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Political and Business Cycles: Interferences and Socio-Economic Implications in Romania and Republic of Moldova

Percic Stanislav
Alexandru Ioan Cuza University of Iaşi, Romania
stanislav.percic@yahoo.com
Apostoaie Constantin-Marius
Alexandru Ioan Cuza University of Iaşi, Romania
marius.apostoaie@uaic.ro
Ulian Galina
Moldova State University, Republic of Moldova
galina_ulian@mail.ru

Abstract

The electoral instability falls into the continuous shifts in paradigms, systems, values and economic performance which countries around the world still experience. We believe it is common sense that the election process in a democratic country has an important impact (even a manipulation effect) on its economy. In this context, this paper aims to test the interferences between the political cycle and the business cycle in Romania and Republic of Moldova. The paper aims to verify if the government has an expansionist policy before the elections, which leads to a lower level of taxes and unemployment and contributes, at the same time, to the increase of the consumption per inhabitant, of the GDP and of the subventions granted by the government, followed by a restrictive one.

Key words: business cycle, political cycle, inflation, unemployment, economic growth
J.E.L. classification: E32, D72, E52, E61

1. Introduction

A cycle can be defined as any phenomenon which repeats itself at relatively regular time intervals. If a system is taken out of its state of equilibrium, its "inertia" will attempt to restore it to the initial state, forming thus a cycle. Although cycles are present everywhere, they never appear at perfect periodic intervals and the length of implementation varies from one cycle to the other.

During the past decades, researchers observed and studied a phenomenon considered at least interesting for many countries: a correlation between the political cycle and the evolution of the economic cycles. This phenomenon shows that, before elections, the economic policy adopted by the government is expansionist, accompanied by the reduction of taxes and of the unemployment rate and by the increase of the GDP, of subventions and of consumption per inhabitant and that, immediately after the elections, the policy becomes restrictive. This observation is the starting point of our research.

2. A brief literature review

The research works concerning the interference between the political cycle and the business one can be divided into two distinct time periods.

In the *first period*, the theoretical basis of electoral manipulations was first laid down by Nordhaus [1975] and Lindbeck [1976]. These researches involve the Philips' curve and the models of economic pre-rational expectations. Nordhaus [1975] proved that governments tend to adopt a series of expansionist macroeconomic policies during the period prior to the elections with a view to reducing unemployment and to increasing their chances of being reelected. Nevertheless, the cost of such a policy consists in the increase of inflation, which is visible only after the elections. Hibbs' model concerning the "partisan" cycles [Hibbs, 1977] focuses on the permanent and systematic differences with regard to inflation – unemployment in the combinations chosen by various political parties.

The *second period* approaches the theory of political cycles from the perspective of the theory of games. It is worth mentioning the reference works of Cukierman and Meltzer [1986], Rogoff [1990], Sibert [1990], Persson and Tabellini [1990] who suggest rational opportunistic models, whereas Alesina [1987] proposes a partisan rational model of political cycles. The models developed during the second period differentiate themselves from those of their predecessors at least through two different hypotheses:a) the rationality of economic operators, which leads to the idea that real economic activity is not influenced by the monetary policy; b) the voters' rationality, which involves the assumption that they cannot be systematically deceived.

The model developed by Rogoff [1990] is the first one which speaks of the presence of political cycles as a consequence of asymmetrical information which travels between the voters and the politicians. Rogoff shows that, if governments want to have a high level of competence, they tend to adopt an expansionist policy in the period before the elections.

Also, the first empirical tests of political business cycles were carriedout mainly in developed countries, but produced only mixed results [Alesina and Roubini 1992], [Alesina et al., 1997], [Faust and Irons, 1999], [Heckelman 2006], [Grier 2008].

3. Models of political business cycles

There are two theoretical approaches to Political Business Cycles (PBC): opportunistic and partisan. Partisan models (as developed by Hibbs, 1977; and Alesina, 1987) assume a two-party political system in which each party has a different policy platform, with PBC arising due to politicians' pursuit of ideological goals. Opportunistic cycles, as initially developed by Nordhaus [1975], are created by incumbents manipulating economic variables in order to maximize their re-election chances just prior to elections. Opportunistic political cycles in fiscal policy variables occur both in developed and developing countries, although they are larger in the latter.

The theories of PBC can also be distinguished in models assuming adaptive [Nordhaus, 1975] and rational expectations [Cukierman and Meltzer, 1986], [Rogoff 1990], [Persson and Tabellini, 1990], [Rogoff and Sibert, 1988] of economic actors. In the traditional approaches with adaptive expectations, opportunistic policymakers can take advantage of an exploitable Phillips curve trade-off. Opportunistic policymakers can fool naive voters and stimulate the economy immediately before each election. In the approaches with rational expectations, informational asymmetries between politicians and voters take center stage in explaining electoral cycles. The incumbent exploits his information advantage to signal his economic competence before elections.

The classification based on the two criteria (whether policy makers have opportunistic or partisan motivations and whether voters evaluate candidates retro- or prospectively) allows us to identify four schools of thought in the PBC literature: (i) the pure opportunistic PBC; (ii) the strong partisan theory; (iii) the rational opportunistic PBC, and (iv) the weak (rational) partisan theory.

The pure opportunistic model is centered on the relation between the following two macroeconomic indicators: unemployment and inflation. In economy, in general, it is believed that a reaction of reversed proportionality exists between the level of unemployment and the inflation rate. Thus, the political factor must make a decision with regard to the reduction of inflation with a higher cost of unemployment or the decrease of the last mentioned indicator with a higher cost of inflation [Nordhaus, 1975].

The strong partisan theory was developed by Hibbs [1977] and is based on the correlation between ideological views and economic policies. According to Hibbs' theory, each party can be identified through its ideology. The partisan theory has divided the political spectrum in two guidelines: left and right. Left-wing parties choose a high level of inflation and a low unemployment rate. On the other hand, right-wing parties will opt for a low inflation rate and a high level of unemployment.

The rational opportunistic model

combines classical hypothesis of politicians having an opportunistic behavior with the ideas of competence and asymmetric information [Rogoff and Sibert, 1988]. Contrary to the pure opportunistic model, where voter don't "learn" from the politician's behavior, the term of rationality indicates that every voter try to maximizes individual preference function.

The weak (rational) partisan theory relies on the traditional operator's wish to resort to the "median voter". The obtained cycle is similar to the ideological cycle in which each party has a distinct set of ideologies which are unique. The difference arises from the desire to deviate from these ideologies in order to maximize votes. The logic behind this theory is explained by Alesina, Roubini Cohen [1997].

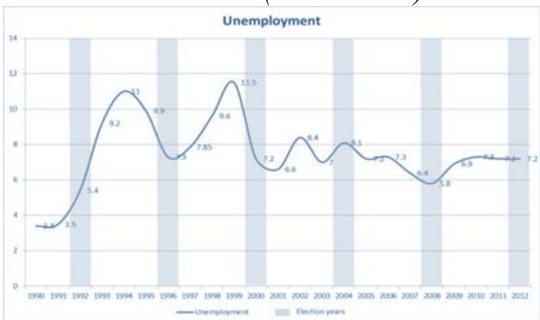
4. Political business cycles in Romania

Romania is a 'semi-presidential republic'. The executive functions are held by both the president and the government. The president is elected by popular vote for a maximum of two terms, and since the amendments in 2003, each term lasts five years. He appoints the prime minister, who in turn appoints the Council of Ministers. The legislative branch of the government, collectively known as the Parliament, consists of two chambers – the Senate with 140 members, and the Chamber of Deputies with 346 members. The members of both chambers are elected every four years by simple plurality.

This part of the study aims to test the interferences between the political/electoral cycle and the business cycle in Romania, verifying the hypothesis according to which the Romanian government had an expansionist policy before the elections, followed by a restrictive one.

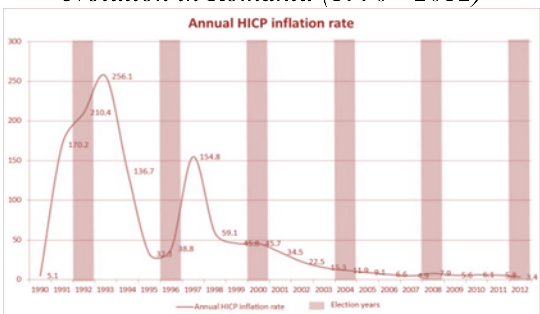
Following the analysis of the unemployment rate (see the Figure 1), we may notice that the labor force market was affected by severe imbalance over the 1990-2012 period. The most important imbalances are the ones between the active and the inactive population (unemployment rate). The unemployment rate shows signs of cyclicity, with significant decreases during the 1996, 2000, 2008 and even 2012 pre-electoral periods, followed by considerable increases of this index in the following periods (excepting the period after 2012, for which we didn't find data yet). The 1992 electoral year (and pre-electoral period) is an exception from the rule, because this year represents the first democratic election in Romania after a 40 years period of socialism. One can see that 2004 electoral year (and pre-electoral period) is also an exception from the rule, the unemployment rate increasing before the election and decreasing after that, fact explained by the Euro-Atlantic aspiration of the Romanian government (joining NATO in 2004 and European Union in 2007). Also we cannot overlook the fact that the migrating tendency of the Romanian population had an important impact on the unemployment rate.

Figure 1. The unemployment rate evolution in Romania (1990 - 2012)



Source: Authors' elaboration based on Eurostat data

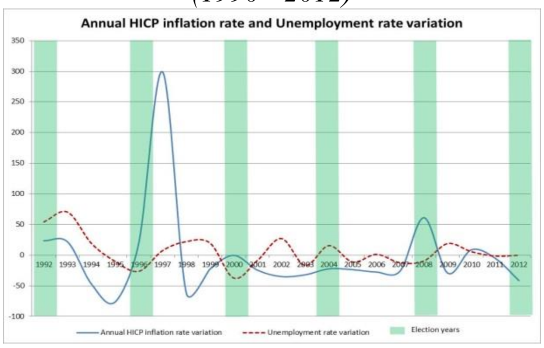
Figure 2. The annual HICP inflation rate evolution in Romania (1990 - 2012)



Source: Authors' elaboration based on Eurostat data

Figure 2 presents the annual evolution of inflation in Romania during the 1990-2012 period. The HICP inflation rate was cyclical and highly volatile until 1998. In the 1992 and 1996 pre-electoral periods, we may notice that the inflation rate increased to a significant extent. If the 1992 pro-political cycle evolution can be left to the socialist period inheritance, the 1996 electoral year (and pre-electoral period) represents a typical political interventions (not policy interventions). Starting with 1998 (with exception of 2008, when the Ministry of Finance unilateral decision to increase VAT from 19% to 24% led to an increase in inflation to 7.9%), the inflation registered a descending trend caused by the efforts of the National Bank of Romania to stabilize the inflation and the setting of the objective of direct inflation targeting in 2005. Overall, this indicator does not follow the trends of the model described by Nordhaus, but rather reflects the conclusions of the economists Alesina, Roubini and Gerald [1999]. The contradictory tendencies that can be traced from 1998 till present may also suggest a high level of independence of the National Bank of Romania.

Figure 3. The annual HICP inflation rate and unemployment rate variation in Romania (1990 - 2012)



Source: Authors' elaboration based on Eurostat data

All above mentioned findings can be proved using the graph of inflation and unemployment variation (see the Figure 3): excepting the 1992 and 2004 electoral years, before elections, the economic policy adopted by the government is expansionist, accompanied by the reduction of the unemployment rate and by the increase of inflation, and that, immediately after the elections, the policy becomes restrictive.

5. Political business cycles in Republic of Moldova

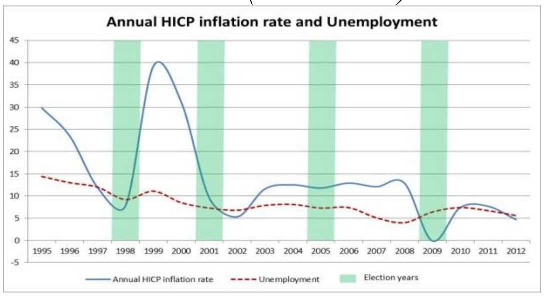
Republic of Moldova is a unitary parliamentary representative democratic republic. The Constitution of Moldova, adopted on July 29, 1994 sets the framework for the government of the country. In order to amend the Constitution of Moldova is required a parliamentary majority of at least two thirds, but in time of war or national emergency it cannot be revised.

The country's central legislative body is the unicameral Moldovan Parliament (Parlament), which is composed of 101 members elected by popular vote on party lists every four years. Under the electoral legislation, starting 1994 the parliamentary elections take place on the basis of the proportional system, with the whole territory of the country being an electoral constituency which elects 101 members of the Parliament. The elections shall take place not later than 3 months after the end of the mandate or dissolution of the precedent Parliament.

The head of state is the President of Moldova, who is elected by the Moldovan Parliament, requiring the support of three fifths of the deputies (at least 61 votes). The president of Moldova has been elected by the parliament since 2001, a change designed to decrease executive authority in favor of the legislative body. The president appoints a prime minister who functions as the head of government, and who in turn assembles a cabinet, both subject to parliamentary approval.

Analyzing the unemployment rate (see Figure 4), one can see that the trend is slightly downward, without incurring any cyclic movements over the 1995-2012 period. Official statistics registers stabilization of the level of logged unemployment. But, it is just a tip of the iceberg. In reality, more complex processes take place: the gap between registered and general unemployment (determined by the ILO Methodology) increases, the extent of hidden and chronic unemployment rises, outward migration of labor force grows and socio-demographic characteristics of the unemployed change. The emigration of population to other countries and improper definition of unemployment are the most appropriate explanations of the low and decreasing rate. In Moldova, the unemployment rate measures the number of people actively looking for a job as a percentage of the labor force. According to latest surveys, the unemployment has hit more than 80 percent of families that means at least a family member was dismissed or obliged to take an undesired vacation. Respectively, 25 percent of those who lost their jobs have plans to immigrate to other countries and the "unemployment rate" does not take them into account. The latest statistics indicates a number of over one million persons that works outside the country, especially in Russia and EU countries.

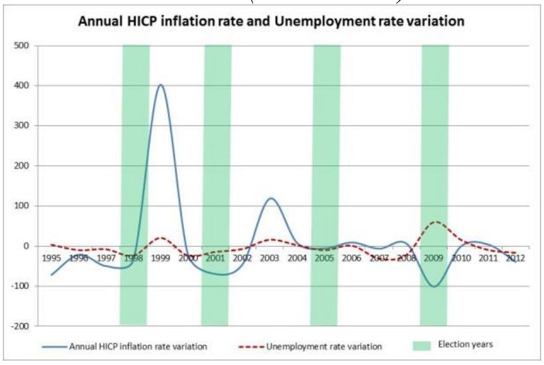
Figure 4. The annual HICP inflation rate and Unemployment rate evolution in Republic of Moldova (1995 - 2012)



Source: Authors' elaboration based on data provided by NBS of Republic of Moldova

Figure 4 also presents the annual evolution of inflation in the Republic of Moldova during the 1995-2012 period. The HICP inflation rate was cyclical and highly volatile during the analyzed period. In the 1998, 2001 and 2009 pre-electoral periods, one can notice that the inflation rate dropped significantly, but in the period after the election it returns to a high level. The explanation is very simple: the population perceives the change for the better by the prices decreasing (Bernd Hayo demonstrated that the success of the Government depends on keeping the rate of inflation to a level as low as possible). People have become accustomed to low prices when they lived in the Soviet Union. Moreover, they associate the Communist Party with that "good times" when they used to live "well". So why at the beginning of 90' in Moldova arose a pseudo-Communist Party, which speculated on the nostalgic feelings of the population by decreasing the inflation rate in pre-electoral periods and won the 1998, 2001 and 2005 elections. They used the same tactics in 2009, but disappointed population punished them with April Revolution from Moldova (or Twitter Revolution). After a long period of communist's governance, Republic of Moldova returns to democratic aspiration and Euro-Atlantic Integration.

Figure 5. The annual HICP inflation rate and Unemployment rate variation in Republic of Moldova (1995 - 2012)



Source: Authors' elaboration based on data provided by NBS of Republic of Moldova

All above mentioned findings can be proved using the graph of inflation and unemployment variation (see Figure 5): excepting the 2005 electoral year, before elections, the economic policy adopted by the government is accompanied by the reduction of the inflation, and that, immediately after the elections, it returns to a high level.

All these trends indicate that the Republic of Moldova followed the Model of "Partisan" (Ideological) Cycles, which is based on the correlation between ideological views and economic policies.

6. Conclusions

The theory concerning the interference between the political cycle and the business cycle is one of the most controversial theories in modern economy. According to the economic theory, and also to the results obtained above, the economic policy adopted by each government prior to elections is expansionist, leads to a lower level of taxes and unemployment and contributes, at the same time, to the increase of the consumption per inhabitant, of the GDP and of the subventions granted by the government. The government adopts a restrictive policy after each electoral campaign.

The analysis conducted in this paper shows that, regardless of the "ideology" of the governing party, the same tactics were employed to attract voters in the analyzed countries (efforts to reduce the unemployment rate during the pre-electoral period). Although it involved very high costs, this policy didn't generate the expected result: in Romania all the elections from the 1996-2012 period were lost. It seems that the parties abandon the ideological dimension of the policies they promote. The new governing parties always mention the "difficult legacy" left by the previous government and leave, in their turn, a similar "legacy" to their successors. The analyzed period fits the Model of the Partisan-Opportunistic Cycles perfectly.

Republic of Moldova (non EU member, non-Euro Zone member) shows a different model of interference. Basing its tactics on the correlation between ideological views and economic policies by keeping the rate of inflation to a level as low as possible before the elections, the political parties follow the Model of "Partisan" (Ideological) Cycles. Making abuse of the same tactics during a long period of time and just fooling the people is the best way to be punished by own electorate. An adequate example is the 2009 election year in Moldova, when disappointed people punished the Communist Party during the April Revolution (or Twitter Revolution). After a long period of communist's governance, Republic of Moldova returns to democratic aspiration and Euro-Atlantic Integration.

This study reveals that some tools and means of economic influence are only used in certain electoral period and not in others. The nowadays rational politicians use different ways to intervene in the economy, depending on the election. The incumbents have the ability to choose several ways to affect the economic situation of the voters: besides the unemployment and inflation rates manipulation, they can use the law on the minimum wage or pension benefits, public spending or tax cuts.

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