

Political business cycle in the light of theory and empirical research

Summary

The Ph.D. thesis has been prepared in the form of a coherent thematic publication cycle, the aim of which is to identify the threats of occurring in Poland after 1989 of the political business cycle. The inspiration to undertake a research topic within one of the currents of research on the cyclical nature of economies regarding the political business cycle was the observation that in countries with a free market economy, where power is obtained as a result of won elections, economic policy can be conducted in the short-term perspective political benefits of the government.

The theory of the political business cycle provides one of the possible answers to the question why this is happening. According to her, in democratic states, where power is gained in the elections, an important role in making economic decisions is played by the desire to maintain or gain power. The above relationship was first observed and described for the US economy. Later on, other economies of highly developed countries with well-established democratic traditions were subjected to analysis.

The introduction of the subject on the basis of Poland is justified due to the distinctive and different from the highly developed economies reasons: processes of transformation and social learning of the mechanisms of the functioning of the free market, including electoral mechanisms. The occurrence of the above circumstances is an important reason for undertaking research in the area of interest in the political theory of the business cycle. In addition, the described problem is not particularly intensively explored in the literature.

The first part of the dissertation entitled "*Genesis and directions of research on the political business cycle*" consists of four previously reviewed and published articles. It begins with the article "*Political aspects of the business cycle*", in which the first reflections on the political business cycle were presented. The problem of the business cycle is inextricably linked to the functioning of the market economy. Among economists, however, there is no unanimity as to the mechanism of fluctuations in economic activity. Over the years, various theories have been created to explain this phenomenon. Until now, none of them has been widely accepted. One of the possible concepts to explain the mechanism of fluctuation is the theory of the

political business cycle. According to her, systematic changes in the level of economic activity are the implications of actions taken by the politicians who are in power. The aim of the article is to answer the question whether indeed and for what reason governments can induce perturbations. The publication presents a comparative analysis of four basic models of the political business cycle. The first two, by M. Kalecki and J. Akerman, initiated a discussion in literature on the possibility of economic fluctuations conditioned by political factors. The next two models of W. D. Nordhaus and D. A. Hibbs, constitute the basis for advanced research within two separate currents of the theory of the political cycle, namely the so-called opportunist and ideological cycle theory.

As a result of the analysis, it was noticed that the political business cycle may arise as a result of manipulation of economic policy instruments, with the participation of the so-called internal and external factors. Internal factors include governmental actions motivated by patriotic or selfish motives resulting from internal beliefs that wield power of politicians or a desire to win in the upcoming elections. External factors include direct or indirect pressures from various groups of people. As a result, it was found that the government can cause fluctuations in both its own interest as well as in the interest of various social groups.

In the next article, entitled "*Economic policy and the theory of the political cycle*", the economic policy of the so-called "New EU member states" in the pre-accession period from the perspective of political theory of the business cycle was reviewed. The aim was to diagnose the risks associated with the possibility of the emergence of a business cycle conditioned by political factors and to assess the effectiveness of safeguard mechanisms. The publication presents the empirical verification of the threat of a political cycle. Both "new EU member states" and euro area countries were analyzed. Based on the results obtained, the Stability and Growth Pact was assessed as a potential mechanism to prevent the emergence of the cycle. The basic conclusion from the article is that the theory of the political business cycle is confirmed by empirical research.

The level of particular macroeconomic variables desired by politicians can be achieved using the tools of both fiscal and monetary policy. Politicians will use instruments that are considered to be the most effective under existing conditions. It was found that in the pre-accession period, in the "new EU Member States" discretionary policy was pursued using fiscal or monetary policy tools, depending on the exchange rate regime, while in the countries belonging to the monetary union only with the use of fiscal policy tools. The research results indicate that there are no mechanisms in the European Union to eliminate the threat of a political cycle. The Stability and Growth Pact is not a sufficient safeguard.

The article entitled "*Monetary policy and the political business cycle*" analyzes the monetary policy from the point of view of political business cycle. When examining the possibilities of the central bank's use of discretionary instruments, implying the emergence of political fluctuations in the economy, attention was paid to the issue of independence of central banks in OECD countries. Based on the analysis of the results of empirical research indicating the possibilities of using these basic monetary policy instruments, such as interest rates, money supply and interventions on the currency market in the cycle creation mechanism, an attempt was made to answer whether the monetary policy in OECD countries could form the basis causative actions in the field of politically motivated economic fluctuations. It was not stated that central banks in these countries trigger political fluctuations. However, empirical research shows that fluctuations in cycles close to electoral cycles do exist.

The first part of the dissertation ends with an article titled "*Institutional conditions of the political business cycle*", in which the analysis of experience in the field of fiscal rules in the EU was made, as potential tools limiting the possibility of making populist decisions by politicians exercising power and their imperfections. The attention was paid to independent fiscal institutions as entities whose functioning could limit the temptation to conduct an inefficient destabilizing economic policy by politicians. The theoretical justification for establishing the Fiscal Council in Poland was presented.

The second part of the doctoral dissertation, entitled "*Consequences of the occurrence of a political business cycle*", consists of the next four previously reviewed and published articles. It opens with an article entitled "*Synchronization of economic fluctuations in the euro area and the theory of the political business cycle*". The aim of the article is to analyze the possibilities of synchronization of economic fluctuations in the euro area, taking into account the conditions resulting from the political business cycle. Research shows that in the countries of the monetary union, the coincidence of cyclical fluctuations is higher than in countries outside the zone. The publication focuses on the model of F. Breuss, indicating that the synchronization of fluctuations may occur following the unification of electoral periods in the EU. However, the conclusion was that harmonizing electoral periods in European Union countries may be difficult to achieve.

In the next article: "*Political business cycle in the time of crisis*", an answer to the question about the political sources of the financial crisis that began in the United States at the turn of 2007 and 2008 and the debt crisis in Europe is sought. Attention is drawn to the importance of political activities, both in the context of the sources of the crisis and also as factors determining the repair of public finances. Referring to the classical theories of the

political business cycle, arguments are suggested that may indicate that right-wing politicians under certain conditions increase state indebtedness. This thesis is not widely known and accepted. At the same time, an answer is being sought as to the extent to which political choices affect the indebtedness of economies. The article points to institutional solutions aimed at limiting the possibilities of creating a political business cycle. It also underlines the importance of inevitable sanctions for non-compliance with fiscal rules within the EU as an indispensable incentive for governments to pursue a rational fiscal policy.

In the article entitled "*Bank credit and political business cycle*" an attempt was made to answer the question whether banks can be included in this group. The ruling politicians, in addition to the use of fiscal and monetary policy instruments, may increase the probability of reelection, leading to an expansionary lending policy by banks before the election. Empirical studies indicate that a much higher risk of such behavior applies to state-owned banks than to private banks. This means that private property in banking is desirable from the point of view of the political possibilities of creating cyclical fluctuations. There is a risk that the lending policy pursued by politically manipulated banks may allow for similar election effects as other cycle creation instruments known and described in the literature. However, this mechanism is more difficult to detect. From the point of view of politicians, it can be more useful. The article shows that Central and Eastern Europe, including Poland, is exposed to the occurrence of a political business cycle caused by the supply of credit stimulated by politicians. The second part of the dissertation ends with an article titled "Stabilization policy and the political cycle", in which there are reflections on the legitimacy of conducting a countercyclical policy in the light of the theory of the political conjunctural cycle. Discretionary measures taken by politicians raise the risk of using available instruments in their own interest, resulting in fluctuations instead of stabilizing the economic situation. As a result, the costs of such a countercyclical policy may outweigh its benefits. The article indicates that this is particularly evident in the case of fiscal policy.

The third and final part of the doctoral dissertation entitled "Empirical verification of the symptoms of the political business cycle" consists of three previously reviewed and published articles. In the article "*Political business cycle in Central and Eastern Europe*", it is noted that in the years preceding the accession to the European Union, the candidate countries showed an increasing diversification of fiscal policy. While larger Central European countries, such as Poland, the Czech Republic and Hungary, pursued an expansive fiscal policy, the Baltic States, such as Lithuania, Latvia and Estonia, limited the budget deficit. Despite the fact that the mentioned phenomenon has been noticed and documented, it is difficult to find and identify

its causes. This state of affairs should not be affected by the shocks resulting from the economic transformation of the first half of the 1990s. It is also difficult to find the justification for this phenomenon in institutional factors that could theoretically be the cause of a different fiscal policy.

The aim of the article is to determine whether the fiscal policy of Central and Eastern European countries in the period preceding the accession to the European Union showed symptoms of the political impact of the business cycle. An attempt was also made to identify the possible implications of both the membership of Central and Eastern European countries in the EU, as well as the fact that they have increasingly mature democratic systems from the point of view of political theory of the business cycle. The analysis shows that larger Central European countries systematically deteriorated their public finances after joining NATO in 1999. This statistically significant relationship can be interpreted on the basis of dependencies arising from opportunistic theories of the political business cycle, bearing in mind the potentially stronger negotiating position of these states towards the EU, which could be the result of both their dominant position in Central Europe as well as NATO membership. The suspension of fiscal expansion could result in the loss of support and, as a result, power by the ruling parties. On the other hand, the continuation of such a policy gave greater chances of winning the election, but at the same time implied the probability of additional costs after the accession.

In the article "*Political decisions and the business cycle in the countries of the Visegrad initiative*", empirical research was presented to determine whether for the Visegrad Group countries a statistically significant relationship can be observed between macroeconomic aggregates and changes in government. Determining whether and how political factors affect the debt of the Visegrad Group countries may be important in the face of the debt crisis with which some European Union countries have struggled in recent years. The research results indicate that in the Visegrad Group countries, with the exception of the Czech Republic, a statistically significant relationship could be observed between political variables and the size of the structural balance of public finances. It could be noted that the deficits of individual countries of the Visegrad initiative showed a dependence in relation to other political variables. What's more, by comparing the results of the estimation for selected countries one could come to the conclusion that even if there is a dependence of the structural deficit on the same political variables, this dependence may have the opposite direction. The results of the research lead to the conclusion that in the case of the Visegrad Group countries, the political cycle may contribute to the indebtedness of economies.

The purpose of the last of the series of articles entitled "*Poland's experiences in the light of the political business cycle theory*" is the identification of signals indicating the possibility of a threat of a political business cycle in Poland. The article analyzes the changes of particular macroeconomic aggregates and their relation to the electoral calendar. Such a combination of GDP, inflation and unemployment as well as the results of political party elections was sought that could indicate a threat to the political cycle. In particular, the symptoms of regularities described in the opportunistic cycle theory were analyzed, based on regional unemployment statistics and the results of electoral parties in power. Signals indicating the threat of a political business cycle have been identified.

The presented publication cycle shows that in Poland, as in other democratic countries, you can find symptoms that indicate the threat of the occurrence of a political business cycle. Choosing the topic of the dissertation as well as analyzing the basic problems connected with it should be helpful in the search for effective security mechanisms