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Political Business Cycles in Australia Elections and Party Ideology

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Abstract:
Party ideology, elections and economic performance can have a significant impact on the overall economic performance. Governments are formed by parties that compete at elections and, based on their ideology, have different preferences regarding the size and scope of government. With respect to economic policy, left-wing parties advocate for government intervention in order to ease the effects of the business cycle whilst right-wing parties favour market solutions as a response to economic fluctuations. According to the partisan theory, left-wing parties are more willing to adopt expansionary fiscal and monetary policies when in government, as they are mainly concerned with employment. On the opposite side, right-wing parties prioritize inflation and fiscal discipline as objectives. Both left-wing and right-wing parties understand the impact that the economy has on their re-election prospects. When in government, in order to maximize their probability of being re-elected, all parties will try and make voters believe that their economic policies were successful. How the electorate will react to this behaviour depends on its ability to understand and predict the impact of current policies on future welfare. In this paper we examine the influence of government ideology and elections on the economy. Using quarterly data for government consumption, money supply, taxation and welfare expenditure, we find that both partisan and opportunistic political cycles characterize Australian politics thus confirming the insights put forward by Nordhaus, W.D. (1975. “The Political Business Cycle.” The Review of Economic Studies 42 (2): 169–190.) and Hibbs, D. (1977. “Political Parties and Macroeconomic Policy.” The American Political Science Review 7: 1467–1487).

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Introduction

Party ideology, elections and economic performance can have a significant impact on the overall economic performance. Governments are formed by parties that compete at elections and, based on their ideology, have different preferences regarding the size and scope of government. With respect to economic policy, left-wing parties advocate for government intervention in order to ease the effects of the business cycle whilst right-wing parties favour market solutions as a response to economic fluctuations.

According to the partisan theory, left-wing parties are more willing to adopt expansionary fiscal and monetary policies when in government, as they are mainly concerned with employment. On the opposite side, right-wing parties prioritize inflation and fiscal discipline as objectives. Both left-wing and right-wing parties understand the impact that the economy has on their re-election prospects. When in government, in order to maximize their probability of being re-elected, all parties will try and make voters believe that their economic policies were successful. How the electorate will react to this behaviour depends on its ability to understand and predict the impact of current policies on future welfare.

In this paper I examine the influence of government ideology and elections on the economy. Using quarterly data for government consumption, money supply, taxation and welfare expenditure, I find evidence that both partisan and opportunistic political cycles characterize Australian politics thus confirming the insights put forward by Nordhaus (1975) and Hibbs (1977).

The paper is organized as follows. The next section presents the development of the political cycles theory and its theoretical basis. In the section after we compare government ideology against unemployment and inflation. The following section presents the empirical results for both Rational Partisan Theory and Political Business Cycle. The last section concludes.
Political business cycles

People are far from indifferent to the fluctuations of the business cycle. Unemployment, inflation and disposable income are just some of the economic variables that affect individuals’ welfare. Poor economic performance will reflect on governments’ popularity therefore, governments have a clear incentive to try and influence the economy to their advantage. The problems that a government is faced with are numerous and their complexity is vast. However, when addressing economic problems, they can be reduced to intertemporal trade-off decisions. Higher unemployment today could mean reduced inflation in the future, lower consumption now could facilitate for increased investment whilst increased borrowing in the current period will allow for reduced taxation at present but, it will result to a future increase in taxes. The common theme in all the above described decisions is the government’s preference between current and future consumption.

In the neoclassical scheme elections are treated as another market. Parties compete with each other in order to maximize votes and win elections. Ideology plays a secondary role for parties as their main goal is to win elections. Therefore, a convergence towards the median voter is to be expected from opposing parties as a result of their vote maximizing behaviour (Hotelling 1929; Downs 1957). Parties that follow this pattern are not stripped of ideology. The core of this hypothesis is that parties need to be elected in order to implement their programmes hence they will prioritize electoral win over ideological purity. However, to have policy goals does not mean that politicians are dogmatic and that they are not concerned with winning (Wittman 1983). Political parties have both election win and policy as objectives (Schlesinger 1975). Compromise and pragmatism are important in politics and winning an election is the first step towards implementing a policy.

When opposing parties are determining their platform for an upcoming election, they will be influenced by the approach they have towards elections. If the parties are opportunistic then, their policies will be determined by the tastes of the median-voter in order for them to maximize their winning prospects. If the parties are ideological then they will diverge from the preferences of the median-voter and move closer to their respective representative-voter’s preferences (Wittman 1983). When in government, a partisan party will shift economic policy towards an ideological direction which can be offset by the succeeding party’s opposite policy. This average performance can be linked back to median-voter preferences as variations in policies are smoothed out (Nordhaus 1989). For example, a government’s ideological decision to increase expenses today can be offset by the succeeding government’s ideological decrease in expenses.

Party behaviour and election outcomes are not independent from the electorate. Voters’ expectations are an important factor in determining how parties, and therefore governments, approach an election. If voters are myopic and asses the government’s performance retrospectively then incumbents, irrespective of their ideological orientation, will follow policies that artificially enhance growth and lower unemployment closer to an election in order to maximize their re-election prospects (Nordhaus 1975; Tufte 1978). After the election, this temporary euphoria will be followed by a tightening of the fiscal and monetary policy, in order to mitigates the costs of the pre-election decisions. However, if voters have rational expectations then they cannot be fooled by artificial economic booms in the pre-election period (McCallum 1978).

Voters’ rationality has been incorporated in the ‘rational opportunistic’ models developed by Alesina (1987), Rogoff (1990), and Persson and Tabellini (1990). Rational voters cannot be systematically fooled by governments and the influence of nominal changes on real economic activity is reduced. However, politicians enjoy better access to information than voters regarding the actual performance of the economy. Therefore, they have a strong incentive to withhold that information if by doing so, increases their re-election prospects. The true state of the economy becomes apparent to the voters only after the election. Because of this asymmetry of information between policymakers and voters, politicians in the ‘rational opportunistic’ models behave in a way similar to that in the model developed by Nordhaus but, with shorter electoral cycles.

Voters’ expectations play an important role in the case of shocks. If an external unfavourable shock occurs then, rational voters will recognize that the incumbent is not responsible, and they will not hold it accountable when voting. Their decision during the election will be based on assessing each party’s ability to address the shock and implement the appropriate policy response to it. If voters are not rational then they might decide to oust the incumbent party as they will falsely consider it responsible for the negative shock. The implications of such a behaviour in the case of partisan parties are really important. Rational voters will assess the economic situation and juxtapose it with the ideology of the competing parties. If the election platform of a party is believed to be inappropriate, then they will not vote for it. For example, in periods of high inflation it would be safe to assume that right-wing parties, which prioritize inflation as an economic risk, will be preferred. Similarly, in periods of economic recession left-wings parties, that are mainly concerned with unemployment, will be seen as appropriate to manage the economic cycle.

Hibbs (1977 and 1987) shifts the focus from the elections to the ideology of the politicians. By being partisan, politicians prioritize objectives differently by exploiting the trade-off between unemployment and inflation. Hibbs, argues that left-wing parties favour lower unemployment and higher inflation whilst conservative parties...
are mainly interested in maintaining inflation levels low. According to the partisan theory, unemployment is the main concern of left-wing parties as it mainly affects constituencies that are ideological closer to them and from which they mainly derive their votes. Similarly, right-wing parties mainly focus on inflation as it poses a major concern for their respective voters in their core constituencies.

At this stage it is also important to consider that ideology is not necessarily the decisive factor that determines the decision of the electorate. The ability of each party to manage the economic cycle efficiently is also important. Voters will not solely base their decision to vote for a party on the fact that it recommends an appropriate policy response, given the economic environment, nor will they vote exclusively on ideological grounds. They will also assess the competence of a party to efficiently manage the economy (Rogoff and Sibert 1988). Therefore, competence, ideology and the economic environment are among the factors that determine voters’ preferences.

**Unemployment and inflation in Australia**

We will firstly discuss inflation and unemployment for the period 1978:2–2015:4 and try to draw possible links between these two economic variables and the governing party’s ideology. This will allow us to directly compare the insights of the political cycles theory against the Australian experience. Australia largely operates as a two-party bicameral democracy strongly influenced by both the Westminster and the US federal systems with federal elections held every three years. In Australian political culture, the Liberal party (LP) is considered centre-right whilst the Labor Party (ALP) is considered centre-left. Our sample consists of 151 quarters out of which left-wing Labour was in government for 75 quarters and right-wing Liberals for 76 quarters. The period under investigation allows for an almost equal number of periods that each party was in government and, captures the period during which Labour engaged in ‘economic rationalism’ which is discussed later.

Average inflation and unemployment of the sample period and for each party when in government, are reported in Table 1. We observe that during Labour governments, unemployment and inflation averaged higher whilst both variables appear on average to be lower during Liberal governments. The difference in the means of unemployment under different government appears to be statistically significant whilst that does not hold for inflation. This preliminary analysis indicates that there is no support for the partisan theory regarding inflation, even though inflation on average was higher under Labour governments, whilst for unemployment the results are counterintuitively.

<table>
<thead>
<tr>
<th>Total Sample</th>
<th>Labour</th>
<th>Liberal</th>
<th>p-Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unemployment</td>
<td>7.04%</td>
<td>7.66% (0.239)</td>
<td>6.42% (0.129)</td>
</tr>
<tr>
<td>Inflation</td>
<td>4.51%</td>
<td>4.65% (0.328)</td>
<td>4.37% (0.403)</td>
</tr>
</tbody>
</table>

Numbers in parentheses are standard errors. The last column reports the p-value for testing the null hypothesis of no difference between the parties.

In Table 2, we divide the sample into five periods according to the time that each party was continuously in government. The first Liberal period is characterized by relatively high inflation and an unemployment rate that is below the sample’s average. It is followed by a Labor government which recorded higher average unemployment and lower average inflation. This finding stands opposite to the partisan theory and it depicts the trade-off between inflation and unemployment. For the first two periods Labour, rather than the Liberals, appear to be the right-wing party in terms of the partisan theory.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Government</td>
<td>Liberal</td>
<td>Labour</td>
<td>Liberal</td>
<td>Labour</td>
</tr>
<tr>
<td>Unemployment</td>
<td>6.54%</td>
<td>8.75%</td>
<td>6.43%</td>
<td>5.18%</td>
</tr>
<tr>
<td>Inflation</td>
<td>9.75%</td>
<td>5.47%</td>
<td>2.53%</td>
<td>2.79%</td>
</tr>
</tbody>
</table>

In the third period, when the Liberal party was again in government, both average unemployment and average inflation have declined. The partisan theory is confirmed for inflation but not for unemployment. However,
when examining the last two periods we can notice that there are strong indications for the existence of partisan political cycles. In the fourth period of the sample, the return of Labour in government coincides with lower average unemployment and higher inflation compared to the previous period. Additionally, in the last period of the sample, when the Liberal party was in government, unemployment increases whilst inflation declines.

By turning to Figure 1, we can observe that towards the end of the first period, a sharp increase in both unemployment and inflation takes place. In the lead-up of the 1983 election, unemployment has increased sharply from 6.63% in 1982:1 to 9.73% at the time of the election whilst inflation reached 11.36%. This development could have resulted in voters reassessing the competence of the incumbent government to resolve the evolving problems of inflation and unemployment and therefore, explain the Labour win in the 1983 election.

![Inflation and Unemployment Rates](image.png)

**Figure 1:** Average unemployment and inflation and change in government.

Labor remained in government for the period 1983–1996. Between 1983 and 1990, unemployment has dropped whilst inflation, after a temporary fall, increased and remained at levels above 7% confirming the partisan theory. In the years between 1990 and 1993, inflation fell significantly from 8.7% to 0.33% whilst unemployment increased from 6.28% to 10.96%. Lastly, during the 1993–1996 years, unemployment started again to decline at the cost of higher prices. Overall, the period 1983–1996 neither confirms nor rejects the partisan theory hypothesis. Initially, the Australian economy appears to experience a form of stagflation with high inflation and unemployment and, during the second half of the period, a clear inverse relationship between the two variables becomes obvious.

At the beginning of the third period, 1996–2007, both inflation and unemployment decrease. Again, this development stands opposite to the partisan theory. With the Liberal party in government, we are to expect that unemployment would rise however, this is not confirmed by the data. Inflation, after a spike during 2000–2001, is characterized by relative stability whilst unemployment steadily decreased during the whole period. The last two periods demonstrate a stable inflation rate with temporary deviations from an average of 2.5%. After the GFC, an increasing trend appears to develop for unemployment.

As the previous discussion demonstrated, by examining inflation and unemployment, we cannot confirm nor reject the existence of partisan political cycles in Australia. Both variables appear to evolve in a manner that is inconsistent with the theory. A possible explanation for this inconsistency could be the decision from Labour to adopt ‘economic rationalism’ as its ideological platform.

During the 1980s and 1990s, Labour introduced a series of policies, such as the floating of the currency, privatisations, tariff cuts and deregulation of the labour market, that appear to be more consistent with a right-wing platform rather than a traditional left-wing party. This policy shift has been attributed, among other factors, to changes in ideology, the rise of globalization, electoral preferences and the end of the post war boom (Pusey 1991; Lavelle 2005; Sawer 1982). The convergence of the policy platforms was not only the result of political rationality and the need for pragmatic government. Labour enthusiastically adopted the shift in economic policy signalling its ideological transformation thus leading to an era of ideological homogeneity in Australia’s political sphere (Beeson and Firth 1998).

With Labour moving away from interventionist policies, both parties appear to be committed to similar economic principals. However, the abandonment of active Keynesian policies from Labour, does not necessarily imply that there are no policy differences between Liberal and Labour. It merely questions the appropriateness of inflation and unemployment as test variables. If the broader economic policies of the two parties are similar then, their different priorities, if any, could become apparent through the examination of more specific economic variables. The next section attempts to identify those differences.
Empirical results

In an effort to fully understand political cycles in Australia, we follow the analysis of Alesina and Roubini (1992) and develop the following empirical model:

\[
y_t = \alpha_0 + \alpha_1 y_{t-1} + \alpha_2 y_{t-2} + \ldots + \alpha_n y_{t-n} + \alpha_{n+1} PDUM_t + \epsilon_t
\]  

(1)

where \( y_t \) symbolizes the time-series data of the data in question and PDUM is the political dummy variable used to capture the implications of the different theories. The autoregressive specification of the dependent variable is chosen as the “best” using standard techniques. Model (1) will be used in testing both partisan and opportunistic political cycles. All estimations of the AR(p) models were performed using the Cochrane–Orcutt estimation.

I consider the effects of political cycles on money supply measured by M3, total government consumption C, taxation T measured by total tax receipts and welfare payments G measured by the total personal benefits amounts paid. The economic data are quarterly observations for each variable in nominal terms, deflated using the appropriate CPI and are taken from the Australian Bureau of Statistics and the Reserve Bank of Australia databases. In all the regressions, the logarithm of the real variables is used and, in order to satisfy the stationarity conditions, first differences are applied. The political data are election dates, the dates of change in government and the political orientation of each government. The summary statistics of the variables are presented in the following table:

<table>
<thead>
<tr>
<th>Table 3: Summary Statistics.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Obs.</td>
</tr>
<tr>
<td>-----</td>
</tr>
<tr>
<td>log C</td>
</tr>
<tr>
<td>log M3</td>
</tr>
<tr>
<td>log T</td>
</tr>
<tr>
<td>log G</td>
</tr>
</tbody>
</table>

As we have seen in the previous section, Labour’s commitment to ‘economic rationalism’, does not allow for the hypothesis of the partisan theory to be tested through the use of inflation and unemployment. By shifting the focus to more specific economic variables that are directly influenced by the government, I attempt to measure the effects of ideology on the economy. The choice of the economic variables aims to capture the preferences of each party with respect fiscal and monetary policy.

The choices that governments make in terms of expenses and revenues are a function of their preference towards fiscal discipline. The role of government in terms of monetary policy is more limited and a function of the degree of independence of the central bank. Nonetheless, government decisions in the fiscal arena and the position of the economy on the business cycle, will have an effect on the decisions of the central bank. Furthermore, governments appoint central bankers therefore, governments have an indirect control on monetary policy.

In the existing literature, Australian political cycles have been tested by including Australia in multi-country samples. Alesina and Roubini (1992), find evidence consistent with the partisan theory however, they reject the opportunistic hypothesis. Alesina, Roubini, and Cohen (1997), reject Nordhaus’ political cycles hypothesis while they find evidence in support of the partisan theory. Potrafke (2012a), confirms the insights of the partisan theory whilst Sakamoto (2008), provides us with evidence that highlight the importance of the central bank’s independence on partisan political cycles. Shi and Svensson (2006), attempt to identify the causal effect from the incidence of elections to fiscal policy by examining a large sample of countries that includes Australia. In the sample used here all elections, with the exemption of December 1984, were held during their predetermined election year. Blinder and Watson (2016), observe that the US economy performs better under Democratic presidents and attribute most of that difference to factors that are not directly related to domestic economic policy. Potrafke (2012b), confirms the convergence of left-wing and right-wing parties by empirically examining the effect of party ideology on social policy in Germany.

This paper aims to contribute to the existing literature by focusing on Australia and through the use of different variables than the ones mainly used in the literature. Australia presents a unique case as it has been characterised by relatively steady election cycles, one party governments and, by an overall uniform economic policy. In the sample period only one government between 2010 and 2013 was a minority government that was supported by smaller parties and independents. Another important factor that characterises the Australian
The political system is the importance of states in determining policies however, federal government still enjoys a significant role in overall policy. This paper will focus on the role of federal government given its importance on economic policy.

The rational partisan theory

The political dummy variable used is:

\[
DPRTN = \begin{cases} 
+1, & \text{in the N quarters starting with a right wing government} \\
-1, & \text{in the N quarters starting with a left wing government} \\
0, & \text{otherwise}
\end{cases}
\]

I test the cases for \( N = 4, 6, 8 \) which is consistent with the existing literature. DPRT assumes values different from zero following an actual change in government. When an incumbent is re-appointed after an election, DPRT is not affected. The results are reported in Table 4.

<table>
<thead>
<tr>
<th>Independent variables</th>
<th>(1)</th>
<th>(2)</th>
<th>(3)</th>
<th>(4)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>C</td>
<td>M</td>
<td>T</td>
<td>G</td>
</tr>
<tr>
<td>Constant</td>
<td>0.013***</td>
<td>0.008***</td>
<td>0.014***</td>
<td>0.024***</td>
</tr>
<tr>
<td>C (−1)</td>
<td>−0.513*</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>C (−2)</td>
<td>−0.234</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>DPRT 6</td>
<td>−0.009**</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>T (−1)</td>
<td>-</td>
<td>-</td>
<td>−0.594***</td>
<td>-</td>
</tr>
<tr>
<td>T (−2)</td>
<td>-</td>
<td>-</td>
<td>−0.250*</td>
<td>-</td>
</tr>
<tr>
<td>DPRT 4</td>
<td>-</td>
<td>−0.003</td>
<td>0.015*</td>
<td>-</td>
</tr>
<tr>
<td>M (−1)</td>
<td>-</td>
<td>0.642***</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>G (−1)</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>−0.910***</td>
</tr>
<tr>
<td>G (−2)</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>−0.527***</td>
</tr>
<tr>
<td>G (−3)</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>−0.345***</td>
</tr>
<tr>
<td>DPRT 6 (−2)</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>−0.034**</td>
</tr>
<tr>
<td>R²</td>
<td>0.19</td>
<td>0.36</td>
<td>0.09</td>
<td>0.39</td>
</tr>
<tr>
<td>S.E.</td>
<td>0.019</td>
<td>0.009</td>
<td>0.029</td>
<td>0.062</td>
</tr>
</tbody>
</table>

*, **, *** denotes statistical significance at 10%, 5% and 1% levels respectively

In column 1, we can observe that DPRT 6 has the expected sign in terms of partisan theory and is statistically significant at the 5% level. Therefore, a change in government towards the right (left) will have a negative (positive) effect on government consumption. Consumption can be one of the most direct avenues that a government can explore when implementing fiscal policy. An increased government consumption can fuel economic growth. According to the partisan theory, left-wing governments are more concerned with economic growth therefore, we are to expect that they will increase their consumption in order to stimulate the economy.

Column 2 reports the results for money supply. The negative sign of the DPRT 4 is the correct in terms of partisan theory however, it is statistically insignificant. Money supply is considered as a fundamental instrument of monetary policy and a determining factor of inflation. According to the partisan theory, a change of government towards the right (left) will result in a contraction (expansion) of the money supply in an effort to ease inflationary pressures. In the case of Australia, we cannot confirm this hypothesis possibly due to the extent of the independence that the Reserve Bank of Australia enjoys.

The results for the effect of political cycles on taxation are reported in column 3. The political variable is statistically significant at the 10% level however; its sign is not the one we were to expect based on the partisan theory. A change of government towards the right (left) will have a positive (negative) effect on overall tax revenue. According to the partisan theory, we would expect a right-wing government to lower taxation in accordance to its commitment to the smaller role of the state in the economy. In the case of Australia, we observe that right-wing governments are linked with higher tax revenues. A possible explanation could be the
commitment of Liberal governments to fiscal discipline which entails a decrease in government expenditure
and an increase in government revenue.

Lastly, column 4 reports the results for the case of welfare payments. The political variable has the correct
sign and is statistically significant at the 5% level. A change in government towards the right (left) will have a
negative (positive) effect on the level of welfare payments in Australia. The political variable DPRT 6 is lagged
by two quarters in order to capture the slow response of welfare, given its nature, to policy changes.

Based on the results from the regression analysis we can conclude that the partisan theory is confirmed in the
case of Australia. Liberal governments reduce government consumption and welfare payment whilst increase
tax revenues. These findings are consistent with the narrative that right-wing governments in Australia are more
concerned with fiscal discipline. Similarly, Labor governments are linked with higher government expenditure,
both in terms of consumption and welfare payments. In terms of monetary policy, the ideological orientation
of the party in government does not have a statistically significant effect on money supply, which is captured
through the use of M3. This finding indicates the degree of independence of the Reserve Bank of Australia.
Overall, the effect that government ideology has on the chosen variables, whilst statistically significant, is in
absolute terms negligible.

**Political business cycle**

In testing Nordhaus (1975) Political Business Cycles (PBC), I will use Model (1) with the following political
dummy variable:

\[
NRDN = \begin{cases} 
1, & \text{in the N - 1 quarters preceding an election and in the election quarter} \\
0, & \text{otherwise} 
\end{cases}
\]

The NRD variable in this model captures the pre-election period during which the incumbent government will
behave opportunistically and try to create a short-term economic euphoria in order to convince the electorate
to re-elect it. The results are reported in Table 5.

**Table 5: Political business cycle regressions.**

<table>
<thead>
<tr>
<th>Independent variables</th>
<th>(1) Government consumption, C</th>
<th>(2) Moneysupply, M</th>
<th>(3) Taxation, T</th>
<th>(4) Welfare payments, G</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>0.011***</td>
<td>0.006***</td>
<td>0.016***</td>
<td>0.030***</td>
</tr>
<tr>
<td>C (−1)</td>
<td>−0.586***</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>C (−2)</td>
<td>−0.252*</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>NRD 4</td>
<td>0.006*</td>
<td>0.002*</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>T (−1)</td>
<td>-</td>
<td>-</td>
<td>−0.582***</td>
<td>-</td>
</tr>
<tr>
<td>T (−2)</td>
<td>-</td>
<td>-</td>
<td>−0.239*</td>
<td>-</td>
</tr>
<tr>
<td>NRD 6</td>
<td>-</td>
<td>-</td>
<td>−0.004</td>
<td>-</td>
</tr>
<tr>
<td>M (−1)</td>
<td>-</td>
<td>0.689***</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>G (−1)</td>
<td>-</td>
<td>-</td>
<td>−0.791***</td>
<td>-</td>
</tr>
<tr>
<td>G (−2)</td>
<td>-</td>
<td>-</td>
<td>−0.419**</td>
<td>-</td>
</tr>
<tr>
<td>G (−3)</td>
<td>-</td>
<td>-</td>
<td>−0.296***</td>
<td>-</td>
</tr>
<tr>
<td>NRD 6 (−1)</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>−0.015</td>
</tr>
<tr>
<td>R²</td>
<td>0.17</td>
<td>0.36</td>
<td>0.08</td>
<td>0.38</td>
</tr>
<tr>
<td>S.E.</td>
<td>0.02</td>
<td>0.009</td>
<td>0.02</td>
<td>0.06</td>
</tr>
</tbody>
</table>

*, **, ***denotes statistical significance at 10%, 5% and 1% levels respectively

When examining government consumption in Column 1, we find that elections have a positive impact on
government consumption. The NRD 4 variable has the correct sign and it is statistically significant at the 10%
level. This effect can be the result of the increased expenses due to the election process however, it does provide a
strong indication that Nordhaus’ insights are confirmed in Australia. By increasing government consumption
closer to an election, incumbents can temporarily stimulate the economy therefore, increase their re-election
prospects. Furthermore, government consumption can be directed at marginal seats which are play an impor-
tant role in determining election outcomes.
Turning to monetary policy, we can confirm the PBC theory as elections are found to have a positive effect on money supply. The increased money supply can create the illusion of an increased available income as prices adjust slowly. This temporary effect can increase the probability of the incumbent government being re-elected as voters are fooled in believing that the economy is performing well. Furthermore, this positive relationship raises issues regarding the degree of independence of the central bank and its link with the government. With central bankers being appointed by politicians, their independence becomes questionable. Columns 3 and 4 report the findings for taxation and welfare expenditures. In both cases the political variable is statistically insignificant and in the case of welfare payments it also has the wrong sign. The empirical results show that elections have a negligible effect on the chosen variables with no more than a 2% change in them attributable to the time of the election.

Conclusions

This paper contributes to the political cycles literature by providing an empirical analysis in the case of Australia. Inflation and unemployment do not seem to be the appropriate variables in estimating Australian political cycles. With both major parties in Australia adopting economic policies that are not distinctive, especially in the labour market, the differences in their approach towards unemployment and inflation disappear. In order to test the existence of political cycles, we had to turn to government consumption, money supply, taxation and welfare expenditure.

Governments in Australia attempt to manipulate the business cycle in their favour during election years. Irrespective of the incumbent’s ideology every government tries to increase its re-election prospects through the use of fiscal and monetary policy. The results support the existence of partisan political cycles with the variables in question reacting in the way that the theory predicts. While the estimated coefficients are statistically significant their effect appears to be negligible. This is an indication of the need for further research using different variables that could potentially better capture the size of the effects of political cycles. Nonetheless, in Australia conservative governments appear to be more disciplined in terms of fiscal policy whilst left-wing governments more expansionary. Overall, Australia seems to be characterized by both opportunistic and partisan political cycles with both, monetary and fiscal policies being influenced by incumbents.

Political cycles have negative and destabilising effects on the economy. Possible solutions that could mitigate those effects could be the introduction of fixed government terms which would remove the incumbents’ ability to call for a snap election when its timing suits their objectives. Mandatory balanced budgets and a debt ceiling would also assist in that direction as well as the setting of a maximum number of terms for politicians. In the case of Australia, the independence of the central bank needs also be strengthened. However, the continuous restriction on the ability of governments to dictate economic policy poses a risk to democratic principles. Political and economic institutions need to be inclusive and transparent in order for the economy to be undemocratic and for democracy to not impede economic growth.

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References


