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The Politics of Inflation and Economic Stagnation

Theoretical Approaches and
International Case Studies

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Inflation, Political Support, and Macroeconomic Policy

Douglas A. Hibbs, Jr.

This chapter explores the connection between macroeconomic outcomes and political support for incumbent governments as they existed during the period of growing and high inflation. During most of the post-World War II period, the U.S. economy performed at higher rates of unemployment and lower rates of inflation than the economies of virtually all other capitalist industrial societies.¹ This held true during the sustained high growth of the 1960s as well as the economic disruption and stagnation of the 1970s. The sizable difference in figure 7-1 between the unemployment records of the United States and six other industrial societies—France, Italy, Japan, Sweden, the United Kingdom, and West Germany—is not an artifact of unusually good performance by one or two of the other countries. On average the U.S. unemployment rate was higher, typically much higher, than that of each of the other six (table 7-1). Nor can the unemployment performance gap be attributed primarily to measurement differences (data for all of the countries are adjusted to U.S. concepts) or to differences in the composition and rate of growth of the labor force, although the heterogeneity of the labor force is a distinguishing feature of the American economy.² However, even if it is granted that the natural rate of unemployment is somewhat higher in the United States than abroad, it is true nonetheless that postwar economic contractions

1. Canada is an exception, but the observations in this chapter apply with almost equal force to that country.

2. Robert H. Havemen, "Unemployment in Western Europe and the United States: A Problem of Demand, Structure or Measurement?" *American Economic Review*, vol. 68 (May 1978, *Papers and Proceedings*, 1977), pp. 44–50; Roger Kaufman, "Why the U.S. Unemployment Rate Is So High," *Challenge*, vol. 21 (May–June 1978), pp. 40–49.

Table 7-1. *Unemployment, Inflation, and Monetary Growth Rates in Seven Countries, 1960-69 and 1970-80*
Percent

Country	Unemployment ^a		Inflation ^b		Growth rate							
	1960-69		1970-80		Money supply			Excess money supply ^c				
	1960-69	1970-80	1960-69	1970-80	1960-69	1970-80	1960-69	1970-80	1960-69	1970-80		
	M1	M2	M1	M2	M1	M2	M1	M2	M1	M2		
France	2.02	4.81	4.12	9.37	10.1	12.5	10.0	12.9	5.0	7.5	6.2	10.5
Italy	3.65	3.67	4.05	12.79	13.0	13.0	17.7	17.0	8.0	8.0	14.6	14.2
Japan	1.32	1.72	4.54	6.67	16.2	14.6	12.6	14.0	5.1	3.5	9.3	9.5
Sweden	1.69	2.05	3.93	8.48	3.3	7.0	11.1 ^d	12.5 ^d	-1.0	2.7	7.9	9.2
United Kingdom	2.97	4.94	3.06	12.79	2.9	4.9	11.5	12.8	-1.3	0.7	10.6	10.5
United States	4.74	6.28	2.50	6.62	3.6	6.5	5.8	9.2	-0.2	2.7	3.6	6.9
West Germany	0.59	2.35	3.76	5.41	7.6	12.0	8.7	9.7	2.8	7.3	7.2	8.0

Sources: Constance Sorrentino, "Unemployment in Nine Industrialized Countries," and Joyanna Moy and Constance Sorrentino, "An Analysis of Unemployment in Nine Industrial Countries," *Monthly Labor Review*, vol. 95 (June 1972), pp. 29-33, and vol. 100 (April 1977), pp. 12-24; U.S. Department of Labor, Bureau of Labor Statistics, December 1981, unpublished data table; Robert J. Gordon, data prepared for "World Inflation and Monetary Accommodation in Eight Countries," *Brookings Papers on Economic Activity*, 2:1977, pp. 409-78; *International Financial Statistics*, various issues.

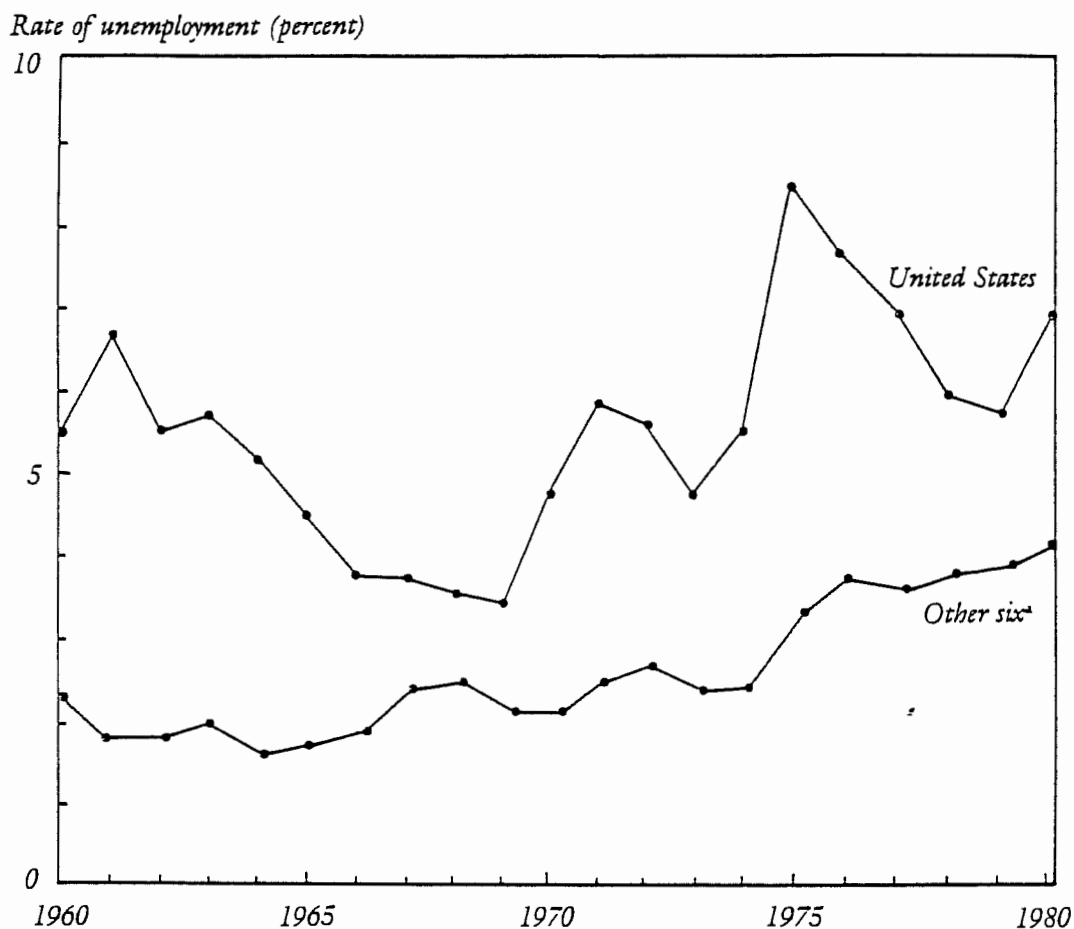
a. Adjusted to U.S. concepts.

b. Rate of change of GDP deflator.

c. Average rate of change of money supply minus average rate of change of trend real GDP.

d. For 1970-79.

Figure 7-1. *Unemployment in the United States and Six Other Countries, 1960–80*



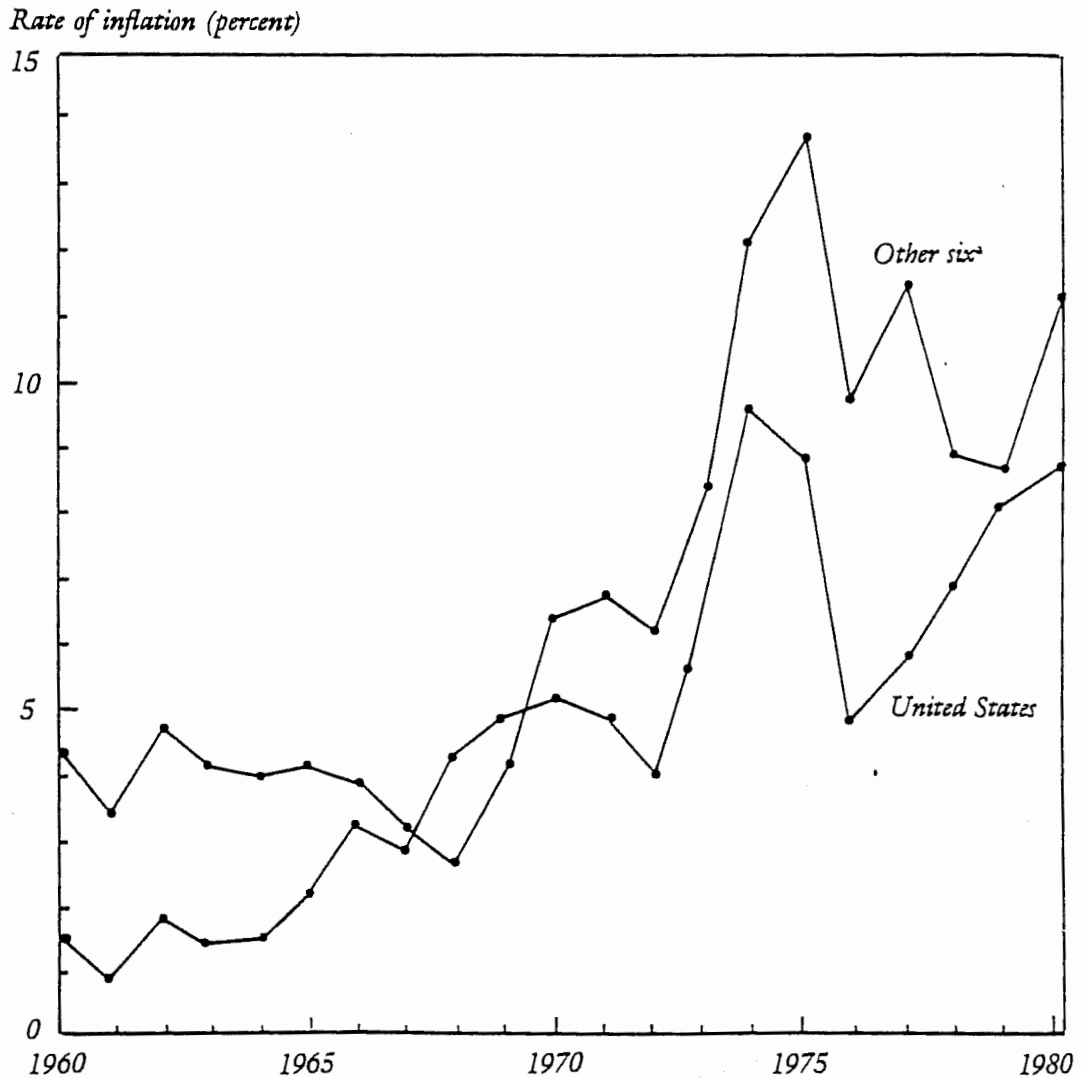
Sources: Constance Sorrentino, "Unemployment in Nine Industrialized Countries," and Joyanna Moy and Constance Sorrentino, "An Analysis of Unemployment in Nine Industrial Countries," *Monthly Labor Review*, vol. 95 (June 1972), pp. 29–33, and vol. 100 (April 1977), pp. 12–24; U.S. Department of Labor, Bureau of Labor Statistics, December 1981, unpublished data table. Unemployment rates of all countries have been adjusted to U.S. concepts.

a. France, Italy, Japan, Sweden, United Kingdom, and West Germany.

have typically been longer, deeper, and more frequent in the United States than anywhere else.

In every year except 1968 and 1969—the peak of the inflationary surge brought on by the Vietnam War boom—the U.S. inflation rate ran behind that of the other six (see figure 7-2). Again, this is not due to unusual performance by one or two of the other six. Generally, U.S. prices exhibit greater stability during the long international boom of the 1960s, the crushing stagflation of the 1970s, and both before and after the demise of fixed exchange rates in 1971. The comparative inflation performance after 1972 is particularly revealing about the aversion of officials in the smaller, open economies to inflation, since the collapse of the Bretton

Figure 7-2. Inflation in the United States and Six Other Countries, 1960-80



Sources: Robert J. Gordon, data prepared for "World Inflation and Monetary Accommodation in Eight Countries," *Brookings Papers on Economic Activity*, 2:1977, pp. 409-78; *International Financial Statistics*, various issues. The GNP deflator is used to compute the rates of inflation.

a. France, Italy, Japan, Sweden, United Kingdom, and West Germany.

Woods stable exchange rate system gave them more control over their inflation rates.³

What explains the rather dramatic differences in rates of unemployment and inflation between the United States and other advanced industrial societies? The political sources of the variation are evident in governments'

3. This follows from the international monetarist theorem of open economies operating under fixed exchange rates, which implies that the free flow of world capital prevents domestic authorities from controlling their own nominal money supplies and, hence, their own long-run rates of inflation and effective demand.

macroeconomic policies—monetary policy (the money supply, interest rates, exchange rate, and credit policy), fiscal policy (expenditure, taxation, the volume of subsidies, and transfer payments), direct controls (primarily wage and price controls), and occasionally rhetoric and persuasion (jawboning and appeals to a social contract). Monetary and fiscal policy instruments are governments' major macroeconomic tools. A large fraction of the economics profession, however, appears to be skeptical of the independent influence of tax and (especially) expenditure manipulations of real output and employment. Ray C. Fair has concluded that "the fiscal authority can do little about changing the output path once the money supply path is fixed."⁴

Ironically, the Keynesian position that government can favorably affect the level of real economic activity now rests heavily on an activist monetary policy. And economists generally acknowledge that "the major historical accelerations and decelerations of inflation—not only during wars and hyperinflations but also during peacetime—have been accompanied by accelerations and decelerations in the rate of growth of the supply of money."⁵

Accepting that the growth rate of the money supply is probably the single most important macroeconomic policy instrument, analysis must proceed to what causes variations in the rates. Confronted with demand shifts, supply shocks, trade union cost-push, and other inflationary pressures, the monetary authority must choose between expanding or (passively if not actively) tightening the supply of money. The former fuels inflation; the latter decreases real money balances, drives up interest rates, and ultimately reduces investment and employment. Monetary officials face the dilemma of accommodating inflationary pressure by expanding the money supply and relinquishing control over the price level in order to preserve effective demand and employment, or leaning against inflationary pressure by tightening the money supply, reducing effective demand and employment, but stabilizing the price level.⁶ The first choice is sensitive to the interests of labor, especially marginal labor; the second defends the position of the financial community, rentiers, small savers, and others who are "exposed" to inflation.

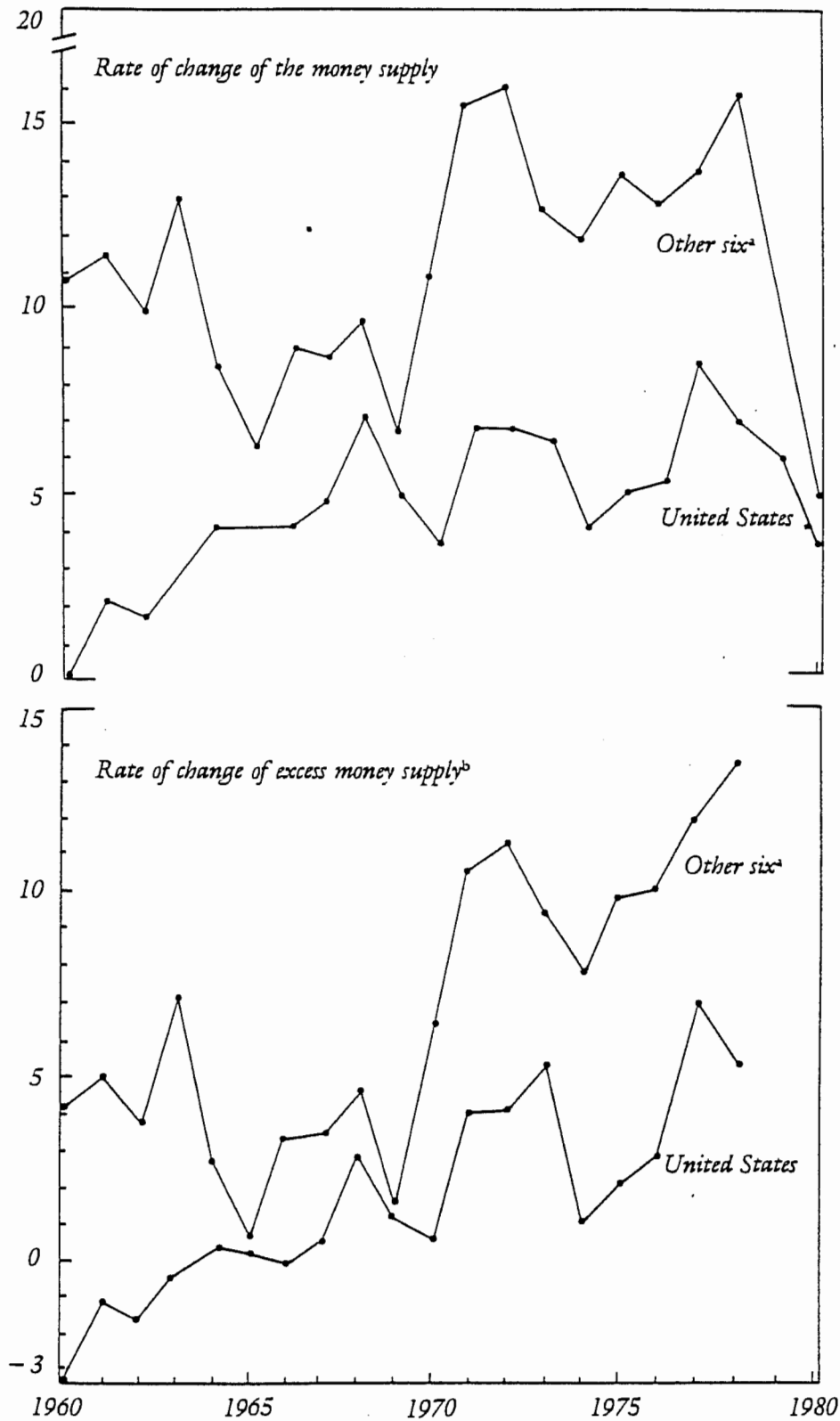
4. "The Sensitivity of Fiscal Policy Effects to Assumptions about the Behavior of the Federal Reserve," *Econometrica*, vol. 46 (September 1978), p. 1177.

5. Robert J. Gordon, "The Demand for and Supply of Inflation," *Journal of Law and Economics*, vol. 18 (December 1975), p. 807.

6. M. W. Reder, "The Theoretical Problems of a National Wage-Price Policy," *Canadian Journal of Economics and Political Science*, vol. 14 (February 1948), pp. 46–61.

Figure 7-3. Rates of Monetary Growth in the United States and Six Other Countries, 1960-80

Rate of change (percent)



Sources: Same as for figure 7-2. Data are on M2 for France, M1 for all others.
 a. France, Italy, Japan, Sweden, United Kingdom, and West Germany.
 b. Rate of change of the money supply less rate of change of trend real GNP.

Figure 7-3 indicates that U.S. authorities pursued a tighter monetary policy than monetary authorities in the other six countries in 1960–80, though U.S. growth rates were in phase with the other countries' after the mid-1960s. When the rate of growth of M1 less the rate of growth of trend real GNP is used to measure monetary expansiveness, the message is the same; in every year the other six appear to have pushed their economies harder, fueling inflation in the process.⁷ The data in table 7-1 confirm that with a couple of exceptions in the 1960s, U.S. monetary policy was less expansive than that of the other industrial societies. This pattern is, of course, consistent with the differences between the United States and the other six with respect to unemployment and inflation rates.⁸

The enormous supply shock of 1973–75, which originated largely in the quadrupling of petroleum prices by the Organization of Petroleum Exporting Countries (OPEC), provides a particularly stark illustration of the choices facing political authorities. The effects of the oil price rise were simultaneously inflationary and contractionary, and policymakers had to decide between accommodating the inflation, allowing nominal demand to grow at a pace sufficient to prevent sharp increases in unemployment, and pushing against the inflation at the cost of exacerbating the contraction. Figure 7-4 illustrates the range of monetary policy responses in relation to the apparent short-run impact on unemployment in the seven countries.⁹ As policy activists would predict, there is an inverse association between the variables. Not surprisingly, Sweden and the United States are the limiting cases. Swedish officials reacted to the OPEC shock with a vigorous expansion of the money supply and succeeded in maintaining the volume of employment during the crisis (unemployment actually declined somewhat). A much more restrictive policy was pursued in the United States, and unemployment rose by more than 3.5 percentage points. The performance of the Federal Republic of Germany more closely resembles the experience of the United States than the rest of Europe,¹⁰

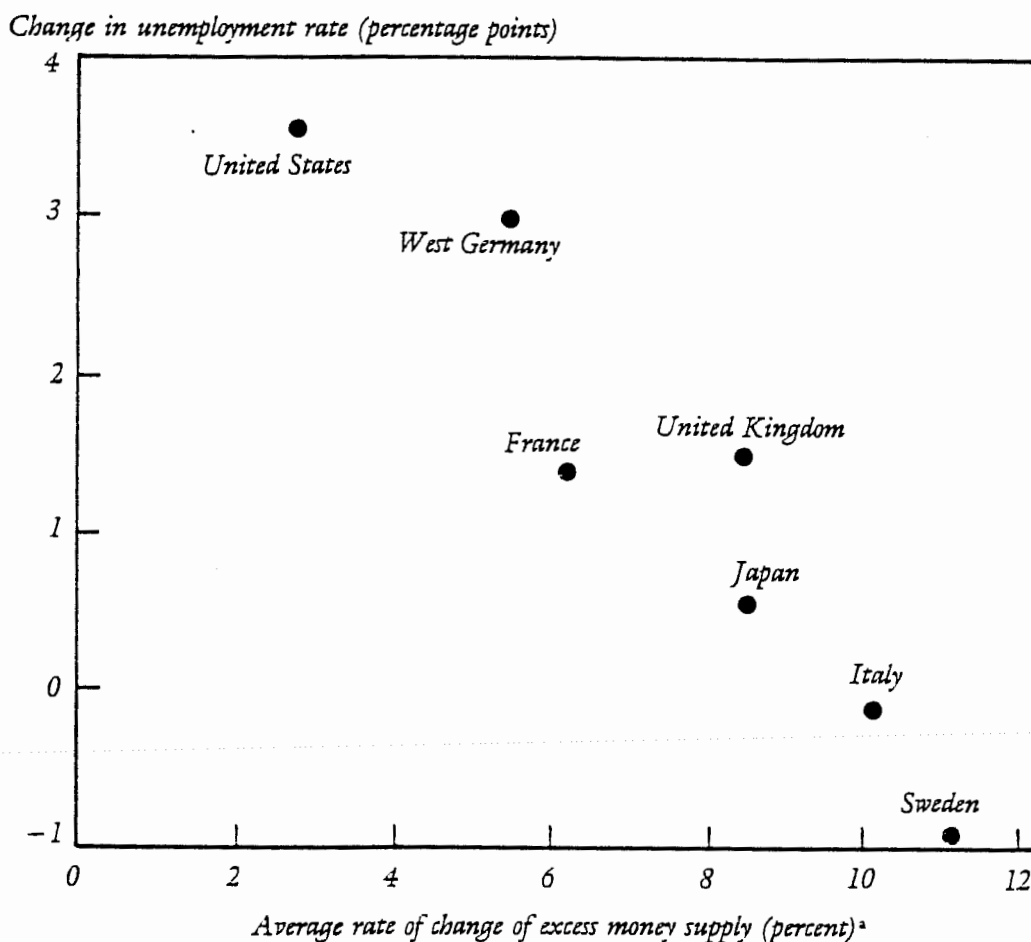
7. In plots of the real money supply—the rate of growth of M1 less the inflation rate—the U.S. growth rate oscillates around a mean of about 0, the other six around a mean of 4.4.

8. Differences in conventional monetary (or fiscal) policy behavior do not account entirely for international variation in unemployment and inflation; exposure to international influences, as well as legal restraints on layoffs, manpower policies, and other institutional factors also affect unemployment as well as inflation rates.

9. The results in figure 7-4 are consistent with the conclusions of James L. Pierce and Jared J. Enzler, "The Effects of External Inflationary Shocks," *Brookings Papers on Economic Activity*, 1:1974, pp. 47–54. (Hereafter *BPEA*.)

10. If the outflow of German guestworkers were included among the unemployed, the increase in the German unemployment rate would have been greater.

Figure 7-4. *Changes in Unemployment and Average Growth of the Money Supply Less Growth of Trend Real Output in Seven Countries, 1973-75*



Sources: Same as for figure 7-2. Data are on M2 for France, M1 for all others.

a. Average rate of change of the money supply less average rate of change of trend real GNP.

which is consistent with the popular wisdom about German aversion to inflation.

The central political question of interest here is why some governments exhibited less monetary discipline than others by monetizing deficits and price and nominal wage increases, especially during the major episodes of inflationary pressure. Put another way, why were some governments more inclined to “supply” inflation and less inclined to “supply” unemployment than other governments? In particular, why were U.S. authorities apparently less tolerant of inflation and more tolerant of unemployment than political officials elsewhere? That question can be partially answered by investigating the demand side of the issue—the response in terms of popular support for elected chief executives or political parties that follows changes in unemployment, inflation, and real income growth.

The Economy as a Political Issue

In March 1968 Prime Minister Harold Wilson reportedly declared to the parliamentary Labour party: "All political history shows that the standing of a Government and its ability to hold the confidence of the electorate at a General Election depend on the success of its economic policy."¹¹ His declaration is consistent with the conclusions of many empirical studies of the impact of macroeconomic performance on public support for incumbent political parties and chief executives. Moreover, during the 1970s the state of the economy (principally, unemployment and inflation) unquestionably was the most salient issue for the mass publics of most industrial democracies.

Perhaps American authorities exhibited less willingness to accommodate inflation and push against unemployment than their counterparts in other industrial societies because mass political support for elected officials in the United States was more sensitive to inflation and less sensitive to unemployment than elsewhere. The differences between the United States and the other six countries (as well as differences among the other six) might therefore reflect, at least in part, the political response of governments to the relative weights attached to inflation and unemployment in their respective mass publics. American officials may have shown more discipline vis-à-vis inflation because demand for deflationary policies was greater.

The public's relative aversion to, or demand for, various economic outcomes in France, Great Britain, West Germany, Sweden, and the United States is estimated in table 7-2. The estimates are based on the idea that political support for an incumbent party (in parliamentary systems) or chief executive (in presidential systems) is influenced by the incumbent's cumulative discounted macroeconomic performance relative to that of its predecessor. The coefficients of statistical models based on quarterly observations from the late 1950s or 1960s through the end of 1978 are used to infer the degree of political support for the chief executive or governing party in each country.

For every country the performance variables are the rate of unemployment, the proportional changes in the rate of the rate of unemployment, the rate of growth of per capita real personal disposable income, the rate

11. David Watt, *Financial Times* (London), March 8, 1968.

Table 7-2. *Change in Support for Political Leaders in Five Countries in Response to Sustained Increases in Rates of Unemployment, Inflation, and Income Growth in the 1960s and 1970s*

Percentage points

Country	Quarters covered	Change in support in response to a 2 percent increase in			
		Real income growth ^a	Unemployment	Consumer price inflation	Change in inflation rate ^b
France	1969:4-1978:4	+3.8	-2, -3 ^c
Sweden	1967:1-1978:3	...	-11.5	-0.5	...
United Kingdom	1959:4-1978:4	+2.8 ^d	-6.4	...	-2.6
United States	1961:1-1978:4	+5.4 ^d	-4.5	-6.2 ^d	...
West Germany	1957:4-1978:4	+2.1	-2.5	-1.7	...

Sources: Douglas A. Hibbs, Jr., with the assistance of R. Douglas Rivers and Nicholas Vasilatos, "On the Demand for Economic Outcomes: Macroeconomic Performance and Mass Political Support in the United States, Great Britain and Germany," *Journal of Politics*, vol. 44 (May 1982), pp. 425-62; Douglas A. Hibbs, Jr., and Henrik Madsen, "The Impact of Economic Performance on Electoral Support in Sweden, 1967-1978," *Scandinavian Political Studies*, vol. 4, no. 1 (1981), pp. 33-50; Douglas A. Hibbs, Jr., with Nicholas Vasilatos, "Economics and Politics in France: Economic Performance and Mass Political Support for Presidents Pompidou and Giscard d'Estaing," *European Journal of Political Research*, vol. 9 (June 1981), pp. 133-45.

a. Per capita real disposable income.

b. Rate sustained for four quarters.

c. Measurement problems make it difficult to estimate effect.

d. Adjusted for adverse effects of shifts in the terms of trade following the OPEC supply shock.

of inflation, and changes in the rate of inflation. For the United Kingdom a term for changes in the dollars-per-pound exchange rate is included. Exchange rate fluctuations of course were influenced by Britain's relative inflation performance.

The estimates in table 7-2 indicate that political support in the five countries is quite sensitive to movements in the unemployment and real income growth rates.¹² In all the countries except Sweden responses to an increase in the growth rate of real disposable income are positive, ranging between 2.1 and 5.4 percent. Since elections often hinge on margins of only a few percentage points of the vote, these results are not merely of academic interest. Macroeconomic management and performance obviously can have a pivotal impact on electoral shifts.

In each country, increases in the unemployment rate yield declines in political support, although in the case of France measurement problems

12. The responses to a sustained increase of 2 percentage points in the economic variables represent the political effects of changes in economic performance after all adjustment lags have worked through the underlying dynamic model. Given the rate of decay of the lag coefficients in the distributed lag regressions, sustained changes mean for practical purposes no more than six years.

with the unemployment data make it difficult to estimate unambiguously the quantitative political effects. The estimated response in Sweden is particularly large. This undoubtedly reflects the preeminence in Swedish political life of the full employment issue. Low unemployment has been the most important theme of the Swedish Social Democrats' electoral mobilization strategy since the early 1930s, and it kept them in control of the government continuously for forty-four years until their narrow defeat by the bourgeois coalition in 1976. Mass political support for British governments also exhibits great sensitivity to unemployment fluctuations, especially when evaluated relative to the political response to changes in the nominal rate of inflation. Again this probably reflects the Labour party's emphasis on low unemployment in political discourse which has generated widespread public expectations of sustained high employment.

Taken together, the general political responses to unemployment, as indicated in table 7-2, suggest that unemployment continued to have adverse political consequences deep into the 1970s, that is, even during a period that provided generous unemployment compensation and other income- and employment-contingent transfers. True, tax and transfer systems do spread the costs of unemployment more widely, and for many people loss of employment no longer poses an economic disaster. In the 1930s the unemployed and their families often went hungry; today most suffer temporary reductions in income.

However, it is no mystery why high unemployment rates tended to erode governments' mass political support. Unemployment after all represents lost real output and underutilized human resources. In the United States, for example, each extra percentage point of unemployment was accompanied by a decline of at least 2 percent in real output, which in 1980 was equal to \$56 billion of unproduced output, or \$700 per household. Moreover, the measured unemployment rate is just that—a rate—and a far larger fraction of the labor force experiences bouts of actual unemployment over any given time interval than the average percentage numbers might suggest.¹³ In addition to households touched directly by some form of unemployment or underemployment, an even larger number will also be aware of unemployment among relatives, friends, neighbors, and work mates.

13. In the United States, for example, a useful rule of thumb for estimating the proportion of the work force experiencing one or more spells of unemployment during any given twelve-month period is to multiply the official average annual rate by about 3.

The estimates of the responses to inflation shown in table 7-2 indicate that the political costs of deteriorating nominal economic performance were less uniform cross-nationally than the analogous costs of higher unemployment and lower real income growth. In France and Sweden the decline in political support associated with increased consumer price inflation appeared to be negligible-to-vanishing. In these countries any adverse political consequences of inflation were transmitted through the impact of rising prices on the real income growth stream (price increases running ahead of money income growth rates) or on the unemployment rate (assuming, contrary to the Keynesian view, that high or accelerating inflation yields increased unemployment). At least until the Thatcher government the British results indicated that the electorate was not averse to inflation per se, but that changes in the inflation rate (accelerations and decelerations of prices) had important consequences for mass political support. Since the change (first difference) of the inflation rate is a reasonable (though simple) measure of inflationary surprises, this result is consistent with the view of contemporary economic theory that the pain induced by rising prices is due primarily to unanticipated bursts of inflation.

Only in West Germany and the United States did the simple rate of change of consumer prices—the inflation rate—appear to have statistically and politically significant consequences. The estimates imply that voters in these countries are averse to rising prices per se, for the models take into account the rate of change of real personal disposable income. Hence, even if money incomes kept pace with price rises, governments nevertheless suffered losses of political support as a result of inflation.

As Keynesian theorists stressed throughout the 1970s, little in conventional economic theory adequately explained this aversion to inflation. Traditionally it was argued that the principal economic costs of anticipated inflation are the resources devoted to economizing cash balances and fixed-interest-rate assets. Surely this is a trivial matter, particularly when viewed in relation to the costs of unemployment. The costs usually associated with unanticipated bursts of inflation are more extensive, but they do not provide a convincing explanation of the public's aversion to rising prices. Empirical evidence (which is thin and pertains primarily to the United States and the United Kingdom) suggests that the aggregate wage and salary income share was not affected adversely by inflation and that rising prices had no dramatic effects on the size distribution of

income.¹⁴ Unanticipated price increases tended to arbitrarily redistribute wealth from nominal creditors to nominal debtors and the aggregate amounts involved were probably large. But most people absorbed losses on some accounts (fixed price assets) and gained on others (fixed price liabilities). The aged poor, retirees whose economic well-being depends on social security or state pensions, are often thought to be more exposed to inflation than other groups. However, during the period of sustained inflation, state transfers to the old were indexed to inflation either by statute or by firmly entrenched custom in virtually all industrial societies.

To the extent that state revenue is raised by direct taxation based on progressive nominal schedules, inflation increases the effective rate of income taxation (inflationary fiscal drag) unless the authorities take compensatory action. Although discretionary tax cuts neutralized much of the potential gross transfer to the state, inflation probably has fueled a rate of growth of government revenue somewhat higher than political authorities would have achieved by making explicit real claims on the electorate.¹⁵ The (unobservable) difference between the historical time path of effective tax rates and what would have occurred in a world of stable prices (or indexed taxes) may explain part of the public's dislike of inflation that is reflected in table 7-2.¹⁶

However, neither the income, wealth, nor tax effects of inflation appear large enough to explain (or, in objective economic terms, to justify) the degree of public aversion to rising prices relative to unemployment and real income growth that appeared to prevail in West Germany and the

14. See Douglas A. Hibbs, Jr., "Public Concern about Inflation and Unemployment in the United States: Trends, Correlates and Political Implications," in R. E. Hall, ed., *Inflation* (University of Chicago Press, 1982); Douglas A. Hibbs, Jr., *Economic Interest and the Politics of Macroeconomic Policy* (Massachusetts Institute of Technology, Center for International Studies, 1976); Douglas A. Hibbs, Jr., "The Mass Public and Macroeconomic Performance: The Dynamics of Public Opinion toward Unemployment and Inflation," *American Journal of Political Science*, vol. 23 (November 1979), pp. 705-31; Stanley Fischer and Franco Modigliani, "Aspects of the Costs of Inflation" (Massachusetts Institute of Technology, 1977); David Laidler and Michael Parkin, "Inflation: A Survey," *Economic Journal*, vol. 85 (December 1975), pp. 741-809; David Piachaud, "Inflation and Income Distribution," in Fred Hirsch and John H. Goldthorpe, eds., *The Political Economy of Inflation* (Harvard University Press, 1978).

15. In the United States as a result of discretionary tax cuts at the federal level, average effective tax rates increased little if at all between 1960 and 1975, fluctuating around 11 percent of adjusted personal income. See Emil M. Sunley, Jr., and Joseph A. Pechman, "Inflation Adjustment for the Individual Income Tax," in Henry J. Aaron, ed., *Inflation and the Income Tax* (Brookings Institution, 1976), p. 157.

16. If the unobserved difference between the quantity of government revenue (or spending) demanded and supplied is approximately a linear function of the inflation rate, then the observed rate of change of prices is an adequate proxy.

United States. Less tangible, psychological factors are therefore probably more important than concrete economic costs.¹⁷ Some empirical evidence does indicate that high rates of inflation have been accompanied by high variability of the inflation rate, and such variability presumably heightens uncertainty about the future stream of prices.¹⁸ It is also possible that people failed to credit the inflation-induced gains on fixed-interest liabilities such as home mortgages against the losses incurred on such money-valued assets as pension and life insurance reserves. Perhaps more important, they may not have understood the connection between rising wages and rising prices.¹⁹ There is some evidence that inflation tends to be viewed as an arbitrary tax that chips away the purchasing power of nominal income increases that people believe they deserve to enjoy fully. For example, in the United States nominal personal disposable income per household rose by about 8 percent between 1975 and 1976, but the real gain was a more modest 2.4 percent because of a 5.6 percent increase in consumer prices. Some people could have had the mistaken idea that household purchasing power could have risen by 8 percent, or nearly so, if prices had not risen.

An important factor contributing to popular concern about inflation after 1973 was probably the decline in real income experienced by consumers of food, raw materials, and especially petroleum as a result of the shift in the terms of trade in favor of the producers of these commodities. It is likely that many people blamed rising prices for the shrinkage of their real incomes, even though the immediate post-OPEC surge of inflation was to a large extent merely the mechanism of a change in relative prices. Had the real loss absorbed by energy consumers taken place about a stable price level, the pain would not have been any less unpleasant, but inflation could not have been held responsible.

Political Support and Economic Outcomes

Since the macroeconomic performance variables do not all share the same metric, and because the typical level of political support for incumbents varies across political systems, it may be misleading to assess

17. For some ideas along these lines, see Arthur M. Okun, "Inflation: Its Mechanics and Welfare Costs," *BPEA*, 2:1975, p. 383.

18. Dwight Jaffee and Ephraim Kleiman, "The Welfare Implications of Uneven Inflation" (University of Stockholm, Institute for International Economic Studies, 1975).

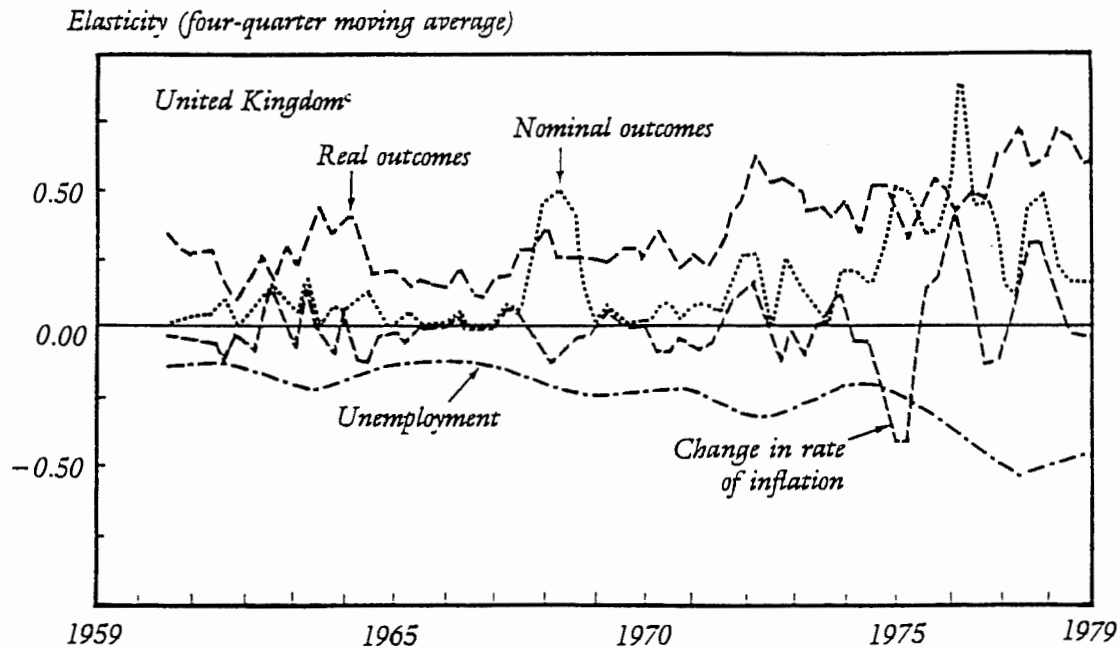
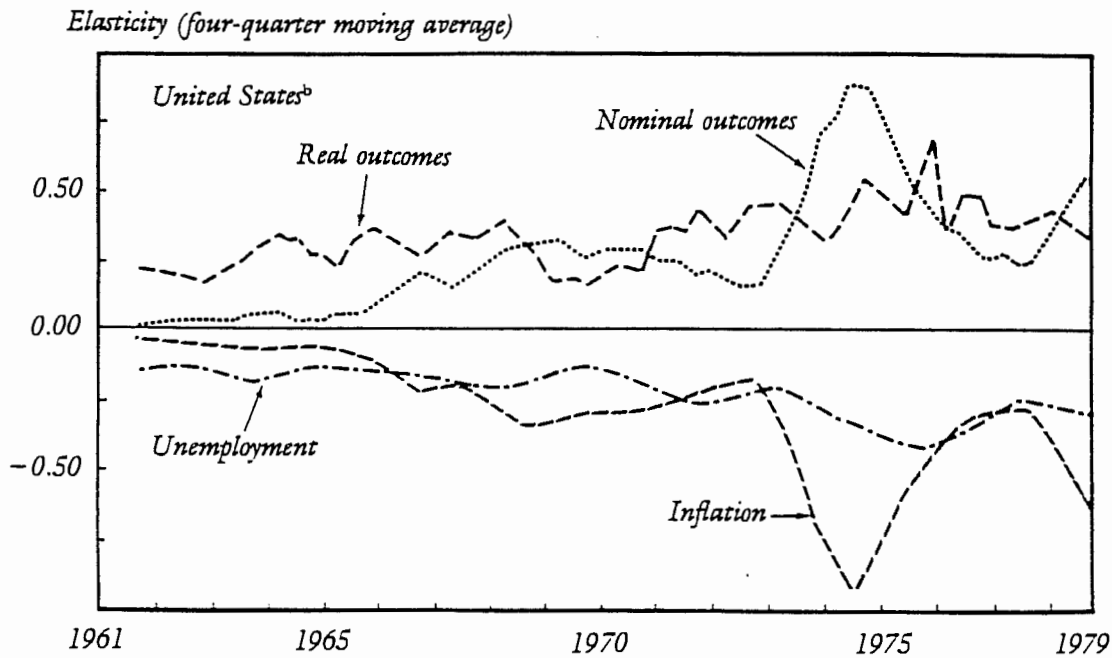
19. George Katona, *Psychological Economics* (Elsevier, 1975).

the relative and comparative impact of inflation, unemployment, and real income growth on popular support for political authorities by direct inspection of results such as those reported in table 7-2. Another means of evaluating the relative sensitivity of political support to economic events is to compare the partial elasticities implied by the regression coefficients of the equations used to model political support. The elasticities suggest the *proportional* response of the political support ratings expected from *proportional* changes in the economic variables and are unaffected by differences of scale. Such elasticities implicitly reveal the public's marginal, proportional aversion to, or demand for, economic outcomes.

Figure 7-5 displays time plots of the estimated long-run political support elasticities for each period in the time range of the underlying regression analyses. Means of the elasticities for the 1960s and 1970s are also reported in the figures. The elasticities are interpreted in the following way. During the 1960s in Great Britain, for example, if the real variables (the unemployment rate and the real income growth rate) changed simultaneously in an adverse direction by a factor of 1 percent, on average the expected long-run proportional decline in the government's political support would equal a factor just under 0.33 percent. In the 1970s the expected long-run proportional decline in political support from the same sustained proportional movement in the real macroeconomy would have been approximately equal to a factor of 0.58 percent. If the adverse change in the macroeconomy was more like 100 percent (that is, if the unemployment rate doubled and the real income growth rate fell by a factor of 100 percent), the expected long-run proportional decline in the incumbent party's political support during the 1970s would have been a factor of about 58 percent. In other words, it is estimated that the government party's political support would have fallen on average by more than one-half.

In terms of proportional responses to proportional changes, mass political support for incumbents is considerably more sensitive to economic performance in the United Kingdom and the United States than in West Germany and Sweden. In large part this probably reflects the fact that macroeconomic performance (particularly unemployment performance) in the 1960s and 1970s was considerably better in the latter pair of countries (see table 7-1) and so proportional changes in performance constitute comparatively small absolute changes in economic conditions. And, because these countries performed so well in the 1960s and absorbed the economic shocks of the 1970s better than most others, macroeconomic

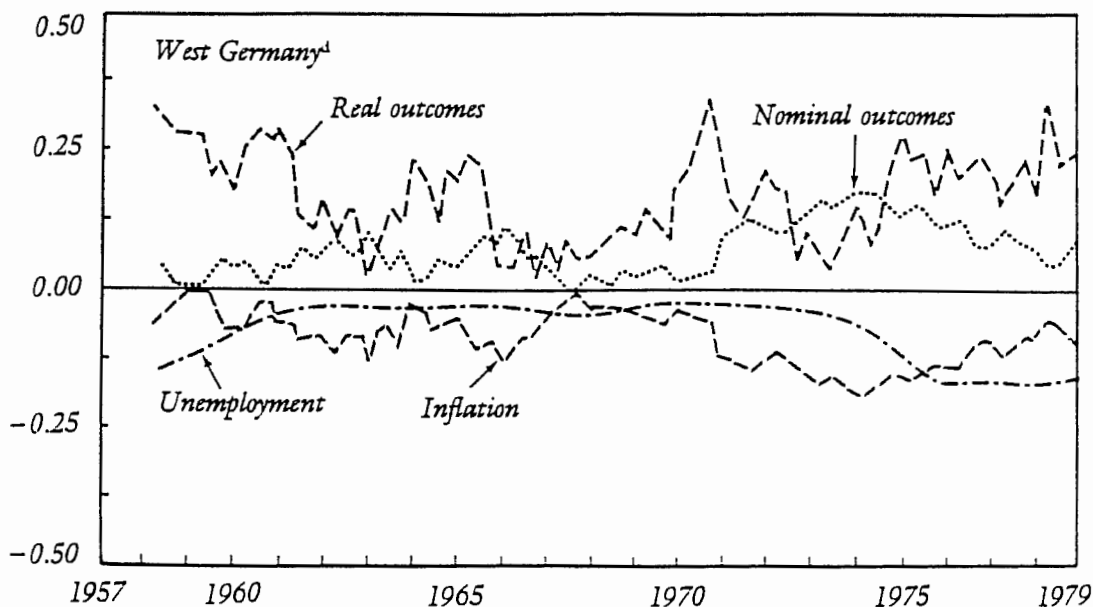
Figure 7-5. *Implied Long-run Elasticities of Political Support with Respect to Macroeconomic Outcomes in Four Countries in the 1960s and 1970s^a*



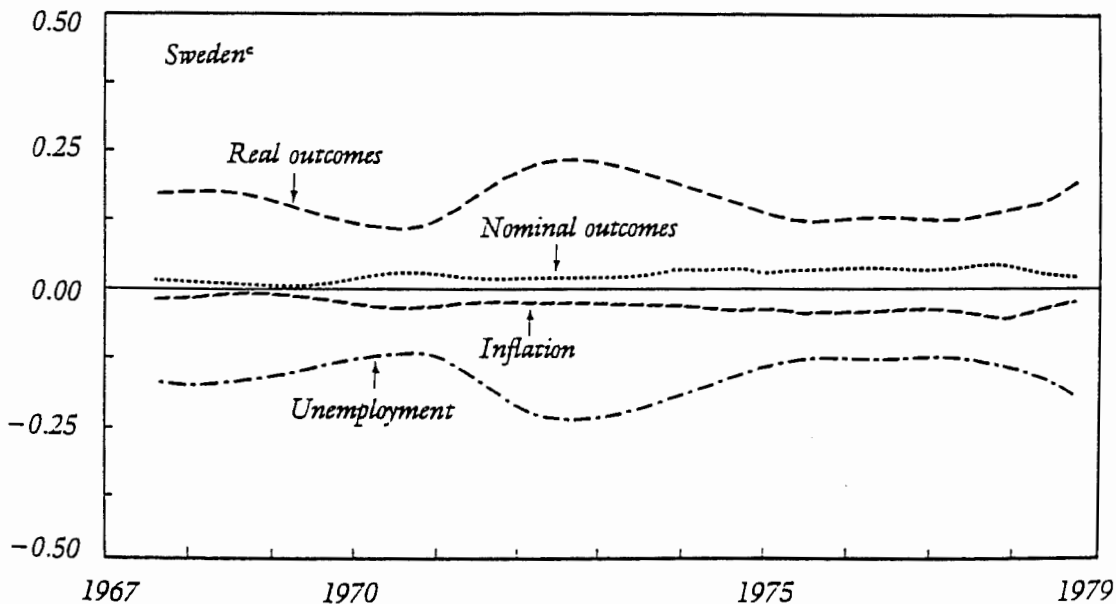
Sources: Douglas A. Hibbs, Jr., with the assistance of R. Douglas Rivers and Nicholas Vasilatos, "On the Demand for Economic Outcomes: Macroeconomic Performance and Mass Political Support in the United States, Great Britain and Germany," *Journal of Politics*, vol. 44 (May 1982), pp. 425-62; Douglas A. Hibbs, Jr., and Henrick Madsen, "The Impact of Economic Performance on Electoral Support in Sweden, 1967-1978," *Scandinavian Political Studies*, vol. 4, no. 1 (1981), pp. 33-50; Douglas A. Hibbs, Jr., with Nicholas Vasilatos, "Economics and Politics in France: Economic Performance and Mass Political Support for Presidents Pompidou and Giscard d'Estaing," *European Journal of Political Research*, vol. 9 (June 1981), pp. 133-45.

a. Each graph depicts below the 0.0 line the changing elasticity of political support with respect to changing unemployment rates and with respect to changing inflation rates. Above the 0.0 line the absolute value of the elasticity of political support with respect to real macroeconomic outcomes (unemployment and growth) is contrasted with the absolute value of support with respect to the nominal (inflation) outcome.

Elasticity (four-quarter moving average)



Elasticity (four-quarter moving average)



b. For 1961-69 the mean elasticity for unemployment is -0.156 , for inflation -0.146 , for real outcomes $+0.287$, and for nominal outcomes $+0.146$; for 1970-78 the mean elasticities are -0.282 , -0.436 , $+0.492$, and $+0.436$, respectively.

c. For 1961-69 the mean elasticity for unemployment is -0.162 , for the change in the rate of inflation -0.010 , for real outcomes $+0.325$, and for nominal outcomes $+0.230$; for 1970-78 the mean elasticities are -0.319 , -0.001 , $+0.581$, and $+0.525$, respectively.

d. For 1961-69 the mean elasticity for unemployment is -0.027 , for inflation -0.060 , for real outcomes $+0.157$, and for nominal outcomes $+0.063$; for 1970-78 the mean elasticities are -0.094 , -0.116 , $+0.295$, and $+0.136$, respectively.

e. For 1967-69 the mean elasticity for unemployment is -0.158 , for inflation -0.012 , for real outcomes $+0.158$, and for nominal outcomes $+0.012$; for 1970-78 the mean elasticities are -0.164 , -0.032 , $+0.164$, and $+0.032$, respectively.

policy was not so contentious a political question in West Germany and Sweden as elsewhere.

In all of the countries, except Sweden, the elasticities increase, typically quite dramatically, from the 1960s to the 1970s; in West Germany, they approximately double, implying that a given proportional change in economic performance would have had twice as much proportional impact on political support in the 1970s as in the 1960s. The elasticities of real outcome also nearly double from one period to the other in the United States and Great Britain, and in the United States the elasticities of nominal (inflation) outcome are on average about three times larger in the later than in the earlier period. This is hardly surprising in view of the favorable economic conditions of the 1960s—virtually a golden age of economic performance—and the economic stagnation (or stagflation) characteristic of later years.

In the case of Sweden it is possible to generalize only for an era of high performance that deteriorated somewhat in the late 1970s. Aside from the small bulge in 1973–74, the real elasticities for Sweden (based entirely on the unemployment rate variable) increased only negligibly because Sweden's unemployment record was so consistently favorable. Although the underlying sensitivity of political support to unemployment is sizable for the Swedish public (see table 7-2), Sweden's unemployment rate stood lower in the 1970s and exhibited a smaller relative increase from the 1960s to the 1970s than any other country's. Even though the Swedish inflation rate more than doubled from the 1960s to the 1970s, the inflation elasticities are for practical purposes negligible in both decades because, as table 7-2 indicates, political support simply was not very responsive to nominal economic outcomes in that country.

A third notable feature of figure 7-5 is that in both decades the elasticities of the real macroeconomy (unemployment and the real income growth rate taken together) are in every country larger on average than the absolute value of the nominal, inflation elasticities. In other words, viewed in terms of elasticities, mass political support for incumbents was more sensitive to real income growth and unemployment than to the economy's nominal, inflation performance, despite the fact that so much political analysis of the 1970s gives the impression that the political fortune of governments in the industrial democracies was dominated by their inflation performance records. Nevertheless, looking back, it is clear that the impact of the inflation rate, and changes in that rate relative to the rate of unemployment and to the real variables taken together, did

increase markedly in the United States and Great Britain. In Britain the change came with the onset of the OPEC-induced instability of inflation rates in 1974, in the United States (and to a much lesser extent in West Germany) with the worldwide price acceleration brought on by the tight labor markets and the policy of (hidden) deficit finance associated with the Vietnam War.

In Great Britain, the United States, and West Germany the terrible recession of 1975-76 of course tempered inflation's relative impact. Nonetheless, the dramatic increase in inflation rates in the 1970s may have implanted long-lasting effects on the macroeconomic priorities of the OPEC generation, perhaps similar to those of the supposedly traumatic impact of the Weimar hyperinflation on older generations in Germany or of the Great Depression on generations of the 1930s in most industrial societies. This made the political outcomes of the 1980s take place in a different matrix. If the discomfort produced by the great post-OPEC inflation does indeed persist in the political and economic memories of the mass publics in the industrial democracies, giving rise to a sustained demand for deflation, then the thrust of macroeconomic policy for many years to come might be turned away from expansion and growth to deflation and price stability. This would represent a rather profound change in the political economies of most industrial democracies.

Is there any evidence from table 7-2 and figure 7-5 that the comparative sensitivity of U.S. macroeconomic policy authorities to inflation as opposed to unemployment reflected a distinctive aversion to rising prices in the American electorate? If the elasticities of nominal outcomes are persistently larger than the elasticities of real outcomes (or, more narrowly, if in the lower frames of the figure the inflation elasticities typically have larger negative values than the unemployment elasticities), that would provide some evidence that a chronic demand for deflation prevailed in the electorate. Policy might then be interpreted as a rational political response to pronounced public preferences in favor of greater price stability.

There is some evidence in the United States favoring this interpretation from the late 1960s on and, more dramatically, during the period following the first OPEC shock. Therefore, the U.S. response to the OPEC catastrophe (see figure 7-4) does appear to be consistent with, or responsive to, aggregate public sentiment. However, for most of the 1960s the nominal elasticities were smaller than the real elasticities; indeed, for the first part of the decade the inflation elasticities were smaller (negative) than the unemployment elasticities alone. This result suggested a political

asymmetry in the sense that the expected payoff in political support from pushing harder on the real macroeconomy should have been large in relation to the political costs that would have accompanied some acceleration of prices in those periods. In short, during the early 1960s Americans probably got less expansive performance from policymakers than they were in fact willing to risk.

The institutional autonomy of monetary authorities from elected political officials in the United States may explain some of the imbalance. Monetary officials invariably give great weight to inflation (they usually are drawn from and have intimate connections with the financial community), and if given free rein they generally are unwilling to sacrifice control of the price level to push growth and expand employment. It is unlikely, however, that the Federal Reserve would (or could) have resisted vigorous and sustained political pressure to push the economy harder. Its statutory autonomy would not have survived if it had.

So part of the explanation probably resides in the fact that organized labor—in all industrial societies the key producer group mobilizing on behalf of high employment policies—was (and is) comparatively weak in the United States. A viable political base in support of greater attention to unemployment probably existed in the United States throughout most of the 1960s (and the 1950s), but in the absence of a strong trade-union movement or a political party harnessing public opinion on the issue, the latent political sentiment was underexploited. As a result, the interests of the financial community and other organized economic groups who were more concerned about inflation than high employment and rapid growth probably received greater weight in the policy process than in other industrial countries, particularly Sweden.

Although a gap also opened up between the inflation and unemployment elasticities in West Germany after the acceleration of prices in the first half of the 1970s, the magnitudes are simply too small to have been a decisive factor in the domestic political environment confronting German macroeconomic policymakers. Hence there is no evidence that the economic situation was severe enough to have produced disequilibrating political pressures. Notice, however, that in West Germany (figure 7-5) the sizable response of the elasticities of mass political support with respect to inflation, following what by international standards was a modest acceleration of prices (see table 7-1), conforms with the claimed sensitivity of the German public to rising prices. The cautious monetary policies pursued during the 1970s by the Bundesbank, which enjoys great

constitutional autonomy, were apparently underpinned by considerable popular support. Part of the reason of course may be that the large foreign component of the German work force sheltered domestic labor from the consequences of contractions.

Thus throughout the 1960s most European societies were willing to risk inflation and secured policies that conformed to these preferences; West Germans, however, sought caution and got caution; and the U.S. public might well have gotten more restraint than it wished. To recapitulate, the U.S. unemployment rate seems to have been too large to be consistent with a support-maximizing policy and outcome configuration. There simply was no evidence of a broad-based demand for deflation relative to the demand for higher growth and employment.

This situation began to change in the 1970s as inflation became a major and at times dominant influence on mass political support for U.S. presidents. Deflationary policies, although painful, became politically more viable; nonetheless, contractionary policies designed to put downward pressure on the inflation rate still conferred substantial political penalties, particularly when their benefits were small and slow in coming.

Obviously by the beginning of the 1980s opinion had evolved so far that the American and British publics elected policymakers pledged to restrictive measures. Yet consistency across national lines was hardly present. The West Germans chose a Christian Democratic government in part as reaction to growing unemployment; the French turned to their Socialist party for the same reason. Incumbents were generally punished for stagflation, through the beginning of the new decade.