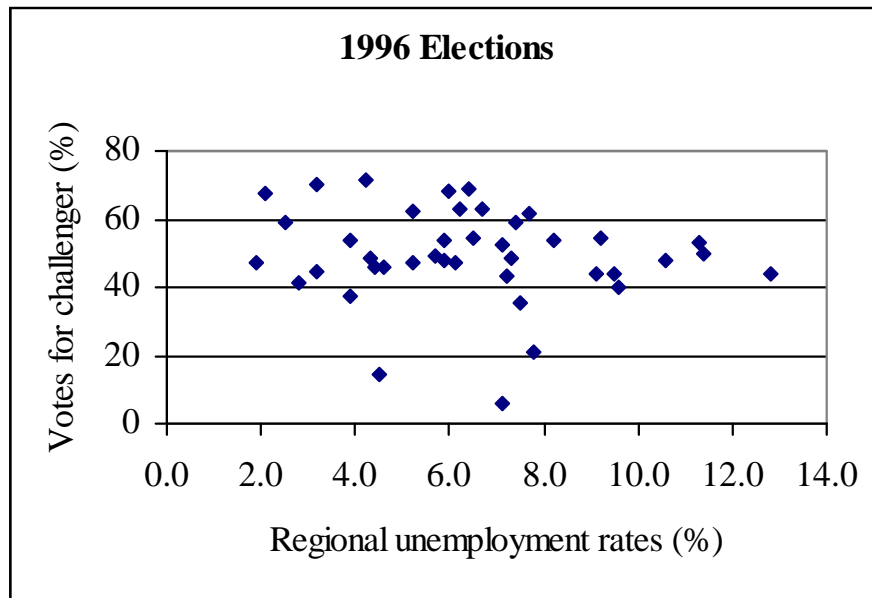
2000 Elections
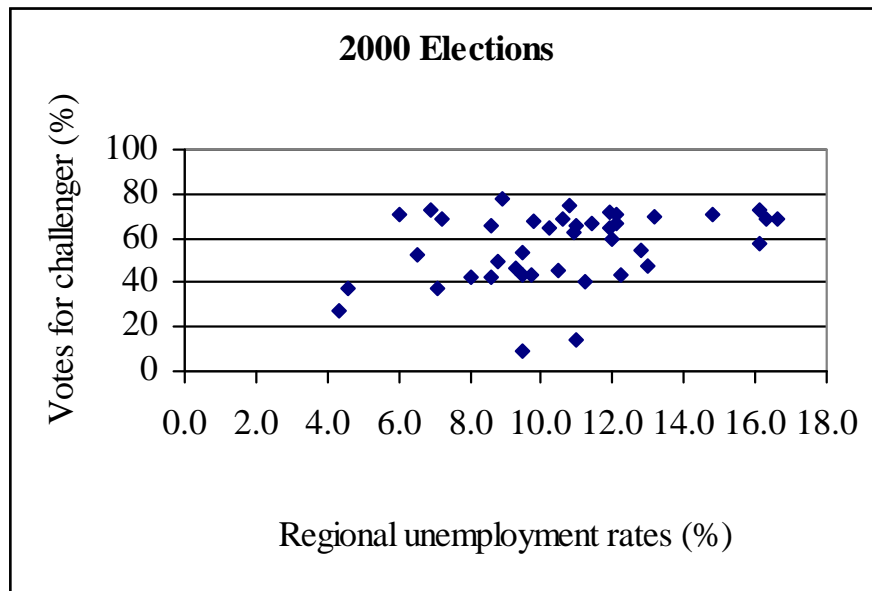
Figure 7: 2000 – votes (%) for political parties, political formations or their coalitions situated in opposition depending on the regional unemployment rates

Further on, I tested for Romanian case a recent hypothesis formulated by Rodrik (1995) and Fidrmuc (1996) for Central and Eastern European transition countries, hypothesis regarding the political support for the economic reform.

Rodrik (1995) formulated the hypothesis th at the unemployed electors cast their vote in favour of a party that realises a fast reform because they think that the rapid

economic reform has as results an outcome increase and an enhance of the economic private sector. The consequence of these evoluti ons consists in the increasing chances for the unemployed to find a job in private sector. According to Rodrik, in the Central and East European Countries only the right -wing parties are pro-reform political formation, while left-wing parties are anti – reform. As a result, the unemployed vote for the right -wing political parties. A version of this hypothesis is given in a paper written by Fidrmuc (1996). According to Fidrmuc, the type of behaviour described by Rodrik is specific for the unemployed only in the first part of the transition, when it is expected a fast and successful reform. As far as the reform processes are developing without major results regarding the employment and the economic status of disadvantaged social categories, the unemployed become supporters of those political parties, which promote a reduction of the reform speed and maintain a high proportion of the public sector. The same as in Rodrik's model, also in Fidrmuc's model, the left -wing parties represent anti-reform political forces and for this reason, after the first transition years the political support of the disadvantaged categories (like unemployed) is straighten towards the left -wing parties.

This caricatured political system model set up for the candidate countries, with strong partisan and ideological influences (supporting the idea that the right -wing parties are pro-reform while the left-wing parties are against, that means that the last ones are anti-European), was invalidated by the political evolutions from these cou ntries. All the candidate countries had both right and left political systems, without recording significant steps forward or backward of the reform process. There are significant differences between countries regarding the reform stage but there are not d ifferences within the same country under different political systems. In spite of these, I have tested the Rodrik model, the same as the Fidrmuc's version of Rodrik model. The tested hypotheses are:

1. There is a positive correlation between unemployment r ate and votes carried to the right-wing parties and a negative correlation between the unemployment rate and votes carried to the left -wing parties (Rodrik's hypothesis)

and

2. There is a positive correlation between the unemployment rate and votes carried to the rights-wing parties and a negative correlation between the unemployment and votes carried to the left -wing parties at the beginning of transition process, while in later reform phases the support of the disadvantaged categories is straightened towa rds the left (Fidrmuc's hypothesis)

The vote's distribution for the rights and left -wing parties (or coalitions) is shown in Table 6. In the Romanian case, because the fluent political environment, it is not easy to include a party in a political wing. In these circumstances, the parties are included in the right or left wing in keeping with theirs official positions.

The Rodrik's hypothesis cannot be empirically upheld, at least starting from electoral regional data. From Table 6 must be notice that alwa ys the correlation between votes from the left- wing parties and the unemployment rate is positive, while the correlation between the unemployment rate and the electoral support for right -wing parties is negative (contrary with Rodrik's hypothesis).

Table 6: The coefficients of correlation between the regional unemployment rates and the electoral behaviour

| Electoral years | The coefficients of correlation between the regional unemployment rates votes carried for: | |
	Left-wing parties	Right-wing parties
1992	0.24 (FDSN+FSN+PSM)	-0.26 (CDR)
1996	0.32 (PDSR+USD)	-0.26 (CDR)
2000	0.30 (PDSR+PD)	-0.23 (PNL)

The obtained results can't be a valuable argument for the Fidrmuc's version model too. The political support for the right wing is maintained relatively constant and it is negatively correlated with unemployment rate, while the political support for left increases, at least for median interval. The last result comes out from defining left -wing side. The correlation coefficient between rate employment and political support of Democratic Party (PD) is insignificant one as results from Table 7. The insertion of this party in the left political side (in 1992 trough FSN – National Salvation Front and in 1996 trough USD – Democratic Social Union) has an influenc e on global correlation coefficient. This aspect is just more evident in the case of PSM – Labour Socialist Party, which was included in the left political side in 1992; its political support was negatively correlated with unemployment rate.

Table 7: The coefficients of correlation between the regional unemployment rates and the votes for Romanian political parties

| Electoral years | The coefficients of correlation between the regional unemployment rates votes carried for: | | | | | | |
	PDSR[*]	PD[**]	PSM	CDR[***]	PUNR	PRM	UDMR
1992	0.33	0.07	-0.20	-0.26	-0.06	-0.14	-0.10
1996	0.33	0.08	–	-0.26	0.02	0.28	-0.13
2000	0.30	-0.03	–	-0.23	–	0.24	-0.26

[*]   For the 1992 elections – FDSN,
[**]   For the 1992 elections – FSN, for the 1996 elections – USD
[***]   For the 2000 elections – PNL

The relative steadfastness of the correlation coefficients recorded by the two important political parties PDSR – Social Democracy Party of Romania and CDR – Democratic Convention from Romania cannot be an argument in the favour of the Fidrmuc's hypothesis[10].

Further, I tested the hypothesis of the *partisan political behaviour*, in the sense defined in section 1. According to this approach, *left-wing parties are relatively more concerned on unemployment* and economic growth, and relatively less interested in

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[10] Even Fidrmuc gave up to this hypothesis and in his later studies he ad opted a partisan hypothesis (see, Fridmuc, 2000).

inflation, while right-wing parties are more concerned on inflation and less on economic growth and unemployment. *The electors' votes are straightened towards that party promoting a program which seen as being closer to their own expectations. As a consequence, the unemployed votes towards left wing parties.*

To assess the hypothesis regarding the partisan political support I was firstly tested two following simple econometric models :

$$PDSR_{it} = a_0 + a_1\ RSOM_{it} + a_2\ CH_{it} + e_t \tag{2}$$

$$CDR_{it} = b_0 + b_1\ RSOM_{it} + b_2\ CH_{it} + v_t \tag{3}$$

Expected results: $a_1 > 0$, $a_2 < 0$, $b_1 < 0$, $b_2 < 0$.

The symbols used in the models have the following meaning:

– $PDSR_{it}$ and CDR_{it} is the share of votes received by the respective parties in county i ($i = 1...41$) at the elections in the electoral year t (t = 1992, 1996, 2000),

– $RSOM_{it}$ represents the unemployment rate recorded in county i in the electoral year t;

– CH is a dummy variable, which takes the value 1 for the county Covasna and Harghita whichever is the electoral moment t and *zero* for all the other counties, because a large share from Covasna and Harghita counties electors are politically faithful, based on nationalist views ;

– a_0, a_1, a_2, b_0, b_1, b_2 these are the six parameters of the models (2) and (3), and

– e_{it} and v_{it} are the error terms – random variables that respect the conditions for using the Ordinary Least Squares Method (normally and independently distributed with zero mean and constant variance).

The estimation's results for 123 records (41 counties × 3 electoral events) are shown in Table 8, and in Figure 8 and 9.

Table 8: Partisan political business cycles estimation in regional data

	PDSR	CDR
Constant	20.399	40.088
	(3.31)	*(2.86)*
RSOM	1.670	-2.092
	(0.35)	*(0.31)*
CH	-28.383	-18.340
	(5.59)	*(4.84)*
Adjusted R-squared	0.28	0.32
F-statistic	24.74	29.67
Akaike info criterion	8.046	7.758
Schwarz criterion	8.114	7.827

(the standard deviations are given in brackets, with *italic* fonts).

The estimators are statistically significant, with a level of significance over 99%. The probability of rejection the models (Prob (F – statistic) is smaller than 0.0001%. The estimators of the models' coefficients have correct signs (the signs anticipated for the partisan business cycle theory):

$a_1 = 1.670$ is positive (according to the theory) and significantly different from zero with a probability over 99.99%

$b_1 = –2.092$ is negative (according to the theory) and significantly different from zero with a probability over 99,99%
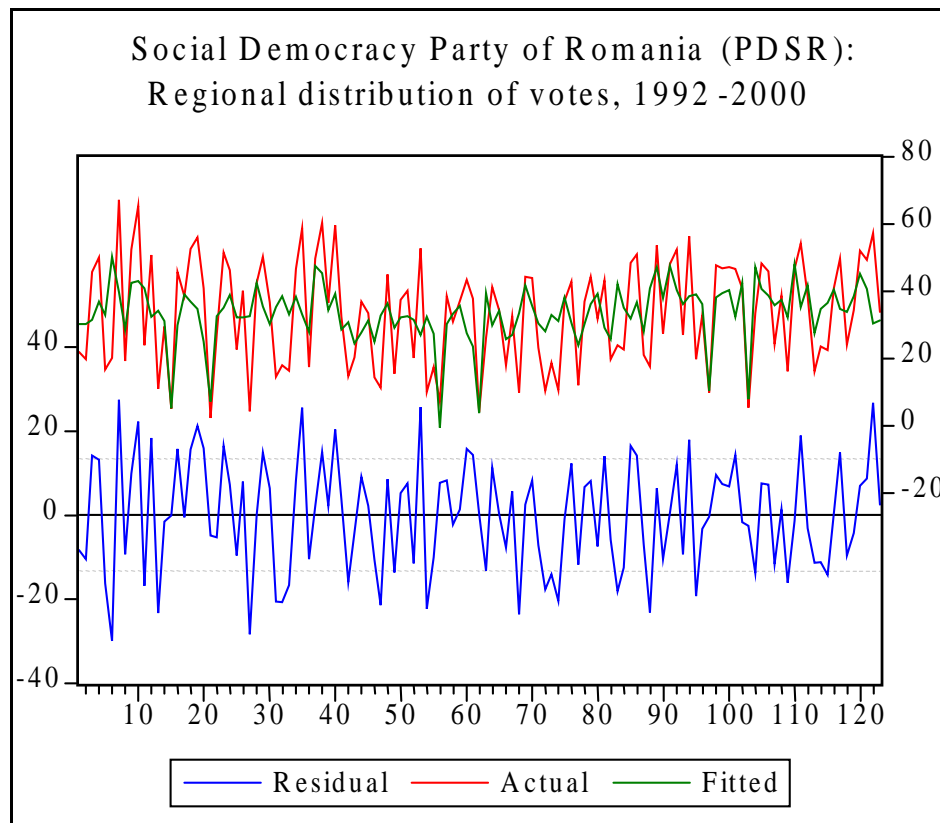

Figure 8: Political regional model estimation – Regional distribution of votes for PDSR – Social Democracy Party of Romania

Because a share from Covasna and Harghita counties electors are politically faithful, based on nationalist views, the estimators' signs for a_2 and b_2 coefficients are negatives (the proportion of the UDMR' *captive* voters affects negatively the formation up of the PDSR and CDR's electors).

The most important problem of these simple models is that they are able to explain only about 28% - 32% of vote behaviour setting up (R^2). For this reason I built up, in the same spirit of the partisan political business cycle theory, other econometric models, starting from the hypothesis that there are faithful electors for every party being on political market and struggle for that.

That means that, without any major political, social or economic events, the political behaviour and options of some electors remain unchanged, while economic factors explain only the forming behaviour of the electors without long – lasting options. More exactly, there is certain inertia in the dynamic of political options, so that electors' behaviour at the moment t is not absolutely independent from the options expressed in the previous elections. Starting from the fact that the formation of the elector s' options at the moment $t – 1$ is depending on the unemployment rate and these options have a some degree of inertia, the conclusion is that the options of non -captive electorate (those electors which don't prefer almost permanently one party or an other), are formed basing on the changes in the unemployment rates between the actual electoral period (t) and the previous one ($t – 1$).
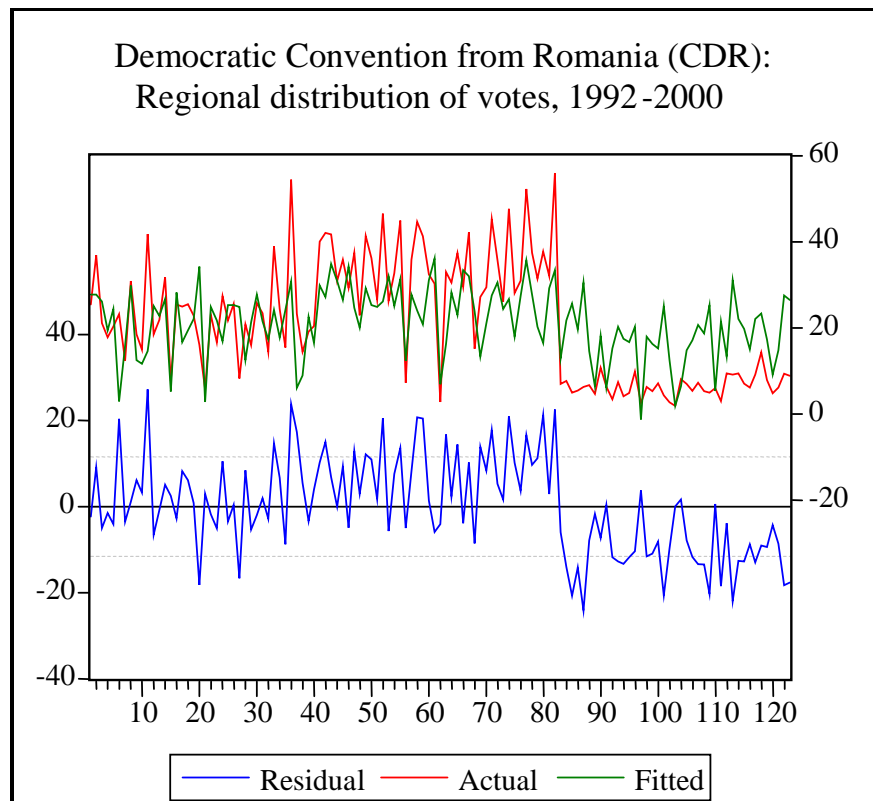

Figure 9: Political regional model estimation – Regional distribution of votes for CDR – Democratic Convention from Romania

The literature analysis also the phenomenon of the political image eroded during the government stay in office (Nannestad and Paldam, 1994, 1997 and 1999). This effect is referred to as the *cost of ruling*, implying the incumbent governments lose support as they alienate some supporters with decisions they make while in office. The longer they stay in office and the higher their vote shares in the preceding elections the more likely it is that such losses will occur.

I have tested, in these conditions, two econometric as following:

$$PDSR_{it} = a_1\, PDSR_{i,\,t-1} + a_2\, (RSOM_{it} – RSOM_{i,\,t-1}) + a_3\, D1996 + e_t \qquad (4)$$

$$CDR_{it} = b_1\,CDR_{i,\,t-1} + b_2\,(RSOM_{it} - RSOM_{i,\,t-1}) + b_3\,D2000 + v_t \qquad (5)$$

The expected results according to the theory are:

$a_1 > 0,\ b_1 > 0,$ Means that every party has a faithful electors;

$a_2 > 0,\ b_2 < 0,$ Means that the increase of the unemployment favours left-wing parties and disadvantage right-wing parties.

$a_3 < 0,\ b_3 < 0,$ Means that it exists a *cost of ruling*.

      The symbols used have the following significances:

– $PDSR_{it}$ and CDR_{it} represents the share of votes gained by the parties in county i ($i = 1...41$) at the elections from moment t ($t = 1992, 1996, 2000$),

– $PDSR_{i,\,t-1}$ and $CDR_{i,\,t-1}$ are the votes (%) gained by parties in the county i at the previous elections (t-1),

– $RSOM_{it}$ and $RSOM_{i,\,t-1}$ are the unemployment rates registered in county i, in the electoral moment t, and at the preceding elections (t-1),

–   D1996 the dummy variable that capture the *cost of ruling* for PDSR,

–   D2000 the dummy variable that capture the *cost of ruling* for CDR,

– a_1, a_3, a_3, b_1, b_2, b_3 are the coefficients of the models (4), respectively (5), and

– e_{it} and v_{it} are the error terms – random variables that respect the conditions for using the Ordinary Least Squares Method (normally and independently distributed with zero mean and constant variance).

      In the models (4) and (5) were not used variables dummy for counties Covasna and Harghita because autoregressive functioning of the models diminishes the effect induced by the stable fidelity of electors from those regions. It must be mentioned that the electors from Covasna and Harghita changes only the amount of the votes gained by PDSR and CDR but not also the dynamic of votes gained by these parties in mentione d counties. The results of the estimation (for 123 data = 41 counties × 3 electoral events) are shown in the Table 9 and in Figure 10 and 11.

Table 9: Partisan political business cycles autoregressive model estimation

	PDSR – Social Democracy Party of Romania	CDR – Democratic Convention from Romania
The share of regional voting in previous elections ($PDSR_{i,\,t-1}$, respectively $CDR_{i,\,t-1}$)	1.004 *(0.036)*	1.123 *(0.062)*
Changes in regional unemployment rates ($RSOM_{it} - RSOM_{i,\,t-1}$)	1.235 *(0.230)*	-1.240 *(0.359)*
Cost of ruling (D1996 for PDSR, respectively D2000 for CDR)	-4.612 *(2.012)*	-26.522 *(3.420)*
Adjusted R-squared	0.77	0.63

	PDSR – Social Democracy Party of Romania	CDR – Democratic Convention from Romania
F-statistic	137.59	71.31
Akaike info criterion	6.737	7.384
Schwarz criterion	6.825	7.472

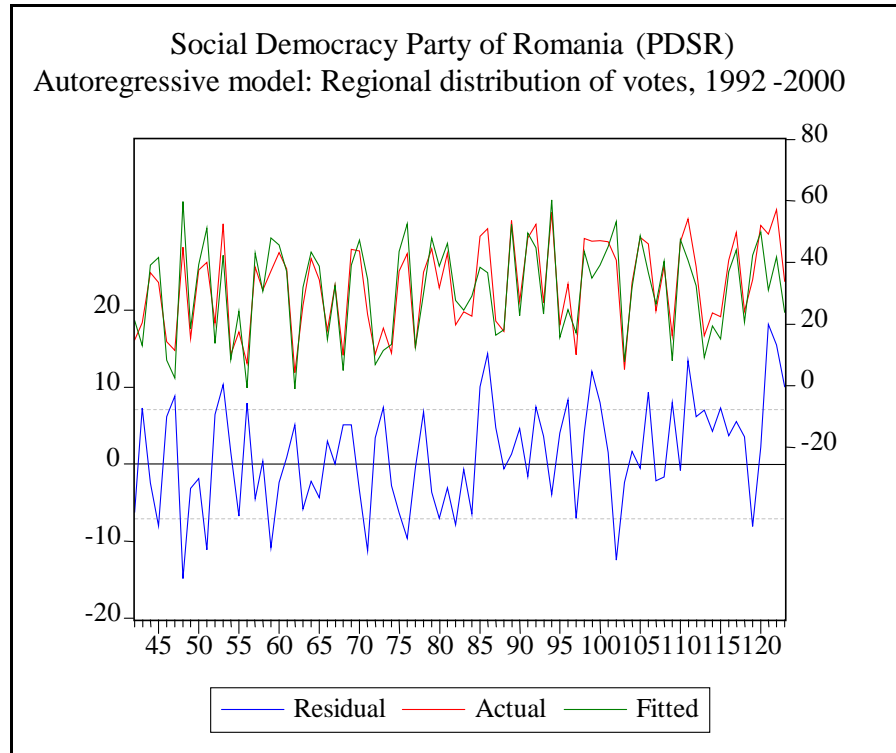(In brackets, with *italic* there are the standard deviations).

Figure 10: Political regional autoregressive model estimation – Regional distribution of votes for PDSR – Social Democracy Party of Romania

The estimators for regression equations parameters are significan t different from zero with a level of significance over 99%. The models' probability of rejecting (Prob (F - statistic) is smaller than 0.0001%. The estimators of the models' coefficients have correct signs (the signs anticipated for the partisan business c ycle theory) and the models (4) and (5) are better from econometric point of view than the models (2), respectively (3). The last conclusion derives both from comparison between the coefficients of determination R^2, and from the analysis of values calculat ed for Akaike and Schwartz criteria.

The obtained results lead to the following conclusions:

– The level and the dynamic of the unemployment rates at regional level have an influence on vote behaviour, and this effect is in accordance with the partisan political business cycle theory: in the areas with a higher unemployment rate a voting preference (tendency) towards the political left is manifest;

- Elasticity of the electoral behaviour in dependence of economic factors (unemployment rate) is rough equal (with different signs of course), in the case of the two parties. According to the Wald' test, the hypothesis of the equality (in absolute value) of the two parameters $|a_2| = |b_2|$, are accepted with a probability over 99%. This means that in the Romanian political environment the two parties have been perceived by the population as being typical for the left (PDSR) and respectively for the political right (CDR).

- Every one from the two parties has faithful electors (a_1 and b_1 are positive and are significantly different from zero). The CDR' electors fidelity is a little bit superior comparable to the PDSR' electors fidelity ($b_1 > a_1$); but in spite of the fact that the Romanian's political right wing has more faithful electors, this captive electorate has a small size (relative to the whole Romanian electorate).

- The *cost of ruling*, implying the incumbent governments lose support while there are in office, was much more strong in the CDR than in the PDSR' s case
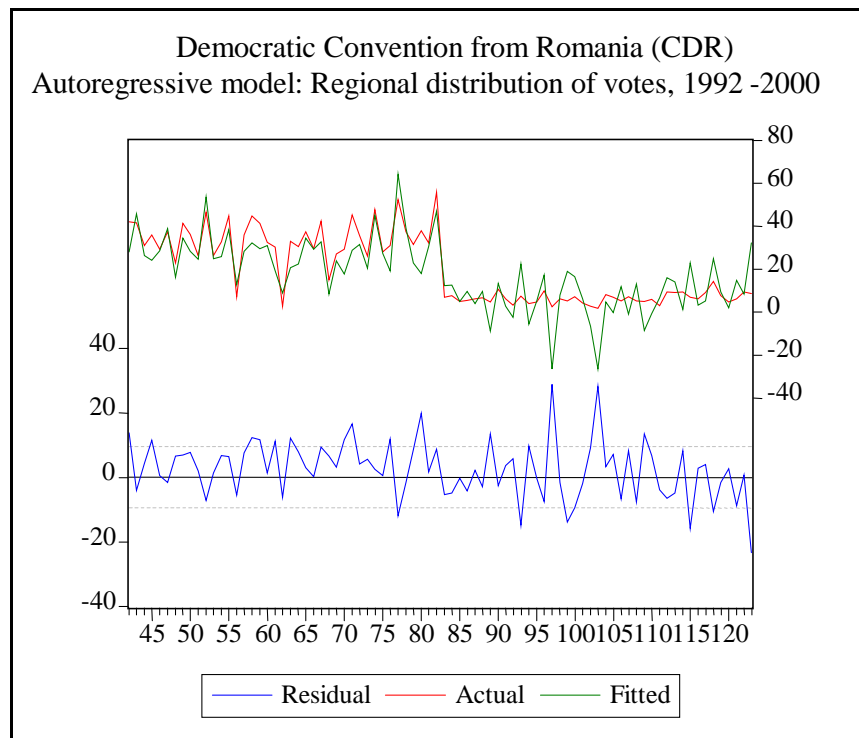
Figure 11: Political regional autoregressive model estimation – Regional distribution of votes for CDR – Democratic Convention from Romania

5.3. Conclusions

For Romania, the macro-economic data suggests that is correct a hypothesis according to which a significantly connection between the political behaviour of the politicians and economic evolution exists. The intensity of the structural changes records local minimum points in electoral years. This fact could be explained by the following phenomenon: to promote economic reforms means to adopt some measures, which

usually are accompanied by unpopular effects. These types of effects are not those desired by the incumbent governments, especially in election years.

At the same time, the maximum intensity of the structural changes was recorded in post – electoral years: all the political programs proposed the speeding of the economic reforms and consequently when a party or a coalition wins the political power, it tries to promote measures to speed up some economic changes process. The regional data also confirm the hypothesis of significantly connections between the state of the economy and political behaviour of the electors. The level and the dynamics of the unemployment at regional level have an influence on vote behavi our, as stated by the partisan political business cycle theory: in the areas with a higher unemployment rate the voting preference (tendency) is skewed towards the political left side. But each of the most important Romanian political parties of the perio d 1992 –2000 (PDSR and CDR} have faithful electors. The CDR fidelity proved to be superior to the fidelity of the PDSR's electors: the CDR captive electorate has a big fidelity, but a small size (relative to total Romanian electorate)

The results obtained must be understood under the limits inner to the research method used. For example, it is likely that the bias towards left –side political spectrum observed in areas with high unemployment rates is actually explained by the behavioural specificity of the population from poor zones. Given the unavailability of credible socio - economic information regarding poverty in Romanian geographical areas over the entire 1992 – 2000 period, the above-mentioned hypothesis is not directly tested in this working paper. The underlying reasoning is that the poor zones have usually high unemployment rates, and the econometric models presented here could offer, after all, arguments for two important hypotheses: (1) the electors from the poor regions vote preponderantly for le ft-wing political parties, and (2) the unemployment rate could be used as a *proxy* variable for poverty in the regional political behaviour models.

6. Policy relevance

The intuitive explanation concerning the existence of political business cycles in Eastern European economies is that poor and lower -educated voters in these countries are more myopic and hence more susceptible to short -term political manipulation. But empirical evidences consistent with such hypothesis do not exist as yet (Khemani, 2000). Seminal analyses confirm that the Eastern European Countries' governments act similarly with their European Union Countries counterparts (Hallenberg and Souza, 2000). However, these resemblances in political behaviours doesn't imply the fact that such the existence of politically driven business cycles will be eliminate in Eastern European states, and therefore, not in Romania too.

Despite the common elements, there are undoubtedly differences between the European Union developed countries and Eastern Europe an transition countries regarding the amplitude and succession of phases composing the electoral policy cycle. These differences are explicated by the level of institutional development, and by the extent of the political tradition in a democratic framew ork. For these reasons, it is very important to identify the institutional and other constraints that can alleviate the incumbents' yearning to generate an electoral cycle.

There are many types of both national and international constraints that may prevent governments from implementing an opportunistic policy (Leertouwer and Maier, 1999). Between the national constraints, the most known are the central bank independence and the existence of a political agreement for some domestic institutions, such as a *strong finance minister* or *negotiated fiscal contracts*. On the other hand, the international constraints can be induced by high capital mobility under a regime of fixed exchange rates. Participation in a fixed exchange rate regime restricts national economic policies and lowers the possibility of political business cycles.

According to Hallenberg and Souza (2000), the government may create political cycles through monetary expansion only in the countries when the exchange rate is flexible and when the central bank is dependent upon the government. But, the accession process assumes that the future member states implement indeed independent central banks. Independent monetary authorities can eliminate such cycles in countries with flexible exchange rates. Moreover, once the Eastern European states will become members, monetary policy will be set by the European Central Bank and exchange rates become fixed. For this reason, political business cycles might be created only by the use of fiscal policy. On the one hand, the election-oriented fiscal policies could be facilitated by the weak institutional structures in many Eastern European countries (Schuknecht, 1998). On the other hand, in developing countries, like Romania, political upheavals may be more frequent, and interest group politics more fractious, leading to higher discount rates for politicians, and poor institutional monitoring of performance in public works may provide considerable room for improvement under political pressure (Khemani, 2000). In these conditions, from a normative perspective, institutional mechanisms which are adapted to each country's institutional framework and which constrain discretionary government policies, might be worthwhile considering if expansionary policy making around elections is perceived to be undesirable (Schuknecht, 2000, p.127). For example, the *strengthening of fiscal rules and institutions* may well be a key element towards reducing policy volatility around elections (Schuknecht, 1998).

Hallenberg and Souza (2000, p.19-20) argue that such constraining domestic institutions can be a *strong finance minister* or *negotiated fiscal contracts*. In their opinion, given that strong finance ministers tend to work best in countries with one-party governments or in countries where there are two clearly opposing blocks of parties (currently a rarity in the European continent), it is likely that only negotiated fiscal contracts will be effective constraining domestic institutions, not only for the Accession Countries, but for the European Union as a whole (Hallerberg and von Hagen, 1999). The negotiating fiscal contracts work as follows: "the respective political parties that form the government negotiate *binding* budget targets for every ministry *before* portfolios are distributed to the parties in a coalition agreement. The negotiation of the targets ensures that the partners consider the full tax burden of their spending decisions, and the process reduces the scope of the *common pool resource proble*m, and along with it its deficit-increasing bias" (Hallerberg and von Hagen, 2000, p.19-20).

The idea that the institutional framework is crucial to maintaining fiscal discipline in many countries, which have featured weak fiscal institutions in the past, is largely sustained in the economic literature[11]. Certain fiscal rules as constitutional or legislative

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[11] According to Schuknecht (2000, p.126-127), this idea is sustained by numerous authors like Buchanan in many of his writings, Von Hagen and Harden (1994), Alesina, Hausmann, Hommes, and Stein (1995), Campos and Pradhan (1996), Tanzi and Schuknecht (1997)

deficit limits, can complement other fiscal institutions (*strong finance minister* or *negotiated fiscal contracts*) in maintaining fiscal discipline and eliminating opportunities for overspending in electoral period (election-oriented spending). Among these rules may be mentioned: emphasis on macroeconomic discipline in the budget formulation stage, constraints on the legislature in introducing new spending proposals in the budget approval stage, and strict implementation of the budget.

Regarding the methodology, a wide literature of outstanding econometric studies relating to the political business cycles in developed countries, and therefore in the European Union countries, appeared. On the other hand, the econometric models are not always best tools when analysing the political business cycles in Eastern European countries. That is because, in these countries, the democratic experience comprises only three or four moments. Besides, the panel data regression models are not the appropriate tools for political cycles analyses, because the great diversity of political conditions in East European region.

Furthermore, in Eastern European countries incumbents have a variety of methods as a mean to earn votes: increasing real minimum wages, pensions, or spending on popular programs such as health, education, social policy, and other current transfers. Also, governments systematic use specific public investment (such as spending in infrastructure) for diminishing unemployment. Therefore, a researcher looking for proves of political business cycles in these countries by looking at any single economic indicator would have to conclude that the evidence is patchy. But if one implies in the analysis a full range of available techniques, a clearer picture emerges – one in which pre-election manipulation is far more evident and significant, and in which rational tradeoffs appear to be made (Treisman and Gimpelson, 1999).

Another important subject in this area dwell on the relationship between the *democracy level*, *political system* and *economic performance* in Eastern European countries and therefore, in Romania too.

Even though a great deal of theoretical model treats the democracy level as an exogenous variable from both economic policy and economic outcomes, it might be argued that the social process shaping a country's political structure and institutions may be influenced by its economic conditions (Gonzalez, 2000). Moreover, no consensus has been reached in the literature regarding the direction of the causality between democracy and economic performance (Drazen, 2000). Political and economic processes tend to develop quickly in Eastern European countries, including in Romania. This is why one could expect an immediate effect of economic policy on a country's degree of democracy. As well, it is reasonable to believe that the effect of the economic conditions over the political environment might be observed, even if the upshot requires some delay.

The democratisation process generates two opposite forces affecting the size of the election cycle in public spending (Gonzales, 2000, p.23-24): as the cost of enforcing the political turnover diminishes, competent governments are enticed to increase the magnitude of the visible component of the government spending before the election to improve their re-election chances, and as the higher level of democracy increases the degree of transparency (i.e. the voters' chances to learn the true value of the office-holder's competence), the political cycle is attenuated. Regarding political system, Gonzales affirm that:

> *The democratisation process has magnified the risk for the government to lose power, but has not increased the country's transparency rapidly enough to reduce*

the incumbent's temptation to engage in opportunistic policy -making (Gonzales, 2000, p.4-5).

The Duch's analysis (Duch, 1999) enforces the Gonzales' conclusion: "It is widely accepted that even in new democracies there exists a strong correlation be tween economic perceptions and political outcomes. This is the basis for both championing democracy as an appropriate set of political institutions but it is also, paradoxically, a constraint on the implementation of painful economic reforms (…) Segments o f the population with information shortfalls and with low levels of democratic satisfaction respond to economic performance in a systematically different fashion than the informed and those satisfied with democracy. The poorly informed and the democratic *cynics* are less likely to reward (or punish) incumbents for good (or bad) economic performance. As citizens in new democracies become more informed about political and economic institutions and processes and as their satisfaction with the performance of dem ocratic institutions rises, support for incumbent political parties becomes more sensitive to economic performance" (Duch, 1999, p.23). These results suggest that:

(…) imperfect democracy might have its advantages. In particular, imperfect information and democratic dissatisfaction might facilitate the simultaneous introduction of democratic institutions and market reform. Incumbents in young democracies are less likely to be judged on the basis of the economy's performance. As information levels rise, and citizens become more satisfied with the performance of democratic institutions, incumbents are more likely to be judged on the basis of the economy's performance. This suggests that the early introduction of potentially painful economic reforms is optimal for new democracies (Duch 1999, p.24).

For Romania, the above analysis (see section 5) suggests that, probably, a certain degree of correlation exist between the political behaviour of the politicians in office and macroeconomic evolution. Because the reform is usually accompanied by unpopular effects, the speed of reform' progression is smaller in electoral years. But, the Romanian electorate didn't react according to opportunistic political business cycles theory: the electoral support for political p arties was partisan, so that the improvement of the economic conditions immediately before election was not accompanied by increase of electoral support for the party in office.

The regional analysis confirms the hypothesis of a significant correlation b etween the status of the economy and political behaviour of the electors. The level and the dynamic of the unemployment at regional level have an influence on vote behaviour, as in the partisan political business cycle theory: in the zones with a higher un employment rate there is a voting preference (tendency) towards the political left side.

This conclusion is interesting in political perspective. If the unemployment electors carried their votes toward left, the PDSR' reform built between 1992 -1996 resulted in a diminishing the electoral support for this party: during this period, the global unemployment rate decreased from 8.2% (at the end of 1992) to 6.6% (at the end of 1996). Moreover, if the hypothesis concerning the partisan electorate behaviour is co rrect, then the employers, the private entrepreneurs and the self -employed vote toward right-wing parties. That means that electoral support for PDSR was also reduced by another result of the reform, namely the strong increase in the number of registered companies (large numbers of them are limited liability companies).

A political analogous situation was recorded during the 1996 -2000 legislature. The global unemployment rate increased and the business environment became

unfavourable, leading to a decrease of the electoral support for the right-wing governmental coalition (CDR).

According to these results, I agree to an optimistic idea like the one of Hallenberg and Souza (2000, p.18):

There are no reasons to believe that the political business cycles as they are currently shaped in the Eastern European Countries, including in Romania, should lead to any delays in the integration process to the European Union.

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